Oxford Public International Law

Land and Maritime Boundary between Cameroon and Nigeria, Cameroon v Nigeria, Judgment, Preliminary Objections, [1998] ICJ Rep 275, ICGJ 64 (ICJ 1998), 11th June 1998, International Court of Justice [ICJ]

Date: 11 June 1998
Content type: International Court Decisions
Jurisdiction: International Court of Justice [ICJ]

Citation(s): [1998] ICJ Rep 275 (Official Case No)
ICGJ 64 (ICJ 1998) (OUP reference)
Product: Oxford Reports on International Law [ORIL]
Module: International Courts of General Jurisdiction [ICGJ]

Parties: Cameroon
Nigeria

Judges/Arbitrators: Stephen M Schwebel (President); Christopher Gregory Weeramantry (Vice-President); Shigeru Oda; Mohammed Bedjaoui; Gilbert Guillaume; Raymond Ranjeva; Géza Herczegh; Carl–August Fleischhauer; Abdul G Koroma; Vladlen Stepanovich Vereshchetin; Rosalyn Higgins; Gonzalo Parra–Aranguren; Pieter H Kooijmans; Francisco Rezek; Kéba Mbaye (Judge ad hoc); Prince Bola Adesumbo Ajibola (Judge ad hoc)

Procedural Stage: Judgment, Preliminary Objections

Previous Procedural Stage(s):
Order, Provisional Measures; *Land and Maritime Boundary between Cameroon and Nigeria, Cameroon v Nigeria,* (1996) ICJ Rep 13, 15 March 1996

Subsequent Development(s):
Order, Counter–Claims; *Land and Maritime Boundary between Cameroon and Nigeria, Cameroon v Nigeria,* (1999) ICJ Rep 983, 30 June 1999
Order, Intervention; *Land and Maritime Boundary between Cameroon and Nigeria, Cameroon v Nigeria: Equatorial Guinea intervening,* (1999) ICJ Rep 1029; ICGJ 62 (ICJ 1999), 21 October 1999
Judgment, Merits; *Land and Maritime Boundary between Cameroon and Nigeria, Cameroon v Nigeria: Equatorial Guinea intervening,* (2002) ICJ Rep 303; ICGJ 63 (ICJ 2002), 10 October 2002

Related Development(s):
Judgment, Preliminary Objections; *Request for Interpretation of the Judgment of 11 June 1998 in the* Case concerning the Land and Maritime Boundary between Cameroon and Nigeria. Cameroon v Nigeria, Preliminary Objections; *Nigeria v Cameroon,* (1999) ICJ Rep 31; ICGJ 55 (ICJ 1999), 25 March 1999

Subject(s):

International courts and tribunals, procedure — Good faith — Estoppel — Delimitation — Treaties, observance — Treaties, reservations and declarations — Boundaries — Territory, title

Core Issue(s):

Whether the Court has jurisdiction to hear the dispute, in light of Nigeria's preliminary objections that Cameroon violated its legal obligations to act in good faith in filing its Application and that the Lake Chad Basin Commission had exclusive competence to settle the boundary dispute in question.

Whether Cameroon's Application was admissible, considering Nigeria's preliminary objection that it

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

involved the rights of third states and that it failed to meet a standard of adequacy as to the facts on which it was based, such that Nigeria had notice of the claim against it.

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

Decision - full text

Paragraph numbers have been added to this decision by OUP

Present: President Schwebel; *Vice–President* Weeramantry; *Judges* Oda, Bedjaoui, Guillaume, Ranjeva, Herczegh, Shi, Fleischhauer, Koroma, Vereshchetin, Higgins, Parra–Aranguren, Kooijmans, Rezek; *Judges* ad hoc Mbaye, Ajibola; *Registrar* Valencia–Ospina.

In the case concerning the land and maritime boundary between Cameroon and Nigeria,

between

the Republic of Cameroon,

represented by

H.E. Mr. Laurent Esso, Minister of Justice, Keeper of the Seals,

as Agent;

Mr. Douala Moutomé, Member of the Cameroon Bar, former Minister,

Mr. Maurice Kamto, Professor, University of Yaoundé II, Member of the Paris Bar,

Mr. Peter Ntamark, Dean, Professor of Law, Faculty of Law and Political Science, University of Yaoundé II, Barrister–at–Law, member of the Inner Temple,

as Co–Agents;

H.E. Mr. Joseph Owona, Minister of Youth and Sport,

Mr. Joseph–Marie Bipoun Woum, Professor, University of Yaoundé II, former Minister,

as Special Advisers;

Mr. Alain Pellet, Professor, University of Paris X–Nanterre and Institute of Political Studies, Paris,

as Deputy–Agent, Counsel and Advocate;

Mr. Michel Aurillac, avocat à la cour, Honorary Member of the Council of State, former Minister,

Mr. Jean–Pierre Cot, Professor, University of Paris I (Panthéon–Sorbonne), Vice–President of the European Parliament, Member of the Paris and Brussels Bars, former Minister,

Mr. Keith Highet, Counsellor in International Law, Vice–Chairman, Inter–American Juridical Committee, Organization of American States,

Mr. Malcolm N. Shaw, Barrister–at–Law, Sir Robert Jennings Professor of International Law, Faculty of Law, University of Leicester,

Mr. Bruno Simma, Professor, University of Munich,

Sir Ian Sinclair, K.C.M.G., Q.C., Barrister–at–Law,

Mr. Christian Tomuschat, Professor, University of Berlin,

as Counsel and Advocates;

H.E. Mr. Pascal Biloa Tang, Ambassador of Cameroon to France,

H.E. Mrs. Isabelle Bassong, Ambassador of Cameroon to the Benelux Coun—tries,

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

H.E. Mr. Martin Belinga Eboutou, Ambassador, Permanent Representative of Cameroon to the United Nations,

Lieutenant General Pierre Semengue, Chief of Staff of the Armed Forces,

Mr. Robert Akamba, Principal Civil Administrator, chargé de mission, Sec—retariat of the Presidency of the Republic,

Mr. Etienne Ateba, Minister–Counsellor, Chargé d'affaires a.i. at the Embassy of Cameroon, The Hague,

Mr. Ernest Bodo Abanda, Director of the Cadastral Survey, Member of the National Boundary Commission of Cameroon,

Mr. Ngolle Philip Ngwesse, Director at the Ministry of Territorial Administration,

Mr. Thomas Fozein Kwanke, Counsellor in Foreign Affairs, Deputy Director at the Ministry of Foreign Relations,

Mr. Jean Gateaud, ingénieur général géographe,

Mr. Bienvenu Obelabout, Director, Central Administration, General Secretariat of the Presidency of the Republic,

Mr. Marc Sassen, Advocate and Legal Adviser, The Hague,

Mr. Joseph Tjop, Consultant at Mignard, Teitgen, Grisoni and Associates, Senior Teaching and Research Assistant, University of Paris X–Nanterre,

Mr. Songola Oudini, Director, Central Administration, General Secretariat of the Presidency of the Republic,

as Advisers;

Mrs. Florence Kollo, Principal Translator–Interpreter,

as Translator–Interpreter;

Mr. Pierre Bodeau, Teaching and Research Assistant, University of Paris X–Nanterre,

Mr. Olivier Corten, Senior Lecturer, Faculty of Law, Université libre de Bruxelles,

Mr. Daniel Khan, Assistant, University of Munich,

Mr. Jean–Marc Thouvenin, Senior Lecturer, University of Maine, and Institute of Political Studies, Paris,

as Research Assistants;

Mr. Guy Roger Eba'a,

Mr. Daniel Nfan Bile,

as Communications Specialists;

Mrs. René Bakker,

Mrs. Florence Jovis,

Mrs. Mireille Jung,

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

as Secretaries,

and

the Federal Republic of Nigeria,

represented by

H.E. the Honourable Alhaji Abdullahi Ibrahim, OFR, SAN, Attorney–General of the Federation and Minister of Justice,

as Agent;

Chief Richard Akinjide, SAN, FCIArb, former Minister, Member of the English and Gambian Bars,

as Co–Agent;

Mr. Ian Brownlie, C.B.E., Q.C., F.B.A., Chichele Professor of Public International Law, University of Oxford, Member of the International Law Commission, Member of the English Bar,

Sir Arthur Watts, K.C.M.G., Q.C., Member of the English Bar,

Mr. James Crawford, S.C., Whewell Professor of International Law, University of Cambridge, Member of the International Law Commission, Member of the Australian Bar,

as Counsel and Advocates;

Mr. Timothy H. Daniel, Partner, D. J. Freeman of the City of London,

Mr. Alan Perry, Partner, D. J. Freeman of the City of London,

Mr. David Lerer, Solicitor, D. J. Freeman of the City of London,

Mr. Christopher Hackford, Solicitor, D. J. Freeman of the City of London,

Ms Louise Cox, trainee Solicitor, D. J. Freeman of the City of London,

as Solicitors;

Mr. A. H. Yadudu, Professor, Special Adviser to the Head of State on Legal Matters,

Mr. A. Oye Cukwurah, Professor, National Boundary Commission, Abuja,

Mr. I. A. Ayua, Professor, Director–General, NIALS,

Brigadier General L. S. Ajiborisha, Director of Operations, DHQ,

Mrs. Stella Omiyi, Director, International and Comparative Law Department, Federal Ministry of Justice,

Mr. K. Mohammed, Director of Research and Analysis, the Presidency,

Mr. Jalal A. Arabi, Legal Adviser to the Secretary to the Government of the Federation,

Mr. M. M. Kida, Assistant Director, Ministry of Foreign Affairs,

Mr. Alhaji A. A. Adisa, Deputy Surveyor–General of the Federation, Abuja,

Mr. P. M. Mann, Chargé d'affaires, Embassy of Nigeria, The Hague,

Mrs. V. Okwecheme, Counsellor, Embassy of Nigeria, The Hague,

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

Mr. Amuzuei, Counsellor, Embassy of Nigeria, The Hague,

Mr. Clive Schofield, Cartographer, International Boundaries Research Unit, Durham University,

Mr. Arthur Corner, Cartographer, Durham University,

Ms Michelle Burgoine, Information Technology Assistant,

as Advisers;

Mrs. Coralie Ayad, D. J. Freeman of the City of London

as Secretary.

The Court,

composed as above,

after deliberation,

delivers the following Judgment:

1. On 29 March 1994, the Government of the Republic of Cameroon (hereinafter called "Cameroon") filed in the Registry of the Court an Application instituting proceedings against the Government of the Federal Republic of Nigeria (hereinafter called "Nigeria") in respect of a dispute described as "relat[ing] essentially to the question of sovereignty over the Bakassi Peninsula". Cameroon further stated in its Application that the "delimitation [of the maritime boundary between the two States] has remained a partial one and [that], despite many attempts to complete it, the two parties have been unable to do so". It accordingly requested the Court, "in order to avoid further incidents between the two countries, … to determine the course of the maritime boundary between the two States beyond the line fixed in 1975". In order to found the jurisdiction of the Court, the Application relied on the declarations made by the two Parties accepting the jurisdiction of the Court under Article 36, paragraph 2, of the Statute of the Court.

2. Pursuant to Article 40, paragraph 2, of the Statute, the Application was immediately communicated to the Government of Nigeria by the Registrar.

3. On 6 June 1994, Cameroon filed in the Registry an Additional Application "for the purpose of extending the subject of the dispute" to a further dispute described in that Additional Application as "relat[ing] essentially to the question of sovereignty over a part of the territory of Cameroon in the area of Lake Chad". Cameroon also requested the Court, in its Additional Application, "to specify definitively" the frontier between the two States from Lake Chad to the sea, and asked it to join the two Applications and "to examine the whole in a single case". In order to found the jurisdiction of the Court, the Additional Application referred to the "basis of … jurisdiction … already … indicated" in the Application instituting proceedings of 29 March 1994.

4. On 7 June 1994, the Registrar communicated the Additional Application to the Government of Nigeria.

5. At a meeting which the President of the Court held with the representatives of the Parties on 14 June 1994, the Agent of Nigeria stated that he had no objection to the Additional Application being treated, in accordance with the wish expressed by Cameroon, as an amendment to the initial Application, so that the Court could deal with the whole in a single case. By an Order dated 16 June 1994, the Court indicated that it had no objection itself to such a procedure, and fixed 16 March 1995 and 18 December 1995, respectively, as the time–limits for the filing of the Memorial of Cameroon and the Counter–Memorial of Nigeria.

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

6. Pursuant to Article 40, paragraph 3, of the Statute, all States entitled to appear before the Court were notified of the Application.

7. Cameroon duly filed its Memorial within the time–limit prescribed in the Court's Order dated 16 June 1994.

8. Within the time–limit fixed for the filing of its Counter–Memorial, Nigeria filed preliminary objections to the jurisdiction of the Court and the admissibility of the Application. Accordingly, by an Order dated 10 January 1996, the President of the Court, noting that, under Article 79, paragraph 3, of the Rules of Court, the proceedings on the merits were suspended, fixed 15 May 1996 as the time–limit within which Cameroon might present a written statement of its observations and submissions on the preliminary objections.

Cameroon filed such a statement within the time–limit so prescribed, and the case became ready for hearing in respect of the preliminary objections.

9. Since the Court included upon the Bench no judge of the nationality of the Parties, each Party exercised its right under Article 31, paragraph 3, of the Statute of the Court to choose a judge *ad hoc* to sit in the case: Cameroon chose Mr. Kéba Mbaye and Nigeria chose Mr. Bola Ajibola.

10. By a letter dated 10 February 1996 and received in the Registry on 12 February 1996, Cameroon submitted a request for the indication of provisional measures under Article 41 of the Statute. By an Order dated 15 March 1996, the Court, after hearing the Parties, indicated certain provisional measures.

11. By various communications, Cameroon stressed the importance of a speedy disposal of the case; it also filed, under cover of a letter dated 9 April 1997, a document with annexes entitled "Memorandum of the Republic of Cameroon on Procedure". Nigeria made known its views on the latter communication in a letter dated 13 May 1997.

12. By a letter dated 2 February 1998, Nigeria sought to introduce a volume of documents entitled "Supplemental Documents (Lake Chad Basin Commission Proceedings)". By a letter dated 16 February 1998, the Agent of Cameroon indicated that Cameroon did not oppose their introduction. The Court admitted the said documents pursuant to Article 56, paragraph 1, of the Rules of Court.

13. By a letter dated 11 February 1998, the Agent of Cameroon sought to introduce certain "new documents relating to events occurring since the filing of the Memorial" of Cameroon, and "moreover requested the Court to consider the annexes to the [Memorandum of April 1997] as an integral part of the proceedings". Having considered the views expressed by Nigeria in its above–mentioned letter of 13 May 1997 (see paragraph 11 above) and in its letter of 24 February 1998, the Court admitted the documents pursuant to the provisions of Article 56 of its Rules.

14. In accordance with Article 53, paragraph 2, of its Rules, the Court decided to make accessible to the public, on the opening of the oral proceedings, the preliminary objections of Nigeria and the written statement containing the observations and submissions of Cameroon on the objections, as well as the documents annexed to those pleadings.

15. Public sittings were held between 2 March and 11 March 1998, at which the Court heard the oral arguments and replies of:

For Nigeria: H.E. the Honourable Alhaji Abdullahi Ibrahim,

Mr. Richard Akinjide,

Mr. Ian Brownlie,

Sir Arthur Watts,

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

Mr. James Crawford.

For Cameroon: H.E. Mr. Laurent Esso,

Mr. Douala Moutomé,

Mr. Maurice Kamto,

Mr. Peter Ntamark,

Mr. Joseph–Marie Bipoun Woum,

Mr. Alain Pellet,

Mr. Michel Aurillac,

Mr. Jean–Pierre Cot,

Mr. Keith Highet,

Mr. Malcolm N. Shaw,

Mr. Bruno Simma,

Sir Ian Sinclair,

Mr. Christian Tomuschat.

At the hearings, a Member of the Court put a question to the Parties, who answered in writing after the close of the oral proceedings.

*

16. In its Application, Cameroon made the following requests:

> "On the basis of the foregoing statement of facts and legal grounds, the Republic of Cameroon, while reserving for itself the right to complement, amend or modify the present Application in the course of the proceedings and to submit to the Court a request for the indication of provisional measures should they prove to be necessary, asks the Court to adjudge and declare:
>
> (a) that sovereignty over the Peninsula of Bakassi is Cameroonian, by virtue of international law, and that that Peninsula is an integral part of the territory of Cameroon;
>
> (b) that the Federal Republic of Nigeria has violated and is violating the fundamental principle of respect for frontiers inherited from colonization *(uti possidetis juris)*;
>
> (c) that by using force against the Republic of Cameroon, the Federal Republic of Nigeria has violated and is violating its obligations under international treaty law and customary law;
>
> (d) that the Federal Republic of Nigeria, by militarily occupying the Cameroonian Peninsula of Bakassi, has violated and is violating the obligations incumbent upon it by virtue of treaty law and customary law;
>
> (e) that in view of these breaches of legal obligation, mentioned above, the Federal Republic of Nigeria has the express duty of putting an end to its military presence in Cameroonian territory, and effecting an immediate and unconditional withdrawal of its

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

troops from the Cameroonian Peninsula of Bakassi;

(e') that the internationally unlawful acts referred to under *(a)*,*(b)*,*(c)*,*(d)* and *(e)* above involve the responsibility of the Federal Republic of Nigeria;

(e") that, consequently, and on account of the material and non–material damage inflicted upon the Republic of Cameroon, reparation in an amount to be determined by the Court is due from the Federal Republic of Nigeria to the Republic of Cameroon, which reserves the introduction before the Court of [proceedings for] a precise assessment of the damage caused by the Federal Republic of Nigeria.

(f) In order to prevent any dispute arising between the two States concerning their maritime boundary, the Republic of Cameroon requests the Court to proceed to prolong the course of its maritime boundary with the Federal Republic of Nigeria up to the limit of the maritime zones which international law places under their respective jurisdictions."

17. In its Additional Application, Cameroon made the following requests:

"On the basis of the foregoing statement of facts and legal grounds, and subject to the reservations expressed in paragraph 20 of its Application of 29 March 1994, the Republic of Cameroon asks the Court to adjudge and declare:

(a) that sovereignty over the disputed parcel in the area of Lake Chad is Cameroonian, by virtue of international law, and that that parcel is an integral part of the territory of Cameroon;

(b) that the Federal Republic of Nigeria has violated and is violating the fundamental principle of respect for frontiers inherited from colonization *(uti possidetis juris)*, and its recent legal commitments concerning the demarcation of frontiers in Lake Chad;

(c) that the Federal Republic of Nigeria, by occupying, with the support of its security forces, parcels of Cameroonian territory in the area of Lake Chad, has violated and is violating its obligations under treaty law and customary law;

(d) that in view of these legal obligations, mentioned above, the Federal Republic of Nigeria has the express duty of effecting an immediate and unconditional withdrawal of its troops from Cameroonian territory in the area of Lake Chad;

(e) that the internationally unlawful acts referred to under *(a)*,*(b)*,*(c)* and *(d)* above involve the responsibility of the Federal Republic of Nigeria;

(e') that consequently, and on account of the material and non–material damage inflicted upon the Republic of Cameroon, reparation in an amount to be determined by the Court is due from the Federal Republic of Nigeria to the Republic of Cameroon, which reserves the introduction before the Court of [proceedings for] a precise assessment of the damage caused by the Federal Republic of Nigeria.

(f) That in view of the repeated incursions of Nigerian groups and armed forces into Cameroonian territory, all along the frontier between the two countries, the consequent grave and repeated incidents, and the vacillating and contradictory attitude of the Federal Republic of Nigeria in regard to the legal instruments defining the frontier between the two countries and the exact course of that frontier, the Republic of Cameroon respectfully asks the Court to specify definitively the frontier between Cameroon and the Federal Republic of Nigeria from Lake Chad to the sea."

18. In the written proceedings, the Parties presented the following submissions:

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

On behalf of the Government of Cameroon,

in the Memorial:

"The Republic of Cameroon has the honour to request that the Court be pleased to adjudge and declare:

(a) That the lake and land boundary between Cameroon and Nigeria takes the following course:

— from the point at longitude 14°04′59″ 9999 E of Greenwich and latitude 13°05′00″0001 N, it then runs through the point located at longitude 14°12′11″7 E and latitude 12°32′17″4 N;

— thence it follows the course fixed by the Franco–British Declaration of 10 July 1919 , as specified in paragraphs 3 to 60 of the Thomson–Marchand Declaration , confirmed by the Exchange of Letters of 9 January 1931, as far as the 'very prominent peak' described in the latter provision and called by the usual name of 'Mount Kombon';

— from Mount Kombon the boundary then runs to 'Pillar 64' mentioned in paragraph 12 of the Anglo–German Agreement of Obokum of 12 April 1913 and follows, in that sector, the course described in Section 6 (1) of the British Nigeria (Protectorate and Cameroons) Order in Council of 2 August 1946 ;

— from Pillar 64 it follows the course described in paragraphs 13 to 21 of the Obokum Agreement of 12 April 1913 as far as Pillar 114 on the Cross River;

— thence, as far as the intersection of the straight line joining Bakassi Point to King Point and the centre of the navigable channel of the Akwayafe, the boundary is determined by paragraphs 16 to 21 of the Anglo–German Agreement of 11 March 1913 .

(b) That notably, therefore, sovereignty over the Peninsula of Bakassi and over the disputed parcel occupied by Nigeria in the area of Lake Chad, in particular over Darak and its region, is Cameroonian.

(c) That the boundary of the maritime zones appertaining respectively to the Republic of Cameroon and to the Federal Republic of Nigeria follows the following course:

— from the intersection of the straight line joining Bakassi Point to King Point and the centre of the navigable channel of the Akwayafe to 'point 12', that boundary is determined by the 'compromise line' entered on British Admiralty Chart No. 3343 by the Heads of State of the two countries on 4 April 1971 (Yaoundé Declaration) and, from that 'point 12' to 'point G', by the Declaration signed at Maroua on 1 June 1975;

— from point G that boundary then swings south–westward in the direction which is indicated by points G, H, I, J and K represented on the sketch–map on page 556 of this Memorial and meets the requirement for an equitable solution, up to the outer limit of the maritime zones which international law places under the respective jurisdictions of the two Parties.

(d) That by contesting the courses of the boundary defined above under *(a)* and *(c)*, the Federal Republic of Nigeria has violated and is violating the fundamental principle

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

of respect for frontiers inherited from colonization *(uti possidetis juris)* and its legal commitments concerning the demarcation of frontiers in Lake Chad and land and maritime delimitation.

(e) That by using force against the Republic of Cameroon and, in particular, by militarily occupying parcels of Cameroonian territory in the area of Lake Chad and the Cameroonian Peninsula of Bakassi, and by making repeated incursions, both civilian and military, all along the boundary between the two countries, the Federal Republic of Nigeria has violated and is violating its obligations under international treaty law and customary law.

(f) That the Federal Republic of Nigeria has the express duty of putting an end to its civilian and military presence in Cameroonian territory and, in particular, of effecting an immediate and unconditional withdrawal of its troops from the occupied area of Lake Chad and from the Cameroonian Peninsula of Bakassi and of refraining from such acts in the future.

(g) That the internationally wrongful acts referred to above and described in detail in the body of this Memorial involve the responsibility of the Federal Republic of Nigeria.

(h) That, consequently, and on account of the material and non–material damage inflicted upon the Republic of Cameroon, reparation in a form to be determined by the Court is due from the Federal Republic of Nigeria to the Republic of Cameroon.

The Republic of Cameroon further has the honour to request the Court to permit it to present an assessment of the amount of compensation due to it as reparation for the damage it has suffered as a result of the internationally wrongful acts attributable to the Federal Republic of Nigeria, at a subsequent stage of the proceedings.

These submissions are lodged subject to any points of fact and law and any evidence that may subsequently be lodged; the Republic of Cameroon reserves the right to complete or amend them, as necessary, in accordance with the Statute and the Rules of Court."

On behalf of the Government of Nigeria,

in the preliminary objections:

First preliminary objection:

"(1) that Cameroon, by lodging the Application on 29 March 1994, violated its obligations to act in good faith, acted in abuse of the system established by Article 36, paragraph 2, of the Statute , and disregarded the requirement of reciprocity established by Article 36, paragraph 2, of the Statute and the terms of Nigeria's Declaration of 3 September 1965 ;

(2) that consequently the conditions necessary to entitle Cameroon to invoke its Declaration under Article 36, paragraph 2, as a basis for the Court's jurisdiction did not exist when the Application was lodged; and

(3) that accordingly, the Court is without jurisdiction to entertain the Application."

Second preliminary objection:

"For a period of at least 24 years prior to the filing of the Application the Parties have in their regular dealings accepted a duty to settle all boundary questions through the existing bilateral machinery.

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

(1) This course of joint conduct constitutes an implied agreement to resort exclusively to the existing bilateral machinery and not to invoke the jurisdiction of the Court.

(2) *In the alternative*, in the circumstances the Republic of Cameroon is estopped from invoking the jurisdiction of the Court."

Third preliminary objection:

"Without prejudice to the second preliminary objection, the settlement of boundary disputes within the Lake Chad region is subject to the exclusive competence of the Lake Chad Basin Commission, and in this context the procedures of settlement within the Lake Chad Basin Commission are obligatory for the Parties.

The operation of the dispute settlement procedures of the Lake Chad Basin Commission involved the necessary implication, for the relations of Nigeria and Cameroon *inter se*, that the jurisdiction of the Court by virtue of Article 36, paragraph 2, would not be invoked in relation to matters within the exclusive competence of the Commission."

Fourth preliminary objection:

"The Court should not in these proceedings determine the boundary in Lake Chad to the extent that that boundary constitutes or is constituted by the tripoint in the Lake."

Fifth preliminary objection:

"(1) In the submission of Nigeria there is no dispute concerning boundary delimitation as such throughout the whole length of the boundary from the tripoint in Lake Chad to the sea, and in particular:

(a) there is no dispute in respect of the boundary delimitation as such within Lake Chad, subject to the question of title to Darak and adjacent islands inhabited by Nigerians;

(b) there is no dispute relating to the boundary delimitation as such from the tripoint in Lake Chad to Mount Kombon;

(c) there is no dispute relating to the boundary delimitation as such between Boundary Pillar 64 on the Gamana River and Mount Kombon; and

(d) there is no dispute relating to the boundary delimitation as such between Pillar 64 on the Gamana River and the sea.

(2) This preliminary objection is without prejudice to the title of Nigeria over the Bakassi Peninsula."

Sixth preliminary objection:

"(1) that the Application (and so far as relevant, Amendment and Memorial) filed by Cameroon does not meet the required standard of adequacy as to the facts on which it is based, including the dates, circumstances and precise locations of the alleged incursions and incidents by Nigerian State organs;

(2) that those deficiencies make it impossible

(a) for Nigeria to have the knowledge to which it is entitled of the circumstances which are said by Cameroon to result in Nigeria's international responsibility and consequential obligation to make reparation; and

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

(b) for the Court to carry out a fair and effective judicial examination of, or make a judicial determination on, the issues of State responsibility and reparation raised by Cameroon; and

(3) that accordingly all the issues of State responsibility and reparation raised by Cameroon in this context should be declared inadmissible."

Seventh preliminary objection:

"There is no legal dispute concerning delimitation of the maritime boundary between the two Parties which is at the present time appropriate for resolution by the Court, for the following reasons:

(1) no determination of a maritime boundary is possible prior to the determination of title in respect of the Bakassi Peninsula;

(2) at the juncture where there is a determination of the question of title over the Bakassi Peninsula, the issues of maritime delimitation will not be admissible in the absence of sufficient action by the Parties, on a footing of equality, to effect a delimitation 'by agreement on the basis of international law'."

Eighth preliminary objection:

"The question of maritime delimitation necessarily involves the rights and interests of third States and is inadmissible."

Concluding submissions:

"For the reasons advanced, the Federal Republic of Nigeria requests the Court to adjudge and declare that:

it lacks jurisdiction over the claims brought against the Federal Republic of Nigeria by the Republic of Cameroon;

and/or

the claims brought against the Federal Republic of Nigeria by the Republic of Cameroon are inadmissible to the extent specified in these preliminary objections."

On behalf of the Government of Cameroon,

in the written statement containing its observations on the preliminary objections:

"For the reasons given …, the Republic of Cameroon requests the International Court of Justice:

(1) to dismiss the preliminary objections raised by the Federal Republic of Nigeria;

(2) to find that, by its formal declarations, Nigeria has accepted the jurisdiction of the Court;

(3) to adjudge and declare:

— that it has jurisdiction to decide on the Application filed by Cameroon on 29 March 1994 as supplemented by the additional Application of 6 June 1994; and

— that the Application, thus consolidated, is admissible;

(4) having due regard to the particular nature of the case, which relates to a dispute

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

concerning the territorial sovereignty of Cameroon and is creating serious tensions between the two countries, to fix time–limits for the further proceedings which will enable the Court to proceed to the merits at the earliest possible time."

19. In the oral proceedings, the Parties presented the following submissions:

On behalf of the Government of Nigeria,

at the hearing on 9 March 1998:

"[F]or the reasons that have been stated either in writing or orally, Nigeria submits:

First preliminary objection

1.1. That Cameroon, by lodging the Application on 29 March 1994, violated its obligations to act in good faith, acted in abuse of the system established by Article 36, paragraph 2, of the Statute , and disregarded the requirement of reciprocity established by Article 36, paragraph 2, of the Statute and the terms of Nigeria's Declaration of 3 September 1965 ;

1.2. that consequently the conditions necessary to entitle Cameroon to invoke its Declaration under Article 36, paragraph 2, as a basis for the Court's jurisdiction did not exist when the Application was lodged;

1.3. that accordingly, the Court is without jurisdiction to entertain the Application.

Second preliminary objection

2.1. That for a period of at least 24 years prior to the filing of the Application, the Parties have in their regular dealings accepted a duty to settle all boundary questions through the existing bilateral machinery;

2.1.1. that this course of joint conduct constitutes an implied agreement to resort exclusively to the existing bilateral machinery and not to invoke the jurisdiction of the Court;

2.1.2. that *in the alternative*, in the circumstances the Republic of Cameroon is estopped from invoking the jurisdiction of the Court.

Third preliminary objection

3.1. That without prejudice to the second preliminary objection, the settlement of boundary disputes within the Lake Chad region is subject to the exclusive competence of the Lake Chad Basin Commission, and in this context the procedures of settlement within the Lake Chad Basin Commission are obligatory for the Parties;

3.2. that the operation of the dispute settlement procedures of the Lake Chad Basin Commission involved the necessary implication, for the relations of Nigeria and Cameroon *inter se*, that the jurisdiction of the Court by virtue of Article 36, paragraph 2, would not be invoked in relation to matters within the exclusive competence of the Commission.

Fourth preliminary objection

4.1. That the Court should not in these proceedings determine the boundary in Lake Chad to the extent that that boundary constitutes or is constituted by the tripoint in the Lake.

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

Fifth preliminary objection

5.1. That, without prejudice to the title of Nigeria over the Bakassi Peninsula, there is no dispute concerning boundary delimitation as such throughout the whole length of the boundary from the tripoint in Lake Chad to the sea, and in particular:

(a) there is no dispute in respect of the boundary delimitation as such within Lake Chad, subject to the question of title to Darak and adjacent islands inhabited by Nigerians;

(b) there is no dispute relating to the boundary delimitation as such from the tripoint in Lake Chad to Mount Kombon;

(c) there is no dispute relating to the boundary delimitation as such between boundary pillar 64 on the Gamana River and Mount Kombon; and

(d) there is no dispute relating to the boundary delimitation as such between pillar 64 on the Gamana River and the sea.

Sixth preliminary objection

6.1. That the Application (and so far as permissible, subsequent pleadings) filed by Cameroon does not meet the required standard of adequacy as to the facts on which it is based, including the dates, circumstances and precise locations of the alleged incursions and incidents by Nigerian State organs;

6.2. that those deficiencies make it impossible

(a) for Nigeria to have the knowledge to which it is entitled of the circumstances which are said by Cameroon to result in Nigeria's international responsibility and consequential obligation to make reparation; and

(b) for the Court to carry out a fair and effective judicial examination of, or make a judicial determination on, the issues of State responsibility and reparation raised by Cameroon;

6.3. that accordingly all the issues of State responsibility and reparation raised by Cameroon in this context should be declared inadmissible;

6.4. that, without prejudice to the foregoing, any allegations by Cameroon as to State responsibility or reparation on the part of Nigeria in respect of matters referred to in paragraph 17 *(f)* of Cameroon's amending Application of 6 June 1994 are inadmissible.

Seventh preliminary objection

7.1. That there is no legal dispute concerning delimitation of the maritime boundary between the two Parties which is at the present time appropriate for resolution by the Court, for the following reasons:

(1) no determination of a maritime boundary is possible prior to the determination of title in respect of the Bakassi Peninsula;

(2) in any event, the issues of maritime delimitation are inadmissible in the absence of sufficient action by the Parties, on a footing of equality, to effect a delimitation 'by agreement on the basis of international law'.

Eighth preliminary objection

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

8.1. That the question of maritime delimitation necessarily involves the rights and interests of third States and is inadmissible beyond point G.

Accordingly, Nigeria formally requests the Court to adjudge and declare that:

(1) it lacks jurisdiction over the claims brought against the Federal Republic of Nigeria by the Republic of Cameroon; and/or

(2) the claims brought against the Federal Republic of Nigeria by the Republic of Cameroon are inadmissible to the extent specified in the preliminary objections."

On behalf of the Government of Cameroon,

at the hearing on 11 March 1998:

"For the reasons developed in the written pleadings and in the oral proceedings, the Republic of Cameroon requests the International Court of Justice:

(a) to dismiss the preliminary objections raised by the Federal Republic of Nigeria;

(b) completely in the alternative, to join to the merits, as appropriate, such of those objections as it may deem not to be of an exclusively preliminary character;

(c) to adjudge and declare: that it has jurisdiction to decide on the Application filed by Cameroon on 29 March 1994 as supplemented by the Additional Application of 6 June 1994; and that the Application, thus consolidated, is admissible;

(d) having due regard to the particular nature of the case, to fix time–limits for the further proceedings which will permit examination of the merits of the dispute at the earliest possible time."

* * *

20. The Court will successively examine the eight preliminary objections raised by Nigeria.

First Preliminary Objection

21. The first objection contends that the Court has no jurisdiction to entertain Cameroon's Application.

22. In this regard, Nigeria notes that it had accepted the Court's compulsory jurisdiction by a declaration dated 14 August 1965, deposited with the Secretary–General of the United Nations on 3 September 1965. Cameroon had also accepted the Court's compulsory jurisdiction by a declaration deposited with the Secretary–General on 3 March 1994. The Secretary–General transmitted copies of the Cameroon Declaration to the parties to the Statute eleven–and–a–half months later. Nigeria maintains, accordingly, that it had no way of knowing, and did not actually know, on the date of the filing of the Application, i.e., 29 March 1994, that Cameroon had deposited a declaration. Cameroon consequently is alleged to have "acted prematurely". By proceeding in this way, the Applicant "is alleged to have violated its obligation to act in good faith", "abused the system instituted by Article 36, paragraph 2, of the Statute" and disregarded "the condition of reciprocity" provided for by that Article and by Nigeria's Declaration. The Court consequently does not have jurisdiction to hear the Application.

23. In contrast, Cameroon contends that its Application fulfils all the conditions required by the Statute. It notes that in the case concerning *Right of Passage over Indian Territory*, the Court held that

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

> “the Statute does not prescribe any interval between the deposit by a State of its Declaration of Acceptance and the filing of an Application by that State, and that the principle of reciprocity is not affected by any delay in the receipt of copies of the Declaration by the Parties to the Statute” (*Right of Passage over Indian Territory, Preliminary Objections, Judgment, I.C.J. Reports 1957*, p. 147).

Cameroon indicates that there is no reason not to follow this precedent, at the risk of undermining the system of compulsory jurisdiction provided by the Optional Clause. It adds that the Cameroonian Declaration was in force as early as 3 March 1994, as at that date it was registered in accordance with Article 102 of the United Nations Charter. Cameroon states that in any event Nigeria has acted, since the beginning of these proceedings, in such a way that it should be regarded as having accepted the jurisdiction of the Court.

24. Nigeria argues in reply that the “case concerning the *Right of Passage over Indian Territory*, was a first impression”, that the Judgment given is outdated, and that it is an isolated one; that international law, especially as it relates to good faith, has evolved since and that in accordance with Article 59 of the Statute, that Judgment only has the force of *res judicata* as between the parties and in respect of that case. For these reasons, the solution adopted in 1957 should not be adopted here. Nigeria does not accept the reasoning of Cameroon based on Article 102 of the Charter. Nigeria also contends that there is no question of its having consented to the jurisdiction of the Court in the case and hence there is no *forum prorogatum*.

Cameroon contests each of these arguments.

25. The Court observes initially that, in accordance with Article 36, paragraph 2, of the Statute:

> “The States parties to the present Statute may at any time declare that they recognize as compulsory *ipso facto* and without special agreement, in relation to any other State accepting the same obligation, the jurisdiction of the Court in all legal disputes”

as specified in that clause.

Article 36, paragraph 4, provides:

> “Such declarations shall be deposited with the Secretary–General of the United Nations, who shall transmit copies thereof to the parties to the Statute and to the Registrar of the Court.”

In the case concerning *Right of Passage over Indian Territory*, the Court concluded, in the light of these provisions, that:

> “by the deposit of its Declaration of Acceptance with the Secretary–General, the accepting State becomes a Party to the system of the Optional Clause in relation to the other declarant States, with all the rights and obligations deriving from Article 36. The contractual relation between the Parties and the compulsory jurisdiction of the Court resulting therefrom are established, ‘*ipso facto* and without special agreement”, by the fact of the making of the Declaration … For it is on that very day that the consensual bond, which is the basis of the Optional Clause, comes into being between the States concerned.” (*Right of Passage over Indian Territory, Preliminary Objections, Judgment, I.C.J. Reports 1957*, p. 146.)

The conclusions thus reached by the Court in 1957 reflect the very essence of the Optional Clause providing for acceptance of the Court's compulsory jurisdiction. Any State party to the Statute, in adhering to the jurisdiction of the Court in accordance with Article 36, paragraph 2, accepts jurisdiction in its relations with States previously having adhered to that clause. At the same time, it makes a standing offer to the other States party to the Statute which have not yet deposited a declaration of acceptance. The day one of those States accepts that offer by depositing in its turn

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

its declaration of acceptance, the consensual bond is established and no further condition needs to be fulfilled. Thus, as the Court stated in 1957:

> "every State which makes a Declaration of Acceptance must be deemed to take into account the possibility that, under the Statute, it may at any time find itself subjected to the obligations of the Optional Clause in relation to a new Signatory as the result of the deposit by that Signatory of a Declaration of Acceptance" (*ibid.*, p. 146).

26. Furthermore, and as the Court also declared in the case concerning *Right of Passage over Indian Territory*, the State making the declaration

> "is not concerned with the duty of the Secretary–General or the manner of its fulfilment. The legal effect of a Declaration does not depend upon subsequent action of the Secretary–General. Moreover, unlike some other instruments, Article 36 provides for no additional requirement, for instance, that the information transmitted by the Secretary–General must reach the Parties to the Statute, or that some period must elapse subsequent to the deposit of the Declaration before it can become effective. Any such requirement would introduce an element of uncertainty into the operation of the Optional Clause system. The Court cannot read into the Optional Clause any requirement of that nature." (I.C.J. Reports 1957, pp. 146–147.)

27. The Court furthermore recalls that, contrary to what is maintained by Nigeria, this Judgment is not an isolated one. It has been reaffirmed in the case concerning the *Temple of Preah Vihear* (*Preliminary Objections, I.C.J. Reports 1961*, p. 31), and in the case concerning *Military and Paramilitary Activities in and against Nicaragua (Nicaragua* v. *United States of America)* (*Jurisdiction and Admissibility, Judgment, I.C.J. Reports 1984*, p. 392). In that latter case, the Court pointed out that:

> "as regards the requirement of consent as a basis of its jurisdiction, and more particularly as regards the formalities required for that consent to be expressed in accordance with the provisions of Article 36, paragraph 2, of the Statute, the Court has already made known its view in, *inter alia*, the case concerning the *Temple of Preah Vihear*. On that occasion it stated: 'The only formality required is the deposit of the acceptance with the Secretary–General of the United Nations under paragraph 4 of Article 36 of the Statute.' (*I.C.J. Reports 1961*, p. 31.)" (*I.C.J. Reports 1984*, p. 412, para. 45.)

28. Nigeria nonetheless contests that conclusion pointing out that, in accordance with Article 59 of the Statute, "[t]he decision of the Court has no binding force except between the parties and in respect of that particular case". Thus, judgments given earlier, in particular in the case concerning *Right of Passage over Indian Territory*, "clearly [have] no direct compelling effect in the present case".

It is true that, in accordance with Article 59, the Court's judgments bind only the parties to and in respect of a particular case. There can be no question of holding Nigeria to decisions reached by the Court in previous cases. The real question is whether, in this case, there is cause not to follow the reasoning and conclusions of earlier cases.

*

29. In this regard, Nigeria maintains first of all that the interpretation given in 1957 to Article 36, paragraph 4, of the Statute should be reconsidered in the light of the evolution of the law of treaties which has occurred since. In that connection, Nigeria relies on Article 78 *(c)* of the Vienna Convention on the Law of Treaties of 23 May 1969. That Article relates to the notifications and communications made under that Convention. It provides that:

> "Except as the treaty or the present Convention otherwise provide, any notification or

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

communication to be made by any State under the present Convention shall:

… … … … … … … … … . .

(c) if transmitted to a depositary, be considered as received by the State for which it was intended only when the latter State has been informed by the depositary."

According to Nigeria, that rule "must apply to Cameroon's Declaration". In the light of the provisions of the Vienna Convention, Nigeria contends that the Court should overturn the solution it adopted earlier in the case concerning *Right of Passage over Indian Territory*. Cameroon states, for its part, that the declarations of acceptance of the Court's compulsory jurisdiction "are not treaties within the meaning of the Vienna Convention" and "it was clearly no part of the intentions of the drafters of the … Convention … to interfere with the settled jurisprudence of the Court in this matter". This jurisprudence, Cameroon argues, should be followed.

30. The Court notes that the régime for depositing and transmitting declarations of acceptance of compulsory jurisdiction laid down in Article 36, paragraph 4, of the Statute of the Court is distinct from the régime envisaged for treaties by the Vienna Convention. Thus the provisions of that Convention may only be applied to declarations by analogy (*Military and Paramilitary Activities in and against Nicaragua (Nicaragua* v. *United States of America), Jurisdiction and Admissibility, Judgment, I.C.J. Reports 1984*, p. 420, para. 63).

31. The Court furthermore observes that in any event the provisions of the Vienna Convention do not have the scope which Nigeria imputes to them. Article 78 of the Convention is only designed to lay down the modalities according to which notifications and communications should be carried out. It does not govern the conditions in which a State expresses its consent to be bound by a treaty and those under which a treaty comes into force, those questions being governed by Articles 16 and 24 of the Convention. Indeed, the International Law Commission, in its Report to the General Assembly on the draft which was subsequently to become the Vienna Convention, specified that if the future Article 78 included *in limine* an explicit reservation, that was "primarily in order to prevent any misconception as to the relation" between that Article and the future Articles 16 and 24 (*Yearbook of the International Law Commission*, 1966, Vol. II, p. 271). It added that consequently "specific provisions [of those latter Articles] will prevail".

According to Article 16:

"Unless the treaty otherwise provides, instruments of ratification, acceptance, approval or accession establish the consent of a State to be bound by a treaty upon:

… … … … … … … … … . .

(b) their deposit with the depositary."

Article 24 further provides in its paragraph 3 that:

"When the consent of a State to be bound by a treaty is established on a date after the treaty has come into force, the treaty enters into force for that State on that date, unless the treaty otherwise provides."

In its report to the General Assembly, the International Law Commission had pointed out that:

"In the case of the deposit of an instrument with a depositary, the problem arises whether the deposit by itself establishes the legal nexus between the depositing State and other contracting States or whether the legal nexus arises only upon their being informed by the depositary." (*Yearbook of the International Law Commission*, 1966, Vol. II, p. 201.)

After describing the advantages and disadvantages of both solutions, it concluded that:

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

> “The Commission considered that the existing general rule clearly is that the act of deposit by itself establishes the legal nexus … This was the view taken by the International Court of Justice in the *Right of Passage over Indian Territory* (preliminary objections) case in the analogous situation of the deposit of instruments of acceptance of the optional clause under Article 36, paragraph 2, of the Statute of the Court … [Therefore] the existing rule appears to be well–settled.” *(Ibid.)*

This general rule is reflected in Articles 16 and 24 of the Vienna Convention: the deposit of instruments of ratification, acceptance, approval or accession to a treaty establishes the consent of a State to be bound by a treaty; the treaty enters into force as regards that State on the day of the deposit.

Thus the rules adopted in this sphere by the Vienna Convention correspond to the solution adopted by the Court in the case concerning *Right of Passage over Indian Territory*. That solution should be maintained.

32. Nigeria maintains however that, in any event, Cameroon could not file an application before the Court without allowing a reasonable period to elapse “as would … have enabled the Secretary–General to take the action required of him in relation to Cameroon's Declaration of 3 March 1994”. Compliance with that time period is essential, the more so because, according to Nigeria, the Court, in its Judgment of 26 November 1984 in the case concerning *Military and Paramilitary Activities in and against Nicaragua*, required a reasonable time for the withdrawal of declarations under the Optional Clause.

33. The Court, in the above Judgment, noted that the United States had, in 1984, deposited with the Secretary–General, three days before the filing of Nicaragua's Application, a notification limiting the scope of its Declaration of acceptance of the Court's jurisdiction. The Court noted that that Declaration contained a clause requiring six months' notice of termination. It considered that that condition should be complied with in cases of either termination or modification of the Declaration, and concluded that the 1984 notification of modification could not, with immediate effect, override the obligation entered into by the United States beforehand (*Military and Paramilitary Activities in and against Nicaragua (Nicaragua* v. *United States of America), Jurisdiction and Admissibility, I.C.J. Reports 1984*, p. 421, para. 65).

The Court noted, moreover, in relation to Nicaragua's Declaration upon which the United States was relying on the grounds of reciprocity, that, in any event,

> “the right of immediate termination of declarations with indefinite duration is far from established. It appears from the requirements of good faith that they should be treated, by analogy, according to the law of treaties, which requires a reasonable time for withdrawal from or termination of treaties that contain no provision regarding the duration of their validity” (*ibid.*, p. 420, para. 63).

The Court added: “the question of what reasonable period of notice would legally be required does not need to be further examined: it need only be observed that [three days] would not amount to a ‘reasonable time’” *(ibid.)*.

34. The Court considers that the foregoing conclusion in respect of the withdrawal of declarations under the Optional Clause is not applicable to the deposit of those declarations. Withdrawal ends existing consensual bonds, while deposit establishes such bonds. The effect of withdrawal is therefore purely and simply to deprive other States which have already accepted the jurisdiction of the Court of the right they had to bring proceedings before it against the withdrawing State. In contrast, the deposit of a declaration does not deprive those States of any accrued right. Accordingly no time period is required for the establishment of a consensual bond following such a deposit.

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

35. The Court notes moreover that to require a reasonable time to elapse before a declaration can take effect would be to introduce an element of uncertainty into the operation of the Optional Clause system. As set out in paragraph 26 above, in the case concerning *Right of Passage over Indian Territory*, the Court had considered that it could not create such uncertainty. The conclusions it had reached then remain valid and apply all the more since the growth in the number of States party to the Statute and the intensification of inter–State relations since 1957 have increased the possibilities of legal disputes capable of being submitted to the Court. The Court cannot introduce into the Optional Clause an additional time requirement which is not there.

*

36. Nigeria's second argument is that Cameroon omitted to inform it that it intended to accept the jurisdiction of the Court, then that it had accepted that jurisdiction and, lastly, that it intended to file an application. Nigeria further argued that Cameroon even continued, during the first three months of 1994, to maintain bilateral contacts with it on boundary questions while preparing itself to address the Court. Such conduct, Nigeria contends, infringes upon the principle of good faith which today plays a larger role in the case–law of the Court than before, and should not be accepted.

37. Cameroon, for its part, argues that it had no obligation to inform Nigeria in advance of its intentions, or of its decisions. It adds that in any event "Nigeria was not at all surprised by the filing of Cameroon's Application and … knew perfectly well what Cameroon's intentions were in that regard several weeks before the filing". The principle of good faith was not at all disregarded.

38. The Court observes that the principle of good faith is a well–established principle of international law. It is set forth in Article 2, paragraph 2, of the Charter of the United Nations; it is also embodied in Article 26 of the Vienna Convention on the Law of Treaties of 23 May 1969. It was mentioned as early as the beginning of this century in the Arbitral Award of 7 September 1910 in the *North Atlantic Fisheries* case (United Nations, *Reports of International Arbitral Awards*, Vol. XI, p. 188). It was moreover upheld in several judgments of the Permanent Court of International Justice (*Factory at Chorzów, Merits, Judgment No. 13, 1928, P.C.I.J., Series A, No. 17*, p. 30; *Free Zones of Upper Savoy and the District of Gex, Order of 6 December 1930, P.C.I.J., Series A, No. 24*, p. 12, and *1932, P.C.I.J., Series A/B, No. 46*, p. 167). Finally, it was applied by this Court as early as 1952 in the case concerning *Rights of Nationals of the United States of America in Morocco* (*Judgment, I.C.J. Reports 1952*, p. 212), then in the case concerning *Fisheries Jurisdiction (Federal Republic of Germany* v. *Iceland) (Jurisdiction of the Court, Judgment, I.C.J. Reports 1973*, p. 18), the *Nuclear Tests* cases (*I.C.J. Reports 1974*, pp. 268 and 473), and the case concerning *Border and Transborder Armed Actions (Nicaragua* v. *Honduras) (Jurisdiction and Admissibility, Judgment, I.C.J. Reports 1988*, p. 105).

39. The Court furthermore notes that although the principle of good faith is "one of the basic principles governing the creation and performance of legal obligations … it is not in itself a source of obligation where none would otherwise exist" (*Border and Transborder Armed Actions (Nicaragua* v. *Honduras), Jurisdiction and Admissibility, Judgment, I.C.J. Reports 1988*, p. 105, para. 94). There is no specific obligation in international law for States to inform other States parties to the Statute that they intend to subscribe or have subscribed to the Optional Clause. Consequently, Cameroon was not bound to inform Nigeria that it intended to subscribe or had subscribed to the Optional Clause.

Moreover:

> "A State accepting the jurisdiction of the Court must expect that an Application may be filed against it before the Court by a new declarant State on the same day on which that State deposits with the Secretary–General its Declaration of Acceptance." (*Right of Passage over Indian Territory, Preliminary Objections, Judgment, I.C.J. Reports 1957*, p. 146.)

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

Thus, Cameroon was not bound to inform Nigeria of its intention to bring proceedings before the Court. In the absence of any such obligations and of any infringement of Nigeria's corresponding rights, Nigeria may not justifiably rely upon the principle of good faith in support of its submissions.

40. On the facts of the matter, to which the Parties devoted considerable attention, and quite apart from legal considerations, the Court would add that Nigeria was not unaware of Cameroon's intentions. On 28 February 1994, Cameroon had informed the Security Council of incidents which had occurred shortly beforehand in the Bakassi Peninsula. In response, on 4 March 1994, Nigeria apprised the Security Council of its surprise in noting that “the Cameroon Government had decided to raise the matter to an international level by … *(c)* bringing proceedings before the International Court of Justice”. Indeed on 4 March, Cameroon had deposited its declaration of acceptance of the compulsory jurisdiction of the Court, but had not yet seised the Court. Nigeria's communication to the Security Council nevertheless showed that it was not uninformed of Cameroon's intentions.

Further the Court points out that, on 4 March 1994, the *Journal of the United Nations*, issued at Headquarters in New York to United Nations organs and to the permanent missions, reported that Cameroon had deposited with the Secretary–General a “declaration recognizing as compulsory the jurisdiction of the International Court of Justice under Article 36, paragraph 2, of the Statute of the Court” (*Journal of the United Nations*, Friday 4 March 1994, No. 1994/43 (Part II)).

Lastly, on 11 March 1994, the bringing of the matter to the Security Council and the International Court of Justice by Cameroon was mentioned at the extraordinary general meeting of the Central Organ of the Mechanism for Conflict Prevention, Management and Resolution of the Organization of African Unity, devoted to the border conflict between Cameroon and Nigeria.

*

41. Nigeria recalls in the third place that, by its Declaration deposited on 3 September 1965, it had recognized

> “as compulsory *ipso facto* and without special agreement, in relation to any other State accepting the same obligation, that is to say, on the sole condition of reciprocity, the jurisdiction of the International Court of Justice in conformity with Article 36, paragraph 2, of the Statute of the Court”.

Nigeria maintains that on the date on which Cameroon's Application was filed, it did not know that Cameroon had accepted the Court's compulsory jurisdiction. Accordingly it could not have brought an application against Cameroon. There was an absence of reciprocity on that date. The condition contained in the Nigerian Declaration was operative; consequently, the Court does not have jurisdiction to hear the Application.

42. Cameroon disputes this argument in fact as well as in law. It states that, in the minds of the States party to the Optional Clause, the condition of reciprocity never possessed the meaning which Nigeria now ascribes to it; the Court had ascribed a completely different meaning to it in a number of its judgments. The interpretation now provided by Nigeria of its own declaration was a new interpretation for which no authority was cited in support. In sum, the purpose of the Nigerian Declaration, according to Cameroon, was only to emphasize that there is “a sole and unique condition to the compulsory character of the Court's jurisdiction in this case, i.e., that Cameroon should accept the same obligation as Nigeria, or in other words that it should accept the jurisdiction of the Court. This Cameroon does.”

43. The Court has on numerous occasions had to consider what meaning it is appropriate to give to the condition of reciprocity in the implementation of Article 36, paragraph 2, of the Statute. As early as 1952, it held in the case concerning *Anglo–Iranian Oil Co.* that, when declarations are made on condition of reciprocity, “jurisdiction is conferred on the Court only to the extent to which

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

the two Declarations coincide in conferring it" (*I.C.J. Reports 1952*, p. 103). The Court applied that rule again in the case of *Certain Norwegian Loans* (*I.C.J. Reports 1957*, pp. 23 and 24) and clarified it in the *Interhandel* case where it held that:

> "Reciprocity in the case of Declarations accepting the compulsory jurisdiction of the Court enables a Party to invoke a reservation to that acceptance which it has not expressed in its own Declaration but which the other Party has expressed in its Declaration… Reciprocity enables the State which has made the wider acceptance of the jurisdiction of the Court to rely upon the reservations to the acceptance laid down by the other Party. There the effect of reciprocity ends." (*I.C.J. Reports 1959*, p. 23.)

In the final analysis, "[t]he notion of reciprocity is concerned with the scope and substance of the commitments entered into, including reservations, and not with the formal conditions of their creation, duration or extinction" (*Military and Paramilitary Activities in and against Nicaragua (Nicaragua* v. *United States of America), Jurisdiction and Admissibility, Judgment, I.C.J. Reports 1984*, p. 419, para. 62). It simply requires that the Court ascertain whether, at the time of filing the Application instituting proceedings "the two States accepted 'the same obligation' in relation to the subject–matter of the proceedings" (*ibid.*, pp. 420–421, para. 64).

Therefore, in legal proceedings, the notion of reciprocity, and that of equality, "are not abstract conceptions. They must be related to some provision of the Statute or of the Declarations" (*Right of Passage over Indian Territory, Preliminary Objections, Judgment, I.C.J. Reports 1957*, p. 145). Consequently, "the principle of reciprocity is not affected by any delay in the receipt of copies of the Declaration by the Parties to the Statute" (*ibid.*, p. 147).

Nigeria considers, however, that that precedent does not apply here. It points out that, although in its 1965 Declaration, it recognized the jurisdiction of the Court as compulsory in relation to any other State accepting the same obligation, it was more explicit in adding the words "and that is to say, on the sole condition of reciprocity". "Those additional words clearly have some meaning and effect … it is the supplementing of the 'coincidence' required by Article 36, paragraph 2, by the element of mutuality inherent in the concept of 'reciprocity'." The Nigerian condition, in other words, sought "to mitigate the effects" of the Court's earlier decision in the case concerning *Right of Passage over Indian Territory* by creating an equality of risk and precluding that proceedings be brought before the Court by surprise.

44. In support of its position, Nigeria invokes the decision given in the case concerning *Anglo–Iranian Oil Co.*, in which the Court stated that it could not base its interpretation of the Iranian Declaration recognizing the jurisdiction of the Court

> "on a purely grammatical interpretation of the text. It must seek the interpretation which is in harmony with a natural and reasonable way of reading the text, having due regard to the intention of the Government of Iran at the time when it accepted the compulsory jurisdiction of the Court." (*Anglo–Iranian Oil Co., Preliminary Objection, I.C.J. Reports 1952*, p. 104.)

The Court had concluded that "[i]t is unlikely that the Government of Iran … should have been willing, on its own initiative, to agree that disputes relating" (*ibid.*, p. 105) to the capitulations which it had just denounced be submitted to an international court of justice.

45. The Court considers that the situation in this case is very different. Nigeria does not offer evidence in support of its argument that it intended to insert into its Declaration of 14 August 1965 a condition of reciprocity with a different meaning from the one which the Court had drawn from such clauses in 1957. In order to protect itself against the filing of surprise applications, in 1965, Nigeria could have inserted in its Declaration an analogous reservation to that which the United Kingdom added to its own Declaration in 1958. Ten or so other States proceeded in this way. Nigeria did not do so at that time. Like the majority of States which subscribe to the Optional Clause, it merely

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

specified that the commitments it was entering into, in accordance with Article 36, paragraph 2, of the Statute, were reciprocal in relation to any other State accepting the same obligation. In the light of this practice, the additional phrase of the sentence, “that is to say, on the sole condition of reciprocity” must be understood as explanatory and not adding any further condition. This interpretation is “in harmony with a natural and reasonable way of reading the text” (*Anglo–Iranian Oil Co., Preliminary Objection, I.C.J. Reports 1952*, p. 104) and Nigeria's condition of reciprocity cannot be treated as a reservation *ratione temporis*.

46. The Court therefore concludes that the manner in which Cameroon's Application was filed was not contrary to Article 36 of the Statute. Nor was it made in violation of a right which Nigeria may claim under the Statute, or by virtue of its Declaration, as it was in force on the date of the filing of Cameroon's Application.

*

47. Nigeria's first preliminary objection is accordingly rejected. The Court is therefore not called upon to examine the reasoning put forward by Cameroon under Article 102 of the Charter, nor Cameroon's alternative submissions based on *forum prorogatum*. In any event, the Court has jurisdiction to pass upon Cameroon's Application.

* *

Second Preliminary Objection

48. Nigeria raises a second preliminary objection stating that

> “for a period of at least 24 years prior to the filing of the Application the Parties have in their regular dealings accepted a duty to settle all boundary questions through the existing bilateral machinery”.

According to Nigeria, an implicit agreement is thus said to have been reached with a view to resorting exclusively to such machinery and to refraining from relying on the jurisdiction of the International Court of Justice. In the alternative, Nigeria claims that by its conduct Cameroon is estopped from turning to the Court. Finally, Nigeria invokes the principle of good faith and the rule *pacta sunt servanda* in support of this argument.

49. Cameroon maintains that the bilateral bodies which dealt with various boundary difficulties that had emerged between the two countries had only been temporary and that no permanent institutional machinery had been set up. It contends that no explicit or implicit agreement had been established between the Parties with a view to vesting exclusive jurisdiction in such bodies. Finally, according to Cameroon, the conditions laid down in the Court's case–law for the application of estoppel to arise were not fulfilled here. Therefore, there was no occasion to apply the principle of good faith and the rule *pacta sunt servanda*.

50. Nigeria's objection thus consists of two branches. But before making a legal determination considering them in turn, the Court will review the relevant facts.

51. The first bilateral contact referred to in the pleadings concerns a local dispute in the districts of Danare (Nigeria) and Budam (Cameroon). This dispute gave rise in 1965 to “exploratory talks” concerning the demarcation of the boundary in this sector. That course having been determined by the German and British authorities at the beginning of the century, it was agreed to locate existing boundary pillars with a view to identifying the boundary and proceeding with its demarcation not only between Danare and Budam, but also on a stretch of some 20 miles from Obokum Falls to Bashu (boundary pillars Nos. 114 to 105). The existing pillars were identified but none of the work planned was subsequently carried out.

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

52. Five years later, in response to incidents that occurred in the Cross River region and the Bakassi Peninsula, the two Governments decided to set up a Joint Boundary Commission. At the first meeting of that Commission, the delegates from Cameroon and Nigeria approved, on 14 August 1970, a declaration recommending that the delimitation of the boundary be carried out in three stages:

> “(a) the delimitation of the maritime boundary;
>
> (b) the delimitation of the land boundary as defined in the Anglo–German Protocol signed at Obokum on 12 April 1913 and confirmed by the London Anglo–German agreement ‘respecting (1) the settlement of Frontier between Nigeria and Cameroon from Yola to the sea; and (2) the Regulation of navigation on the Cross River”, and the exchange of letters between the British and German Governments on 6 July 1914;
>
> (c) the delimitation of the rest of the land boundary”.

The declaration further specified the bases on which the delimitation of the maritime boundary was to be carried out. It recommended that the demarcation work commenced in 1965 be resumed. Finally, it recommended that, on completion of each of these stages, a separate treaty be signed by the two countries to give effect to the boundary so demarcated and surveyed.

A Joint Technical Committee was then set up for the purpose of implementing the joint declaration. As agreed, it began its work with the delimitation of the maritime boundary. Negotiations went on at various levels on this matter for almost five years. They concluded on 4 April 1971 as regards the maritime boundary at the mouth of the Cross River, then led on 1 June 1975 to a declaration in Maroua by the two Heads of State concerning the course of the maritime boundary from the mouth of the Cross River to a point denominated “G” situated, according to the Parties, some 17 nautical miles from the coast.

53. Over the following years, contacts between the two countries on these boundary issues became less frequent. At most, it may be noted that two Joint Committee meetings were held. The first, in 1978, was attended by the two Foreign Ministers. They set forth their points of view on a number of boundary problems without undertaking negotiations and the meeting did not result in any joint minutes. The second meeting, held in 1987, brought together the Ministers responsible for planning in the two countries and did not broach boundary matters.

54. The negotiations on these issues, which were interrupted after 1975, were only resumed between the two States 16 years later when, on 29 August 1991, the two Foreign Ministers adopted a joint communiqué stating:

> “On border issues, the two sides agreed to examine in detail all aspects of the matter by the experts of the National Boundary Commission of Nigeria and the experts of the Republic of Cameroon at a meeting to be convened at Abuja in October 1991 with a view to making appropriate recommendations for a peaceful resolution of outstanding border issues.”

Indeed, a first meeting of these experts took place at the same time as that of the Foreign Ministers in August 1991. It was followed by a second meeting at Abuja in December 1991, then by a third at Yaoundé in August 1993. No agreement could be reached at these meetings, in particular as regards the Maroua Declaration, which was considered binding by Cameroon but not by Nigeria.

55. In sum, the Court notes that the negotiations between the two States concerning the delimitation or the demarcation of the boundary were carried out in various frameworks and at various levels: Heads of State, Foreign Ministers, experts. The negotiations were active during the period 1970 to 1975 and then were interrupted until 1991.

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

*

56. Turning to legal considerations, the Court will now consider the first branch of the Nigerian objection. It recalls first that, “Negotiation and judicial settlement are enumerated together in Article 33 of the Charter of the United Nations as means for the peaceful settlement of disputes” (*Aegean Sea Continental Shelf, Judgment, I.C.J. Reports 1978*, p. 12, para. 29). Neither in the Charter nor otherwise in international law is any general rule to be found to the effect that the exhaustion of diplomatic negotiations constitutes a precondition for a matter to be referred to the Court. No such precondition was embodied in the Statute of the Permanent Court of International Justice, contrary to a proposal by the Advisory Committee of Jurists in 1920 (Advisory Committee of Jurists, *Procès–verbaux of the Proceedings of the Committee (16 June–24 July 1920) with Annexes*, pp. 679, 725–726). Nor is it to be found in Article 36 of the Statute of this Court.

A precondition of this type may be embodied and is often included in compromissory clauses of treaties. It may also be included in a special agreement whose signatories then reserve the right to seise the Court only after a certain lapse of time (cf. *Territorial Dispute (Libyan Arab Jamahiriya/Chad), Judgment, I.C.J. Reports 1994*, p. 9). Finally, States remain free to insert into their optional declaration accepting the compulsory jurisdiction of the Court a reservation excluding from the latter those disputes for which the parties involved have agreed or subsequently agree to resort to an alternative method of peaceful settlement. In this case, however, no reservation of this type was included in the Declarations of Nigeria or Cameroon on the date of the filing of the Application.

Moreover, the fact that the two States have attempted, in the circumstances set out in paragraphs 54 and 55 above, to solve some of the boundary issues dividing them during bilateral contacts, did not imply that either one had excluded the possibility of bringing any boundary dispute concerning it before other fora, and in particular the International Court of Justice. The first branch of Nigeria's objection accordingly is not accepted.

57. Turning to the second branch of the objection, the Court will examine whether the conditions laid down in its jurisprudence for an estoppel to exist are present in the instant case.

An estoppel would only arise if by its acts or declarations Cameroon had consistently made it fully clear that it had agreed to settle the boundary dispute submitted to the Court by bilateral avenues alone. It would further be necessary that, by relying on such an attitude, Nigeria had changed position to its own detriment or had suffered some prejudice (*North Sea Continental Shelf, Judgment, I.C.J. Reports 1969*, p. 26, para. 30; *Land, Island and Maritime Frontier Dispute (El Salvador/Honduras), Application to Intervene, Judgment, I.C.J. Reports 1990*, p. 118, para. 63).

These conditions are not fulfilled in this case. Indeed, as pointed out in paragraph 56 above, Cameroon did not attribute an exclusive character to the negotiations conducted with Nigeria, nor, as far as it appears, did Nigeria. Furthermore, Nigeria does not show that it has changed its position to its detriment or that it has sustained prejudice in that it could otherwise have sought a solution to the border problems existing between the two States by having recourse to other procedures, but was precluded from doing so by reliance on the positions allegedly taken by Cameroon.

58. Finally, the Court has not been persuaded that Nigeria has been prejudiced as a result of Cameroon's having instituted proceedings before the Court instead of pursuing negotiations which, moreover, were deadlocked when the Application was filed.

59. This being so, in bringing proceedings before the Court, Cameroon did not disregard the legal rules relied on by Nigeria in support of its second objection. Consequently, Nigeria is not justified in relying on the principle of good faith and the rule *pacta sunt servanda*, both of which relate only to the fulfilment of existing obligations. The second branch of Nigeria's objection is not accepted.

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

60. The second preliminary objection as a whole is thus rejected.

* *

Third Preliminary Objection

61. In its third preliminary objection, Nigeria contends that "the settlement of boundary disputes within the Lake Chad region is subject to the exclusive competence of the Lake Chad Basin Commission".

62. In support of this argument, Nigeria invokes the treaty texts governing the Statute of the Commission as well as the practice of member States. It argues that "the procedures for settlement by the Commission are binding upon the Parties" and that Cameroon was thus barred from raising the matter before the Court on the basis of Article 36, paragraph 2, of the Statute.

63. For its part, Cameroon submits to the Court that

> "no provision of the Statute of the Lake Chad Basin Commission establishes in favour of that international organization any exclusive competence in relation to boundary delimitation".

It adds that no such exclusive jurisdiction can be inferred from the conduct of member States. It therefore calls upon the Court to reject the third preliminary objection.

*

64. The Court observes that the Statute of the Lake Chad Basin Commission was annexed to an Agreement of 22 May 1964 signed on that date by Cameroon, Chad, Niger and Nigeria. According to its preamble, this convention concerning the development of the Lake Chad Basin is designed "to formulate principles of the utilization of the resources of the Basin for economic purposes, including the harnessing of the water".Article IV of the Statute develops those principles by providing that

> "[t]he development of the said Basin and in particular the utilisation of surface and ground waters shall be given its widest connotation and refers in particular to domestic, industrial and agricultural development, the collection of the products of its fauna and flora".

In addition, under Article VII of the Statute, member States undertake to "establish common rules for the purpose of facilitating navigation on the Lake and on the navigable waters in the Basin and to ensure the safety and control of navigation".

Article I of the Convention establishes the Lake Chad Basin Commission. The Commission comprises two commissioners per member State. In accordance with Article X, paragraph 3, of the Statute, the decisions of the Commission shall be by unanimous vote.

The functions of the Commission are laid down in Article IX of the same Statute. They are *inter alia* to prepare "general regulations which will permit the full application of the principles set forth in the present Convention and its annexed Statute, and to ensure their effective application". The Commission exercises various powers with a view to co–ordinating action by member States regarding the use of the waters of the Basin. Finally, one of its responsibilities under Article IX, paragraph *(g)*, is "to examine complaints and to promote the settlement of disputes and the resolution of differences".

65. Member States have also entrusted to the Commission certain tasks that had not originally been provided for in the treaty texts. Further to incidents between Cameroon and Nigeria in 1983 in the Lake Chad area, an extraordinary meeting of the Commission was convened from 21 to 23 July

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

1983 in Lagos on the initiative of the Heads of State concerned, in order to entrust to the Commission certain boundary and security matters. Two sub–commissions of experts were then set up. They met from 12 to 16 November 1984. An agreement was immediately reached between the experts to adopt "as working documents" various bilateral conventions and agreements concluded between Germany, France and the United Kingdom between 1906 and 1931 "on the delimitation of Borders in the Lake Chad area". The experts proposed at the same time that the boundary so delimited be demarcated as early as possible.

This demarcation was carried out from 1988 to 1990 in the course of three boundary–marking operations involving the setting up of seven main and 68 intermediary boundary pillars. The Final Report on Beaconing was signed by the delegates of the four States concerned. Then, on 23 March 1994, at the Eighth Summit of the Lake Chad Basin Commission in Abuja, the Heads of State and Government were informed that "the physical work in the field on the border demarcation exercise was fully completed". They then decided "to approve the technical document on the demarcation of the international boundaries of member States in Lake Chad", on the understanding "that each country should adopt the document in accordance with its national laws". The question of the ratification of that document came up at the Ninth Summit of Heads of State of the Commission held on 30 and 31 October 1996 in N'Djamena when Heads of State of Cameroon and Nigeria were absent and where no progress was recorded. Since then, however, on 22 December 1997, Cameroon deposited its instrument of ratification, whereas Nigeria has not done so.

*

66. In the light of the treaty texts and the practice thus recalled, the Court will consider the positions of the Parties on this matter. For its part, Nigeria first of all contends that "the role and Statute of the Commission must be understood "in the framework of regional agencies" referred to in Article 52 of the United Nations Charter. It accordingly concludes that "the Commission has an exclusive power in relation to issues of security and public order in the region of Lake Chad and that these issues appropriately encompass the business of boundary demarcation".

Cameroon argues, for its part, that the Commission does not constitute a regional arrangement or agency within the meaning of Article 52 of the Charter, pointing in particular to the fact that

> "there has never been any question of extending this category to international regional organizations of a technical nature which, like the [Commission], can include a mechanism for the peaceful settlement of disputes or for the promotion of that kind of settlement".

67. The Court notes that Article 52, paragraph 1, of the Charter refers to "regional arrangements or agencies for dealing with such matters relating to the maintenance of international peace and security as are appropriate for regional action". According to paragraph 2 of that Article,

> "[t]he Members of the United Nations entering into such arrangements or constituting such agencies shall make every effort to achieve pacific settlement of local disputes through such regional arrangements or by such regional agencies before referring them to the Security Council".

Under Article 53, the Security Council may use these arrangements or agencies for "enforcement action under its authority".

From the treaty texts and the practice analysed at paragraphs 64 and 65 above, it emerges that the Lake Chad Basin Commission is an international organization exercising its powers within a specific geographical area; that it does not however have as its purpose the settlement at a regional level of matters relating to the maintenance of international peace and security and thus does not fall under Chapter VIII of the Charter.

68. However, even were it otherwise, Nigeria's argument should nonetheless be set aside. In this

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

connection, the Court notes that, in the case concerning *Military and Paramilitary Activities in and against Nicaragua*, it did not consider that the Contadora process could "properly be regarded as a 'regional arrangement' for the purposes of Chapter VIII of the United Nations Charter". But it added that, in any event,

> "the Court is unable to accept either that there is any requirement of prior exhaustion of regional negotiating processes as a precondition to seising the Court; or that the existence of the Contadora process constitutes in this case an obstacle to the examination by the Court of the Nicaraguan Application" (*Military and Paramilitary Activities in and against Nicaragua (Nicaragua* v. *United States of America), Jurisdiction and Admissibility, Judgment, I.C.J. Reports 1984*, p. 440).

Whatever their nature, the existence of procedures for regional negotiation cannot prevent the Court from exercising the functions conferred upon it by the Charter and the Statute.

69. Nigeria further invokes Article 95 of the United Nations Charter according to which:

> "Nothing in the present Charter shall prevent Members of the United Nations from entrusting the solution of their differences to other tribunals by virtue of agreements already in existence or which may be concluded in the future."

According to Nigeria, the Lake Chad Basin Commission should be seen as a tribunal falling under the provisions of this text. This would mean that, if the Court were to pronounce on this submission of Cameroon it "would be in breach of the principle of the autonomy of jurisdictional competence" and "would be exercising an appellate jurisdiction".

The Court considers that the Lake Chad Basin Commission cannot be seen as a tribunal. It renders neither arbitral awards nor judgments and is therefore neither an arbitral nor a judicial body. Accordingly, this contention of Nigeria must also be set aside.

70. Nigeria further maintains that the Convention of 22 May 1964, confirmed by the practice of the member States of the Commission, attributes to that Commission an exclusive competence for the settlement of boundary disputes. It concludes from this that the Court cannot entertain Cameroon's submissions requesting it to determine the boundary between the two countries in this sector.

The Court cannot subscribe to that reasoning. It notes first of all that no provision in the Convention ascribes jurisdiction and *a fortiori* exclusive jurisdiction to the Commission as regards the settlement of boundary disputes. In particular, such a jurisdiction cannot be deduced from Article IX, paragraph *(g)*, of the Convention (see paragraph 64 above).

The Court further notes that the member States of the Commission subsequently charged it with carrying out the demarcation of boundaries in the region on the basis of the agreements and treaties referred to in the experts' report of November 1984 (see paragraph 65 above). Thus, as pointed out by Nigeria, "the question of boundary demarcation was clearly within the competence of the [Commission]". This demarcation was designed by the States concerned as a physical operation to be carried out in the field under the authority of the Commission with a view to avoiding the reoccurrence of the incidents that had arisen in 1983.

But the Commission has never been given jurisdiction, and *a fortiori* exclusive jurisdiction, to rule on the territorial dispute now involving Cameroon and Nigeria before the Court, a dispute which moreover did not as yet exist in 1983. Consequently, Nigeria's argument must be dismissed.

71. Nigeria also argues that, from 1983 to 1994, "Cameroon had clearly and consistently evinced acceptance of the régime of exclusive recourse to the Lake Chad Basin Commission"; Cameroon then appealed to the Court contrary to the commitments it had entered into. This course of conduct, it was argued, had been prejudicial to Nigeria, deprived as it was of the "consultation"

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

and “negotiation” procedures afforded by the Commission. Nigeria claims that Cameroon is estopped from making its Application.

The Court points out that the conditions laid down in its case–law for an estoppel to arise, as set out in paragraph 57 above, are not fulfilled in this case. Indeed, Cameroon has not accepted that the Commission has jurisdiction to settle the boundary dispute now submitted to the Court. This argument must also be set aside.

72. In the alternative, Nigeria finally argues that, on account of the demarcation under way in the Lake Chad Basin Commission, the Court “cannot rule out the consideration of the need for judicial restraint on grounds of judicial propriety” and should decline to rule on the merits of Cameroon's Application, as it did in 1963 in the case concerning *Northern Cameroons*.

In that case, the Court had noted that the United Nations General Assembly had terminated the trusteeship agreement in respect of the Northern Cameroon by resolution 1608 (XV); it observed that the dispute between the parties “about the interpretation and application [of that agreement therefore concerned a treaty] no longer in force”; it went on to say that “there can be no opportunity for a future act of interpretation or application of that treaty in accordance with any judgment the Court might render”. It had concluded that any adjudication would thus be “devoid of purpose” and that no purpose “would be served by undertaking an examination of the merits in the case”. Observing that the limits of its judicial function “do not permit it to entertain the claims submitted to it [by Cameroon, it had considered itself unable to] adjudicate upon the merits of [those] claim[s]” (*Northern Cameroons, Judgment, I.C.J. Reports 1963*, pp. 37–38).

The Court considers that the situation in the present case is entirely different. Indeed, whereas in 1963 Cameroon did not challenge the validity of the General Assembly resolution terminating the trusteeship, Nigeria, in the present case, does not regard the technical document on the demarcation of the boundaries, approved at the Abuja Summit of the Lake Chad Basin Commission, as a document definitively settling boundary problems in that region. Nigeria reserved its position before the Court as regards the binding character of that document. It contends that the document requires ratification and recalls that it has not ratified it. Lastly, it specified at the Ninth Summit of the Commission at N'Djamena in 1996 that “Nigeria could not even start processing ratification unless the issue was out of Court”.

Cameroon for its part considers that Nigeria is obliged to complete the process of approval of the document concerned and, that, even in the absence of so doing, the boundary between the two countries in this sector is “legally defined”, “marked out on the ground” and “internationally recognized”.

It is not for the Court at this stage to rule upon these opposing arguments. It need only note that Nigeria cannot assert both that the demarcation procedure initiated within the Lake Chad Commission was not completed and that, at the same time, that procedure rendered Cameroon's submissions moot. There is thus no reason of judicial propriety which should make the Court decline to rule on the merits of those submissions.

73. In the light of the above considerations, Nigeria's third preliminary objection must be rejected.

* *

Fourth Preliminary Objection

74. The Court will now turn to the fourth preliminary objection raised by Nigeria. This objection contends that:

> “The Court should not in these proceedings determine the boundary in Lake Chad to the extent that that boundary constitutes or is constituted by the tripoint in the Lake.”

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

75. Nigeria holds that the location of the tripoint within Lake Chad directly affects a third State, the Republic of Chad, and that the Court therefore cannot determine this tripoint. Nigeria maintains that the finding of the Chamber in the case concerning the *Frontier Dispute (Burkina Faso/Republic of Mali)*

> "that its jurisdiction is not restricted simply because the end–point of the frontier lies on the frontier of a third State not party to the proceedings. The rights of the neighbouring State, Niger, are in any event safeguarded by the operation of Article 59 of the Statute ..." (*I.C.J. Reports 1986*, p. 577, para. 46)

is not applicable in the present case. It says there is a difference because the 1986 *Frontier Dispute* case was instituted by Special Agreement, which reflected the agreement of the Parties to have the entire boundary delimited. In addition, in the *Frontier Dispute* case Niger was treated as a wholly third party, while in the present case there is the Lake Chad Basin Commission in which the States bordering Lake Chad co–operate. Because of that co–operation, boundary or other agreements relating to Lake Chad between Nigeria and Cameroon are not *res inter alios acta* for the other member States of the Commission. Therefore, neither Niger nor Chad are simple third parties in this case. According to Nigeria, "the régime of Lake Chad is subject to multilateral co–operation, and is not susceptible to the thorough–going bilateralization" which the Chamber adopted in the *Frontier Dispute* case.

Nigeria also alleges that it is not the case that Chad as a third party is merely theoretically or contingently involved in the question of boundaries; there had been clashes between Nigeria and Chad in and in relation to Lake Chad. Finally, Nigeria questions the distinction which the Chamber in the *Frontier Dispute* case drew between maritime and land delimitation. "Criteria of equidistance, proportionality and equity have been applied to the delimitation of lacustrine boundaries, especially in large lakes." Nigeria's position is such that it would warrant the conclusion that its fourth preliminary objection goes not only to the jurisdiction of the Court (by analogy with the principle in the case of the *Monetary Gold Removed from Rome in 1943, Preliminary Question, Judgment, I.C.J. Reports 1954*, p. 19), but also to the admissibility of the Application, as the objection is in its view well founded on either basis.

76. Cameroon claims that the Court must exercise its jurisdiction over the totality of the disputed boundary, as far as the northern end–point within Lake Chad; Nigeria's fourth preliminary objection directly conflicts with consistent case–law relating to tripoints. Cameroon particularly rejects the Nigerian argument which distinguishes the *Frontier Dispute* decision from the present case: the absence of a special agreement, and therefore the consent of Nigeria to the institution of the proceedings, is irrelevant; Nigeria does not cite any precedent in which a differentiation was made between "wholly third States" and States which would not be real third States. *Inter se* boundary agreements from which third States are absent are frequent. Article 59 suffices as protection of the third States' rights. The concept of theoretical involvement of a third State in a boundary question is, in the view of Cameroon, not pertinent. There is no support for this concept, the implications of which are not clearly explained. Lastly Cameroon contests the efforts made by Nigeria to exclude the applicability of the *Frontier Dispute* Judgment to delimitation in lakes.

77. The Court notes that, to the extent that Nigeria's reference to the Lake Chad Basin Commission is to be understood as referring to an exclusive competence of the Commission for boundary delimitation in Lake Chad, this argument has been dealt with under the third preliminary objection. As the third preliminary objection has not been upheld, the Court need not deal with this argument again.

78. The Court moreover notes that the submissions of Cameroon addressed to it in the Additional Application (para. 17) and as formulated in the Memorial of Cameroon (Memorial of Cameroon, pp. 669–671, para. 9) do not contain a specific request to determine the localization of the tripoint

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

Nigeria–Cameroon–Chad in the Lake. The Additional Application requests the Court "to specify definitively the frontier between Cameroon and the Federal Republic of Nigeria from Lake Chad to the sea" (para. 17 *(f)* of the Additional Application), while the Memorial requests the Court to adjudge and declare:

> "that the lake and land boundary between Cameroon and Nigeria takes the following course:
>
> — from the point at longitude 14°04′59″ 9999 E of Greenwich and latitude 13°05′00″0001 N, it then runs through the point located at longitude 14°12′11″7 E and latitude 12°32′17″4 N″ (p. 669, para. 9.1 *(a)*).

These submissions nevertheless bear upon the localization of the tripoint. They could lead either to a confirmation of the localization of the tripoint as accepted in practice up to now on the basis of acts and agreements of the former colonial powers and the demarcation carried out by the Commission (see paragraph 65 above), or they could lead to a redetermination of the situation of the tripoint, possibly as a consequence of Nigeria's claims to Darak and adjacent islands. Thus these claims cannot be considered on the merits by the Court at this stage of the proceedings. However, the Court notes, at the present stage, that they are directed against Cameroon and that in due course the Court will be in a position to take its decision in this regard without pronouncing on interests that Chad may have, as the Court will demonstrate hereafter.

79. The Court therefore now turns to the crux of Nigeria's fourth preliminary objection, namely the assertion that the legal interests of Chad would be affected by the determination of the tripoint, and that the Court can therefore not proceed to that determination.

The Court recalls that it has always acknowledged as one of the fundamental principles of its Statute that no dispute between States can be decided without their consent to its jurisdiction (*Monetary Gold Removed from Rome in 1943, Judgment, I.C.J. Reports 1954*, p. 32.) Nevertheless, the Court has also emphasized that it is not necessarily prevented from adjudicating when the judgment it is asked to give might affect the legal interests of a State which is not a party to the case; and the Court has only declined to exercise jurisdiction when the interests of the third State "constitute the very subject–matter of the judgment to be rendered on the merits" (*Certain Phosphate Lands in Nauru (Nauru* v. *Australia), Preliminary Objections, Judgment, I.C.J. Reports 1992*, p. 261, para. 55; *East Timor (Portugal* v. *Australia), Judgment, I.C.J. Reports 1995*, pp. 104–105, para. 34).

The Court observes that the submissions presented to it by Cameroon refer to the frontier between Cameroon and Nigeria and to that frontier alone. These submissions do not refer to the frontier between Cameroon and the Republic of Chad either as contained in the Additional Application of Cameroon or as formulated in the Memorial. Certainly, the request to "specify definitively the frontier between Cameroon and the Federal Republic of Nigeria from Lake Chad to the sea" (para. 17 *(f)* of the Additional Application) may affect the tripoint, i.e., the point where the frontiers of Cameroon, Chad and Nigeria meet. However, the request to specify the frontier between Cameroon and Nigeria from Lake Chad to the sea does not imply that the tripoint could be moved away from the line constituting the Cameroon–Chad boundary. Neither Cameroon nor Nigeria contests the current course of that boundary in the centre of Lake Chad as it is described in the "technical document on the demarcation of the … boundaries" mentioned in paragraph 65 above. Incidents between Nigeria and Chad in the Lake, as referred to by Nigeria, concern Nigeria and Chad but not Cameroon or its boundary with Chad. Any redefinition of the point where the frontier between Cameroon and Nigeria meets the Chad–Cameroon frontier could in the circumstances only lead to a moving of the tripoint along the line of the frontier in the Lake between Chad and Cameroon. Thus, the legal interests of Chad as a third State not party to the case do not constitute the very subject–matter of the judgment to be rendered on the merits of Cameroon's Application; and therefore, the absence of Chad does not prevent the Court from proceeding to a specification of the border

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

between Cameroon and Nigeria in the Lake.

80. The Court notes also that, in the case concerning the *Territorial Dispute (Libyan Arab Jamahiriya/Chad)*, the tripoint where the boundary between Libya and Chad meets the western boundary of the Sudan, on the 24th meridian east of Greenwich, was determined without involvement of the Sudan. The eastern end–points of the principal lines taken into consideration by the Court in that case for the delimitation of the boundary between Libya and Chad were situated at various locations on the western boundary of the Sudan.

Furthermore, in that case, the Court, in the absence of Niger, fixed the western boundary between Libya and Chad as far as the point of intersection of the 15th meridian east and the parallel 23° of latitude north, a point at which, according to Chad, the frontiers of Chad, Libya and Niger meet.

81. The factual situation underlying the case concerning the *Frontier Dispute (Burkina Faso/Republic of Mali)* was quite different from the present case in the sense that the relevant part of the boundary of Niger at the time was not delimited; in that case the fixing of the tripoint therefore immediately involved Niger as a third State, which, however, did not prevent the Chamber from tracing the boundary between Burkina Faso and the Republic of Mali to its furthest point. Whether the location of the tripoint in Lake Chad has actually to be changed from its present position will follow from the judgment on the merits of Cameroon's Application. Such a change would have no consequence for Chad.

82. Finally the Court observes that, since neither Cameroon nor Nigeria challenge the current course of the boundary, in the centre of Lake Chad, between Cameroon and the Republic of Chad (see paragraph 79 above), it does not have to address — even if that was possible at the present preliminary stage — the argument presented by Nigeria concerning the legal principles applicable to the determination of boundaries in lakes and especially in large lakes like Lake Chad.

83. The fourth preliminary objection is accordingly rejected.

* *

Fifth Preliminary Objection

84. In its fifth preliminary objection Nigeria alleges that there is no dispute concerning “boundary delimitation as such” throughout the whole length of the boundary from the tripoint in Lake Chad to the sea, subject, within Lake Chad, to the question of the title over Darak and adjacent islands, and without prejudice to the title over the Bakassi Peninsula.

85. In the course of the oral proceedings, it became clear that in addition to Darak and Bakassi, there are competing claims of Nigeria and Cameroon in respect of the village of Tipsan, which each Party claims to be on its side of the boundary. Also, in the course of the oral proceedings, a question was asked of the Parties by a Member of the Court as to whether Nigeria's assertion that there is no dispute as regards the land boundary between the two States (subject to the existing problems in the Bakassi Peninsula and the Darak region) signifies,

> “that, these two sectors apart, there is agreement between Nigeria and Cameroon on the geographical co–ordinates of this boundary as they result from the texts relied on by Cameroon in its Application and its Memorial”.

The reply given to this question by Nigeria will be examined below (paragraph 91).

86. For Cameroon its existing boundary with Nigeria was precisely delimited by the former colonial powers and by decisions of the League of Nations and acts of the United Nations.

These delimitations were confirmed or completed by agreements made directly between Cameroon

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

and Nigeria after their independence. Cameroon requests that the Court "specify definitively the frontier between Cameroon and Nigeria from Lake Chad to the sea" (Additional Application, para. 17 *(f)*) along a line the co–ordinates of which are given in Cameroon's Memorial.

The fact that Nigeria claims title to the Bakassi Peninsula and Darak, and adjacent islands, means, in the view of Cameroon, that Nigeria contests the validity of these legal instruments and thus calls into question the entire boundary which is based on them. That, in the view of Cameroon, is confirmed by the occurrence, along the boundary, of numerous incidents and incursions. Nigeria's claims to Bakassi as well as its position regarding the Maroua Declaration also throw into doubt the basis of the maritime boundary between the two countries. In Cameroon's view, and contrary to what Nigeria asserts, a dispute has arisen between the two States concerning the whole of the boundary.

87. The Court recalls that,

> "in the sense accepted in its jurisprudence and that of its predecessor, a dispute is a disagreement on a point of law or fact, a conflict of legal views or interests between parties (see *Mavrommatis Palestine Concessions, Judgment No. 2, 1924, P.C.I.J., Series A, No. 2*, p. 11; *Northern Cameroons, Judgment, I.C.J. Reports 1963*, p. 27; and *Applicability of the Obligation to Arbitrate under Section 21 of the United Nations Headquarters Agreement of 26 June 1947, Advisory Opinion, I.C.J. Reports 1988*, p. 27, para. 35)" (*East Timor (Portugal* v. *Australia), Judgment, I.C.J. Reports 1995*, pp. 99–100, para. 22);

and that,

> "[i]n order to establish the existence of a dispute, 'It must be shown that the claim of one party is positively opposed by the other' (*South West Africa, Preliminary Objections, Judgment, I.C.J. Reports 1962*, p. 328); and further, 'Whether there exists an international dispute is a matter for objective determination' (*Interpretation of Peace Treaties with Bulgaria, Hungary and Romania, First Phase, Advisory Opinion, I.C.J. Reports 1950*, p. 74)" (*I.C.J. Reports 1995*, p. 100).

On the basis of these criteria, there can be no doubt about the existence of disputes with respect to Darak and adjacent islands, Tipsan, as well as the Peninsula of Bakassi. This latter dispute, as indicated by Cameroon, might have a bearing on the maritime boundary between the two Parties.

88. All of these disputes concern the boundary between Cameroon and Nigeria. However, given the great length of that boundary, which runs over more than 1,600 km from Lake Chad to the sea, it cannot be said that these disputes in themselves concern so large a portion of the boundary that they would necessarily constitute a dispute concerning the whole of the boundary.

89. Further, the Court notes that, with regard to the whole of the boundary, there is no explicit challenge from Nigeria. However, a disagreement on a point of law or fact, a conflict of legal views or interests, or the positive opposition of the claim of one party by the other need not necessarily be stated *expressis verbis*. In the determination of the existence of a dispute, as in other matters, the position or the attitude of a party can be established by inference, whatever the professed view of that party. In this respect the Court does not find persuasive the argument of Cameroon that the challenge by Nigeria to the validity of the existing titles to Bakassi, Darak and Tipsan, necessarily calls into question the validity as such of the instruments on which the course of the entire boundary from the tripoint in Lake Chad to the sea is based, and therefore proves the existence of a dispute concerning the whole of the boundary.

90. The occurrence of boundary incidents certainly has to be taken into account in this context. However, not every boundary incident implies a challenge to the boundary. Also, certain of the incidents referred to by Cameroon took place in areas which are difficult to reach and where the

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

boundary demarcation may have been absent or imprecise. And not every incursion or incident alleged by Cameroon is necessarily attributable to persons for whose behaviour Nigeria's responsibility might be engaged. Even taken together with the existing boundary disputes, the incidents and incursions reported by Cameroon do not establish by themselves the existence of a dispute concerning all of the boundary between Cameroon and Nigeria.

91. However, the Court notes that Nigeria has constantly been reserved in the manner in which it has presented its own position on the matter. Although Nigeria knew about Cameroon's preoccupation and concerns, it has repeated, and has not gone beyond, the statement that there is no dispute concerning "boundary delimitation as such". Nigeria has shown the same caution in replying to the question asked by a Member of the Court in the oral proceedings (see paragraph 85 above). This question was whether there is agreement between the Parties on the geographical co–ordinates of the boundary as claimed by Cameroon on the basis of the texts it relies upon. The reply given by Nigeria reads as follows:

> "The land boundary between Nigeria and Cameroon is not described by reference to geographical co–ordinates. Rather, the relevant instruments (all of which pre–date the independence of Nigeria and Cameroon) and well–established practice, both before and after independence, fix the boundary by reference to physical features such as streams, rivers, mountains and roads, as was common in those days. Since independence, the two States have not concluded any bilateral agreement expressly confirming or otherwise describing the pre–independence boundary by reference to geographical co–ordinates. Nevertheless, the course of the boundary, which was well established before independence and related United Nations procedures, has continued to be accepted in practice since then by Nigeria and Cameroon."

92. The Court notes that, in this reply, Nigeria does not indicate whether or not it agrees with Cameroon on the course of the boundary or on its legal basis, though clearly it does differ with Cameroon about Darak and adjacent islands, Tipsan and Bakassi. Nigeria states that the existing land boundary is not described by reference to geographical co–ordinates but by reference to physical features. As to the legal basis on which the boundary rests, Nigeria refers to "relevant instruments" without specifying which these instruments are apart from saying that they pre–date independence and that, since independence, no bilateral agreements "expressly confirming or otherwise describing the pre–independence boundary by reference to geographical co–ordinates" have been concluded between the Parties. That wording seems to suggest that the existing instruments may require confirmation. Moreover, Nigeria refers to "well–established practice both before and after independence as one of the legal bases of the boundary whose course, it states, "has continued to be accepted in practice"; however, it does not indicate what that practice is.

93. The Court is seised with the submission of Cameroon which aims at a definitive determination of its boundary with Nigeria from Lake Chad to the sea (see paragraph 86 above). Nigeria maintains that there is no dispute concerning the delimitation of that boundary as such throughout its whole length from the tripoint in Lake Chad to the sea (see paragraph 84 above) and that Cameroon's request definitively to determine that boundary is not admissible in the absence of such a dispute. However, Nigeria has not indicated its agreement with Cameroon on the course of that boundary or on its legal basis (see paragraph 92 above) and it has not informed the Court of the position which it will take in the future on Cameroon's claims. Nigeria is entitled not to advance arguments that it considers are for the merits at the present stage of the proceedings; in the circumstances however, the Court finds itself in a situation in which it cannot decline to examine the submission of Cameroon on the ground that there is no dispute between the two States. Because of Nigeria's position, the exact scope of this dispute cannot be determined at present; a dispute nevertheless exists between the two Parties, at least as regards the legal bases of the boundary. It is for the Court to pass upon this dispute.

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

94. The fifth preliminary objection raised by Nigeria is thus rejected.

* *

Sixth Preliminary Objection

95. The Court will now turn to Nigeria's sixth preliminary objection which is to the effect that there is no basis for a judicial determination that Nigeria bears international responsibility for alleged frontier incursions.

96. Nigeria contends that the submissions of Cameroon do not meet the standard required by Article 38 of the Rules of Court and general principles of law regarding the adequate presentation of facts on which Cameroon's request is based, including dates, the circumstances and precise locations of the alleged incursions and incidents into and on Cameroonian territory. Nigeria maintains that what Cameroon has presented to the Court does not give Nigeria the knowledge which it needs and to which it is entitled in order to prepare its reply. Similarly, in Nigeria's view, the material submitted is so sparse that it does not enable the Court to carry out fair and effective judicial determination of, or make determination on, the issues of State responsibility and reparation raised by Cameroon. While Nigeria acknowledges that a State has some latitude in expanding later on what it has said in its Application and in its Memorial, Cameroon is said to be essentially restricted in its elaboration to the case as presented in its Application.

97. Cameroon insists that it stated clearly in its pleadings that the facts referred to in order to establish Nigeria's responsibility were only of an indicative nature and that it could, where necessary, amplify those facts when it comes to the merits. Cameroon refers to the requirements established in Article 38, paragraph 2, of the Rules and which call for a “succinct” presentation of the facts. It holds that parties are free to develop the facts of the case presented in the application or to render them more precise in the course of the proceedings.

98. The decision on Nigeria's sixth preliminary objection hinges upon the question of whether the requirements which an application must meet and which are set out in Article 38, paragraph 2, of the Rules of Court are met in the present instance. The requirements set out in Article 38, paragraph 2, are that the Application shall “specify the precise nature of the claim, together with a succinct statement of the facts and grounds on which the claim is based”. The Court notes that “succinct”, in the ordinary meaning to be given to this term, does not mean “complete” and neither the context in which the term is used in Article 38, paragraph 2, of the Rules of Court nor the object and purpose of that provision indicate that it should be interpreted in that way. Article 38, paragraph 2, does therefore not preclude later additions to the statement of the facts and grounds on which a claim is based.

99. Nor does Article 38, paragraph 2, provide that the latitude of an applicant State, in developing what it has said in its application is strictly limited, as suggested by Nigeria. That conclusion cannot be inferred from the term “succinct”; nor can it be drawn from the Court's pronouncements on the importance of the point of time of the submission of the application as the critical date for the determination of its admissibility; these pronouncements do not refer to the content of applications (*Questions of Interpretation and Application of the 1971 Montreal Convention arising from the Aerial Incident at Lockerbie (Libyan Arab Jamahiriya* v. *United Kingdom), Preliminary Objections, Judgment, I.C.J. Reports 1998*, p. 26, para. 44; and *Questions of Interpretation and Application of the 1971 Montreal Convention arising from the Aerial Incident at Lockerbie (Libyan Arab Jamahiriya* v. *United States of America), Preliminary Objections, Judgment, I.C.J. Reports 1998*, p. 130, para. 43). Nor would so narrow an interpretation correspond to the finding of the Court that,

> “whilst under Article 40 of its Statute the subject of a dispute brought before the Court *shall be* indicated, Article 32 (2) of the Rules of Court [today Article 38, paragraph 2] requires the Applicant ‘as far as possible’ to do certain things. These words apply not only to

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

> specifying the provision on which the Applicant founds the jurisdiction of the Court, but also to stating the precise nature of the claim and giving a succinct statement of the facts and grounds on which the claim is based." (*Northern Cameroons (Cameroon* v. *United Kingdom), Preliminary Objections, Judgment, I.C.J. Reports 1963*, p. 28.)

The Court also recalls that it has become an established practice for States submitting an application to the Court to reserve the right to present additional facts and legal considerations. The limit of the freedom to present such facts and considerations is "that the result is not to transform the dispute brought before the Court by the application into another dispute which is different in character" (*Military and Paramilitary Activities in and against Nicaragua (Nicaragua* v. *United States of America), Jurisdiction and Admissibility, Judgment, I.C.J. Reports 1984*, p. 427, para. 80). In this case, Cameroon has not so transformed the dispute.

100. As regards the meaning to be given to the term "succinct", the Court would simply note that Cameroon's Application contains a sufficiently precise statement of the facts and grounds on which the Applicant bases its claim. That statement fulfils the conditions laid down in Article 38, paragraph 2, and the Application is accordingly admissible.

This observation does not, however, prejudge the question whether, taking account of the information submitted to the Court, the facts alleged by the Applicant are established or not, and whether the grounds it relies upon are founded or not. Those questions belong to the merits and may not be prejudged in this phase of the proceedings.

101. Lastly, the Court cannot agree that the lack of sufficient clarity and completeness in Cameroon's Application and its inadequate character, as perceived by Nigeria, make it impossible for Nigeria to respond effectively to the allegations which have been presented or makes it impossible for the Court ultimately to make a fair and effective determination in the light of the arguments and the evidence then before it. It is the applicant which must bear the consequences of an application that gives an inadequate rendering of the facts and grounds on which the claim is based. As the Court has stated in the case concerning *Military and Paramilitary Activities in and against Nicaragua (Nicaragua* v. *United States of America)*:

> "[u]ltimately … however, it is the litigant seeking to establish a fact who bears the burden of proving it; and in cases where evidence may not be forthcoming, a submission may in the judgment be rejected as unproved, but is not to be ruled out as inadmissible *in limine* on the basis of an anticipated lack of proof." (*Ibid.*, p. 437, para. 101.)

102. The Court consequently rejects the sixth preliminary objection raised by Nigeria.

* *

Seventh Preliminary Objection

103. In its seventh preliminary objection Nigeria contends that there is no legal dispute concerning delimitation of the maritime boundary between the two Parties which is at the present time appropriate for resolution by the Court.

104. Nigeria says that this is so for two reasons: in the first place, no determination of a maritime boundary is possible prior to the determination of title in respect of the Bakassi Peninsula. Secondly, at the juncture when there is a determination of the question of title over the Bakassi Peninsula, the issues of maritime delimitation will not be admissible in the absence of prior sufficient action by the Parties, on a footing of equality, to effect a delimitation "by agreement on the basis of international law". In Nigeria's view, the Court cannot properly be seised by the unilateral application of one State in relation to the delimitation of an exclusive economic zone or continental shelf boundary if that State has made no attempt to reach agreement with the respondent State over that boundary,

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

contrary to the provisions of Articles 74 and 83 of the United Nations Convention on the Law of the Sea. Any such unilateral application, in the view of Nigeria, is inadmissible.

105. Cameroon is of the view that the first argument invoked by Nigeria concerns neither jurisdiction nor the admissibility of its Application, but simply the method whereby the merits of the case are best addressed, a decision which falls within the discretion of the Court. As to the second argument put forward by Nigeria, Cameroon denies that the conduct of negotiations is a precondition for instituting proceedings before the Court in cases of delimitation. Cameroon views the identical paragraphs 2 of Articles 74 and 83 of the United Nations Convention on the Law of the Sea not as barring recourse to third party settlement, but as an obligation for such recourse in order to avoid unilateral delimitations.

Cameroon says that, in any event, it had sufficiently negotiated with Nigeria before it seised the Court, and it seised the Court only when it became clear that any new negotiation would be doomed to failure. In this respect, it contends that since the actual occupation of the Bakassi Peninsula by Nigeria, any negotiation on the delimitation of the maritime boundary has become impossible.

106. The Court will initially address the first argument presented by Nigeria. The Court accepts that it will be difficult if not impossible to determine the delimitation of the maritime boundary between the Parties as long as the title over the Peninsula of Bakassi has not been determined. The Court notes, however, that Cameroon's Application not only requests the Court

> "to proceed to prolong the course of its maritime boundary with the Federal Republic of Nigeria up to the limit of the maritime zones which international law places under their respective jurisdictions" (Application of Cameroon of 29 March 1994, p. 15, para. 20 *(f)*),

but also,

> "to adjudge and declare:
>
> > (a) that sovereignty over the Peninsula of Bakassi is Cameroonian, by virtue of international law, and that that Peninsula is an integral part of the territory of Cameroon" (*ibid.*, para. 20).

Since, therefore, both questions are before the Court, it becomes a matter for the Court to arrange the order in which it addresses the issues in such a way that it can deal substantively with each of them. That is a matter which lies within the Court's discretion and which cannot be the basis of a preliminary objection. This argument therefore has to be dismissed.

107. As to the second argument of Nigeria, the Court notes that, while its first argument concerned the whole maritime boundary, the second one seems only to concern the delimitation from point G seawards. That was accepted by counsel for Nigeria and seems to correspond to the fact that there were extensive negotiations between the two Parties in the period between 1970 and 1975 on the maritime boundary from the landfall on Bakassi to point G, which resulted in the disputed Maroua Declaration.

Moreover, the Court recalls that, in dealing with the cases brought before it, it must adhere to the precise request submitted to it. Nigeria here requests the Court to hold that,

> "at the juncture where there is a determination of the question of title over the Bakassi Peninsula, the issues of maritime delimitation will not be admissible in the absence of sufficient action by the Parties, on a footing of equality, to effect a delimitation 'by agreement on the basis of international law'".

What is therefore in dispute between the Parties and what the Court has to decide now is whether

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

the alleged absence of sufficient effort at negotiation constitutes an impediment for the Court to accept Cameroon's claim as admissible or not.

This matter is of a genuinely preliminary character and has to be decided under Article 79 of the Rules of Court.

108. In this connection, Cameroon and Nigeria refer to the United Nations Convention on the Law of the Sea, to which they are parties. Article 74 of the Convention, relating to the exclusive economic zone, and Article 83, concerning the continental shelf, provide, in their first identical paragraphs, that the delimitation

> “between States with opposite or adjacent coasts shall be effected by agreement on the basis of international law, as referred to in Article 38 of the Statute of the International Court of Justice, in order to achieve an equitable solution”.

These are followed by identical paragraphs 2 which provide that “If no agreement can be reached within a reasonable period of time, the States concerned shall resort to the procedures provided for in Part XV.” One of these procedures is the submission of the case to the Court for settlement by contentious proceedings.

109. However, the Court notes that, in this case, it has not been seised on the basis of Article 36, paragraph 1, of the Statute, and, in pursuance of it, in accordance with Part XV of the United Nations Convention on the Law of the Sea relating to the settlement of disputes arising between the parties to the Convention with respect to its interpretation or application. It has been seised on the basis of declarations made under Article 36, paragraph 2, of the Statute, which declarations do not contain any condition relating to prior negotiations to be conducted within a reasonable time period.

The second argument of Nigeria cannot therefore be upheld.

*

110. In addition to what has been put forward by the Parties, the question could arise whether, beyond point G, the dispute between the Parties has been defined with sufficient precision for the Court to be validly seised of it. The Court observes not only that the Parties have not raised this point, but Cameroon and Nigeria entered into negotiations with a view to determining the whole of the maritime boundary. It was during these negotiations that the Maroua Declaration relating to the course of the maritime boundary up to point G was drawn up. This declaration was subsequently held to be binding by Cameroon, but not by Nigeria. The Parties have not been able to agree on the continuation of the negotiations beyond point G, as Cameroon wishes. The result is that there is a dispute on this subject between the Parties which, ultimately and bearing in mind the circumstances of the case, is precise enough for it to be brought before the Court.

*

111. The Court therefore rejects the seventh preliminary objection.

* *

Eighth Preliminary Objection

112. The Court will now deal with the eighth and last of the preliminary objections presented by Nigeria. With that objection Nigeria contends, in the context of and supplementary to the seventh preliminary objection, that the question of maritime delimitation necessarily involves the rights and interests of third States and is to that extent inadmissible.

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

113. Nigeria refers to the particular concave configuration of the Gulf of Guinea, to the fact that five States border the Gulf and that there are no agreed delimitations between any two of those States in the disputed area. In these circumstances, the delimitation of the maritime zones appertaining to two of the States bordering the Gulf will necessarily and closely affect the others. Nigeria also holds that the situation between Cameroon and Nigeria is distinct from that underlying the case concerning the *Frontier Dispute (Burkina Faso/Republic of Mali) (Judgment, I.C.J. Reports 1986*, p. 554) as that case concerned a land boundary to the delimitation of which apply principles that are different from those applying to the delimitation of maritime boundaries. The case concerning the *Continental Shelf (Libyan Arab Jamahiriya/Malta) (Application for Permission to Intervene, Judgment, I.C.J. Reports 1984*, p. 3) was different from the present case in the sense that the areas to which the claims of the third State (Italy) related, were known; and in the case concerning the *Continental Shelf (Tunisia/Libyan Arab Jamahiriya) (Application for Permission to Intervene, Judgment, I.C.J. Reports 1981*, p. 3) the Court was merely laying down principles applicable to the delimitation of the continental shelf in a given context without actually drawing any particular line. Nigeria acknowledges that by virtue of Article 59 of the Statute, third States are not formally bound by decisions of the Court; it maintains nevertheless that Article 59 of the Statute gives insufficient protection, since in specific situations, in spite of that Article, decisions of the Court may have clear and direct legal and practical effects on third States, as well as on the development of international law.

114. Cameroon holds that the maritime delimitation which it is requesting the Court in part to confirm and in part to determine, concerns only the Parties to the present dispute. In Cameroons view, the interests of all other States are preserved by Article 59 of the Statute and by the principle according to which any delimitation as between two States is *res inter alios acta*. Referring to the jurisprudence of the Court, Cameroon claims that the Court has not hesitated to proceed to maritime delimitations in cases where the rights of third States were more clearly in issue than they are in the present case. Cameroon also finds that practice of State treaties confirms that a delimitation is in no way made impossible by the existence of the interests of neighbouring States.

115. The Court notes, as do the Parties, that the problem of rights and interests of third States arises only for the prolongation, as requested by Cameroon, of the maritime boundary seawards beyond point G. As to the stretch of the maritime boundary from point G inwards to the point of landfall on the Bakassi Peninsula, certainly a dispute has arisen because of the rival claims of the Parties to Bakassi and the fact that the Maroua Declaration is considered binding by Cameroon but not by Nigeria.

That dispute however does not concern the rights and interests of third States. That is so because the geographical location of point G is clearly closer to the Nigerian/Cameroonian mainland than is the location of the tripoint Cameroon–Nigeria–Equatorial Guinea to the mainland.

116. What the Court has to examine under the eighth preliminary objection is therefore whether prolongation of the maritime boundary beyond point G would involve rights and interests of third States and whether that would prevent it from proceeding to such prolongation. The Court notes that the geographical location of the territories of the other States bordering the Gulf of Guinea, and in particular Equatorial Guinea and Sao Tome and Principe, demonstrates that it is evident that the prolongation of the maritime boundary between the Parties seawards beyond point G will eventually run into maritime zones where the rights and interests of Cameroon and Nigeria will overlap those of third States. It thus appears that rights and interests of third States will become involved if the Court accedes to Cameroon's request. The Court recalls that it has affirmed, “that one of the fundamental principles of its Statute is that it cannot decide a dispute between States without the consent of those States to its jurisdiction” (*East Timor (Portugal* v. *Australia), Judgment, I.C.J. Reports 1995*, p. 101, para. 26). However, it stated in the same case that, “it is not necessarily prevented from adjudicating when the judgment it is asked to give might affect the legal interests of a State which is not a party to the case” (*ibid.*, p. 104, para. 34).

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

Similarly, in the case concerning *Certain Phosphate Lands in Nauru (Nauru* v. *Australia)*, it adopted the same approach:

> "a finding by the Court regarding the existence or the content of the responsibility attributed to Australia by Nauru might well have implications for the legal situation of the two other States concerned, but no finding in respect of that legal situation will be needed as a basis for the Court's decision on Nauru's claims against Australia. Accordingly, the Court cannot decline to exercise its jurisdiction." (*I.C.J. Reports 1992*, pp. 261–262, para. 55.)

The Court cannot therefore, in the present case, give a decision on the eighth preliminary objection as a preliminary matter. In order to determine where a prolonged maritime boundary beyond point G would run, where and to what extent it would meet possible claims of other States, and how its judgment would affect the rights and interests of these States, the Court would of necessity have to deal with the merits of Cameroon's request. At the same time, the Court cannot rule out the possibility that the impact of the judgment required by Cameroon on the rights and interests of the third States could be such that the Court would be prevented from rendering it in the absence of these States, and that consequently Nigeria's eighth preliminary objection would have to be upheld at least in part. Whether such third States would choose to exercise their rights to intervene in these proceedings pursuant to the Statute remains to be seen.

117. The Court concludes that therefore the eighth preliminary objection of Nigeria does not possess, in the circumstances of the case, an exclusively preliminary character.

* * *

118. For these reasons,

The Court,

(1)

(a) By fourteen votes to three,

Rejects the first preliminary objection;

IN FAVOUR: *President* Schwebel; *Judges* Oda, Bedjaoui, Guillaume, Ranjeva, Herczegh, Shi, Fleischhauer, Vereshchetin, Higgins, Parra–Aranguren, Kooijmans, Rezek; *Judge* ad hoc Mbaye;

AGAINST: *Vice–President* Weeramantry; *Judge* Koroma; *Judge* ad hoc Ajibola;

(b) By sixteen votes to one,

Rejects the second preliminary objection;

IN FAVOUR: *President* Schwebel; *Vice–President* Weeramantry; *Judges* Oda, Bedjaoui, Guillaume, Ranjeva, Herczegh, Shi, Fleischhauer, Vereshchetin, Higgins, Parra–Aranguren, Kooijmans, Rezek; *Judges* ad hoc Mbaye, Ajibola;

AGAINST: *Judge* Koroma;

(c) By fifteen votes to two,

Rejects the third preliminary objection;

IN FAVOUR: *President* Schwebel; *Vice–President* Weeramantry; *Judges* Oda, Bedjaoui, Guillaume, Ranjeva, Herczegh, Shi, Fleischhauer, Vereshchetin, Higgins, Parra–

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

Aranguren, Kooijmans, Rezek; *Judge* ad hoc Mbaye;

AGAINST: *Judge* Koroma; *Judge* ad hoc Ajibola;

(d) By thirteen votes to four,

Rejects the fourth preliminary objection;

IN FAVOUR: *President* Schwebel; *Vice–President* Weeramantry; *Judges* Bedjaoui, Guillaume, Ranjeva, Herczegh, Shi, Fleischhauer, Vereshchetin, Higgins, Kooijmans, Rezek; *Judge* ad hoc Mbaye;

AGAINST: *Judges* Oda, Koroma, Parra–Aranguren; *Judge* ad hoc Ajibola;

(e) By thirteen votes to four,

Rejects the fifth preliminary objection;

IN FAVOUR: *President* Schwebel; *Vice–President* Weeramantry; *Judges* Bedjaoui, Guillaume, Ranjeva, Herczegh, Shi, Fleischhauer, Higgins, Parra–Aranguren, Kooijmans, Rezek; *Judge* ad hoc Mbaye;

AGAINST: *Judges* Oda, Koroma, Vereshchetin; *Judge* ad hoc Ajibola;

(f) By fifteen votes to two,

Rejects the sixth preliminary objection;

IN FAVOUR: *President* Schwebel; *Vice–President* Weeramantry; *Judges* Oda, Bedjaoui, Guillaume, Ranjeva, Herczegh, Shi, Fleischhauer, Vereshchetin, Higgins, Parra–Aranguren, Kooijmans, Rezek; *Judge* ad hoc Mbaye;

AGAINST: *Judge* Koroma; *Judge* ad hoc Ajibola;

(g) By twelve votes to five,

Rejects the seventh preliminary objection;

IN FAVOUR: *President* Schwebel; *Vice–President* Weeramantry; *Judges* Bedjaoui, Guillaume, Ranjeva, Herczegh, Shi, Fleischhauer, Vereshchetin, Parra–Aranguren, Rezek; *Judge* ad hoc Mbaye;

AGAINST: *Judges* Oda, Koroma, Higgins, Kooijmans; *Judge* ad hoc Ajibola;

(2) By twelve votes to five,

Declares that the eighth preliminary objection does not have, in the circumstances of the case, an exclusively preliminary character;

IN FAVOUR: *President* Schwebel; *Vice–President* Weeramantry; *Judges* Bedjaoui, Guillaume, Ranjeva, Herczegh, Shi, Fleischhauer, Vereshchetin, Parra–Aranguren, Rezek; *Judge* ad hoc Mbaye;

AGAINST: *Judges* Oda, Koroma, Higgins, Kooijmans; *Judge* ad hoc Ajibola;

(3) By fourteen votes to three,

Finds that, on the basis of Article 36, paragraph 2, of the Statute , it has jurisdiction to adjudicate upon the dispute;

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

IN FAVOUR: *President* Schwebel; *Judges* Oda, Bedjaoui, Guillaume, Ranjeva, Herczegh, Shi, Fleischhauer, Vereshchetin, Higgins, Parra–Aranguren, Kooijmans, Rezek; *Judge* ad hoc Mbaye;

AGAINST: *Vice–President* Weeramantry; *Judge* Koroma; *Judge* ad hoc Ajibola;

(4) By fourteen votes to three,

Finds that the Application filed by the Republic of Cameroon on 29 March 1994, as amended by the Additional Application of 6 June 1994, is admissible.

IN FAVOUR: *President* Schwebel; *Judges* Oda, Bedjaoui, Guillaume, Ranjeva, Herczegh, Shi, Fleischhauer, Vereshchetin, Higgins, Parra–Aranguren, Kooijmans, Rezek; *Judge* ad hoc Mbaye;

AGAINST: *Vice–President* Weeramantry; *Judge* Koroma; *Judge* ad hoc Ajibola.

Done in French and in English, the French text being authoritative, at the Peace Palace, The Hague, this eleventh day of June, one thousand nine hundred and ninety–eight, in three copies, one of which will be placed in the archives of the Court and the others transmitted to the Government of the Republic of Cameroon and the Government of the Federal Republic of Nigeria, respectively.

(Signed) Stephen M. Schwebel,

President.

(Signed) Eduardo Valencia–Ospina,

Registrar.

Judges Oda, Vereshchetin, Higgins, Parra–Aranguren and Kooijmans append separate opinions to the Judgment of the Court.

Vice–President Weeramantry, Judge Koroma and Judge *ad hoc* Ajibola append dissenting opinions to the Judgment of the Court.

(Initialled) S.M.S.

(Initialled) E.V.O.

Separate Opinion of Judge Oda

Judge Oda

I. Introductory Remarks

II. Cameroon's Application as a Whole

1. The structure of Cameroon's 1994 Application

2. The submissions contained in Cameroon's 1995 Memorial

III. Request for Delimitation of a Boundary Line

1. The drawing of a maritime boundary

2. Lake and land boundary

3. Part III — Conclusion

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

IV. The Legal Disputes Which May Be Submitted to the Court

V. Conclusions

I. Introductory Remarks

1. I voted in favour of subparagraph 3, as well as of subparagraph 1 *(a)*, of the operative part of the Judgment, as I agree that the Court, on the basis of Article 36 (2) of the Court's Statute, has jurisdiction to adjudicate upon certain of the issues unilaterally presented by Cameroon. I share the view expressed in the Judgment concerning the interpretation and application of the Optional Clause of the Statute.

I have given this opinion the title of "separate" opinion, rather than "dissenting" opinion, mainly because, in spite of my negative votes on some points relating to admissibility, I support, in general, the Court's jurisdiction to entertain certain of the claims in Cameroon's Applications.

2. I also voted in favour of subparagraph 4, as I believe that some, but not all, of the issues in the Application are admissible. But I cast my vote on some of the subsections of subparagraph 1 and on subparagraph 2 reluctantly, as the Judges are not permitted, for any reason whatsoever, to abstain from voting on the operative part of the Judgment. Otherwise I would have abstained from voting on certain of Nigeria's objections relating to the admissibility of Cameroon's Application on the ground that Cameroon's claims were presented in a somewhat irregular way, as I shall explain later, while Nigeria's objections do not necessarily correspond to those claims and do not appear to have been formulated in a proper manner.

Thus, in seeking, both in the Judgment as a whole and in its operative part, to deal with Nigeria's objections in isolation, the Court has adopted an approach which, in my view, is not wholly adequate.

3. Cameroon's Application lacks precision and some parts of it do *not*, in my view, constitute a claim which may properly be presented to the Court by a *unilateral* application of one of the parties to a dispute. Among the contentions that Cameroon has made, only some very limited issues can be deemed as falling within the purview of the Court's jurisdiction. Just as Cameroon's Application lacks precision and is inadequate, so Nigeria's objections are also quite irregular.

The question of whether or not Cameroon's Application is admissible falls irrefutably within the competence of the Court. Although the Court is still at the jurisdictional phase due to Nigeria's presentation of preliminary objections, it does not necessarily have to restrict itself to a discussion of Nigeria's objections, but must also examine more carefully, on its own initiative, the substance of Cameroon's Application.

In addition, Nigeria, in raising a number of preliminary objections, seems to have confused the question of admissibility of the claims with the matters to be argued at the merits stage. Thus the Court is faced with an extremely difficult situation at this jurisdictional stage of the case.

4. The Court should have attempted *proprio motu* to scrutinize whether or not any of Cameroon's claims made in its Application are admissible — with or without reference to Nigeria's objections.

II. Cameroon's Application as a Whole

5. Cameroon's position has lacked clarity from the outset. Its Application appears to me to be so irregular that, from the standpoint of the Court, it should only have been received after a number of modifications. I shall begin with an examination of the irregular aspects of Cameroon's Application itself, which causes us so much difficulty in dealing with the present case.

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

1. The Structure of Cameroon's 1994 Application

6. On examination of the various Court documents, I note that on 29 March 1994 Cameroon filed with the Registry an "Application instituting proceedings" and on 6 June 1994 an "Application additional to the Application instituting proceedings". Having heard Cameroon's wishes, and having also ascertained that Nigeria "had no objection to the *Additional* Application being treated, in accordance with the wishes expressed by Cameroon, as an *amendment* to the initial Application" (emphasis added), the Court decided, on 16 June 1994, to deal with these two originally distinct Applications as a single case (see Judgment, para. 5).

7. The Court's document entitled "Application instituting proceedings filed in the Registry of the Court on 29 March 1994 — *Land and Maritime Boundary between Cameroon and Nigeria (Cameroon* v. *Nigeria)*" (bearing the legend "1994 General List No. 94") contains:

(I) the letter of the Cameroonian Ambassador to the Netherlands, addressed to the Registrar, dated 28 March 1994 (p. 3);

(II) the "Application instituting proceedings" (undated but filed in the Registry on 29 March 1994) (hereinafter referred to as "Application–I") (p. 5); and

(III) the "Application additional to the Application instituting proceedings brought by the Republic of Cameroon filed in the Registry of the Court on 29 March 1994" (on which no date is indicated but which was actually filed in the Registry on 6 June 1994) (hereinafter referred to as "Application–II") (p. 77).

The confused structure of these documents produced by the Court conveys an impression of the irregularity of the case.

8. The two Applications, Application–I and Application–II, each consist of five sections (the titles of which are identical in both Applications), namely, Section I ("Subject of the Dispute"), Section II ("The Facts"), Section III ("The Jurisdiction of the Court"), Section IV ("The Legal Grounds upon Which Cameroon Bases Its Case") and Section V ("Decision Requested"). In each Application, the content of Section III is approximately the same. In each case the Section indicates, explicitly or implicitly if not in identical terms, that both Parties have accepted the Court's compulsory jurisdiction in conformity with Article 36 (2) of the Statute, without any reservation. By contrast, the other four Sections in both Application–I and Application–II tend to complement one another.

9. *Application–I*. In Section I ("Subject of the Dispute"), paragraphs 1 and 2 deal with the disputes relating essentially to the question of sovereignty over the Bakassi Peninsula, whereas paragraph 3, without referring to any particular dispute, mentions simply the issue of the maritime boundary in the Gulf of Guinea beyond the terminal point (namely point G) of the boundary line alleged by Cameroon in the mouth of the Cross River.

Section II ("The Facts") traces the history over the past century of some parts of the boundary in the so–called "hinterland" including the Bakassi Peninsula. Mention is made solely of the land area, particularly the Bakassi Peninsula. If any frontier incidents or aggressions are mentioned here, they are limited mainly to the Bakassi Peninsula. The subject of maritime delimitation is not mentioned at all in this section.

In Section IV ("The Legal Grounds upon Which Cameroon Bases Its Case") a great deal is said concerning Nigeria's impairment of Cameroon's sovereignty and territorial integrity, mainly in the Bakassi Peninsula, and Nigeria's violation of the prohibition of the use of force. There is no mention of the maritime boundary in this section either.

In Section V ("Decision Requested") all the seven items *(a),(b),(c),(d),(e),(e′)* and *(e″)*, which are quoted in full in paragraph 16 of the Judgment, and on which Cameroon asks the Court to adjudge

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

and declare, appear to relate to questions and incidents concerning the Bakassi Peninsula. *Only* in item *(f)* does Cameroon, "[i]n order to prevent any dispute arising between the two States", request the Court "to proceed to prolong the course of its maritime boundary with [Nigeria] up to the limit of the maritime zones which international law places under the respective jurisdictions", in other words, the course of the boundary of the continental shelf and the exclusive economic zone within the Gulf of Guinea.

Most of the issues mentioned throughout Application–I, except for the maritime delimitation in the Gulf of Guinea, are related mainly to the border incidents in the Bakassi Peninsula. Those issues seem to constitute the real "legal dispute" between the two States for which interim measures were indicated by the Court in 1996 (*Land and Maritime Boundary between Cameroon and Nigeria, Provisional Measures, Order of 15 March 1996, I.C.J. Reports 1996*, p. 11).

It may be observed that Sections I, II, IV and V, entitled "Subject of the Dispute", "The Facts", "The Legal Grounds" and "Decision Requested", respectively, are thus presented in a random fashion.

10. *Application–II*. Section I ("Subject of the Dispute") deals with the question relating to Lake Chad, but in that same section Cameroon refers to the course of the boundary from Lake Chad to the sea. It is said that Nigeria's challenge to Cameroon's sovereignty took the form of "a massive introduction of Nigerian nationals into the disputed area, followed by an introduction of Nigerian security forces".

In Section II ("The Facts") most of the discussion is devoted to the subject of Lake Chad, but reference is also made in paragraph 6 to the "illegal and massive presence" of Nigerian nationals in various parts along the boundary from Lake Chad to the sea. In paragraph 7 the prolonged presence of the Nigerian security forces is mentioned *only* in Cameroon's part of Lake Chad.

In Section IV ("The Legal Grounds upon Which Cameroon Bases Its Case") Nigeria's alleged occupation of the territory of Cameroon is mentioned extensively, but this concerns *only* the part of Cameroon in Lake Chad.

Under Section V ("Decision Requested"), the six items *(a),(b),(c),(d),(e)* and *(e′)* (which are quoted in full in paragraph 17 of the Judgment) seem to relate *only* to Lake Chad, but in item *(f)* Cameroon requests that the Court *specify the frontier* "from Lake Chad to the sea" in view of the repeated incursions of Nigeria into Cameroon's territory.

In Application–II, as with Application–I, the four Sections I, II, IV and V, entitled "Subject of the Dispute", "The Facts", "The Legal Grounds", and "Decision Requested", respectively, are presented in a random fashion.

11. It should also be noted that, because of the random fashion of presentation and the irregular nature of each corresponding section of Application–I and Application–II (except for Section III ("The Jurisdiction of the Court"), the sections are not sufficiently interrelated. This makes the present case extremely complicated, and a proper understanding of the issues involved very difficult.

2. The Submissions Contained in Cameroon's 1995 Memorial

12. On 16 March 1995 Cameroon filed its Memorial within the time–limit prescribed in the Court's Order dated 16 June 1994 (*Land and Maritime Boundary between Cameroon and Nigeria, I.C.J. Reports 1994*, p. 104). In fact, the text of "the decision that the Court is asked to hand down" read out by the Registrar of the Court, at the President's request, at the beginning of the oral pleadings on 2 March 1998 was taken only from Section V ("Decision Requested") as it appears in both Application–I and Application–II. The "submissions" made by Cameroon in its Memorial were not even mentioned on that day in the Registrar's statement.

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

The main part of the “submissions” contained in Cameroon's Memorial is quoted in part below (the full text is quoted in the Judgment, paragraph 18). Cameroon requests the Court

“to adjudge and declare:

(a) That the lake and land boundary between Cameroon and Nigeria takes the following course: [Cameroon indicates a line from Lake Chad to the sea reflecting the alleged existing boundary provided for by treaties or international documents].

(b) That notably, therefore, sovereignty over the Peninsula of Bakassi and over the disputed parcel occupied by Nigeria in the area of Lake Chad, in particular over Darak and its region, is Cameroonian.

(c) That the boundary of the maritime zones appertaining respectively to [Cameroon] and to [Nigeria] follows the following course: [Cameroon indicates (1) a line covering the offshore area provided for in the 1975 Maroua Declaration (first subparagraph of submission *(c)*) and (2) a line beyond the offshore area, as indicated above, for the delimitation of the exclusive economic zone and the continental shelf (second subparagraph of submission *(c)*)].

(d) That by contesting the courses of the boundary defined above under *(a)* and *(c)*, [Nigeria] has violated and is violating the fundamental principle of respect for frontiers inherited from colonization *(uti possidetis juris)* and its legal commitments concerning the demarcation of frontiers in Lake Chad and land and maritime delimitation.

(e) That by using force against [Cameroon] and, in particular, by militarily occupying parcels of Cameroonian territory in the area of Lake Chad and the Cameroonian Peninsula of Bakassi, and by making repeated incursions, both civilian and military, all along the boundary between the two countries, [Nigeria] has violated and is violating its obligations under international treaty law and customary law.

(f) That [Nigeria] has the express duty of putting an end to its civilian and military presence in Cameroonian territory and, in particular, of effecting an immediate and unconditional withdrawal of its troops from the occupied area of Lake Chad and from the Cameroonian Peninsula of Bakassi and of refraining from such acts in the future;

(g) That the internationally wrongful acts referred to above and described in detail in the body of this Memorial involve the responsibility of [Nigeria].

(h) That, consequently, and on account of the material and non–material damage inflicted upon [Cameroon], reparation in a form to be determined by the Court is due from [Nigeria] to [Cameroon].” (Memorial of Cameroon, Vol. I, pp. 669–671.)

13. As in the Section entitled “Decision Requested” in Application–I and Application–II, these eight submissions (*(a)*–*(h)*) in the 1995 Memorial are complex and presented in a complicated manner. I am somewhat surprised to find that these “submissions” do not correspond particularly well to the “Decision Requested” (Section V) in Application–I and Application–II; nor does what Cameroon asks the Court to adjudge and declare, in its 1995 Memorial, even constitute an amendment to the “Decision Requested” in the 1994 Applications. It is thus difficult, given this confused presentation, to ascertain Cameroon's real intentions in bringing the present case before the Court.

Accordingly, I consider that Cameroon has failed to formulate adequately the issues set out under the title “Subject of the Dispute” (Section I) and “Decision Requested” (Section V) in Application–I and Application–II, respectively, which issues could have been, and indeed should have been, amplified in the “submissions” made in the Memorial. In my view Cameroon's claims require

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

clarification, and in effect the Court is having to make good the apparent irregularities in the Applications and in the “submissions” so that they may be presented in a proper form.

14. Careful examination of the submissions discloses the following inconsistencies on points of details. *Firstly*, I note that

— submission *(a)* concerning the lake and land boundary corresponds to item *(f)* of Section V (“Decision Requested”) of Application–II;

— submission *(c)*, second subparagraph, concerning the boundary of the maritime zone (exclusive economic zone and continental shelf) corresponds to a part of item *(f)* of Section V (“Decision Requested”) of Application–I,

and that by these submissions Cameroon simply asks the Court to *specify a boundary line either on land or at sea*. Submission *(c)*, first subparagraph, concerning the boundary in the offshore area is not mentioned at all in the 1994 Application and Cameroon further contends in this connection in submission *(d)* that Nigeria, by contesting the course put forward by Cameroon in submissions *(a)* and *(c)*, has violated and is violating the interests of Cameroon.

15. *Secondly*, I note that the submissions also include the actual boundary disputes, which constitute “legal disputes”. Thus:

— submission *(b)*, concerning the sovereignty over the Bakassi Peninsula and over the parcel in the area of Lake Chad, in particular over Darak and its region, corresponds to the seven items *(a)* to *(e″)* inclusive in Section V (“Decision Requested”) of Application–I and to the six items *(a)* to *(e′)* inclusive in Section V (“Decision Requested”) of Application–II, respectively;

— submission *(e)*, referring to repeated incursions all along the boundary between the two countries, corresponds to the allegation set out in item *(f)* in Section V (“Decision Requested”) of Application–II, namely that Nigeria, by using force against Cameroon and, in particular, by militarily occupying parcels of Cameroonian territory in the area of Lake Chad and the Cameroonian Peninsula of Bakassi, and by making repeated incursions all along the boundary between the two countries “has violated and is violating its obligations under international treaty law and customary law”;

— submissions *(e),(f),(g)* and *(h)*, concerning the alleged violation by Nigeria of its obligations under international law, the removal by Nigeria of “its military presence”, the alleged “responsibility” to be borne by Nigeria, and the payment of “reparation”, which are essentially related to the “legal disputes” as mentioned above, are in fact referred to in items *(b)* to *(e″)* of Section V (“Decision Requested”) of Application–I and also in items *(b)* to *(e′)* of Section V of Application–II.

III. Request for Delimitation of a Boundary Line

16. As stated above, in a part of its Application Cameroon requests the Court to specify the boundary line with Nigeria both at sea and on land, and to prolong the maritime boundary.

1. The Drawing of a Maritime Boundary

17. My *first* main point is the *issue of maritime matters*. In this respect, Cameroon's Application and “submissions” are not entirely consistent. In its 1994 Application–I, Cameroon “[i]n order to prevent any dispute between the two States concerning their maritime boundary” requests the Court

“to proceed to prolong the course of its maritime boundary with [Nigeria] up to the limit

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

of the maritime zones which international law places under their respective jurisdictions" (Section V, item *(f)*; emphasis added).

This is clearly a request solely for delimitation of the exclusive economic zone and the continental shelf between Cameroon and Nigeria in the Gulf of Guinea.

In contrast, in submission *(c)* of its 1995 Memorial, Cameroon not only refers to the question of the delimitation of the exclusive economic zone and the continental shelf beyond those narrow coastal areas in the Gulf of Guinea (second subparagraph of submission *(c)*) but also asks the Court to declare the course of the boundary in the areas at the mouth of the Cross River close to the coast (first subparagraph of submission *(c)*).

18. *Maritime delimitation in the mouth of the Cross River*. The delimitation in the offshore area at the mouth of the Cross River depends entirely on which country, either Cameroon or Nigeria, has sovereignty over the Bakassi Peninsula. The delimitation line down to point G, as indicated by Cameroon pursuant to the Maroua Declaration of 1975, is based on the firm assumption that the Bakassi Peninsula is in Cameroonian territory.

It may well be that Cameroon's maritime boundary in the mouth of the Cross River could only be challenged by Nigeria in connection with its alleged claim to sovereignty over the Bakassi Peninsula. Otherwise the maritime boundary in the mouth of the Cross River could not be a "legal dispute". Unless the territoriality of that region is settled, the question of the maritime delimitation in this coastal sea area would obviously be meaningless. I repeat that submission *(c)*, first subparagraph, is not *per se* a subject that may be presented to this Court.

Incidentally, though, I should like to reiterate that this issue concerning the frontier in the coastal sea areas in the mouth of the Cross River was not referred to or mentioned at all in the 1994 Application–I.

19. *Maritime delimitation in the Gulf of Guinea*. The delimitation of the exclusive economic zone and the continental shelf between neighbouring States beyond the limit of their territorial seas also cannot be an issue in the present case unless, as in the case of the offshore areas in the mouth of the Cross River, as mentioned above, the land boundary between Cameroon and Nigeria at the coast is settled by those neighbouring States. More concretely, the issue of maritime delimitation in the whole vast area of the Gulf of Guinea cannot arise independently of the territoriality of the Bakassi Peninsula. In fact the Parties have not even negotiated on such a delimitation, and no "legal dispute" has ever arisen between the two States on the delimitation of the exclusive economic zone and the continental shelf.

20. More generally, the delimitation of the exclusive economic zone and the continental shelf shall, according to the 1982 United Nations Convention on the Law of the Sea, be "effected by agreement on the basis of international law … in order to achieve an equitable solution" (Arts. 74 and 83).

In the event that a delimitation of the maritime boundary line for the exclusive economic zone or the continental shelf is required between neighbouring States, the firm wishes of the parties to delimit their respective areas must in general exist, and negotiation must be continued for this purpose. The relevant parties, after negotiation, may determine the line by agreement and, if they fail to agree, they may then seek a third–party judgment. However, the mere fact that the parties have not been able to reach agreement on the delimitation in their negotiations does not constitute a "legal dispute".

21. There has been no negotiation between Cameroon and Nigeria with a view to deciding on the delimitation of the exclusive economic zone and the continental shelf, nor has a "legal dispute" arisen between Cameroon and Nigeria which might fall within the purview of Article 36 (2) of the

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

Court's Statute.

If the Court considers that Cameroon's Application concerning the delimitation of the exclusive economic zone and the continental shelf can be entertained on the grounds that there is a “legal dispute” under the circumstances appertaining to this case, then there will be hundreds of similar disputes that could be brought to the Court from all parts of the world.

22. Over the past 20 years, I have made known my belief that maritime delimitation may be dealt with more properly by recourse to arbitration than to judicial settlement. However, I concede that the Court cannot, in principle, refuse to receive a request for demarcation of a maritime boundary *if* that request is made *jointly* by the parties. It should be noted that delimitation cases have in the past been brought to the Court by *special agreement* under Article 36 (1) of the Court's Statute — namely, the cases concerning the *North Sea Continental Shelf (Federal Republic of Germany/Denmark; Federal Republic of Germany/Netherlands)*; the case concerning the *Continental Shelf (Tunisia/Libyan Arab Jamahiriya)*; the case concerning the *Continental Shelf (Libyan Arab Jamahiriya/Malta)*; the chamber case concerning *Delimitation of the Maritime Boundary in the Gulf of Maine Area (Canada/United States of America)*; the chamber case concerning the *Frontier Dispute (Burkina Faso/Republic of Mali)*; and the chamber case concerning *Land, Island and Maritime Frontier Dispute (El Salvador/Honduras)*.

23. In conclusion, Cameroon's request that the Court specify the boundary or prolong the maritime boundary stated in item *(f)* of Section V (“Decision Requested”) of Application–I and in submission *(c)*, both first and second subparagraphs, is not a matter that can be unilaterally presented to the Court. The Court should have refused Cameroon's request, as mentioned above, as it is not competent to entertain such a unilateral application.

2. Lake and Land Boundary

24. The *second* main point that I would like to take up in connection with the drawing of a boundary line is the *issue of the lake and land boundary* between Cameroon and Nigeria. Item *(f)* of Section V (“Decision Requested”) in Application–II states:

> “[t]hat in view of the repeated incursions of Nigerian groups and armed forces into Cameroonian territory, all along the frontier between the two countries, the consequent grave and repeated incidents, and the vacillating and contradictory attitude of [Nigeria] in regard to the legal instruments defining the frontier between the two countries and the exact course of that frontier, [Cameroon] respectfully *asks the Court to specify definitively the frontier between Cameroon and [Nigeria] from Lake Chad to the sea*” (emphasis added).

In submission *(a)* Cameroon requests the Court “to adjudge and declare … that the lake and land boundary between Cameroon and Nigeria takes the … course [as indicated by Cameroon in concrete terms]”.

25. The fact is that there have occurred certain incidents of trespass by Nigerian armed forces or authorities into the border areas which Cameroon claims to be its own territory, as demarcated by the existing demarcation line interpreted from the diplomatic documents or historical facts. Such disputes have been reported in a certain parcel in the area of Lake Chad and in the Bakassi Peninsula, as well as in certain other border areas.

Cameroon deems all the incidents reported in these areas to be simply trespass in its territory by Nigeria. By contrast, Nigeria may certainly refuse to accept that these incidents were trespass and may consider that the areas or locations where the incidents occurred were its own territory. These are examples of typical boundary disputes that constitute “legal disputes” and, when a “legal dispute” concerning boundary incidents is filed with the Court Registry, the Court would certainly

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

need to ascertain whether the boundary claimed by the Applicant has been violated and whether historically or legally it is the legitimate boundary.

However, Cameroon's request that the Court definitively specify the frontier in the lake and on land is quite a different matter. Cameroon's contentions should not have concerned the *demarcation* of the boundary line.

The simple fact that one State wishes to specify the frontier between it and a neighbouring State does *not* constitute a “legal dispute” between those States. Cameroon's unilateral request for a boundary line to be indicated between its territory and Nigeria's from Lake Chad to the sea cannot be regarded as constituting a “legal dispute”, in terms of Article 36 (2) of the Statute, which may be presented unilaterally to the International Court of Justice for its adjudication.

26. I do not deny that the International Court of Justice is competent to undertake the indication of a boundary line if States refer such a matter to it under Article 36 (1) of the Statute. If Cameroon had wished, with the concurrence of Nigeria, to revise its boundary which it claimed as legitimate on the basis of legal or historical title, it could have done so by means of negotiations with the latter. If such negotiations failed, the parties would then certainly be free to seek a decision of the International Court of Justice by agreement. However, this case does not come under that category.

3. Part III — Conclusion

27. In concluding my argument in sections 1 and 2 of part III above, I am bound to point out, first of all, that the Court's decisions requested in item *(f)* of Section V of Cameroon's Application–I and Application–II, respectively, and in submissions *(c)* and *(a)* in the Cameroonian Memorial, namely, to specify the course of a boundary line or the frontier — either at sea or on land — between Cameroon and Nigeria, cannot be a subject to be presented unilaterally to this Court. This is far different from a “legal dispute” which can be the object of a unilateral application in a case between States which have both accepted the compulsory jurisdiction of the Court under Article 36 (2) of the Statute.

It is not a function of any judicial organ to accede to a unilateral request for the demarcation of a boundary line, which cannot be deemed to constitute a “legal dispute”, as the issues which may be brought unilaterally under Article 36 (2) of the Statute are limited to “legal disputes”.

28. In this respect, item *(f)* of Section V (“Decision Requested”) in both Application–I and Application–II, as well as submissions *(c)* and *(a)* in the Memorial, should be set aside. In other words, Cameroon's request that the Court indicate a boundary line, either at sea or on land, cannot be considered as falling within the purview of the Court's jurisdiction.

As I consider that Nigeria's fourth, fifth, seventh and eighth objections relate to this point in that respect, I voted in support of those objections.

IV. The Legal Disputes Which May Be Submitted to the Court

29. The only part of Cameroon's Application which can be regarded as being the presentation of a “legal dispute” under Article 36 (2) of the Statute — which the Court has jurisdiction to entertain — is related to actual incidents which took place as territorial and boundary disputes in the border lands between the two States.

I would suggest that in the present case Cameroon's Applications should have been related to the following “legal disputes”:

(1) as regards the Bakassi Peninsula, which territory Cameroon claims to be its own, a great number of intrusions by Nigerian authorities has been reported as indicated in items *(a)* to

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

(e″) of Section V (“Decision Requested”) of Application–I;

(2) as regards Lake Chad, which is divided among the four countries that border on its shores, Cameroon described some incursions by Nigerian authorities into its parcel in that area, as indicated in items *(a)* to *(e′)* of Section V (“Decision Requested”) of Application–II; and,

(3) as regards the certain border areas from Lake Chad to the sea, Cameroon describes incursions as referred to in item *(f)* of Section V (“Decision Requested”) of Application–II.

30. These three main issues, as indicated above and as demonstrated in Application–I and Application–II, are again presented in the “submissions” of the Memorial in the following manner:

“[Cameroon] … request[s] that the Court … adjudge and declare:

… … … … … … … … … . .

(b) That notably … sovereignty over the Peninsula of Bakassi and over the disputed parcel occupied by Nigeria in the area of Lake Chad, in particular over Darak and its region, is Cameroonian.

… … … … … … … … … . .

(e) That by using force against [Cameroon] and, in particular, by militarily occupying parcels of Cameroonian territory in the area of Lake Chad and the Cameroonian Peninsula of Bakassi, and by making repeated incursions, both civilian and military, all along the boundary between the two countries, [Nigeria] has violated and is violating its obligations under international treaty law and customary law.”

In connection with these incidents of trespass, Cameroon contended that Nigeria should bear responsibility and should pay reparation for the repeated incursions into those areas.

31. I conclude that the Court has jurisdiction to entertain Cameroon's Applications relating to the “legal disputes” arising out of the alleged intrusion by Nigeria into the territory in which Cameroon is allegedly entitled to sovereignty and territoriality; in other words, by the alleged violation by Nigeria of Cameroon's sovereignty in the Bakassi Peninsula and in a certain parcel in the area of Lake Chad, as well as in certain other border areas.

The issues of whether or not Nigeria has trespassed on territory claimed by Cameroon, namely in the Bakassi Peninsula and in the area of Lake Chad and elsewhere, and, in other words, whether or not the relevant areas where such trespass is alleged to have occurred were Cameroon's territory at the time of the incidents, and thus whether Nigeria has breached Cameroon's rights, and must bear responsibility and pay reparation for such breach, should certainly constitute the substance of the merits at a later stage of the proceedings in the present case. It would be open to Nigeria to lay claim to such areas on the basis of whatever diplomatic or historical facts might be available to it, and such a situation would be capable of constituting a “legal dispute”.

V. Conclusions

32. It may not be necessary to draw any conclusions in addition to what I have stated above. However, if I may repeat myself, Cameroon *cannot* bring unilaterally to the Court a case concerning simple demarcation of a boundary line either on land or at sea. In contrast, the alleged incursion by Nigeria into the alleged territory of Cameroon, for which violation of international law Nigeria may be responsible and may be liable to pay reparation, is the kind of “legal dispute” that *can* be unilaterally brought to the Court by Cameroon. The question of whether or not the boundary line which Cameroon has claimed is legitimate should be decided by the Court at the merits phase but, I

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

repeat, that should not be a question of the simple demarcation of a boundary line between two States.

33. In connection with Cameroon's Application, Nigeria certainly is free to challenge the jurisdiction of the Court to entertain that Application and its admissibility. Nigeria in fact did so. I submit, however, that apart from Nigeria's objection to the Court's jurisdiction (first preliminary objection), most of the objections raised by that Party concerning the border incidents and the borderline of the territory (second, third and sixth preliminary objections) are matters that should be dealt with at the merits phase.

(Signed) Shigeru Oda.

Separate Opinion of Judge Vereshchetin

Judge Vereshchetin

Argument of Cameroon that a dispute exists concerning the whole of the boundary from the tripoint in Lake Chad to the sea — Objection of Nigeria as to the existence of such a dispute — Non–exdusively preliminary character of this objection.

1 I voted with the majority of the judges on all the points of the operative part of the Judgment, except point 1 *(e)*. I am unable to vote “in favour” of that part of the Judgment because of my belief that the finding on which it is based is not duly supported by the evidence offered by the Applicant and does not stand the test of objective determination.

2 The *onus probandi* of the contention that the Republic of Nigeria disputes the entire boundary between the two States lies primarily with the Applicant, i.e., the Republic of Cameroon. In the reasoning of the Judgment, relating to the fifth preliminary objection of Nigeria, the Court rejected practically all the main arguments of Cameroon advanced in support of its contention. In particular, the Court stated that it:

> “does not find persuasive the argument of Cameroon that the challenge by Nigeria to the validity of the existing titles to Bakassi, Darak and Tipsan, necessarily calls into question the validity as such of the instruments on which the course of the entire boundary from the tripoint in Lake Chad to the sea is based, and therefore proves the existence of a dispute concerning the whole of the boundary” (paragraph 89 of the Judgment).

The Court also held that:

> “Even taken together with the existing boundary disputes, the incidents and incursions reported by Cameroon do not establish by themselves the existence of a dispute concerning all of the boundary between Cameroon and Nigeria.” (Paragraph 90 of the Judgment.)

3 The logical consequence of this assessment of Cameroon's arguments would have been the upholding of the fifth preliminary objection of Nigeria, or, at the least, a finding that the corresponding objection did not have an exclusively preliminary character and therefore required further consideration by the Court at the merits stage.

4 Instead, the Court itself shouldered the burden of proof of the Applicant's claim, and having briefly analysed one single document — the answer of Nigeria to a question put to the Parties by a Member of the Court — reached a conclusion which, in contradistinction to its previous reasoning, recognizes the existence of a dispute between the two States concerning the boundary as a whole. The geographical parameters of the disputed sectors of the land and lacustrine frontiers have thereby been extended to 1,600 km.

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

5 Admittedly, international contentious proceedings do not presuppose the passive reliance by the Court on the evidence produced by the litigating States. The objective determination of the existence or otherwise of a legal dispute and more so the adjudication on the substance of a dispute may require a more active role of the Court *proprio motu*, including questioning the parties, taking of independent evidence, etc. However, I cannot agree with the weight given by the Court to the answer provided by Nigeria. That answer could not be determinative for so important a finding of the Court. Nor can I subscribe to the assessment of the answer made by the Court.

6 From the reply given by Nigeria or, more generally, from the positions taken by the Parties in the course of the written and oral proceedings, it does not necessarily flow that "the claim of one Party [relating to the entire boundary] is positively opposed by the other", as is required by the settled jurisprudence of the Court for establishing the existence of a dispute (*South West Africa, Preliminary Objections, Judgment, I.C.J. Reports 1962,* p. 328).

7 For the Court to decide on the existence of a dispute between the two Parties as to the legal bases of the whole of the existing boundary, it must previously have been established that the Republic of Nigeria challenges the validity of the legal title to the whole of the boundary relied on by the Republic of Cameroon, or relies on a different legal title, or places a different interpretation on a given legal instrument relating to the entire boundary. None of those conclusions may be "positively" inferred from the documents or statements presented to the Court.

8 Indeed, Nigeria's answer recognizes that the boundary between the two States has been "fix[ed]" by "the relevant instruments (all of which pre–date the independence of Nigeria and Cameroon)". It also states that "the course of the boundary, which was well established before independence and related United Nations procedures, has continued to be accepted in practice since then by Nigeria and Cameroon" (see the reply of Nigeria reproduced in paragraph 91 of the Judgment). In my view, this position, albeit cautiously and somewhat vaguely expressed, does not conflict with the position of Cameroon, according to which the existing boundary has been delimited by the legal instruments entered into by the former colonial powers and by decisions and acts of the League of Nations and of the United Nations.

9 The repeated statements of Nigeria to the effect that there is no dispute concerning "boundary delimitation as such" and the reserved and cautious formulations in the above–quoted answer may signify the disinclination of Nigeria to unfold its legal arguments on the merits. True, they may also be viewed as evidence of the probable emergence of a broader dispute. However, the real scope of such a dispute, if any, its parameters and concrete consequences can be clarified only at the merits stage when the Court has compared the maps produced by both Parties and more fully heard and assessed the substance of interpretation placed by each Party on respective legal instruments.

10 This prompts the conclusion that the objection in question does not possess an exclusively preliminary character within the meaning of Article 79, paragraph 7, of the Rules of Court. At this stage, the Court cannot easily dismiss the objection of Nigeria, according to which, with the exception of the concretely defined sectors of the common frontier, "there is no dispute concerning boundary delimitation as such throughout the whole length of the boundary from the tripoint in Lake Chad to the sea". Moreover, in its submissions Nigeria has specified long stretches, not to say most, of the boundary, remaining outside the disputed areas (see, for example, the final submissions on behalf of Nigeria in the oral proceedings, paragraph 19 of the Judgment).

11 Thus, from the factual point of view, the competing claims of Cameroon and Nigeria over territories situated in three sectors of their common boundary, namely in the areas of the Bakassi Peninsula, Darak and adjacent islands and Tipsan, taken together with sporadic incidents in some other sectors of the boundary, do not justify the sweeping conclusion that a dispute has already manifestly arisen concerning the whole length of the boundary between the two States. Therefore, the finding of the Court on the existence of such a dispute is not well founded on the facts of the

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

matter. It is equally ill founded in point of law, for the Court has not objectively determined that the legal basis of the whole of the boundary is challenged by one of the Parties.

(Signed) Vladlen S. Vereshchetin.

Separate Opinion of Judge Higgins

Judge Higgins

Discretionary power of the Court concerning sequence in which it settles issues before it — Sufficiently precise character of a dispute — Whether existence of a dispute under Article 38 of the Statute — Court's powers proprio motu regarding objections to jurisdiction.

1 As is recalled in the first paragraph of the Court's Judgment, Cameroon on 29 March 1994 instituted proceedings against Nigeria in respect of a dispute "relat[ing] essentially to the question of sovereignty over the Bakassi Peninsula". Cameroon recalled in its Application that the delimitation of its maritime boundary with Nigeria had been partial and the two Parties had been unable to complete it. It accordingly requested the Court, "in order to avoid further incidents between the two countries, … to determine the course of the maritime boundary between the two States beyond the line fixed in 1975".

2 Nigeria, in its seventh preliminary objection, stated:

> "There is no legal dispute concerning delimitation of the maritime boundary between the two Parties which is at the present time appropriate for resolution by the Court, for the following reasons:
>
> > (1) no determination of a maritime boundary is possible prior to the determination of title in respect of the Bakassi Peninsula;
> >
> > (2) at the juncture where there is a determination of the question of title over the Bakassi Peninsula, the issues of maritime delimitation will not be admissible in the absence of sufficient action by the Parties, on a footing of equality, to effect a delimitation 'by agreement on the basis of international law'."

3 In its written pleadings Nigeria advanced certain arguments to support this preliminary objection. These were further developed and elaborated in oral argument before the Court. As the Court recounts at paragraphs 104 to 108 of its Judgment, Nigeria contended that as determination of title to the Bakassi Peninsula must precede a delimitation of the maritime boundary, a claim as to the latter was inadmissible. Nigeria also stated that there had been no negotiations on any delimitation beyond the point identified as "G" in Cameroon's proposed maritime frontier line.

4 The Court recalls Cameroon's responses to these points at paragraph 105 and it has rendered its judgment on them at paragraphs 106 to 110. I am essentially in agreement with what it says in paragraphs 106 to 109 but not in paragraph 110.

5 There is an aspect related to the first limb of Nigeria's objection which seems to me important. I refer to the question of whether there is, in fact and in law, a dispute relating to the maritime zones of Cameroon and Nigeria out to the limit of their respective jurisdictions. Nigeria, in its written and oral pleadings on its seventh preliminary objection, has focused on the alleged absence of relevant negotiations. It contends that as a matter of general international law and by virtue of Articles 74 and 83 of the United Nations Convention on the Law of the Sea, a State must negotiate its maritime boundary and not impose it unilaterally and that the Court thus lacks jurisdiction and/or the claim on maritime delimitation is inadmissible. But it may be that the real relevance of the issue of negotiation lies rather in providing an indication as to whether a dispute exists at all over this matter. This, rather than whether negotiation is a "free standing" pre–condition for bringing a claim on a maritime

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

boundary, seems to me the real issue.

6 In its Application Cameroon states its purpose in seeking the maritime delimitation as the avoidance of further incidents. The Court has not been informed of any maritime "incidents" beyond the territorial seas. Further, paragraph 20 *(f)* of its original Application, is in the following terms:

> "In order *to prevent any dispute arising* between the two States concerning their maritime boundary, the Republic of Cameroon requests the Court to proceed to prolong the course of its maritime boundary with the Federal Republic of Nigeria up to the limit of the maritime zones which international law places under their respective jurisdictions." (Emphasis added.)

7 Whose fault it was that no agreement had been reached beyond point G, and whether the record shows that it was because of Nigeria's change of position on the Maroua Declaration or because both sides accepted that delimitation beyond G should be on a multilateral basis in order to take account of the interest of other States in the region, is in a sense beside the point. These matters, which assume a certain importance if the key issue is whether there is a duty to negotiate before bringing a maritime delimitation claim (and if so, whether this is a preliminary or substantive matter), become less pertinent if the real preliminary issue is whether a dispute exists between the parties as to the maritime boundary out to the limit of their respective jurisdictions.

8 An initial question that I have carefully considered is as to whether it is appropriate to be concerned about this issue at all, given that Nigeria has not chosen to advance the point in these terms. Although the Court always may raise points of law *proprio motu*, it is in principle for a respondent State to decide what points of jurisdiction and inadmissibility it wishes to advance. If a State is willing to accept the Court's jurisdiction in regard to a matter, it is generally not for the Court — its entitlement to raise points *proprio motu* notwithstanding — to raise further jurisdictional objections. However, I think that an exception to this principle exists where the matter relates to the requirements of Article 38 of the Statute. Article 38 is not a clause to be accepted or waived by respondents at will. It prescribes the fundamental conditions for the Court to be able to exercise its jurisdiction. And it is there that the Court's function is described as "to decide in accordance with international law such disputes as are submitted to it".

9 The Court must always therefore itself be satisfied that a dispute exists. The Court has recalled, when pronouncing upon Nigeria's fifth preliminary objection, the various legal requirements elaborated in its case–law on the question of the existence of a dispute (see Judgment, paras. 87–89, above). It is not necessary to repeat them here. But in my view these legal requirements should have been systematically tested in relation to the seventh preliminary objection and not just in relation to the fifth.

10 The record shows that it was intended by the Parties that their entire maritime frontier should be delimited. There were some discussions about the totality of such a frontier, even going beyond what came to be agreed up to point G. At the same time, the specific line that was negotiated and agreed upon, in 1975, was the line to point G. Nigeria has informed the Court, and Cameroon has not denied, that "the very first time Nigeria saw [Cameroon's claim] line, or indeed any Cameroon continental shelf or EEZ claim line, was when it received the Cameroon Memorial" (CR 98/2, p. 40).

11 Nigeria resiled from the Maroua Declaration and the record shows that meetings held at the Joint Expert level were understandably pre– occupied with the legal status of that Declaration. The information provided to the Court also shows that there had been an intention that progress beyond point G should be on a multilateral basis, given the proximity, in particular, of Equatorial Guinea beyond that point. Possible ways to engage Equatorial Guinea in discussions had been canvassed.

12 It matters not whether the failure to reach agreement beyond point G was due primarily to the

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

dispute over the status of the Maroua Declaration; or difficulties in engaging the interest of Equatorial Guinea in the delimitation; or what Cameroon terms the invasion of the Bakassi Peninsula by Nigeria in December 1993. Nor is it legally pertinent that the Parties entered into negotiations with a view to regulating the whole of the boundary, or even that there were some discussions about the frontier beyond point G. These elements are indeed relevant to the issue as formulated by the Parties — namely, whether there is an obligation to negotiate before bringing a maritime boundary claim to the Court, and if so, if that is a procedural or substantive matter, and if the former, to whom fault may be attributed and whether there are circumstances in which negotiations became impossible and thus legally unnecessary.

13 But whether there exists a dispute or not is a different question and is “a matter for objective determination” (*Interpretation of Peace Treaties with Bulgaria, Hungary and Romania, First Phase, Advisory Opinion, I.C.J. Reports 1950*, p. 74). Quite different elements from those the Parties have debated apply. There has to be a “claim of one party [that] is positively opposed by the other” (*South West Africa* cases, *Preliminary Objections, Judgment, I.C.J. Reports 1962,* p. 328). It is not sufficient for this purpose to say that as the Bakassi Peninsula is disputed, it necessarily follows that the maritime boundary is in dispute. And, in contrast to the position with regard to the land boundary, there is (beyond point G) no existing treaty line which constitutes the claim of one Party and which the other Party — even by implication — appears not to accept. No specific claim line beyond point G had, before the institution of these proceedings, been advanced by Cameroon and rejected by Nigeria.

14 The fact that Nigeria and Cameroon have not been able to have detailed negotiations, still less agreement, beyond point G does not mean that there exists a dispute over H to K. Indeed, Nigeria has offered no opinion on where the line should run after point G.

15 What the Court will decide on the merits as to title over the Bakassi Peninsula will inevitably have implications for the drawing of the maritime boundary out to the limits of the jurisdiction of the two States. This is so whether the decision would favour Cameroon or Nigeria. The Court has no way to know whether any specific line that might, as a consequence, be proposed by one Party would be accepted or rejected by the other. The point is not that a maritime boundary cannot be drawn before the territorial title to Bakassi is determined and, as Nigeria contends, a request to the Court to determine the line must be rejected as inadmissible. As the Court correctly says, the handling of the territorial and maritime elements would be within its own discretion and cannot be the basis of a preliminary objection (Judgment, para. 106). The point rather is that the claim as formulated in Cameroon's Application at paragraph 20 *(f)* is unattached to a defined dispute and thus also lacks a certain reality.

16 Nor can it be the case that where there is jurisdiction over a territorial dispute, and the parties have in consequence (and perhaps also for other reasons) not been able to agree a maritime boundary, there is *ipso facto* and without need to show anything more, a dispute over the entirety of their maritime boundary to the limits permitted under international law. Such a contention — had it been formulated this way — would both have been inconsistent with the Court's jurisprudence on the concept of a dispute for purposes of Article 38 of the Statute, and have disturbing policy implications.

17 It is because paragraph 110 has not satisfied me on this matter, and notwithstanding my agreement with the rest of what the Judgment has to say on Nigeria's seventh preliminary objection, that I have had to vote against paragraph 1 *(g)* of the *dispositif*.

18 As I believe the Court presently has no jurisdiction over the question of maritime delimitation beyond point G, Nigeria's eighth preliminary objection thus becomes without purpose and falls away, and the Court's response to it too. It is for that reason, and that reason only, that I have voted against paragraph 2 of the *dispositif*. My views on the seventh preliminary objection have certain consequences for the eighth. But I do not otherwise disagree with what the Court has to say

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

at paragraphs 115 to 117.

(Signed) Rosalyn Higgins.

Separate Opinion of Judge Parra–Aranguren

Judge Parra–Aranguren

Nigeria's fourth preliminary objection — The determination of the States "affected" by the decision of the Court belongs to the merits — It cannot be left to the Parties but must be made by the Court — The decision, at the jurisdictional stage, that the interests of Chad are not affected, precludes the possibility of its eventual subsequent intervention according to Article 62 of the Statute of the Court — The objection does not have, in the circumstances of the case, an exclusively preliminary character.

1. I have voted against subparagraph 1 *(d)* of the operative part of the Judgment rejecting the fourth preliminary objection raised by Nigeria for the following reasons:

2. Nigeria's fourth preliminary objection requests the Court not to determine in these proceedings the boundary in Lake Chad to the extent that that boundary constitutes or is determined by the tripoint Nigeria–Cameroon–Chad in Lake Chad, because its location affects a third State, the Republic of Chad. Nigeria also stated that the matter raised by its objection is not affected whether it

> "is considered as one going to the Court's jurisdiction (on the analogy of the principle in the case concerning *Monetary Gold Removed from Rome in 1943, Judgment, I.C.J. Reports 1954*, p. 32, as applied by the Court, most recently, in the case concerning *East Timor (Portugal* v. *Australia), Judgment, I.C.J. Reports 1995*, p. 90) or as to the admissibility of the proceedings (on the analogy of cases such as the case concerning *Northern Cameroons, I.C.J. Reports 1963*, p. 32)" (Preliminary Objections of the Federal Republic of Nigeria, p. 84, para. 4.11).

3. The question of third States "affected" by the decision on the merits was examined by the Court in its Judgment of 26 November 1984 in the case concerning *Military and Paramilitary Activities in and against Nicaragua (Nicaragua* v. *United States of America), Jurisdiction and Admissibility*. On that occasion it was stated that:

> "this is a question concerning matters of substance relating to the merits of the case: obviously the question of what States may be 'affected' by the decision on the merits is not in itself a jurisdictional problem" (*I.C.J. Reports 1984, p. 425*, para. 76).

4. I am in agreement with the principle embodied in the above quotation. I therefore support paragraph 78 of the Judgment, in which it is maintained that Nigeria's claims to Darak and adjacent islands could bring about a redetermination of the situation of the tripoint Nigeria– Cameroon–Chad in Lake Chad, and that these claims cannot be considered by the Court at this stage of the proceedings.

5. I cannot accept, however, the statement at the end of paragraph 78, in which it is concluded that the Court, in due course, will be in a position to take its decision regarding the redetermination of the tripoint Nigeria–Cameroon–Chad "without pronouncing on interests that Chad may have, as the Court will demonstrate hereafter". This statement clearly runs counter to the jurisprudence of the Court in the *Nicaragua* case, as quoted above, which I consider correct. Accordingly, in my opinion it is not possible for the Court, at this stage of the proceedings, to decide whether or not the redetermination of the tripoint Nigeria– Cameroon–Chad in Lake Chad may be made "without pronouncing on interests that Chad may have".

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

6. Paragraph 79 of the Judgment repeats that the request made by Cameroon to

> "'specify definitively the frontier between Cameroon and the Federal Republic of Nigeria from Lake Chad to the sea" (para. 17 *(f)*) of the Additional Application), may affect the tripoint, i.e., the point where the frontiers of Cameroon, Chad and Nigeria meet";

and in order to demonstrate why the legal interests of the Republic of Chad are not affected the Court states:

> "However, the request to specify the frontier between Cameroon and Nigeria from Lake Chad to the sea does not imply that the tripoint could be moved away from the line constituting the Cameroon–Chad boundary. Neither Cameroon nor Nigeria contests the current course of that boundary in the centre of Lake Chad as it is described in the 'technical document of the demarcation of the … boundaries' mentioned in paragraph 65 above … Any redefinition of the point where the frontier between Cameroon and Nigeria meets the Chad–Cameroon frontier could in the circumstances only lead to a moving of the tripoint along the line of the frontier in the Lake between Chad and Cameroon. Thus, the legal interests of Chad as a third State not party to the case do not constitute the very subject–matter of the judgment to be rendered on the merits of Cameroon's Application; and therefore, the absence of Chad does not prevent the Court from proceeding to a specification of the border between Cameroon and Nigeria in the Lake."

7. As stated by the Court in its Judgment of 26 November 1984, rendered in the *Nicaragua* case, "[c]ertainly the determination of the States 'affected' could not be left to the parties but must be made by the Court" (*Military and Paramilitary Activities in and against Nicaragua (Nicaragua* v. *United States of America), Jurisdiction and Admissibility, I.C.J. Reports 1984*, p. 425, para. 75). Consequently, in my opinion, it is not for Cameroon and Nigeria to decide whether the interests of the Republic of Chad are affected or not, as suggested in paragraph 79 of the Judgment.

8. I agree with the statement in paragraph 79 that "the legal interests of Chad as a third State not party to the case do not constitute the very subject–matter of the judgment to be rendered on the merits of Cameroon's Application"; but I cannot accept that, at this stage of the proceedings, the Court can decide whether the interests of the Republic of Chad are "affected" by the determination of the tripoint Nigeria– Cameroon–Chad in Lake Chad, and in the affirmative, to what extent. Such a determination is a matter for the merits, as decided by the Court in the *Nicaragua* case, because "it is only when the general lines of the judgment to be given become clear that the States 'affected' could be identified" (*I.C.J. Reports 1984*, p. 425, para. 75).

9. I am in agreement with paragraph 81 of the Judgment, when it states that "Whether the location of the tripoint in Lake Chad has actually to be changed from its present position will follow from the judgment on the merits of Cameroon's Application." Therefore, it is very difficult for me to understand how the Court, at this stage of the proceedings, may also decide in the same paragraph that an eventual and unknown change of the tripoint Nigeria–Cameroon–Chad in Lake Chad "would have no consequence for Chad".

10. According to Article 62 of the Statute, "[s]hould a State consider that it has an interest of a legal nature which may be affected by the decision in the case, it may submit a request to the Court to be permitted to intervene". Consequently, in stating that the interest of the Republic of Chad is not affected by the determination of the tripoint Nigeria– Cameroon–Chad in Lake Chad, as it does in paragraphs 78, 79 and 81 of the Judgment, the Court is, at the same time, precluding any possible intervention by the Republic of Chad at a later stage of the present case between Cameroon and Nigeria. In my opinion, this is a quite astonishing decision, in particular because the Court does not have the slightest idea as to what is the viewpoint of the Republic of Chad on the matter.

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

11. In the above–mentioned Judgment of 26 November 1984, rendered in the *Nicaragua* case, the Court examined in particular the reservation made by the United States, when depositing its Optional Clause declaration, to exclude disputes arising under multilateral treaties unless all parties to the treaty affected by the decision were also parties to the case; and it stated:

> "since the procedural technique formerly available of joinder of preliminary objections to the merits has been done away with since the 1972 revision of the Rules of Court, the Court has no choice but to avail itself of Article 79, paragraph 7, of the present Rules of Court, and declare that the objection based on the multilateral treaty reservation of the United States Declaration of Acceptance does not possess, in the circumstances of the case, an exclusively preliminary character, and that consequently it does not constitute an obstacle for the Court to entertain the proceedings instituted by Nicaragua under the Application of 9 April 1984" (*Military and Paramilitary Activities in and against Nicaragua (Nicaragua* v. *United States of America), Jurisdiction and Admissibility, I.C.J. Reports 1984*, pp. 425–426, para. 76).

12. The reasons stated by the Court on that occasion are applicable to the fourth preliminary objection raised by Nigeria requesting the Court not to determine in these proceedings the boundary in Lake Chad to the extent that that boundary constitutes or is determined by the tripoint Nigeria–Cameroon–Chad in Lake Chad, because its location directly affects a third State, the Republic of Chad. Accordingly, in my opinion, the Court should have declared that the objection does not have, in the circumstances of the case, an exclusively preliminary character.

(Signed) Gonzalo Parra–Aranguren.

Separate Opinion of Judge Kooijmans

Judge Kooijmans

Whether there is a dispute between the Parties as to the continuation of the maritime boundary beyond point G — No specific claim raised by Applicant at date of filing of Application which was positively opposed by Respondent — Seventh preliminary objection should have been partially upheld — Eighth preliminary objection consequently without object — Judicial propriety, unilateral application and rights and interests of third States in cases of delimitation of maritime boundary.

1. I have voted in favour of paragraphs 3 and 4 of the *dispositif*, which state that the Court has jurisdiction to adjudicate upon the dispute and that Cameroon's Application is admissible. That does not mean, however, that I support the Court's findings with regard to each and every preliminary objection raised by Nigeria. I voted against the Court's conclusion in subparagraph 1 *(g)* that the seventh preliminary objection must be rejected. Consequently, I had to vote also against the Court's conclusion in paragraph 2 that the eighth preliminary objection does not have, in the circumstances of the case, an exclusively preliminary character. In the following I wish to set out my viewpoints with regard to these matters.

2. In its seventh preliminary objection, Nigeria submitted that there is no legal dispute concerning delimitation of the maritime boundary between the two Parties which is at the present time appropriate for resolution by the Court. In this respect, Nigeria relied on two arguments; in the first place it contended that no determination of a maritime boundary is possible prior to the determination of title in respect of the Bakassi Peninsula. I fully share the Court's view that, since Cameroon has also requested the Court to decide on the question of the title to the Bakassi Peninsula, the issue raised by Nigeria is a question of method and that it lies within the Court's discretion how to deal with these two issues (paragraph 106 of the Judgment).

3. Nigeria's second argument is that the issue of maritime delimitation is inadmissible in the

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

absence of sufficient prior negotiations with regard to the maritime boundary beyond point G. Nigeria does not contest that extensive negotiations have taken place with regard to the course of the boundary from the landfall on Bakassi to point G; these negotiations led to the Declaration of Maroua, the binding character of which is contested by Nigeria. Nigeria does not deny, therefore, that there is a legal dispute between the Parties concerning that part of the boundary. It contends, however, that there never have been serious negotiations on the determination of the boundary between point G and "the limit of the maritime zones which international law places under the Parties' respective jurisdiction", whereas such negotiations are prescribed by Articles 74 and 83, paragraphs 2, of the 1982 Convention on the Law of the Sea.

4. I am of the opinion that, whatever must be held of the interpretation of these Articles of the Law of the Sea Convention with respect to the necessity of prior negotiations before a maritime delimitation issue may be unilaterally submitted to third–party settlement, such negotiations must have the possibility of leading to an agreement. In the present case, negotiations clearly could not have led to a positive result. The dispute which has developed on the legal value of the Maroua Declaration may be said to have made negotiations on the seaward continuance of the line agreed upon in that Declaration futile. And this situation has been aggravated by the subsequent dispute about the legal status of the Bakassi Peninsula. If negotiations cannot lead to results, they cannot be seen as a necessary pre–condition in the meaning of Articles 73 and 84 of the 1982 Convention, even if these Articles were to be interpreted as making such negotiations indispensable.

5. Nigeria further contends that the negotiations leading to the Maroua Declaration only dealt with the delimitation of what both Parties at the time considered to be their territorial sea and that the bilateral negotiations were never intended to cover also the delimitation of the exclusive economic zone and the continental shelf (Preliminary Objections of Nigeria, p. 119; CR 98/2, p. 41). Whatever the character, and, in particular, the intensity of such more general negotiations, Cameroon's claim that the negotiations which had taken place since 1970 had always been carried out with a view to delimiting the whole of the maritime boundary is in my view correct. This is borne out by the fact that already in the Declaration of the Nigeria–Cameroon Joint Boundary Commission of June 1971 it is stated that the delimitation of the maritime boundary should be done in due course to include the delimitation of the boundary in the continental shelf in accordance with the 1958 Geneva Convention on the Continental Shelf (Preliminary Objections of Nigeria, Ann. 21, p. 240). Moreover, even at that early moment, it was recognized that:

> "since the Continental Shelves of Nigeria, Cameroon and Equatorial Guinea would appear to have a common area, the attention of the Heads of State of Cameroon and Nigeria should be drawn to this fact so that appropriate action might be taken" (*ibid.,* Ann. 21, p. 241).

At a later stage, even after the breakdown of the negotiations as a result of the dispute over the Maroua Declaration, such appropriate action was specified as taking the form of a "tripartite meeting" to examine the issue of the determination of the triple point as an essential condition for the delimitation of the maritime borders between the three countries (Third Session of the Nigeria–Cameroon Joint Meeting of Experts on Boundary Matters, August 1993, Preliminary Objections of Nigeria, Ann. 55, p. 465).

6. Although I share the Court's view that the alleged absence of sufficient prior negotiations is no impediment for the admissibility of Cameroon's claim, I cannot follow the Court when it says that it, consequently, rejects the seventh preliminary objection in its entirety. In this respect, it is necessary to recall Nigeria's formulation that there is no legal dispute concerning delimitation of the maritime boundary between the two Parties which is *at the present time appropriate for resolution* by the Court (emphasis added). The Statute of the Court explicitly states that its jurisdiction is concerned with the decision on disputes (Art. 38, para. 1, and Art. 36, para. 2; the latter is also

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

applicable in the present case). For the Court to have jurisdiction it is therefore of vital importance to determine whether there is a dispute and in the affirmative case to identify such dispute. As Professor Rosenne says:

> "The function of the concept of *dispute* is to express in a legally discrete term the matter in connection with which the Court is empowered to make a judicial decision having final and binding force on the parties."[1]

And the Court itself stated in the *Nuclear Tests* cases:

> "The Court, as a court of law, is called upon to resolve existing disputes between States. Thus the existence of a dispute is the primary condition for the Court to exercise its judicial function." (*Nuclear Tests (Australia* v. *France), Judgment, I.C.J. Reports 1974*, pp. 270–271, para. 55.)

7. During their history, the present Court and its predecessor have given great attention to determine what a dispute, which lends itself for judicial decision, is. Their findings have been recalled in the present Judgment (para. 87) where the Court deals with the fifth preliminary objection. The Court there refers to the *South West Africa* cases where it stated that "[i]t must be shown that the claim of one party is positively opposed by the other" (*South West Africa, Preliminary Objections, Judgment, I.C.J. Reports 1962*, p. 328). It also referred to another statement by the Court, namely "[w]hether there exists an international dispute is a matter for objective determination" (*Interpretation of Peace Treaties with Bulgaria, Hungary and Romania, First Phase, Advisory Opinion, I.C.J. Reports 1950*, p. 74). Both statements were recently repeated in the Judgment in the *East Timor (Portugal* v. *Australia)* case, *I.C.J. Reports 1995*, p. 100, para. 22). After a painstaking analysis, the Court came with regard to the fifth preliminary objection to the conclusion that a dispute exists between the two Parties, at least as regards the legal bases of the whole of the existing boundary, although it is not yet possible to determine its exact scope. I fully subscribe to that conclusion.

8. In my view, the Court should have applied the same criteria with regard to the question whether a dispute exists between Cameroon and Nigeria as to the delimitation of the maritime boundary from point G to the outer limit of the various maritime zones. It is undoubtedly true that Nigeria has not raised this point as a separate argument and that, consequently, Cameroon has not seen fit to try and define the exact subject–matter of this dispute. This does, in my opinion, not relieve the Court of the task to determine *proprio motu* whether there exists a dispute which is the subject of the Application. As the Court said in the *South West Africa* cases:

> "A mere assertion is not sufficient to prove the existence of a dispute any more than a mere denial of the existence of the dispute proves its non–existence." (*South West Africa, Preliminary Objections, Judgment, I.C.J. Reports 1962,* p. 328),

whereupon the Court, independently of the arguments of the Parties, decided that a dispute existed. It is therefore for the Court to "objectively determine whether there exists an international dispute".

9. In its Application, filed on 29 March 1994, Cameroon requested

> "the Court …
>
>> (f) In order to prevent any dispute arising between the two States concerning their maritime boundary … to prolong the course of [this] boundary with the Federal Republic of Nigeria up to the limit of the maritime zones which international law places under their respective jurisdictions."

No further legal grounds for this request nor any other details underpinning it were provided in the

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

Application which, therefore, hardly seems to meet the conditions of Article 38, paragraph 2, of the Rules of Court as far as this part of the claim is concerned.

In its Memorial, dated 16 June 1994, Cameroon specified its request by asking the Court to adjudge and declare:

> "(c) That the boundary of the maritime zones appertaining respectively to the Republic of Cameroon and to the Federal Republic of Nigeria follows the following course:
>
> … … … … … … … … …
>
> — from point G that boundary then swings south–westward in the direction which is indicated by points G, H, I, J and K represented on the sketch–map on page 556 of this Memorial and meets the requirements for an equitable solution, up to the outer limit of the maritime zones which international law places under the respective jurisdictions of the two Parties."

On page 556 of the Memorial a map was reproduced entitled "La Délimitation Equitable" on which the various points mentioned in the submissions were indicated; an explanatory memorandum on the location of these points is contained in paragraphs 5.107 to 5.128 of the Memorial.

10. The critical date for the Court having jurisdiction and for the admissibility of an Application and, therefore, of the determination of the existence of a dispute is that of the Application's filing. This has been the established jurisprudence of the Court and has been recently confirmed in the Judgment of 27 February 1998 on the Preliminary Objections in the *Lockerbie* case (*Questions of Interpretation and Application of the 1971 Montreal Convention arising from the Aerial Incident at Lockerbie (Libyan Arab Jamahiriya* v. *United States of America), I.C.J. Reports 1998,* pp. 128–129, para. 36, and pp. 130–131, para. 43). Can it really be said that at the day the Application was filed there was with regard to the maritime boundary beyond point G a claim of Cameroon which was "positively opposed" by Nigeria, a "disagreement on a point of law or fact, a conflict of legal views or interests" between the Parties?

11. Although Nigeria did raise the matter of the non–existence of a dispute only in the context of an alleged absence of prior negotiations, it nevertheless drew the Court's attention to the fact that it had never been presented with a specific claim by Cameroon with regard to the continuation of the projected boundary line beyond point G. In its preliminary objections it stated:

> "Nigeria for its part has not yet had the opportunity to consider, in the context of diplomatic negotiations, *any* proposal for the delimitation of the respective maritime zones … beyond 'point G'. It learned of Cameroon's actual position as to delimitation beyond 'point G' *only when it received the* Memorial." (Preliminary Objections of Nigeria, p. 120, para. 7.15; emphasis added.)

12. If Rosenne is correct in saying that the existence of a dispute may be established from the examination of the positions of the parties, as expressed in the diplomatic history of the matter[2], what more do we learn from that diplomatic history than that there is a clear disagreement about the location of point G, the starting point of the "prolonged" maritime boundary, and the fact that the Parties agree that for the delimitation of their maritime zones the involvement of third countries, in particular Equatorial Guinea, is essential to the delineation of their maritime borders (Preliminary Objections of Nigeria, Ann. 55, p. 465), an understanding which was confirmed as late as 1993, long after the dispute about the binding character of the Maroua Declaration emerged?

How can the subject–matter of such a dispute be described in legal terms? What are the opposing legal claims which empower the Court to make a judicial decision having final and binding force on the Parties? Can it really be said that there "is a legal dispute which is at the present time

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

appropriate for resolution by the Court"?

13. It deserves mentioning also that — in so far as there would be a dispute as to the "prolonged" boundary beyond point G — the whole issue is obfuscated by the fact that it is exactly the contested location of point G which is determinative for the settlement of that dispute. Now it may be said that this is as much a matter of method as the relationship between the disputed title to Bakassi and the initial leg of the maritime boundary up till point G and that the order in which the various issues will be dealt with lies within the discretion of the Court. Here, however, the position of points H–K are indissolubly linked with the location of point G as established in the Maroua Declaration. Any determination by the Court, which is different from Cameroon's claim, will totally unsettle its claim with regard to the seaward continuation of the maritime boundary in case the specific claim, as rephrased in its Memorial, would be accepted as an element of the dispute.

14. All this would have been different, of course, if the two Parties had concluded an agreement to submit the matter of the determination of the maritime boundary to the Court and had been able to plead their differing or opposing views, asking the Court either to define the legal principles and rules applicable to the delimitation of the maritime zones or to determine it itself. It would have been difficult for the Court to avoid or even refuse to give such a decision, even if the constituent elements of the dispute were not worded in very clear or precise terms.

It is, however, quite another matter — and hardly desirable in my view — if the Court can be unilaterally seised by a State with the request to determine a maritime boundary in more remote zones, if negotiations with another State on the delimitation of more in–shore areas have been unsuccessful, without a clear difference of views on the legal *criteria* for the delimitation in these more remote zones as well.

15. For all these reasons, I am of the opinion that the Court should not have concluded that the seventh preliminary objection must be rejected *in its entirety*, but that it should have been partially sustained; there does not exist a legal dispute between the Parties as to the continuation of the maritime boundary beyond point G, as is required by Article 36, paragraph 2, of the Statute.

16. This position also has its consequences for my vote on the eighth preliminary objection. I share the Court's view that the problem of rights and interests of third States only arises for the prolongation of the maritime boundary seawards beyond point G and that the dispute as to the boundary between the landfall on the Bakassi Peninsula and point G does not concern the rights and interests of third States (para. 115 of the Judgment).

Since in my opinion the Court should have refrained from taking upon itself the task of determining the maritime boundary beyond point G by partially upholding the seventh preliminary objection, I could not vote for the Court's conclusion with regard to the eighth objection either, since this objection, in my view, should have been declared without object.

17. This may not be interpreted as implying that I disagree with the Court's finding that an objection of this character *in se* does not possess an exclusively preliminary character and can only be decided upon in connection with the merits.

I feel, however, that in the present case the Court, for reasons of judicial propriety, could or even should already *in limine litis* have sustained this objection instead of reserving that possibility for the phase of the merits.

18. Nigeria, in its eighth preliminary objection, stated "[t]hat the question of maritime delimitation necessarily involves the rights and interests of third states and is inadmissible beyond point G".

In the present Judgment the Court

"notes that the geographical location of the territories of the other States bordering the Gulf

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

of Guinea, and in particular Equatorial Guinea and Sao Tome and Principe, demonstrates that it is *evident* that the prolongation of the maritime boundary between the Parties seawards beyond point G will eventually run into maritime zones where the rights and interests of Cameroon and Nigeria *will* overlap those of third States. It thus appears that rights and interests of third States will become involved if the Court accedes to Cameroon's request.” (Para. 116; emphasis added.)

This leads the Court to the conclusion that it

> “cannot rule out the possibility that the impact of the judgment required by Cameroon on the rights and interests of the third States could be such that the Court would be prevented from rendering it in the absence of these States …” *(ibid.)*.

The pivot on which everything hinges, therefore, seems to be the willingness of such third States to exercise their right to intervene under Article 62 of the Statute in the present proceedings.

19. In the case concerning the *Continental Shelf (Libyan Arab Jamahiriya/Malta)* the Court stated that it

> “has not been endowed with jurisdiction to determine what principles and rules govern delimitations with third States, or whether the claims of the Parties outside that area prevail over the claims of those third States in the region”.

This was the logical conclusion of the Court's finding that its decision

> “must be confined to the area in which, *as the Court has been informed by Italy*, that State has no claims to continental shelf rights. The Court, *having been informed of Italy's claims*, … thus ensures Italy the protection it sought.” (*I.C.J. Reports 1985*, p. 26, para. 21; emphasis added.)

20. In delimitation of maritime boundary cases, therefore, knowledge of the viewpoints of third States involved is quintessential for the Court to enable it to perform its judicial task as requested by the parties if an application has been brought by Agreement. That would be even more so with regard to the position of Equatorial Guinea, if the present case had been brought by Agreement, in view of the fact that both parties had considered the determination of the triple point an essential condition for the delimitation of the maritime borders between the three countries. If there had been an Application by Agreement, the present case would, apart from geographical factors, have reflected the *Libya/Malta* case.

21. The present case, however, has been brought by unilateral application under Article 36, paragraph 2, of the Statute. The Applicant requests the Court to determine the maritime boundary with the Respondent, whereas it has itself, together with the Respondent, admitted that such delimitation requires the involvement of, and thus negotiations with, a third State. Under such conditions it does not seem proper or reasonable to “compel” that third State to expose its views and its position by means of an intervention under Article 62 even before negotiations with the neighbouring States have begun. Of course, the third State is free not to intervene but in that case the Court could — and in the present case in all probability would — be prevented from rendering the judgment required by the Applicant. Since there is no agreed request by both Parties, considerations of judicial propriety could in the present case have led the Court to the decision to uphold the eighth preliminary objection in the preliminary phase of the proceedings.

(Signed) Pieter H. Kooijmans.

Dissenting Opinion of Vice–President Weeramantry

Vice–President Weeramantry

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

Article 36, paragraphs 2 and 4, and Article 38, paragraph 1 (c), of the Statute — Need for communication of acceptance before consensual relationship is formed — Duty imposed on Secretariat by Article 36, paragraph 4 — Use under Article 38, paragraph 1 (c), of comparative law perspectives regarding formation of consensus — Need for time interval between deposit of declaration and formation of consensual bond — Avoidance of surprise to party sought to be bound — Strengthening of Court's jurisdiction through due compliance with Article 36, paragraph 4.

1 I have some reservations in regard to the Court's conclusions on objection 1. Since the principles involved are of considerable importance to the jurisprudence of the Court, I consider it necessary to set out these reservations in some detail.

2 Briefly stated, my concerns centre on the proposition that the deposit of a declaration under Article 36, paragraph 2, of the Statute is all that is required to establish the necessary consensual bond under the Optional Clause. It follows from this proposition that the moment a declaration is lodged under Article 36, paragraph 2, the party lodging the declaration has the right to bring another declarant to Court, irrespective of that other party's knowledge that such declaration has been lodged. It seems to me that such a proposition cannot be in conformity with either the express law or the essential philosophy governing the Optional Clause.

3 Such a view negates a specific provision of the applicable law which is contained in Article 36, paragraph 4, of the Statute, and runs contrary to the philosophy of consensus on which the structure of the Court's jurisdiction, as well as of this particular provision, is based. It is also in disharmony with the principles of equality, fairness, good faith, and reciprocity. Moreover, it results in the rather incongruous situation that, during the interim period between the filing of the declaration and the communication of this fact, there is great inequality between the parties in relation to their practical right of access to the Court. The right to take one's adversary to court is, in any circumstances, a valuable right. It is rendered all the more valuable — and inequitably so — if one's adversary does not know that it has a corresponding right. If such a one–sided state of affairs prevails for nearly a year — which could occur, as we have seen, owing to delays in communication by the Secretariat — so much the greater is the advantage to one party and the resulting lack of equality and reciprocity. The declarant can regulate its conduct and direct its negotiations from the vantage point of its certain knowledge that the matter is now justiciable before the Court, while its opponent negotiates in ignorance of this vital item of information regarding its rights.

4 I do not think such results were within the contemplation of those who drafted the Statute of the Court, especially having regard to their particular concern with the question of communication, as reflected in the wording of the Article itself.

5 The authority for the proposition underlying the Court's ruling is the often–invoked *Right of Passage* case[1], but, with much respect, it seems to me that that case, though followed in the Court's subsequent jurisprudence, needs re–examination. It affects too fundamental an aspect of the Court's jurisdiction to remain as the leading authority on this question. After 40 years of development of international law, in the spheres of such concepts as fairness, reciprocity and good faith, so sweeping a hypothesis as the immediate creation of a right to sue, regardless of the other party's knowledge thereof, is much in need of review.

* * *

6 A word is necessary regarding the facts of this particular case. Nigeria had filed its Declaration in 1965. Cameroon filed its Declaration on 3 March 1994, and made its Application to the Court three weeks later. The Secretary–General did not communicate Cameroon's Declaration for nearly a year, and Nigeria states that it first received formal intimation of Cameroon's Application from the Registrar on 29 March 1994.

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

7 Cameroon relies on informal references to such a possibility in the communications between the States, and on other sources from which Nigeria might have gleaned this information. In dealings between States on a matter of such importance and formality, one would require something more than a communication which is both informal and indefinite. The question arises whether, in any event, the announcement of the Declaration in the *Journal of the United Nations* would have been sufficient notice to Nigeria of the Declaration of Cameroon. It is necessary to observe in this connection that not every mission in the United States is so well equipped with professional personnel that it can keep a tab on all the treaties deposited and link up the declarations under Article 36, paragraph 2, with their country's immediate concerns. Such a view would operate harshly on the less well–equipped missions at the United Nations. I cite, in this connection, the following passage from Rosenne's work on *The Law and Practice of the International Court of Justice, 1920–1996*:

> "An announcement of the deposit of a declaration is published immediately in the *Journal of the United Nations* issued on each weekday in New York. That announcement is made for information purposes. It is accompanied by a footnote specifying that the date indicated is the date of receipt of the relevant documents, meaning that the documents will have to be reviewed for determination as to the actual deposit. Given the Court's interpretation of Article 36, paragraph 4, this announcement is not a satisfactory method of bringing the deposit of a declaration to the immediate notice of the parties to the Statute, since the *Journal of the United Nations* is not a document of general circulation but rather the day's work programme in United Nations Headquarters in New York. Permanent Missions in New York are unlikely to appreciate the significance of announcements of this character appearing in the *Journal*."[2]

* * *

8 I shall now deal with the reasons why I consider the *Right of Passage* decision to be in need of review, commencing with the strictly legal provisions, and moving thereafter to the conceptual reasons underpinning them.

9 That decision, which receives endorsement from the Court's Judgment in the present case, holds that:

> "A State accepting the jurisdiction of the Court must expect that an Application may be filed against it before the Court by a new declarant State on the same day on which that State deposits with the Secretary–General its Declaration of Acceptance. For it is on that very day that the consensual bond, which is the basis of the Optional Clause, comes into being between the States concerned."[3]

10 My first point of disagreement with the *Right of Passage* case is based on its unequal treatment of the two mandatory clauses contained in Article 36, paragraph 4, of the Statute. The two requisites stipulated by Article 36, paragraph 4, are deposit with the Secretary–General and transmission by the Secretary–General of copies to the parties to the Statute and to the Registrar of the Court. The Court, in *Right of Passage*, treats the first request as essential and virtually discounts the other. I do not think that two parallel statutory requirements can be treated so differently, especially when both alike are couched in imperative terms.

11 Secondly, it is an important rule of statutory interpretation that all words in the instrument under interpretation should, as far as possible, be given full efficacy. The Court must necessarily avoid any interpretation which would reduce important words or clauses in the Statute to mere surplusage which has no legal effect whatever. Under the *Right of Passage* interpretation, the words "who shall transmit copies thereof to the parties to the Statute and to the Registrar of the Court" might as well have been omitted from the Statute. Such an interpretation does not seem to me to be in conformity with the recognized rules of legal interpretation. The Court is under a duty to

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

render effective all the provisions of its Statute, rather than to encourage the disregard of sections of it by interpretations which denude them of significance or meaning.

12 The Court's Judgment means that if the Secretariat ignored these words completely, the legal result would still be the same. Such a view is all the more questionable when the statutory requirement is not an arbitrary imposition, but is based, as will be shown, upon well–accepted universal norms and concepts pertinent to the creation of consensual relationships.

13 It is true this Judgment has been followed in the Court's later jurisprudence in *Temple of Preah Vihear* and *Military and Paramilitary Activities in and against Nicaragua (Nicaragua* v. *United States of America)*. However, no amount of contrary jurisprudence can override the imperative requirements of the Court's Statute and, if indeed the Statute makes such a communication compulsory, it must be treated as such.

14 Thirdly, one must look upon the deposit of the declaration and the communication by the Secretary–General as together constituting the composite package of conditions which needs to be satisfied to give legal efficacy to the declaration. It is clear that the first requisite must be satisfied, for, without it, there could be no question of the declaration being operative. The article in question designedly does not place that requisite alone, but couples it with another in terms which are equally mandatory.

15 One constituent element cannot be detached from this statutory package by a process of judicial interpretation. Nor can one element be emphasized and the other neutralized when the Statute itself gives no indications to that effect. If the juristic right fashioned by Article 36 is to come into existence, the events attending its creation must fit the mould cast for that purpose by the governing statutory provision.

16 A fourth reason why the *Right of Passage* decision needs review is that it could well encourage the Secretariat to take a more relaxed view regarding its obligations under Article 36, paragraph 4. Since the interpretation placed by *Right of Passage* on the requirement of communication deprives that requirement of all effective impact upon the matter it was meant to regulate, it is not to be wondered at that the Secretariat, acting presumably on that ruling, takes its time — up to one year — in transmitting the required communication.

17 If, indeed, a practice of delay in communication has resulted in the United Nations from the belief that one of these imperative conditions is not imperative, despite the language of the Statute to the contrary, it is important that the practice be rectified and the procedures brought into regularity with the binding requirements of the Statute.

18 It is true the second of these requirements is not within the control of the party depositing the declaration, but it is to be presumed that official acts will be duly performed, the more especially where they relate to matters of such fundamental importance to the rights of States, as the voluntary surrender of some part of their sovereign autonomy — for declarations by States under Article 36 amount to no less than this. Due performance by the Secretariat of its responsibility of transmitting such copies in a matter such as this can mean nothing short of transmission of such declarations forthwith. This is yet another reason why I believe the Court should take this opportunity to review that Judgment, and stress the imperative nature of this statutory responsibility. The delay of nearly one year that has occurred in communication in this instance is not, in any event, a proper compliance with the Statute.

19 My fifth objection to the *Right of Passage* case is that it takes out of context the expression "*ipso facto* and without special agreement", and treats it as an indication of the point of time at which the parties became consensually bound. This provision was not intended to produce such a result, nor can it bear such a construction. What Article 36, paragraph 2, provides is that where a declaration is filed, no special agreement is necessary, as the declaration has a compulsory force

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

of its own. Nowhere does this provision purport to indicate *when* that declaration becomes operative.

20 I would endorse what Vice–President Badawi observed of this construction in his dissenting opinion in the *Right of Passage* case when he criticized the isolation of the expression *"ipso facto"* from its context. This led to the achievement of a result by which, in his words, "the complete idea contained in the Statute has been dismembered and disregarded"[4].

21 As a sixth objection, I note the prejudice that the *Right of Passage* interpretation may cause to a party. A ruling which in effect confirms that the filing of a declaration becomes operative the very next moment after it is filed could be an embarrassment to a State which is in the process of negotiation with another. Unknown to itself, it could have the ground surreptitiously cut from under its feet, perhaps after it has made some vital concession, in the belief that the matter is still under negotiation. This aspect is further developed later in this opinion.

22 A seventh reason is that the declaration which constitutes the act of acceptance is not a declaration in a standard form. It is infinitely variable in its terms, and the mere fact of deposit cannot be an intimation of the terms in which the declaration is framed. The party sought to be bound is entitled to know those terms. If it is held to be consensually bound, it cannot reasonably be held to be bound to terms of which it is unaware. This factor militates so strongly against the core content of the concept of consensus that even had it stood alone, it would, in my view, have been conclusive.

23 An eighth and final reason why, in my view, the *Right of Passage* decision needs re–examination is that it could have an adverse effect on the development of the Court's jurisdiction. The Court's interpretation could well result in a reluctance on the part of States to make such declarations in the first instance. Indeed, the Court's ruling in the *Right of Passage* case was followed shortly thereafter by the introduction of a series of reservations to declarations already filed under Article 36. For example, the United Kingdom's Declaration on 26 November 1958 excepted from the scope of its Declaration disputes

> "where the acceptance of the Court's compulsory jurisdiction on behalf of any other Party to the dispute was deposited or ratified less than twelve months prior to the filing of the application bringing the dispute before the Court"[5].

So, also, India filed an amended declaration on 14 September 1959, restricting the Court's jurisdiction in respect of future applications to cases where the acceptance of the Court's compulsory jurisdiction was deposited or ratified more than twelve months prior to the filing of an application bringing the dispute to the Court[6].

24 Other States may well be expected to take similar steps to protect themselves against surprise applications if this view of the law is confirmed, while some others contemplating the filing of such a declaration may well have second thoughts on the subject. All this is not conducive to the extension of the compulsory jurisdiction of the Court.

25 Indeed, while the Court has been deliberating on its Judgment, Nigeria itself has taken action, on 29 April 1998, to amend its Declaration, so as to impose a time–limit of twelve months before acceptance of the Court's jurisdiction by a State becomes operative against Nigeria.

26 So much in regard to the interpretation of the governing statutory provision.

* * *

27 I pass now to an examination of some conceptual considerations which underlie the statutory provision and reinforce the conclusions already reached.

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

28 Since the so–called compulsory jurisdiction clause is consensual in its architecture, one must satisfy oneself that the results of the Court's Judgment are in conformity with the legal concept of consensus.

29 A State lodging a declaration under Article 36, paragraph 2, performs a twofold juristic act. On the one hand, it is making an *offer* to every other State that has not already filed a declaration that it will be bound by its terms to such State, upon that State making a declaration in accordance with Article 36. On the other hand, a declaration made in terms of Article 36 is an *acceptance* of the offers made by other States which have already filed such a declaration. A declaration duly made under Article 36 is thus both an offer to some States and an acceptance of the offer already made by other States.

30 It is true we are considering a question of international law, but this analysis shows us also that we are very much in the sphere of the law of consensual obligations, from which we draw our general principles and foundation requirements. We must not be diverted from the basic principles of this body of law, as universally recognized, by the circumstance that we are operating in the territory of international law. Where any situation in international law depends on consensus, the generally accepted principles relating to consensual obligations would apply to that situation, unless expressly varied or abrogated.

31 How is a consensual obligation formed? The completed legal product results from the classical process of the meeting of minds which follows from a confluence of offer and acceptance. This is accepted by most legal systems, with the rarest of exceptions[7]. This principle is accepted alike by the Anglo–American law and the Romanistic legal systems[8]. There are indeed substantial differences among different legal systems regarding such matters as the status and revocability of the offer[9], but the basic principle that the minds of offeror and offeree must meet remains unaffected by these considerations, and belongs to the common core of legal systems.

32 Probably the most exhaustive study available on the core content of consensus across a wide variety of legal systems is Schlesinger's monumental work on the *Formation of Contracts*[10]. Schlesinger would indeed appear to have anticipated cases such as the present where the Court needs to satisfy itself on the universally agreed fundamentals of consensus.

33 One of the purposes of this study, as expressly stated therein, was to render assistance to judges of international tribunals having occasion, under Article 38, paragraph 1 *(c)*, of the Statute of the International Court of Justice, to deal with issues relating to the formation of agreements[11]. Schlesinger was examining the “reservoir of legal concepts and precepts traditionally utilized in, and shared by, a number of national legal systems”[12], and expressed the hope that international judges “would make ample use of the ‘general principles’ as prime materials for the building of a systematic body of international law”[13].

34 The present case of interpretation of a statutory provision arising out of the concept of consensus or agreement is an apt occasion for the use of such scholarly research for the purposes of international law. In particular, it would be helpful in testing whether the interpretation adopted in the *Right of Passage* case conforms to the “general principles” attending agreement as universally understood.

35 Schlesinger notes preliminarily the following general propositions:

> “I A. In all legal systems under consideration, the first requirement of a ‘contract’, in the core meaning of the word, is the existence of an agreement, *i.e.*, of manifestations of mutual assent on the part of two or more persons. Whether or not they are promissory in nature, these manifestations as a rule must be referable to each other.” [14]

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

"III. …

In all legal systems under consideration, contracts are normally (although not necessarily …) formed by offer and acceptance occurring in an ascertainable sequence." [15]

* * *

36 Once this norm of offer and acceptance is established, the next question for examination is whether the acceptance needs to be communicated. In this regard, Schlesinger observes as follows, in the section of the General Report dealing with the question:

"*Is Communication of Acceptance Necessary?*

The problem to be treated in this Report is connected with the offeror's interest in obtaining knowledge concerning the conclusion of the contract.

Normally, although not necessarily, such knowledge is obtained through communication, *i.e.*, an act of the offeree aimed at bringing acceptance to the offeror's knowledge.

With the possible exception of French law, all systems under consideration agree, as a matter of principle, that communication of acceptance is necessary to bring about a contract."[16]

37 He also observes that the differences between French law and the other systems under consideration may be more apparent than real[17].

38 There are indeed exceptional circumstances in which legal systems do not require a specific communication of acceptance, e.g., in standard form contracts or contracts of adhesion[18]. Vice–President Badawi, in the *Right of Passage* case, distinguished this category of contracts from Declarations under Article 36 in the following terms:

"Indeed, whereas the essential feature of the 'adherence' or 'accession' contract is uniformity, that of Declarations is variety and diversity. Each Declaration expresses the conditions, the purposes and the policy of the State which makes it. Furthermore, in 'adherence contracts' one of the parties in fact is in a position in which it is impossible to discuss the terms of the contract. It is obliged to contract and gives its adherence to the all powerful will of the other. In this category are included, *inter alia*, contracts of service, contracts for transport and for insurance. What analogy can there be between such contracts and Declarations accepting jurisdiction?"[19]

39 Another such exceptional category consists of postal offers, in regard to which a variety of theories have been propounded[20] to meet the difficulties arising from time taken in transit, revocation pending transmission, and the like. All theories have been the subject of contention, but they are all designed to meet the special difficulties arising from this particular mode of communication. There may also be cases where an unusual mode of acceptance is prescribed by the offeror, and compliance with this method obviates the need for communication, which is therefore considered to be waived[21]. It is in such cases, where good reasons exist for departure from the norm, that the law of contract waives the requirement of communication of an acceptance. This is not such a case. Indeed, the present situation is the very opposite of the case where actual communication is *waived* by the law, for the Statute in fact expressly *requires* communication by action of the Secretary–General.

40 Except in such exceptional circumstances, or where communication is expressly dispensed with by the parties, there is very good reason for concluding that there can be no consensus in the absence of communication of the acceptance. Without it, the offeror would be in a state of

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

ignorance that it is bound by a contractual relationship. In the words of Nigeria, the “consensual bond” between itself and Cameroon in regard to the Court's jurisdiction “cannot be said to exist with respect to another State of whose participation in the system established by Article 36.2 of the Statute Nigeria knew nothing”[22]. This is contrary to the considerations of fairness that should govern such relationships; and the exceptional circumstances in which a merely notional communication is deemed sufficient are not replicated in the case of Article 36, paragraph 2, declarations. Such a conclusion is strengthened further by the requirement of communication built into Article 36, paragraph 2, itself.

41 The procedure of deposit of the declaration with the Secretariat is clearly not tantamount to a notification to all the world, as would be the case, for example, of the deposit and registration of a deed with a Land Registry within a domestic legal system. Indeed, the Statute would not specifically require communication if the mere fact of the deposit were to be constructive notice to all the world.

42 An important principle involved in all of the foregoing considerations is the principle of the protection of the offeror.

43 I quote Schlesinger's conclusions again, in relation to the recognition by legal systems of the need for the protecting the offeror. He refers to the fact that

> “most of the legal systems under consideration will in some way protect the offeror's interest in obtaining knowledge that the contract has been concluded. Such protection is given by imposing a duty on the acceptor to inform the offeror, promptly or at least within a reasonable time, of the conclusion of the contract. However, these systems differ as to the scope of the duty and the consequences of non–compliance.”[23]

44 I can do no better than to conclude this discussion with a reference to what Grotius himself has to say on the matter, not in his treatises on the Roman–Dutch law, but in *De Jure Belli ac Pacis* itself. His conclusions are as follows:

> “*Whether an acceptance ought to be made known to the promisor; explanation, with a distinction*
>
> This question is also commonly raised, whether it is sufficient that the acceptance be signified, or whether, in fact, the acceptance ought also to be made known to the promisor before the promise attains its full effect.
>
> It is certain that a promise can be made in both ways, either thus: ‘I desire that this be valid, if it be accepted’; or thus: ‘I desire that this shall be valid if I shall have understood that it has been accepted’. In promises which deal with mutual obligations the latter meaning is assumed, but in merely generous promises it is better that the former meaning should be believed to be present, unless something else should appear.”[24]

45 Declarations under Article 36, paragraph 2, deal with mutual obligations, and there is no doubt that they fall into the category in which the offeror must know that his offer has been accepted[25].

46 This discussion of the general principles of law relating to the formation of consensus through the process of offer and acceptance show their applicability to the matter under consideration by the Court. It indicates also how the Court's decision departs from those principles, and thereby weakens the foundation of true consensus on which the Court's jurisdiction must in all circumstances be based.

47 There are two ancillary matters which need some consideration to complete an examination of the matter before the Court — the need for a time interval between deposit of the declaration and the creation of the consensual bond, and the question of prejudice to a party that can result from

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

the view of the law which the Court has endorsed.

* * *

48 A time interval between deposit of the declaration and the creation of the consensual bond provides a necessary safety cushion to ensure that the party sought to be bound by the declaration is not taken by surprise.

49 Scholarly writings on Article 36, paragraph 4, reinforce this point. I refer, in particular, to Shabtai Rosenne, who points out that Article 36, paragraph 4, was added at a late stage of the San Francisco Conference, and immediately became subject to interpretation[26]. Rosenne's own view is that, should the Statute ever be revised, there should be “a short interval between the date of deposit and the date on which the deposit of the instrument produces its effects”[27]. The manifest reasons for such a precaution have already been discussed. Such a view underlines the need for knowledge of the declaration on the part of the States who are to be bound. This result would follow inevitably if the terms of Article 36, paragraph 4, are to be given their natural meaning rather than the truncated meaning given to them by the decision in *Right of Passage*.

50 Indeed, Rosenne's conviction of the need for such an interval was so strong that he made submissions to the International Law Commission in this regard when it was giving consideration to Article 78 of the Vienna Convention — a consideration which was no doubt heavily influenced by the prevailing *Right of Passage* jurisprudence[28]. Indeed, that eminent jurist, in dealing with the “small time–lag before the other States become aware that the treaty is in force between them and the State depositing the instrument”, suggested that this period should be fixed at 90 days, “thus allowing both for the observance of the normal administrative practices of the depositary and for receipt of the notice by the home authorities of the States concerned and the observance of their normal administrative practices”[29].

51 This suggestion was meant to allow for different depositary practices, the notices being sometimes transmitted “through a government's own diplomatic posts abroad, sometimes through diplomatic posts accredited to the depositary; and sometimes by mail”. The essential thrust of the recommendation was no doubt to ensure that the State sought to be bound was informed of the existence of the instrument which locked it into a consensual relationship.

52 I doubt very much that the interpretation of Article 36, paragraph 4, according to its natural meaning, could unsettle the Court's jurisdiction. Rather, a clarification of that provision and of the reasons underpinning it would regularize and strengthen that jurisdiction. It would also give to States making such declarations the confidence that they will not be taken by surprise, thereby reinforcing their willingness to accept the Court's optional jurisdiction.

53 No doubt modern methods of duplication and transmission of documents could considerably expedite this process, but it seems to me that the “small time–lag” stipulated by Rosenne is essential.

54 It is also relevant to refer to the full recognition accorded by Article 78 *(c)* of the Vienna Convention on the Law of Treaties to the necessity of communication of notifications in regard to treaties, if the recipient is to be bound. This is an application of the normal consensual rule. The Court does indeed refer to this provision, but observes that, in so far as declarations under Article 36 are concerned, the régime for depositing and transmitting declarations of acceptance of compulsory jurisdiction is prescribed by Article 36, paragraph 4, of the Statute of the Court (Judgment, para. 30). I respectfully agree, but that very régime prescribes a method of transmitting the communication, and must therefore be followed.

* * *

55 I refer finally to the question of possible prejudice to parties, which can result from the

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

interpretation the Court lays upon Article 36.

56 I have already adverted to the first item of prejudice: that for the period between the deposit of a declaration and the communication of that declaration to the party who is to be impleaded, the party depositing the declaration is at an advantage over the other, in that the former is aware that the Court has jurisdiction, and the latter is not. The vesting of jurisdiction in the Court is an important juristic act with major repercussions on State sovereignty. If one party is aware of its rights under this provision, and the other is not, a disparity is created between the parties, which fundamentally breaches the basic principle of equality on which the Court's jurisdiction is premised.

57 This inequality can have practical repercussions on the course of the informal negotiations between parties, that precede the formal institution of an action. I believe it is in the interests of the peaceful resolution of disputes and the general principles of our jurisprudence that such informal negotiation should be encouraged and promoted, and I can only see the effect of such a ruling as inhibiting this process.

58 It is important that when parties are in bona fide negotiation with each other there should not even theoretically be the possibility of one of those parties filing a declaration and lodging an application before the Court almost simultaneously. This could amount, in a hypothetical case, to an abuse of the process of the Court. It is by no means implied that such is the case here, but the decision of the Court opens the door to such a possibility in the future.

59 It is important to international peace and goodwill that the processes of negotiation between parties be given full scope, without the fear of a sudden and unexpected termination, followed by the dragging of a reluctant respondent to the Court. The deleterious effect that could ensue in regard to the willingness of States to file an Article 36, paragraph 2, declaration at all could be damaging to the development of the Court's jurisdiction. This is an important reason why such a construction should be avoided.

60 In the process of bona fide negotiations, concessions are made, facts are accepted, compromises are worked out, admissions and apologies are offered. Documents embodying such acts may well be exchanged. It is important that all this should take place on a footing of openness and equality.

* * *

61 For all these reasons, I am of the view that Nigeria has made out a case of lack of consensus in regard to Cameroon's declaration under Article 36, paragraph 2, at the time Cameroon's Application was filed.

62 An interpretation of Article 36, paragraph 4, according to its natural meaning, would result in more confidence on the part of States in making declarations under Article 36, paragraph 2. Any uncertainty as to whether consensus had been established could be removed by the prompt discharge by the Secretariat of its statutory duties under Article 36, paragraph 4, which modern methods of reproduction and communication of documents render much less labour intensive and time consuming than they were when the Statute was framed. A proper attention to this statutory obligation could result in communication within a matter of a few days, thus removing all uncertainty.

63 Other advantages of this view are that it would bring the operation of consensual jurisdiction within the consensual principles which lie at its very foundation, ensure fairness and reciprocity between the parties, and bring the operation of declarations under Article 36 within the express terms of the article which fashioned them.

(Signed) Christopher G. Weeramantry.

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

Dissenting Opinion of Judge Koroma

Judge Koroma

Optional clause (Article 36, paragraph 2, of the Statute) — Mandatory requirements prior to invoking compulsory jurisdiction of the Court — Reliance on Judgment in Right of Passage *case — Non–recognition or application of principle of stare decisis by Court — Article 59 of Statute — Article 38 of Statute establishes a hierarchy as to the application of the law — Article 36, paragraph 4, of Statute — Deposit of declaration and requirement of transmission by Secretary–General — Distinguished from Article 78 of Law of Treaties — Treaty–related communication–trend in international law — Whether time period required after deposit of a declaration before seising Court of a matter — Principle of good faith — How it should have been considered by the Court — Condition of reciprocity — Need for mutuality and equality — Submissions relating to inadmissibility of claim — Not to cross threshold of jurisdictional and admissibility phase into merits*.

1 In its reply to the first preliminary objection by Nigeria that the Court has not been invested with jurisdiction to entertain the Application by Cameroon, as the condition precedent for the Applicant to invoke Article 36, paragraph 2, of the Statute had not been met, the Court, in rejecting the objection, held that the manner in which Cameroon's Application was lodged was not contrary to Article 36 of the Statute, nor was it made in violation of any right which Nigeria may claim under the Statute or by virtue of its Declaration; and that in any event it has jurisdiction to pass upon Cameroon's Application. Since I strongly disagree with the holding that the manner of lodging the Application was consistent with the mandatory requirements of Article 36 of the Statute, that it was not made in violation of Nigeria's rights under the Statute, and that in any event the Court has jurisdiction to pass upon Cameroon's Application, I feel it incumbent upon me to set out the basis of my disagreement.

2 My view is that, in order to invoke the jurisdiction of the Court under Article 36, paragraph 2, of the Statute, two mandatory requirements must have been fulfilled. First, a State must have made a declaration that it recognizes as compulsory *ipso facto* and without special agreement, in relation to any other State accepting the same obligation, the jurisdiction of the Court in all legal disputes which fall under that provision. Second, such a declaration should be deposited with the Secretary–General of the United Nations, who is obliged to transmit copies thereof to the parties to the Statute and to the Registrar of the Court.

3 Nigeria, in its first preliminary objection, stated that it had accepted the Court's jurisdiction under Article 36, paragraph 2, of the Statute on 14 August 1965, and had deposited a declaration to that effect with the Secretary–General of the United Nations on 3 September 1965; Cameroon had done likewise on 3 March 1994, and copies were transmitted by the Secretary–General of the United Nations to the parties to the Statute eleven–and–a–half months later, prior to which Cameroon had lodged its Application with the Court on 29 March 1994 instituting the present action. Nigeria claimed that it had no knowledge that Cameroon had deposited a declaration under Article 36, paragraph 2, until it was informed by the Registrar of the lodging of Cameroon's Application. In the light of the foregoing, it submitted that the requirements of Article 36, paragraph 2, read with its own Declaration, had not been satisfied when Cameroon lodged its Application, in other words, that Cameroon had acted prematurely and had not satisfied the conditions necessary for the Court to be invested with jurisdiction; and that the Court accordingly lacks jurisdiction to entertain the Application.

4 As stated earlier, the Court rejected this line of reasoning and reached the conclusion that it has jurisdiction to pass upon Cameroon's Application. In reaching this conclusion, the Court overwhelmingly and substantively relied on the Judgment it had rendered in the case concerning *Right of Passage over Indian Territory (Preliminary Objections, I.C.J. Reports 1957*, p. 125).

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

5 While it is understandable that the Court should seek guidance from its previous decisions, one of the disturbing aspects of the present Judgment would seem to be the reluctance or disinclination on the part of the Court to undertake a juristic and judicial enquiry or examination of the meaning of Article 36 of the Statute — the meaning of which has been in contention between the two Parties in this first preliminary objection. To reinforce and justify its overwhelming reliance on the *Right of Passage* case, the Court in turn cited those cases which had been decided on the basis of the decision in the *Right of Passage* case, as justification for its reasoning in the present case. I am not sure whether in fact much has been gained in terms of legal clarity or in the dispensation of justice by this method of judicial accretion, as a judicial response to this particular legal problem. To illustrate the point, the Court commenced its Judgment by quoting Article 36, paragraphs 2 and 4, of the Statute and proceeded immediately to quote with approval a passage of the Court's Judgment in the *Right of Passage* case, as follows, that:

> "by the deposit of its Declaration of Acceptance with the Secretary–General, the accepting State becomes a Party to the system of the Optional Clause in relation to the other declarant States, with all the rights and obligations deriving from Article 36. The contractual relation between the Parties and the compulsory jurisdiction of the Court resulting therefrom are established, '*ipso facto* and without special agreement', by the fact of the making of the Declaration … For it is on that very day that the consensual bond, which is the basis of the Optional Clause, comes into being between the States concerned." (*Right of Passage over Indian Territory, Preliminary Objections, Judgment, I.C.J. Reports 1957*, p. 146.)

6 The Court further quoted from that Judgment and stated with approval that the State making the Declaration

> "is not concerned with the duty of the Secretary–General or the manner of its fulfilment. The legal effect of a Declaration does not depend upon subsequent action or inaction of the Secretary–General. Moreover, unlike some other instruments, Article 36 provides for no additional requirement, for instance, that the information transmitted by the Secretary–General must reach the Parties to the Statute, or that some period must elapse subsequent to the deposit of the Declaration before it can become effective. Any such requirement would introduce an element of uncertainty into the operation of the Optional Clause system. The Court cannot read into the Optional Clause any requirement of that nature." (*Ibid.*, pp. 146–147.)

7 In paragraph 27 of the present Judgment, the Court, referring to the *Right of Passage* case, stated that "this Judgment is not an isolated one", and then went on to cite a series of cases that had been decided on the basis of that case. In paragraph 28 the Court dealt with Article 59 of the Statute, and acknowledged that there should be no question of holding Nigeria to decisions reached in prior cases. But reliance on the *Right of Passage* case continued and the Court again made reference to it in paragraph 39 of the present Judgment.

8 The point which is now sought to be made is the fact that the Court did not grasp the opportunity which the present case presented, as well as the circumstances surrounding it, to carry out a juristic as well as a judicial reappraisal of Article 36 of the Statute, a provision which is not only fundamental to the two Parties in this case but also pivotal in determining whether compulsory jurisdiction has been properly invoked and the Court rightfully seised of the matter. In view of the fact that this provision is so crucial to both Parties for the establishment of the jurisdiction of the Court, and in view of the fact that the Judgment in the *Right of Passage* case not only was rendered more than 40 years ago but has been the subject of repeated calls for reconsideration, it would have been more than timely for the Court to undertake a reappraisal both of the provision of the Statute and the Judgment itself. Regrettably the Court appears to have adopted an uncritical approach to that Judgment, basing itself mainly on the Judgment to reach its decision in the present case. Whatever may be the merits or demerits of that Judgment, and many eminent scholars of the

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

jurisprudence of the Court have taken issue with it, Nigeria specifically requested the Court to review the Judgment, given the circumstances of the present case, and in the interests of justice. Since that Judgment was delivered, not only have many changes taken place in the practice of States, but international law has developed in a way which should have some bearing on the *Right of Passage* case and on the meaning of the Article. It is my view that, while the Judgment in the *Right of Passage* case bears on the present case, it should not have controlled its outcome, as it would seem to have done.

9 Moreover, it is an important principle of this Court that it does not recognize the principle of *stare decisis* — the principle of binding precedent does not apply in the Court. It is also part of the Court's jurisprudence that even when legal principles are accepted by the Court in a particular case, they are not regarded as binding upon other States or in other disputes. The Court has the power and the duty to depart from previous decisions when this is necessary and in the interests of justice. To my mind, the present case before it is just such a case.

10 With regard to this case, it should be recalled that Article 38 of the Statute provides that the Court in deciding disputes should do so in accordance with international law, and should apply:

> "**(a)** international conventions, whether general or particular, establishing rules expressly recognized by the contesting States;
>
> … … … … … … … … … . .
>
> **(d)** subject to the provisions of Article 59, judicial decisions … as subsidiary means for the determination of rules of law."

11 In other words the Article establishes a hierarchy as to the application of the law, and the Court is called upon to determine — to find out — what the existing law is in respect of the dispute before it and to apply that law. The Court has, on the whole, shown a tendency to develop the law, to interpret the law and not to consider itself burdened or bound by previous decisions.

12 It is a well–established principle of international law, and one accepted by the Court's jurisprudence, that the jurisdiction of the Court is based on consent. In other words, a State may not be compelled to submit to the jurisdiction of the Court without its consent. In this regard, for the Court to assume jurisdiction on the basis of a declaration made under Article 36 of the Statute, the Court has to ensure that jurisdiction has been conferred on it; such conferment cannot be presumed. Article 36, paragraphs 2 and 4, provide as follows:

> "**2.** The States parties to the present Statute may at any time declare that they recognize as compulsory *ipso facto* and without special agreement, in relation to any other State accepting the same obligation, the jurisdiction of the Court in all legal disputes concerning:
>
> > **(a)** the interpretation of a treaty;
> >
> > **(b)** any question of international law;
> >
> > **(c)** the existence of any fact which, if established, would constitute a breach of an international obligation;
> >
> > **(d)** the nature or extent of the reparation to be made for the breach of an international obligation.
>
> … … … … … … … … … . .
>
> **4.** Such declarations shall be deposited with the Secretary–General of the United Nations, who shall transmit copies thereof to the parties to the Statute and to the Registrar of the Court."

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

13 When this provision is interpreted and given its plain and natural meaning, it follows that, for a State to be in a position to invoke the jurisdiction of the Court, under Article 36, paragraph 2, of the Statute and to seise the Court of a matter, it must first of all have made a declaration recognizing the jurisdiction of the Court; such a declaration must have been deposited with the Secretary–General of the United Nations, who should have transmitted copies thereof to the parties to the Statute and to the Registrar of the Court.

14 In other words, when a State makes a declaration in conformity with the Article, that State not only assumes the obligations embodied in the provision, including the obligation to accept the jurisdiction of the Court, but also acknowledges that such acceptance, if the Statute is to be complied with, can only be effected after the Secretary–General has transmitted copies of the declaration, and, in the absence of such transmission, parties to the Optional Clause system cannot be aware that another State has become a party to the system. While it is true that the object and purpose of the Optional Clause system is to ensure advance acceptance of the jurisdiction of the Court, it is essentially the case that, by making a declaration, a State is not making a commitment to bring another party before the Court, but indicating a willingness to be brought before the Court. In the absence of the transmission of copies of the declaration, there will be no knowledge that the declarant State can be brought before the Court.

15 Relying on the Judgment in the *Right of Passage* case, where the Court had stated that "the legal effect of a Declaration does not depend upon subsequent action or inaction of the Secretary–General", and in a later case that

> "'The only formality required is the deposit of acceptance with the Secretary–General of the United Nations under paragraph 4 of Article 36 of the Statute.' (*I.C.J. Reports 1961*, p. 31.)" (*Military and Paramilitary Activities in and against Nicaragua (Nicaragua* v. *United States of America), Jurisdiction and Admissibility, Judgment, I.C.J. Reports 1984*, p. 412),

the Court took the view that to require transmission of a declaration, which would involve allowing a reasonable time to elapse before it could be said to take effect, would be to introduce an element of uncertainty into the operation of the Optional Clause, which in the opinion of the Court would not be helpful at a time when the intensification of State relations has multiplied the possibilities of legal disputes which are capable of being submitted to the Court. The Court would seem to read the obligation of the Secretary–General to transmit copies of a declaration to the parties to the Statute and to the Registrar as the introduction of an additional time requirement into the Optional Clause system.

16 To construe the provision in this way would mean that the obligation of the Secretary–General is not only not mandatory but even superfluous; that it is of no interest or moment whether the Secretary–General fulfils this statutory function. Not only would such a construction be contrary to the intent and clear meaning of the provision, but transmission is necessary and indispensable for the States parties to be aware that another State has made such a declaration, thereby putting in place the consensual bond necessary to establish the jurisdiction of the Court. The functional obligation of the Secretary–General is therefore not only not superfluous but is mandatory if the Optional Clause system is to operate as it was conceived. Contrary to the Court's reasoning, in my view, transmission of the declaration by the Secretary–General would ensure the avoidance of that "uncertainty" which the Court feared would be introduced if the Secretary–General were to perform his duty in the manner prescribed in the Statute of the Court. On the contrary, it can only lead to legal security for the parties to the Statute.

17 The Court, in attempting to distinguish the deposit and transmission of a declaration pursuant to Article 36, paragraph 4, of the Statute from the régime laid down for treaties by the Vienna Convention on the Law of Treaties, stated that Article 78 of the Convention is only designed to lay down the modalities according to which notifications and communications should be carried out; that the provision does not govern the conditions in which a State expresses its consent to be

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

bound and those under which a treaty comes into force. This attempted distinction, it would seem to me, missed the point of Nigeria's contention with reference to that Article. Article 78 provides as follows:

> "Except as the treaty or the present Convention otherwise provide, any notification or communication to be made by any State under the present Convention shall:
>
> … … … … … … … … … . .
>
> **(c)** if transmitted to a depositary, be considered as received by the State for which it was intended only when the latter State has been informed by the depositary …".

18 According to Nigeria, that rule "must apply to Cameroon's Declaration".

19 Nigeria had argued that, since 1957, the trend in international law has been that where a State makes a treaty–related communication to a depositary for transmission to other States, those other States are only to be considered to have received it when they have been informed of it by the depositary acting in fulfilment of its obligation to inform other States of such communications; and that, although a declaration made under Article 36, paragraph 2, of the Statute is not a treaty as such, to the extent that both Parties are in agreement that such a declaration is to be treated as a treaty, then Cameroon's Declaration, made after the Vienna Convention entered into force, is subject to that provision.

20 For the Court to dismiss this contention by saying that Article 78 *(c)* does not govern the conditions in which a State expresses its consent to be bound, and those under which a treaty comes into force, does not constitute a proper response to the submission that, as the law has developed, other States are to be deemed as having received communications relating to a treaty only if the obligation to transmit has been fulfilled. As the Court is aware, consent to be bound by a treaty can be established either upon the exchange of instruments between the States parties, on their deposit with the depositary, or on their notification to the States parties or to the depositary. In the case of multilateral treaties, to which declarations made under the Statute can be likened in nature, the law as it has developed is that transmission of a treaty cannot be deemed to have taken place until the depositary has forwarded it to the other States. It is for this reason that Articles 16 and 24 of the Vienna Convention must be construed in the light of Article 78 *(c)* of the Vienna Convention of the Law of Treaties of 1969 and the principles it enunciated. In other words, declarations made under Article 36, paragraph 2, of the Statute of the Court can only be deemed to have established the consensual link between the relevant States for the purpose of the Court's jurisdiction after they have been transmitted by the Secretary–General.

21 The Court refers to the views expressed by the International Law Commission when it was considering the problem of the deposit of an instrument with a depositary, and reached the conclusion that the act of deposit establishes the legal nexus. Those views are correct as far as the deposit of a treaty goes; they do not impair the validity of the argument that transmission is a requirement for the establishment of a consensual bond under Article 36, paragraph 2, of the Statute. The point is not that declarations are treaties, which they are not as such, but even as unilateral acts, they establish a series of bilateral engagements with other States accepting the same obligation of compulsory jurisdiction, in which the conditions, reservations and time–limit clauses are to be observed. Hence, although the rules of treaties do not apply to declarations as such, which are governed by the Statute, in particular Article 36, paragraph 4, on this point both the Statute and treaty law coincide. Article 36, paragraph 4, requires the Secretary–General to transmit copies of a declaration in order to consummate the consensual bond between parties to the Optional Clause for the jurisdiction of the Court to be established. In other words, the deposit of the declaration is the beginning of the process in meeting the conditions precedent for the jurisdiction of the Court to be established, as a declaration by itself cannot establish the Court's jurisdiction, unless and until it has been deposited and transmitted by the Secretary–General. It is

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

only after such transmission that the States that are parties or will become parties accept the consequence and recognize that there is jurisdiction between them and the State which has made the declaration.

22 Nigeria objected that Cameroon could not file an application before the Court without allowing a reasonable period to elapse "as would … have enabled the Secretary–General to take the action required of him in relation to Cameroon's Declaration of 3 March 1994". Nigeria, in advancing this view, had relied on the Court's Judgment of 26 November 1984 in the case concerning *Military and Paramilitary Activities in and against Nicaragua (Nicaragua* v. *United States of America)*, in which the Court stated that a reasonable time is required for the withdrawal of declarations under the Optional Clause. In that case the Court stated, *inter alia*, that

> "the right of immediate termination of declarations with indefinite duration is far from established. It appears from the requirements of good faith that they should be treated, by analogy, according to the law of treaties, which requires a reasonable time for withdrawal from or termination of treaties that contain no provision regarding the duration of their validity." (*I.C.J. Reports 1984*, p. 420, para. 63.)

23 The Court considers that in this case "no time period is required" to establish a consensual bond, as opposed to a withdrawal which would bring such a bond to an end. This conclusion by the Court would seem to be at variance with the evolution of the law. Nowadays, and in spite of the Judgment in the *Right of Passage* case, international legal instruments tend to impose a time period for them to take effect after they have been ratified and deposited. Moreover, the conclusion of the Court when examined closely does not appear to respond to the objection as formulated. The objection was not that a reasonable time was required for the establishment of a consensual bond, but that Cameroon should not have filed its Application before the Court without allowing a reasonable period "as would have enabled the Secretary–General to take action required of him in relation to Cameroon's Declaration of 3 March 1994". In other words, when could a State that has made a declaration under the Optional Clause seise the Court? One would have thought that both under the Statute and in conformity with legal principles, a reasonable time period would be required before the Court could be seised. In the first place, under the Statute itself, a reasonable time will be required to enable the Secretary–General to transmit copies of the Declaration to the other States parties to the Optional Clause as well as to the Registrar. Secondly, if only to prevent the allegation of bad faith, a State would surely not wish to be seen to be seising the Court so soon after it had deposited its Declaration that the Secretary–General had not had time to carry out his statutory duty.

24 Thirdly, if a reasonable time period is not to be required for the transmission of a declaration before the filing of an action, the other States parties to the Optional Clause would not be in a position of knowing that such a deposit has been made, that the declarant State is entitled to exercise its right, or that the other States parties to the Statute have had such a right conferred on them and are entitled to exercise such a right as well. Hence, in my view, both under the Statute and from a position of principle, a reasonable time is required after the deposit of a declaration before the Court may be seised. Related to this matter is Nigeria's contention that, even while continuing, during the first three months of 1994, to maintain contacts with it on boundary questions, Cameroon was in fact preparing to seise the Court. Such conduct, Nigeria contends, infringes the principle of good faith and should not be accepted.

25 While the Court acknowledged the principle of good faith as "one of the basic principles governing the creation and performance of legal obligations …", but that "it is not in itself a source of obligation where none would otherwise exist" (*Border and Transborder Armed Actions (Nicaragua* v. *Honduras), Jurisdiction and Admissibility, Judgment, I.C.J. Reports 1988*, p. 105, para. 94), it concluded that there is no specific obligation for States to inform other States parties to the Statute that they intend to subscribe or have subscribed to the Optional Clause. Cameroon was

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

not bound to inform Nigeria of its intentions. In justification of this conclusion, the Court cited with approval its statement in the *Right of Passage* case, that:

> "A State accepting the jurisdiction of the Court must expect that an Application may be filed against it before the Court by a new declarant State on the same day on which that State deposits with the Secretary–General its Declaration of Acceptance." (*Right of Passage over Indian Territory, Preliminary Objections, Judgment, I.C.J. Reports 1957*, p. 146.)

26 In my view, not only is this statement too sweeping but, if applied, the effect would be not only to make the Optional Clause system confusing, but would be a risky enterprise as well. Therefore when the Court decided to follow this dictum, which it was not bound to do, it decided the matter too simply by stating that "[t]here is no specific obligation in international law to inform other States party to the Statute that they intend to subscribe or have subscribed to the Optional Clause". Perhaps the Court could also have viewed this matter from the perspective of what it recognizes as part of its jurisprudence also, namely, the principle of good faith. As Vice–President Judge Alfaro stated, good faith "must prevail in international relations, inasmuch as inconsistency of conduct or opinion on the part of a State to the prejudice of another is incompatible with good faith" (*Temple of Preah Vihear (Cambodia* v. *Thailand), Merits, Judgment, I.C.J. Reports 1962*, p. 42).

27 Judge Sir Percy Spender thought that the principles operated

> "to prevent a State contesting before the Court a situation contrary to a clear and unequivocal representation previously made by it to another State, either expressly or impliedly, on which representation the other States was, in the circumstances, entitled to rely and in fact did rely, and as a result that other State has been prejudiced or the State making it has secured some benefit or advantage for itself" (*ibid.*, pp. 143–144).

28 While the tendency of the Court has been to apply good faith only in situations where a legal obligation is said to exist, perhaps the Court could have taken a less abstract position in applying the principle to this case. For, despite the absence of a legal obligation on a State to inform another State that it intends to subscribe to the Optional Clause, the Court could have determined whether the bilateral negotiations on boundary problems which both States had been conducting created an expressed or implied representation on which one or the other had come to rely as a means of resolving their boundary problems. Instead the Court devoted its attention to considering whether or not Nigeria was aware of Cameroon's intentions to bring the matter before the Court. Nor did the Court say what effect or value should be given to the *Journal of the United Nations* of 4 March 1994, which it had itself introduced, and which reported that Cameroon had deposited with the Secretary–General its declaration under Article 36, paragraph 2, of the Statute recognizing the compulsory jurisdiction of the Court. Is this best evidence to be substituted for the statutory obligation of the Secretary–General to transmit copies of a declaration to parties to the Statute? If that is the intention it should be pointed out that, both for reasons of principle and of practical experience, the *Journal* cannot replace the statutory duty of the Secretary–General under Article 36, paragraph 4, of the Statute. Moreover, as a matter of experience, no delegation can rely on the *Journal* alone, susceptible as it is to so many vagaries, as an official channel for the purposes of Article 36, paragraph 2, of the Statute.

29 However that may be, one cannot help but observe the inconsistency in this section of the Judgment. In paragraph 30 of the Judgment, the Court stated that the Optional Clause régime as prescribed by Article 36, paragraph 4, of the Statute is distinct from the régime laid down for treaties by the Vienna Convention. Later, however, the Court took the view that the general rule with regard to treaties equally applies to a declaration made under the Optional Clause. With respect, it cannot be both ways. As pointed out earlier, although declarations made under the Optional Clause are not to be regarded as treaties, this is not to say that the relationships which are established do not partake of the characteristics of a treaty relationship, in other words that, in certain respects, the rule governing treaty relationships would govern declarations made under the

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

Optional Clause. This is owing to the fact that, in my view, the consensual link which is eventually established between States parties is a result of the offer and acceptance of each other's declaration and is binding. Under Article 78 *(c)* of the Vienna Convention on the Law of Treaties of 1969, States are only to be deemed to have received a treaty communication such as an instrument of ratification when they have been informed of it by the depositary in the fulfilment of its obligation.

30 It seems to me that, when the Court stated in the Judgment in the *Right of Passage* case that "the day a State deposits its Declaration of Acceptance under Article 36, paragraph 2, of the Statute, a consensual bond is established with other States that have made similar or identical Declarations", this presupposes, that following the deposit of a declaration with the Secretary–General acting as a depositary, he would in turn have performed his statutory duty by transmitting copies of that declaration to the other parties. If these copies are in conformity with similar or identical declarations, the consensual bond thus established would look to the date of the deposit or the date stipulated as the date on which the bond took effect for jurisdictional title. This construction would also appear to be in harmony with Article 102 of the Charter of the United Nations, which provides as follows:

> "**1.** Every treaty and every international agreement entered into by any Member of the United Nations after the present Charter comes into force shall as soon as possible be registered with the Secretariat *and published by it*.
>
> **2.** No party to any such treaty or international agreement which has not been registered in accordance with the provisions of paragraph 1 of this Article may invoke that treaty or agreement before any organ of the United Nations." (Emphasis added.)

31 The intent of this provision "that every treaty shall be registered with the Secretariat and published by it" is, as it has been recognized, to ensure that a treaty when concluded receives publicity, as well as its contents. By parity of reasoning, when Article 36, paragraph 4, of the Statute enjoins a party to deposit its instrument of declaration with the Secretary–General, who shall transmit copies thereof, the implication is that with transmission a State is put on notice to accept such a declaration or that its declaration made previously has been accepted. It seems to me that it is only then that a consensual bond would have been established and jurisdiction would thus have been conferred on the Court. To suggest that a declaration takes effect instantaneously and automatically without transmission, as the Court has held, would deprive other States of the knowledge that such a declaration had been made, and the consensual bond necessary and indispensable for the establishment of the jurisdiction of the Court would be missing.

32 The Court also held, in paragraph 35 of the Judgment, that to allow a reasonable time which the transmission of a declaration requires for it to take effect would introduce an element of uncertainty into the Optional Clause régime. With respect, it was this rejection of a reasonable lapse of time before a declaration could take effect in the *Right of Passage* case that had an unsettling effect on that régime, albeit unintentionally. Following that Judgment, some States which had previously made a declaration under Article 36, paragraph 2, of the Statute took measures to protect themselves against the institution of surprise proceedings by introducing further reservations into their declarations, in addition to that of reciprocity. The United Kingdom, for instance, amended its declaration to include the following reservation:

> "disputes in respect of which any other Party to the dispute has accepted the compulsory jurisdiction of the International Court of Justice only in relation to or for the purpose of the dispute; or where the acceptance of the Court's compulsory jurisdiction on behalf of any other Party to the dispute was deposited or ratified less than twelve months prior to the filing of the application bringing the dispute before the Court" (*I.C.J. Yearbook 1959–1960*, p. 255).

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

33 France, for its part, excluded disputes with any State which, at the date of the occurrence of the facts or situations giving rise to the dispute, had not accepted the compulsory jurisdiction of the Court.

34 Similar reservations have since been made by several other States to their declarations under the Optional Clause system, and the trend seems to have continued. In other words, instead of the certainty which the Court in its Judgment in the *Right of Passage* case predicted, the experience has been in the opposite direction. The Court indirectly acknowledged this when it stated in the present Judgment that

> "In order to protect itself against the filing of surprise applications, in 1965, Nigeria could have inserted in its Declaration an analogous reservation to that which the United Kingdom added to its own Declaration in 1958. Ten or so other States proceeded in this way. Nigeria did not do so." (Para. 45.)

In other words the Court is saying that a declaration under Article 36, paragraph 2, of the Statute involves risks for a State and that, as a result of its decision in the *Right of Passage* case, States have found it necessary and are deeming it necessary, in order to protect themselves against surprise applications, to take measures which they had not understood Article 36, paragraph 4, to entail when they first deposited their declarations.

35 It is also Nigeria's contention that, when Cameroon filed its Application on 3 March 1994, it acted prematurely and so failed to satisfy the requirement of reciprocity as a condition to be met before the jurisdiction of the Court under Article 36, paragraph 2, of the Statute could be invoked against it. Nigeria further contended that, for the consensual bond to exist between it and Cameroon under Article 36, paragraph 2, invoking the jurisdiction of the Court implies that there must exist not only "coincidence" and "reciprocity", but mutuality as well, so that each would be in the same position vis–à–vis the other as that other is in relation to itself. Nigeria further claimed that, at the time Cameroon instituted its proceedings, it was in ignorance of any possibility of instituting proceedings against Cameroon; that ignorance, it claimed, resulted in the lack of reciprocity. Nigeria also claimed that the haste with which Cameroon filed its Application affected its position adversely, including its position as a Respondent before this Court, since the resources it has had to devote to these proceedings, both now and at the earlier interim measures phase, and the harassment which it has suffered from Cameroon on the international plane, have had a clear and substantial material dimension.

36 In answer to this contention, the Court stated, *inter alia*, and referred to its dictum in the *Right of Passage* case, that "'the principle of reciprocity is not affected by any delay in the receipt of copies of the Declaration by the Parties to the Statute' (*Right of Passage over Indian Territory, Preliminary Objections, Judgment, I.C.J. Reports 1957*, p. 147" (Judgment, para. 43).

37 Such response, with respect, does not seem to meet this particular objection of Nigeria. As I understand it, the complaint is not about the delay as such, but one of substance, namely, that reciprocity under the Optional Clause should ensure jurisdictional equality. To the extent that an application had been filed against a Party, but one which was not in a position to invoke the jurisdiction of the Court had it felt the need to do so — to that extent, the jurisdictional equality which should exist between the two Parties had not existed. Nigeria claims that, until it was informed by the Registrar of the Application filed by Cameroon, it was not in a position to file a claim against Cameroon, as it could not have been aware that Cameroon had become a party to the Optional Clause system. It seems as if the proviso had envisaged this problem and solved it by enjoining the Secretary–General to perform his statutory function of transmitting a declaration, and, since this would allow for the receipt or acceptance of that declaration, reciprocal equality between the Parties would have thus been established.

38 It may be argued that the lapse of a reasonable time before a declaration would be allowed to

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

take effect would allow a State to modify its declaration. The customary norm governing the modification is that a declaration cannot be modified after a dispute has developed. According to the Court, as stated in the *Nottebohm* case:

> "At the time when the Application was filed, the Declarations of Guatemala and of Liechtenstein were both in force. The regularity of the seising of the Court by this Application has not been disputed. The subsequent lapse of the Declaration of Guatemala, by reason of the expiry of the period for which it was subscribed, cannot invalidate the Application if the latter was regular: consequently, the lapse of the Declaration cannot deprive the Court of the jurisdiction which resulted from the combined application of Article 36 of the Statute and the two Declarations.
>
> … … … … … … … … … . .
>
> An extrinsic fact such as the subsequent lapse of the Declaration … by denunciation, cannot deprive the Court of the jurisdiction already established." (*Nottebohm, Preliminary Objection, Judgment, I.C.J. Reports 1953*, pp. 122–123.)

39 To sum up on this point, since Nigeria's Declaration under Article 36, paragraph 2, of the Statute was based on reciprocity, for there to have been reciprocal equality with Cameroon, Nigeria should have been in a position in which, had it wanted to invoke the jurisdiction of the Court at the same time as Cameroon filed its Application, it would have been able to do so. According to the material before the Court, it was not in a position to exercise such a right had it wished to do so, hence the element of reciprocal equality and mutuality was absent. The jurisdiction of the Court cannot be imposed on a State against its clearly expressed will.

40 Nigeria, in its submissions, had also asked the Court to declare that the claims brought by the Republic of Cameroon are inadmissible to the extent specified in the preliminary objections an objection based on law and fact; in other words for the Court to rule on the Application other than on its ultimate merits.

41 In my view, while making such a ruling, one way or the other, the Court should have resisted the temptation of what could be read as taking a position on the merits of the matter, which is still in the preliminary objection phase. As I understand the material presented to the Court, to rule on whether the entire boundary between the countries is contested or whether or not the Court is in a position to delimit the maritime boundary when the rights of third countries could be involved would not have required entering into the merits of the dispute. In paragraph 109 of the Judgment the Court should have made it clear that the Court's jurisdiction cannot be established on the basis of a declaration made under Article 36, paragraph 2, of the Statute, if such a declaration would be contrary to the provisions of or obligations undertaken in a prior treaty otherwise than in conditions laid down in that treaty. On the other hand, I am constrained to note that, by some of its holdings, the Court would appear to have gone too far in taking positions which may appear prejudicial when it reaches the merits phase of the matter and would in that regard have crossed the threshold on a matter which is still at the jurisdictional and admissibility phase. There is a general recognition in the jurisprudence of the Court that, during the preliminary phase of a matter before it, the Court could not pre–empt — even in a remote way — its order, judgment or advisory opinion on the merits of a case when deciding questions of jurisdiction.

Conclusion

42 In view of the reasons which I have advanced above, I regret that I cannot support the Court's holding that it has jurisdiction to pass on Cameroon's Application. The decision of the Court should have been governed by the provisions of the Statute. Jurisdiction cannot be imposed on a State contrary to the clearly expressed provision of the Statute. The Court should not have allowed its decision to be governed by the Judgment in the *Right of Passage* case. It is also a matter of regret

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

that the Court did not take this opportunity to review the decision in the *Right of Passage* case.

(Signed) Abdul G. Koroma.

Dissenting Opinion of Judge Ajibola

Judge Ajibola

Introduction: Why the case concerning Right of Passage over Indian Territory *should be revisited*.

First preliminary objection — Why the Court should not reject it — Questions of reciprocity — Need to re–examine the requirements of Article 36 (2) and (4) of the *Statute — Contractual concept of good faith — Element of surprise and "unfriendly" act — Analysis and comparison of the* Right of Passage over Indian Territory *case vis–à–vis this case — Differences and issue of precedent — Other compelling considerations*.

Third preliminary objection — Reason for disagreement with the decision of the Court — Competence of Lake Chad Basin Commission — Whether LCBC is a regional agency within the meaning of Article 52 of the Charter — Whether LCBC is a tribunal within the meaning of Article 95 of the Charter.

Fourth preliminary objection and reason for voting in favour.

Fifth preliminary objection and reason for voting against the decision of the majority Members of the Court — Failure by the Court to address this objection as framed by Nigeria.

Sixth preliminary objection and reason for voting against the decision of the Court.

Seventh preliminary objection and reason for voting in favour of upholding the second part of Nigeria's objection — Application and interpretation of Articles 74 and 83 of the United Nations Convention on the Law of the Sea.

Eighth preliminary objection and reason for voting against the decision of the Court.

Reasons for voting in favour of the decision of the majority Members of the Court on the second preliminary objection and the first part of the seventh preliminary objection.

Conclusion: The need for the Parties to come to Court by way of special agreement — Need for caution.

Introduction

1 The first preliminary objection of Nigeria, filed on 17 December 1995 in this case, gives the Court another opportunity once more to examine critically its case–law on the provision in Article 36 (2) of the Statute, and more particularly Article 36 (4), which deals with the question of the Optional Clause as it relates to the jurisdiction of the Court. Unfortunately, the Court decided to follow its case–law in the *Right of Passage over Indian Territory* case of 1957, which I strongly disagree with; hence my basic reason for appending this dissenting opinion to the Judgment of the Court. But in addition to disagreeing with the Court with respect to its decision on the first preliminary objection of Nigeria, in which this case–law — decided over 40 years ago — was reaffirmed, I also express my disagreement with the decision reached by the Court on six other preliminary objections raised by Nigeria.

I. The First Preliminary Objection

2 The first preliminary objection of Nigeria is the most important objection addressed to the Court,

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

and was extensively argued by both Parties. In fact, if the objection had been accepted by the Court, it would have disposed of the entirety of the Applications of Cameroon, filed on 29 March 1994 and 6 June 1994 respectively, and in my view the Court ought to have dismissed the Applications on the basis of this objection.

3 It appears to me that this first preliminary objection is fundamental and that it goes to the very root of Cameroon's Application. The objection essentially concerns the interpretation of the requirements of paragraphs 2 and 4 of Article 36 of the Statute of the Court. In order to reach a decision on whether this preliminary objection should be rejected or upheld, some relevant issues raised by Nigeria and Cameroon in their respective arguments and presentations require examination.

4 Among these issues are:

1. Reciprocity or coincidence as expressed in Article 36 (2) in the phrase "in relation to any other State accepting the same obligation", and the use of the word "reciprocity" in the Optional Clause Declaration of Nigeria .

2. The question of good faith and the element of surprise.

3. The requirements contained in Article 36 (4) of the Statute of the Court , namely:

   > "Such declarations shall be *deposited* with the Secretary–General of the United Nations, who shall *transmit* copies thereof to the parties to the Statute and to the Registrar of the Court." (Emphasis added.)

4. The Judgment in the case concerning *Right of Passage over Indian Territory* (*I.C.J. Reports 1957,* p. 125).

A. Reciprocity

5 The argument of Nigeria is that Cameroon, in lodging

> "its Application on 29 March, acted prematurely and so failed to satisfy the requirement of reciprocity as a condition to be met before the jurisdiction of the Court can be invoked against Nigeria" (CR 98/1, p. 29).

6 Cameroon lodged its Optional Clause Declaration on 3 March 1994 and filed its Application three weeks thereafter (i.e., on 29 March 1994), whereas Nigeria had accepted the Court's jurisdiction under Article 36 (2) of the Statute as far back as 14 August 1965.

7 The argument of Cameroon is that this objection raised by Nigeria is "untenable". Cameroon argues that:

> "According to international law pertinent in the matter as well as the firm jurisprudence of this Court, a State party to the system of the Optional Clause may bring a case against another State party to that system immediately after the deposit of its declaration of acceptance with the Secretary–General of the United Nations." (CR 98/3, p. 47, para. 54.)

It should be noted, in this preliminary objection, that there are two aspects with regard to the use and application of the word "reciprocity": the "statutory reciprocity" embodied in Article 36 (2) of the Statute of the Court (i.e., "in relation to any other State accepting the same obligation") and the word "reciprocity" as used by Nigeria in its Optional Clause Declaration, wherein Nigeria recognizes "as compulsory *ipso facto* and without special agreement, in relation to any other State accepting the same obligation, that is to say, on the sole condition of *reciprocity* …" (emphasis added). Therefore, in order for Cameroon to invoke the jurisdiction of the Court against Nigeria it must clear the two hurdles: *(a)* by satisfying the request for "reciprocity" indicated by Nigeria and

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

also *(b)* by satisfying the “statutory reciprocity” under Article 36 (2) of the Statute.

8 A careful examination of Nigeria's Optional Clause Declaration has been the subject of arguments by counsel on both sides and each has given different interpretations to the use of the word “reciprocity”.

9 However, if words are to be given their ordinary meaning, Nigeria's Optional Clause Declaration contains a clear expression of reciprocity in terms of *coincidence*, when it states, *inter alia*, “in relation to any other State accepting the same obligation”, and another requirement of reciprocity when it declares “on the sole condition of reciprocity”. The former requirement is worded exactly as in Article 36 (2) of the Statute of the Court. It is therefore not enough for Cameroon to have attempted to satisfy the statutory requirement of reciprocity by filing its own Optional Clause Declaration as Nigeria had done in 1965; it must also have ensured that the same was done in good faith and not surreptitiously.

10 What is surreptitious about Cameroon's action? It is its failure to notify Nigeria formally (perhaps by a diplomatic note) of its intention to file this case before the Court. After all, both Parties are neighbours. There are arguments on both sides that somehow Nigeria knew about the proposed action of Cameroon, that it was announced in the media and discussed in some other forums like meetings of the Organization of African Unity. This appears to me to beg the question. Nigeria ought to have been formally notified; in my view, this is an apparent prerequisite which Cameroon cannot ignore and which will later be elaborated upon.

B. The Requirement of Article 36 (4) of the Statute of the Court

11 Article 36 (4) makes it mandatory for any State filing its Declaration to deposit the same with the Secretary–General of the United Nations. The Secretary–General *shall* in turn transmit copies thereof to the parties to the Statute and to the Court's Registrar. This paragraph was added to Article 36 during the deliberations stage in Committee IV/1 at the San Francisco Conference.

12 Shabtai Rosenne, in *The Law and Practice of the International Court, 1920–1996*, referred to the commentary of Hudson on this particular point. Hudson considered, “that the insertion of this provision into the Statute was a ‘detail of housekeeping but one which, in view of uncertainties which had arisen, might prove to be useful’” (Vol. II, p. 753). Neither Party denies that such a declaration falls within the provision in Article 102 of the Charter of the United Nations, which also requires the registration of such documents with the Secretariat. The issue here is not that Cameroon failed to register the Optional Clause Declaration with the Secretary–General but that the Declaration was not transmitted to Nigeria until nearly one year later. What then is the consequence of this lapse, having regard to the fact that Nigeria demands reciprocity? Of course, Nigeria's Optional Clause Declaration had since 1965 been communicated to all Members of the United Nations, including Cameroon, and had been published since then. Reciprocity in this context requires that Nigeria should have been informed about Cameroon's Optional Clause Declaration before its Application was filed with the Court, to avoid being surprised and to be assured that Cameroon had acted in good faith.

C. The Contractual Concept

13 In its Judgment in the *Right of Passage* case in 1957, the Court observed that by merely depositing its declaration of acceptance with the Secretary–General of the United Nations, the accepting State automatically becomes a party to the Optional Clause system in relation to any other declarant State. The Court employed the word “contractual” and stated that: “The contractual relation between the Parties and the compulsory jurisdiction of the Court resulting therefrom are established …” (*Right of Passage over Indian Territory, Preliminary Objections, Judgment, I.C.J. Reports 1957*, p. 146.) If, therefore, such a deposit of a declaration of acceptance is considered to be an *offer* to States parties to the Statute which have not yet deposited their

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

declarations, the important question is when (*ratione personae* and *ratione temporis*) can it be said that such an offer has been accepted by a new declarant State? The decision of the Court in 1957 and in all other similar cases, like the *Temple of Preah Vihear* case, is that such an offer is deemed to have been accepted on the date of the deposit of the new acceptance declaration with the Secretary–General of the United Nations.

14 The Court stated in this case that:

> "The only formality required is the deposit of the acceptance with the Secretary–General of the United Nations under paragraph 4 of Article 36 of the Statute." (*Temple of Preah Vihear, Preliminary Objections, Judgment, I.C.J. Reports 1961*, p. 31.)

Although the subject of formation of contracts by correspondence varies from one domestic legal system to another, it is nevertheless indisputable that an offer must be communicated to the offeree before a contract can be considered binding. Judge Badawi, in his dissenting opinion in the *Right of Passage* case, confirmed this view when he observed:

> "Whatever that moment may be, the position in the present case is that, in any event, and whatever criterion or moment may be adopted with regard to the formation of a contract by correspondence, it was prior to that moment. The present case is similar to one in which there is an offer which has not yet been dispatched." (*Right of Passage over Indian Territory, Preliminary Objections, Judgment, I.C.J. Reports 1957*, p. 157.)

15 It is difficult to perceive of a situation whereby a contract is considered as binding on a party when that party is unaware of the content and terms of that contract. There is therefore a cardinal prerequisite condition that the other party be notified that its offer had been accepted. This is the obvious omission in this case. Nigeria was not informed about Cameroon's Declaration before it (Cameroon) filed its Application before the Court. Further, in his dissenting opinion, Judge Badawi concluded that: "The offer by Portugal, contained in its Declaration and addressed to the other States, had not been accepted by India or, indeed, communicated to India." (*Ibid.,* p. 156.)

16 When the Court was called upon by India in 1957 to decide on its preliminary objections, two vital issues of substance (and not of procedure) were invoked in interpreting the provision in Article 36 (4); both conditions are patently mandatory because in both cases the word used in the Article is "shall". On the first condition, the Court rightly decided that the declaration must be deposited by the declarant State with the Secretary–General of the United Nations. But the Court failed to require compliance with the second prerequisite condition, that is to "transmit copies thereof to the parties to the Statute and to the Registrar of the Court". This also is a condition precedent which the declarant State must comply with before it can validly invoke the jurisdiction of this Court. There is no other ordinary meaning or interpretation (in accordance with Article 31 of the 1969 Vienna Convention on the Law of Treaties) that would ensure that both conditions are given the same interpretation and meaning. Such a transmission is the only valid and binding means of official notification to other States parties, and in this case to Nigeria. To enable Cameroon to file a proper application before the Court there is essentially the need for Nigeria to have been notified of Cameroon's Declaration, but which was not done until eleven–and–a–half months thereafter, by which time Cameroon had filed its Application. Regrettably the Court has consistently followed its 1957 decision for over forty years, on the basis on this case–law in *Right of Passage over Indian Territory*.

17 The reasoning of the Court that the requirement of transmission is purely procedural was based on the view that to state otherwise could bring about uncertainty as to the moment when jurisdiction can be invoked. But all that is required of the declarant State is to ensure from the Office of the Secretary–General of the United Nations that this condition of transmission has been met by the Secretariat before filing its application, just as it should ensure that its instrument of declaration had been properly deposited with the Secretary–General. A declarant State which knows that the

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

condition of transmission is a prerequisite, like the deposit, would ascertain that both conditions have been fulfilled before filing its application; in my view, the issue of uncertainty can thereby be disposed of without much waste of time. If the requirement of transmission is made compulsory, the declarant State would nevertheless comply with both conditions by making the necessary enquiry with the Secretary–General of the United Nations.

18 One other point that could have persuaded the Court in 1957 to decide that the issue of transmission is merely procedural concerned the nature of India's Declaration of Acceptance of 28 February 1940, in which it accepted the jurisdiction of the Court for a specified period "from today's date". This is the obvious difference between the case on *Right of Passage over Indian Territory* and the present case. Nigeria's Declaration is based on reciprocity and as such it is essential that it be given due notice and effect.

D. Good Faith and the Element of Surprise

19 It is Nigeria's argument that Cameroon's Application to the Court came as a surprise and was perhaps filed in a clandestine manner. Nigeria further alleges the absence of good faith on the part of Cameroon. Cameroon denies all these accusations and states that Nigeria was informed about Cameroon's intention to bring the action before the Court. Cameroon refers to an earlier meeting where it mentions arbitration as a means of resolving the dispute.

20 Since 1957, when the Court decided the case on *Right of Passage over Indian Territory*, the doctrine of good faith in international law has further developed considerably. There is the Friendly Relations Declaration of the General Assembly of 1970 (General Assembly resolution 2625 (XXV)), which enjoins States to fulfil in *good faith* obligations assumed by them in accordance with the Charter. Article 26 of the Vienna Convention on the Law of Treaties of 1969 also provides that "every treaty in force is binding upon the parties to it and must be performed by them in good faith". The Charter of the United Nations, in paragraph 2 of its Article 2, requires that Members shall fulfil in good faith their obligations under the Charter. The Court has also made reference to the principle of good faith in much of its case–law. In 1974, in the case concerning *Nuclear Tests (New Zealand* v. *France)*, the Court observed that:

> "One of the basic principles governing the creation and performance of legal obligations, whatever their source, is the principle of good faith. Trust and confidence are inherent in international co–operation, in particular in an age when this co–operation in many fields is becoming increasingly essential." (*I.C.J. Reports 1974*, p. 473, para. 49.)

21 One issue of good faith that is very relevant to this particular preliminary objection is the case concerning *Military and Paramilitary Activities*. In this case, the United States purported to act on 6 April 1984 in such a way as to modify its 1946 Declaration, which in fact sufficiently and immediately barred the Application filed by Nicaragua on 9 April 1984. (Nicaragua had filed its Optional Clause Declaration on 24 September 1929.)

22 In that case, the Court found that there was sufficient basis for its jurisdiction. In its Judgment, the Court observed as follows:

> "But the right of immediate termination of declarations with indefinite duration is far from established. It appears from the requirements of good faith that they should be treated, by analogy, according to the law of treaties, *which requires a reasonable time for withdrawal from or termination of treaties that contain no provision regarding the duration of their validity*. Since Nicaragua has in fact not manifested any intention to withdraw its own declaration, the question of what reasonable period of notice would legally be required does not need to be further examined: it need only be observed that from 6 to 9 April would not amount to a 'reasonable time'." (*Military and Paramilitary Activities in and against Nicaragua (Nicaragua* v. *United States of America), Jurisdiction and Admissibility,*

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

Judgment, I.C.J. Reports 1984, p. 420; emphasis added.)

23 If therefore the Court has moved a step ahead since pronouncing its Judgment in 1957 in the *Right of Passage* case by accepting the requirement of good faith as a prerequisite for the termination of an Optional Clause declaration, it stands to reason that it could now move further and do the same in this case.

24 It is the view of the Court that the principle of good faith plays an important role in Optional Clause declarations with regard to reciprocity.

25 The Court observed further in the same *Nicaragua* case that:

> "In fact, the declarations, even though they are unilateral acts, establish a series of bilateral engagements with other States accepting the same obligation of compulsory jurisdiction, in which the conditions, reservations and time–limit clauses are taken into consideration. *In the establishment of this network of engagements, which constitutes the Optional Clause system, the principle of good faith plays an important role; the Court has emphasized the need in international relations for respect for good faith and confidence in particularly unambiguous terms* ..." (*Military and Paramilitary Activities in and against Nicaragua (Nigaragua* v. *United States of America), Jurisdiction and Admissibility, Judgment, I.C.J. Reports 1984,* p. 418; emphasis added.)

26 If, *ex hypothesi,* Nigeria, being aware of the fact that Cameroon was about to file its Application on 29 March 1994 had withdrawn its Optional Clause Declaration, say on 26 March 1994, putting Cameroon in a situation similar to that of Nicaragua, the Court would have decided that Nigeria did not act in good faith and that such withdrawal would not invalidate the Application of Cameroon. The Court is now being asked to deal with "the other side of the coin" and, in my opinion, it ought to give a "reciprocal judgment" by rejecting the Application of Cameroon as an application filed *mala fide*.

27 It has been strongly canvassed by Cameroon that instituting proceedings before the Court cannot be considered an unfriendly act. However, it is the practice among States that cases are addressed to the Court when negotiation and agreement have failed. It is not unusual for States to consider litigation as an unfriendly act especially in the absence of a Special Agreement. A good example is found in the steps taken by Peru and Colombia in the *Asylum* case of 1950, before the Application was eventually filed by Colombia on 15 October 1949. The "Act of Lima" agreement signed on 31 August 1949, which permits either of the parties to file its application before the Court, states in its second paragraph thus:

> "The Plenipotentiaries of Peru and Colombia having been unable to reach an agreement on the terms in which they might refer the dispute jointly to the International Court of Justice, agree that proceedings before the recognized jurisdiction of the Court may be instituted on the application of either of the Parties without this being regarded as *an unfriendly act toward the other, or as an act likely to affect the good relations between the two countries*. The Party exercising this right *shall, with reasonable advance notice, announce in a friendly way to the other Party the date on which the application is to be made*." *(Asylum, Judgment, I.C.J. Reports 1950*, p. 268; emphasis added.)

It is therefore not unusual for a State to consider an application filed with the Court as "unfriendly" when the same is done without notice from the applicant or from other expected sources.

E. The Case Concerning Right of Passage over Indian Territory

28 Two points have to be considered under this heading:

(a) that the present case is easily distinguishable from the *Right of Passage* case;

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

(b) that, even if it is not distinguishable from the *Right of Passage* case, the Court ought not to follow that precedent.

(a) The differences

29 First, it can be clearly observed that the issue of good faith was not strongly canvassed by India, whereas in Nigeria's case absence of good faith on the part of Cameroon was strongly argued on the basis of the available facts and the law.

30 Secondly, on 28 February 1940, when India made its Optional Clause Declaration, it accepted the jurisdiction of the Court for a specified period "from today's date" (*Right of Passage over Indian Territory, Preliminary Objections, Judgment, I.C.J. Reports 1957*, p. 146). There is no such provision in Nigeria's Declaration; on the contrary it demands reciprocity from any declarant State.

31 The issue of reciprocity was not strongly canvassed by India, unlike Nigeria, and as a result the Court did not put much emphasis on it. The situation in the present case is different from the situation in the *Right of Passage* case, which concerned certain enclaves in India, the right of passage to which Portugal claimed. In the present case Cameroon is seeking a determination of all its land and maritime boundaries with Nigeria. Again in the present case, third States' rights are involved. In the Lake Chad area the interests of Chad and Niger are involved, and within the maritime area the interests of Equatorial Guinea, Sao Tome and Principe, and Gabon are involved.

(b) The issue of precedent

32 As a prelude to his book *Precedent in the World Court*, Judge Mohamed Shahabuddeen writes:

> "Decisions of the International Court of Justice are almost as replete with references to precedent as are decisions of a common law court. *Even though previous decisions are not binding, the Court relies upon them as authoritative expressions of its views on decided points of law*." (Emphasis added.)

33 The principle of *stare decisis* does not apply in this Court and, that being so, it has no rule of precedent. Article 59 of the Court's Statute expressly states that a decision of the Court is only binding between the parties and in respect of that particular case. Article 62 of the Statute permits a State which considers that it has an interest of a legal nature which may be affected by the decision of the Court in a particular case to file a request to the Court for permission to intervene.

34 In practice, however, the Court in most cases relies upon and follows its previous decisions.

35 While that practice is desirable in order to ensure some degree of certainty in the jurisprudence of the Court, there are occasions when it is necessary for the Court, for one reason or the other, not to follow its previous decisions. The present case is just such a case.

36 This latter practice is not unknown in the Court and had been employed in a few cases: in the case concerning *Interpretation of Peace Treaties with Bulgaria, Hungary and Romania* the Court declined to follow the strict rule which it had laid down in the *Status of Eastern Carelia* case regarding the rendering of an advisory opinion. Similarly, in the *Barcelona Traction* case the Court did not follow its decision in the *Nottebohm* case on the issue of diplomatic protection.

37 Of recent, Shabtai Rosenne has taken a keen interest in cases connected with Optional Clause declarations under Article 36 (4) vis–à–vis the *Right of Passage* case. He observed in his recent publication, *An International Law Miscellany*:

> "In the present Court this litigation tactic has been followed in five cases of high political implication: *Nuclear Tests (Australia* v. *France)* case, the *Aegean Sea Continental Shelf* case, the *Military and Paramilitary Activities in and against Nicaragua* case, and the two cases *Questions of Interpretation and Application of the 1971 Montreal Convention*

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

> *arising from the Aerial Incident at Lockerbie*. What is more, in all of these cases the phenomenon of the ‘unwilling respondent’ (in the first and third, a permanent member of the Security Council) was encountered, and in the first two of those cases, that unwilling respondent refused to have any part in the proceedings, all adding to the difficulties of jurisdiction and admissibility.
>
> The existence of this well–established procedure coupled with the last five precedents raises serious doubts about the continued unchecked application of the doctrine accepted by the Court in the *Right of Passage* case. Paragraph 4 was inserted into Article 36 of the Statute at the San Francisco Conference almost as a matter of routine, and like any text it is open to more than one interpretation. Since then, important developments have taken place both as regards the general law of the depositary of multilateral instruments, formulated for the first time (as stated) in the Vienna Conventions, and in State practice as exemplified in the cases mentioned.” (P. 92.)

And finally he offered some suggestions, as follows:

> “The question can be asked whether what has occurred since the *Right of Passage* case does not justify a reconsideration of the doctrine of that case should an opportunity to do so present itself. At all events, it is to be hoped that should occasion arise for a revision of the Statute, more attention will be paid to the implications of Article 36, paragraph 4, than was given in 1945, and that a method will be found to protect States which have accepted the jurisdiction under paragraph 2 from the surprise deposit of a declaration in New York and the immediate institution of proceedings accompanied by a request for the indication of interim measures of protection before the respondent can be (not ‘is’) aware that the declaration has been deposited; and that the provisions regarding the making of declarations, their modification and their termination and other related instruments, will be co–ordinated with what is now established law and practice regarding the exercise of the functions of the depositary of multilateral treaties and other international instruments.” (Rosenne, *op. cit.,* pp. 92–93.)

38 From all that has been said and quoted above, it is clear that the decision in the case concerning *Right of Passage over Indian Territory* should generally be revisited and to regard such case–law as bad law, because the decision failed to take into proper consideration the second mandatory condition provided in Article 36 (4) of the Statute of the Court, namely that States parties “shall” be notified before jurisdiction can be invoked by any declarant State. Both conditions, of “deposit” and “transmission”, are mandatory, as set forth in that paragraph 4 of Article 36, which provision must be complied with by any litigant State that intends to file its application.

F. Other Compelling Considerations

39 So many circumstances of this particular case are sufficiently compelling as to persuade the Court to accept the argument of Nigeria, even on objective grounds. Firstly, Nigeria and Cameroon are neighbours and will remain so for all time, and it is therefore not in the interests of peace and good neighbourliness in that region that one Party should be dragged to the Court against its wish. The record before the Court is that both Parties are already involved in the settlement of some of the dispute. Delimitation and demarcation have been effected in some areas and it will be in bad faith that the matter is brought to the Court while other means of settlement of the Parties' dispute is pending.

40 Moreover, many cases of delimitation in land and maritime disputes have been instituted in this Court by way of Special Agreement. A very recent and successful example is the case concerning the *Territorial Dispute (Libyan Arab Jamahiriya/Chad)*, which was concluded and judgment delivered on 3 February 1994; by the end of May of that year Libya had complied with the

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

Judgment of the Court. There are ten other similar cases: *Minquiers and Ecrehos (United Kingdom/France), I.C.J. Reports 1953*, p. 47; *Sovereignty over Certain Frontier Land (Belgium/Netherlands), I.C.J. Reports 1959*, p. 209; *North Sea Continental Shelf (Federal Republic of Germany/Denmark; Federal Republic of Germany/Netherlands), I.C.J. Reports 1969*, p. 3; *Continental Shelf (Tunisia/Libyan Arab Jamahiriya), I.C.J. Reports 1982*, p. 18; *Delimitation of the Maritime Boundary in the Gulf of Maine Area (Canada/United States of America), I.C.J. Reports 1984*, p. 246; *Continental Shelf (Libyan Arab Jamahiriya/Malta), I.C.J. Reports 1985*, p. 13; *Frontier Dispute (Burkina Faso/Republic of Mali), I.C.J. Reports 1986*, p. 554; *Land, Island and Maritime Frontier Dispute (El Salvador/Honduras: Nicaragua intervening), I.C.J. Reports 1992*, p. 351; and the pending territorial disputes *Maritime Delimitation and Territorial Questions between Qatar and Bahrain and Kasikili/Sedudu Island (Botswana/Namibia)*.

41 Three further cases were instituted by unilateral application: *Temple of Preah Vihear (Cambodia* v. *Thailand), I.C.J. Reports 1962*, p. 6; *Aegean Sea Continental Shelf (Greece* v. *Turkey), I.C.J. Reports 1978*, p. 3; and *Maritime Delimitation in the Area between Greenland and Jan Mayen (Denmark* v. *Norway), I.C.J. Reports 1993*, p. 38; however, these cases deal either with maritime delimitation or with frontier disputes, but not with both as in the present case.

42 It is a well–accepted fundamental principle of international law that the jurisdiction of the Court is based on consent of the States involved. The Court echoed this view in the recent case of *Maritime Delimitation and Territorial Questions between Qatar and Bahrain*:

> "There is no doubt that the Court's jurisdiction can only be established on the basis of the will of the Parties, as evidenced by the relevant texts." (*Jurisdiction and Admissibility, Judgment, I.C.J. Reports 1995*, p. 23, para. 43.)

Rosenne also comments as follows on this same established principle:

> "There exists an uncontroverted principle of general international law according to which no State is obliged to submit any dispute with another State or to give an account of itself to any international tribunal. The agreement of the parties to the dispute is the prerequisite to adjudication on the merits." (*The Law and Practice of the International Court, 1920–1996*, Vol. II, p. 563.)

With this consensual basis of jurisdiction, it can be strongly argued in this case that unless such consent is genuinely given, and not forced, the Court should exercise judicial caution in proceeding with the case on its merits. Nigeria's objection is premised on the argument that the Application was a surprise and that Nigeria was not given the prerequisite notice either by Cameroon or by the Secretary–General of the United Nations before the Application was filed by Cameroon.

43 In a similar vein it is also important for the Court to consider the issue of justice underpinning this preliminary objection, and ask whether a jurisdiction forced on Nigeria, as an unwilling Respondent, would promote peace and good neighbourliness between the Parties and in that region. This concept of justice is not abstract; it is to be defined and determined in accordance with the provision in Article 2, paragraph 3, of the Charter. Jurisdiction is defined by Rosenne as follows:

> "Broadly speaking the expression *jurisdiction* refers to the power of the Court to 'do justice' between the litigating States, to decide the case before it with final and binding force on those States. The expression 'do justice' has been used by the Court several times, notably in the *UNAT* advisory opinion." (*The Law and Practice of the International Court, 1920–1996*, Vol. II, p. 536.)

44 It is for all the reasons stated above that I felt convinced that the Court ought to uphold the first preliminary objection of Nigeria and, therefore, dismiss the Applications of Cameroon.

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

II. The Third Preliminary Objection

45 The third preliminary objection of Nigeria is that "the settlement of boundary disputes within the Lake Chad region is subject to the exclusive competence of the Lake Chad Basin Commission" (CR 98/5, p. 64). Nigeria argues that the provisions of the Statute of the Lake Chad Basin Commission, annexed to an agreement dated 22 May 1964, are binding on the four States which are signatories to that agreement, including Cameroon. It argues further that the provisions of the Statute coupled with the agreements and other understandings between the four States parties to the Agreement are binding on them, and thus Cameroon cannot file its Application under Article 36 (2) of the Statute of the Court. The two other members of the Commission are Chad and Niger. Cameroon denies the meaning that Nigeria attaches to the function and power of the Commission. Both Parties refer to the Statute of the Commission as well as the assignments given to it by the four member States of the Commission.

46 A careful examination of the duties of the Commission is more than sufficient to confer on it the task of dealing with all the requests that are now being submitted by Cameroon to this Court. These assignments can be viewed in two parts: those that are contained in the Statute, i.e., under Article IX, paragraphs

> "**(c)** to maintain the liaison between the High Contracting parties with a view to the most effective utilization of the waters of the Basin;
>
> **(d)** to follow the progress of the execution of surveys and work in the Chad Basin as envisaged in the present Convention, and to keep the Member States informed at least once [a] year thereon, through systematic and periodic reports which each State shall submit to it;
>
> … … … … … … … … … . .
>
> **(g)** *to examine complaints and to promote the settlement of disputes and the resolution of differences*" (emphasis added),

and those that are assigned to the Commission by the authority of the member States. As evidence of this, two sub–commissions of experts were, *inter alia*, assigned to carry out the demarcation and delimitation of borders in the Lake Chad area, having as their working documents various conventions and agreements concluded between the former colonial Powers. It is important to emphasize that the sub–commissions were assigned the duty not only to delimit boundaries but also to demarcate the same. This exercise was carried out between 1989 and 1990; by 1994 the assignment had been fully completed and awaited the signing and ratification of the pertinent document by individual Heads of State. Although the document was ratified by Cameroon last year (after this case had been filed in the Court), Nigeria did not respond accordingly, presumably because of the Application of Cameroon pending in the Court.

47 One important and convincing argument in favour of upholding this preliminary objection is the fact that the Commission had already carried out and completed the work that the Court is now called upon by Cameroon to carry out. The four member States are not disputing the final work of the Commission and all that is left to be done is the ratification of the resulting instrument. Apart from the fact that it is difficult, under the circumstances, to establish a case of any dispute between Nigeria and Cameroon within the Lake Chad Basin (except for Darak and adjacent islands), it can be concluded that the Parties, having submitted their claims to the Commission, are bound by its decision. The enigma, or the confusion, that might arise in this regard is the apparent bifurcation of judicial authority within the Lake Chad Basin which could occur if all the four member States agreed to ratify the Commission's instrument in the future.

48 In its further argument Nigeria refers to Article 52 of the United Nations Charter, and considers the Commission's assignment as being within the framework of regional arrangements "or agencies

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

for dealing with such matters relating to the maintenance of international peace and security as are appropriate for regional action …”. The question here is whether the Lake Chad Basin Commission can be regarded as a regional organization. In my view, the Commission can be so regarded and therefore qualifies as coming under Article 52 of the Charter. The reason for this is not far–fetched: as already mentioned, paragraph IX *(g)* of the Commission's Statute empowers the Commission to examine complaints, promote settlement of disputes and resolve differences. The maintenance of international peace and security, as stipulated in Article 52 (1) of the Charter, is in accord with the assignments conferred on the Commission by this regional group of States.

49 Another point raised by Nigeria during its argument in the oral proceedings concerns Article 95 of the United Nations Charter, which provides that:

> “Nothing in the present Charter shall prevent Members of the United Nations from entrusting the solution of their differences to other tribunals by virtue of agreements already in existence or which may be concluded in the future.”

The crucial question here is whether the Lake Chad Basin Commission is a tribunal. To my mind it is, because it is vested with all the powers, functions and duties of a tribunal and it is competent to act as one. The word “tribunal” is a generic term that encompasses various dispute settlement jurisdictions. In *Law Terminology*, a document of the United Nations, the word “tribunal” is defined as “person or body exercising adjudicatory functions outside the regular judicial system, i.e. exercising quasi–judicial functions”; tribunals are referred to as:

> “often established by statutory authority, in which case they are sometimes called statutory tribunals. Although outside the regular judicial system they are nevertheless subject to the supervisory jurisdiction of the High Court of Justice by the process of judicial review. They may be called tribunal, board, *commission*, committee or council and are divided into three categories: administrative tribunal, domestic tribunal, tribunal of enquiry …” (Emphasis added.)

After all, the assignment of the Commission includes not only the delimitation and demarcation of boundaries within the Lake Chad Basin; it also includes the function of dispute settlement and it therefore qualifies as an arbitral or administrative tribunal, as the case may be. Hence Nigeria rightly invokes the provision in Article 95 of the Charter. An examination of Article 94 of the Charter, which deals with the issue of compliance “with the decision of the International Court of Justice”, clearly distinguishes this Court from the establishment of such a tribunal as that envisaged in Article 95 as an alternative body that could be set up instead of an application being filed with the Court.

50 One point is therefore clear with regard to this preliminary objection: that the Commission had been assigned and is still seised of the duty to delimit and demarcate the boundary between both Parties in the Lake Chad Basin, and the subsequent assignment of the same work to the Court is, therefore, inadmissible. Hence my conclusion that the Court lacks jurisdiction. Furthermore, the Commission's assignment, carried out for and on behalf of the four member States, is a joint affair, apparently indivisible. Both Parties in the present case are therefore obliged to recognize and abide by the exclusive competence of the Lake Chad Basin Commission.

51 Finally on this preliminary objection, there is need for a note of caution: that the Court should not be called upon to carry out what has already been accomplished by the Parties through the Commission.

52 For all these reasons it is my view that the third preliminary objection of Nigeria should be upheld.

III. The Fourth Preliminary Objection

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

53 The Court rejects the fourth preliminary objection of Nigeria that:

> "The Court should not in these proceedings determine the boundary in Lake Chad to the extent that that boundary constitutes or is constituted by the tripoint in the Lake." (Preliminary Objections of Nigeria, Vol. I, p. 84, para. 4.12.)

However, I hold a contrary view. The reason for so doing is that, having regard to the position of the tripoint, it is difficult if not impossible to entertain the request of Cameroon.

54 Cameroon disagrees with this preliminary objection and argues that the case–law of the Court does not support the argument of Nigeria. Both Parties made mention of the *Frontier Dispute (Burkina Faso/Republic of Mali)*, where the Chamber of the Court conceded that it had jurisdiction to adjudicate on the case notwithstanding the fact that the endpoint of the frontier lies on the frontier of another, third State. The view of Cameroon is that the *Frontier Dispute* case, as well as the case of the *Territorial Dispute (Libyan Arab Jamahiriya/Chad)*, are case–law that cannot be distinguished from this present case as claimed by Nigeria.

55 As I have mentioned earlier in this opinion, a case of this nature requires the unequivocal consensus of both Parties to enable the Court to be seised of the matter. For example, both the *Frontier Dispute* and *Territorial Dispute* cases were brought before the Court by Special Agreement. Another important factor in favour of Nigeria's argument is the fact that its interests and those of Chad and Niger are interwoven within the Lake Chad Basin, in respect of which the Commission has performed its obligations of demarcation and delimitation.

56 But the position of Chad with regard to the tripoint is more relevant in this case when compared to the cases of *Frontier Dispute* and *Territorial Dispute*. Mention has been made of earlier clashes between Nigeria and Chad in the same area which might or might not affect the tripoint. It can therefore be said that the interests of Chad and to some extent those of Niger constitute the subject–matter of this case which, to my mind, cannot be heard on the merits without Chad intervening as a party. Of course the immediate answer on this could be the invocation of Article 59 of the Statute, in that the decision of the Court is binding only on the parties. However, this is a case which is in line with the cases of *East Timor (Portugal* v. *Australia)* and *Certain Phosphate Lands in Nauru (Nauru* v. *Australia)*. The earlier case of *Monetary Gold Removed from Rome* is also relevant here. The point has been made by Cameroon that its Applications relate only to the issue of the boundary between it and Nigeria. The issue here is not what Cameroon files or says but what, practically, is on the ground as to the position of the tripoint between Chad and the Parties. Quite definitely, the frontier between Cameroon and Nigeria will affect the frontier between Cameroon and Chad by virtue of the tripoint. A desirable situation that would certainly confer jurisdiction on the Court would be the seising of the Court by way of special agreement between Cameroon, Nigeria and Chad. For all these reasons my conclusion is that the fourth preliminary objection of Nigeria ought to be upheld.

IV. The Fifth Preliminary Objection

57 In my view, the Court ought to uphold the fifth preliminary objection as framed by Nigeria which regrettably it rejected, hence my disagreement with the decision of the Court. There are two important reasons which underlie my decision to take a contrary view to that of the Court: in effect the Court has failed to respond to the preliminary objection as framed and presented by Nigeria, and further the conclusions reached by the Court are contradictory in terms.

58 Nigeria in its fifth preliminary objection maintains that there is no dispute between it and Cameroon "concerning boundary delimitation as such throughout the whole length of the boundary from the tripoint in Lake Chad to the sea". It maintains that there simply is no evidence of such a dispute, either in Cameroon's original Application or in its Additional Application filed on 6 June 1994. It went further to particularize the objection as follows:

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

"(1) there is no dispute in respect of the boundary delimitation as such within Lake Chad, subject to the question of title to Darak and adjacent islands inhabited by Nigerians;

(2) there is no dispute relating to the boundary delimitation as such from the tripoint in Lake Chad to Mount Kombon;

(3) there is no dispute relating to the boundary delimitation as such between Boundary Pillar 64 on the Gamana River and Mount Kombon; and

(4) there is no dispute relating to the boundary delimitation as such between Boundary Pillar 64 on the Gamana River and the sea" (Preliminary Objections of Nigeria, Vol. I, p. 87).

Cameroon denies the assertion of Nigeria and argues that in fact there are not only disputes within the Lake Chad Basin area and on the frontier to the sea but that there are also maritime delimitation disputes. The question put to Nigeria by the Court was not limited to the land boundary but speaks of the whole boundary. Consequently, in the conclusion reached by the Court, its finding is that there is a dispute between the Parties concerning the "boundary as a whole". It is thus clear that, strictly speaking, the fifth preliminary objection of Nigeria as put before the Court has not been specifically addressed. The Court ought to have limited itself to the preliminary objection as framed by Nigeria and therefore it cannot be said that the fifth preliminary objection of Nigeria has been properly dealt with.

59 As claimed by Nigeria there has been partial demarcation of the boundary. In fact, Nigeria points out that "something a little over 200 miles of the present boundary has been clearly demarcated by the erection of boundary pillars" (CR 98/2, p. 21). This is not denied by Cameroon. Nigeria goes further to state:

"Even taking a generous view of the extent of the boundary affected by these local incidents (say, ¼ of a mile of boundary for each 'incident') they concern, even if all of them were relevant (which they are not), perhaps some 10 or a dozen miles of its length. That cannot be taken as representing doubt or dispute as to the whole length of that 1,000–mile boundary." (CR 98/2, p. 25.)

Thus it may be concluded that, contrary to the claim of Cameroon, the area in dispute can be considered as relatively minor or even negligible. In any case, at least it is clear from the alleged facts of the incidents and disputes presented by the Parties that there is no question of the entire length of the boundary from Lake Chad to the sea being in dispute.

60 Another aspect of Nigeria's fifth preliminary objection concerns the legal and geographical scope of the boundary dispute. It appears that, in the view of the Court, Nigeria has not definitively made its position clear regarding the course of the boundary, or at least does not agree with the claim of Cameroon. Equally, the Court cannot ascertain from the answer given by Nigeria (based on the question put to it as already referred to) what is its own view of the legal scope of the dispute either now or in the future. Since Nigeria has not filed its Counter–Memorial, it is not bound to disclose its line of defence at this stage of the procedure. Hence, as concluded by the Court, "the exact scope of this dispute cannot be determined at present" (Judgment, para. 93). Yet the Court still concluded that "a dispute nevertheless exists between the two Parties, at least as regards the legal bases of the boundary" *(ibid.)*. In my view, these are contradictory statements which I do not agree with. In fact, Cameroon's claim in its Application ought to have been restricted to the disputed boundary locations and area of incidents, which amount to less than 5 per cent of the entire boundary.

61 Again, the Court ought to have restricted its Judgment to the preliminary objection as framed by

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

Nigeria, and amplified therein under the enumerated four points. Based on this view, the Court initially and rightly concluded that: "On the basis of these criteria, there can be no doubt about the existence of disputes with respect to Darak and adjacent islands, Tipsan, as well as the Peninsula of Bakassi." (Paragraph 87 of the Judgment.)

62 The Court should therefore have concerned and indeed limited itself exclusively to this clear area of boundary disputes, undenied by both Parties. This view is further confirmed by the Court when it observes:

> "All of these disputes concern the boundary between Cameroon and Nigeria. However, given the great length of that boundary, which runs over more than 1,600 km from Lake Chad to the sea, it cannot be said that these disputes in themselves concern so large a portion of the boundary that they would necessarily constitute a dispute concerning the whole of the boundary." (Para. 88.)

63 In effect, the Court on this preliminary objection considered the entire area from Lake Chad to the sea as being in dispute rather than the locations referred to by Nigeria.

64 The Court's failure to limit its decision to the preliminary objection of Nigeria as framed calls into question its Judgment in view of the *non ultra petita* rule. The Court addressed a similar matter in submissions in the *Asylum* case (*I.C.J. Reports 1950*, p. 402). It is not for the Court to expand or enlarge the scope of the preliminary objection as framed and presented by an applicant, nor is the Court called upon to modify it *suo motu*; the objection must be considered and decided upon as put forward by the Applicant in its preliminary objection.

65 For example, France and the United Kingdom, in their Special Agreement in the *Minquiers and Ecrehos* case, asked the Court to decide which of the parties owns these group of islands. The Court might perhaps have decided that the islands had the status of *"res nullius"* or of *"condominium"* (*I.C.J. Reports 1953*, p. 52), but it was obliged to restrict itself to determining "which of the Parties has produced the more convincing proof of title to one or the other of these groups, or to both of them" *(ibid.)*.

66 Rosenne, in *The Law and Practice of the International Court, 1920–1996,* is of the opinion that,

> "in principle it is the duty of the Court, in deciding on the basis of international law the disputes that are submitted to it, to limit itself to the terms of its remit — the special agreement, the submissions, or the question put for an advisory opinion, as the case may be. This — the *non ultra petita* rule — gives the parties the last word in the ability of the Court to settle their dispute." (Vol. I, p. 173.)

67 In conclusion, had the Court followed this principle and restricted itself to the content of the fifth preliminary objection, as formulated and argued by Nigeria, it might have arrived at a decision different from the one reached in regard to this objection.

68 It is for all these reasons that I have voted against the decision of the Court.

V. The Sixth Preliminary Objection

69 I voted against the decision on the sixth preliminary objection because I am convinced that Nigeria is justified in its objection that the Application filed by Cameroon does not meet the required standard of adequacy as to the facts on which its Application is based, particularly in relation to the dates, circumstances and precise locations of the alleged incursions and incidents by Nigeria, in alleged breach of its international responsibility. A careful perusal of Cameroon's Applications reveals incongruities, irregularities, imprecision and mistakes.

70 Some of these incongruities are patent from the Applications as filed on 29 March 1994 and 6

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

June 1994. With reference to the requirement to be satisfied by Cameroon, its Applications must specify,

> "as far as possible the legal grounds upon which the jurisdiction of the Court is said to be based; *it shall also specify the precise nature of the claim, together with a succinct statement of the facts and grounds on which the claim is based*" (Art. 38 (2) of the Rules; emphasis added).

While it is true that Cameroon sufficiently specified the legal grounds upon which its Applications are based, it has, however, failed to specify adequately the precise nature of the claim or to provide a "succinct statement of the facts and grounds on which the claim is based".

71 For Cameroon to invoke Nigeria's international responsibility and consequent obligation to make reparation, it is not enough for Cameroon to make general and unsubstantiated statements about incidents. Cameroon must supply full particulars of the place, the time and the nature of the alleged incidents, and also make it clear precisely how these were serious enough to call into question Nigeria's international responsibility as recognized by international law.

72 It is true, as the Court stated, that "succinct" does not mean "complete", but it connotes conciseness, and that is a requirement which Cameroon failed to satisfy in its Applications. In its oral argument Nigeria contended that

> "the respondent State, and the Court, need, as a minimum, to know four things — the essential facts about *what* is alleged to have occurred, *when* it is supposed to have taken place, precisely *where* it is supposed to have taken place (especially in relation to any relevant boundary), and *why* the Respondent is thought to bear international responsibility for the incident" (CR 98/2, p. 28).

73 In its pleadings Cameroon stated that, in order to establish Nigeria's responsibility, its Applications were only indicative of the nature of such responsibility and that the allegations contained therein would be amplified when the matter reached the merits stage.

74 However "indicative" such a statement may be, it must be sufficiently clear as to the nature of Nigeria's responsibility. And since Cameroon fails in this regard, the Court ought not to reject Nigeria's sixth preliminary objection.

VI. The Seventh Preliminary Objection

75 The seventh preliminary objection of Nigeria contends that there is "no legal dispute concerning delimitation of the maritime boundary between the two Parties which is at the present time appropriate for resolution by the Court" (Preliminary Objections of Nigeria, Vol. I, p. 113). In support of this contention Nigeria gave two reasons:

> "(1) In the first place, no determination of a maritime boundary is possible prior to the determination of title in respect of the Bakassi Peninsula.
>
> (2) Secondly, at the juncture when there is a determination of the question of title over the Bakassi Peninsula, the issues of maritime delimitation will not be admissible in the absence of sufficient action by the Parties, on a footing of equality, to effect a delimitation 'by agreement on the basis of international law'." (Preliminary Objections of Nigeria, Vol. I, p. 113.)

76 On the first reason, I agree with the conclusion reached by the Court that this is simply a question of method. It is true that the Court determines its procedure and could easily arrange its own adjudicatory process so as to ensure that the land disputes are dealt with first, before embarking on the maritime dispute. As a matter of fact, this does not appear to me as an issue of

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

preliminary objection and as such it has been rightly rejected.

77 However, I hold a contrary view to the conclusion reached by the Court on the second strand of Nigeria's seventh preliminary objection. Here the issue is an important one under international law, as it relates to the provisions of the United Nations Law of the Sea Convention of 1982. What Nigeria contends here is that the issue of maritime delimitation is inadmissible in the absence of negotiation and agreement by the Parties on a footing of equality to effect a delimitation. In other words, Nigeria alleges that Cameroon failed to seek first an attempt for a delimitation by agreement based on international law under the principles and provisions of the United Nations Convention on the Law of the Sea of 1982. The relevant provisions are Articles 74 and 83. Article 74, paragraphs 1 and 2, provides as follows:

> "**1.** The delimitation of the exclusive economic zone between States with opposite or adjacent coasts *shall be effected by agreement on the basis of international law*, as referred to in Article 38 of the Statute of the International Court of Justice, *in order to achieve an equitable solution*.
>
> **2.** If no agreement can be reached within a reasonable period of time, the States concerned shall resort to the procedures provided for in Part XV." (Emphasis added.)

Article 83, paragraphs 1 and 2, provides as follows:

> "**1.** The delimitation of the continental shelf between States with opposite or adjacent coasts *shall be effected by agreement on the basis of international law*, as referred to in Article 38 of the Statute of the International Court of Justice, *in order to achieve an equitable solution*.
>
> **2.** If no agreement can be reached within a reasonable period of time, the States concerned shall resort to the procedures provided for in Part XV." (Emphasis added.)

78 As quoted above, the provisions of the two Articles are similar, but while one deals with the exclusive economic zone (Art. 74), the other deals with the issue of the continental shelf (Art. 83). Furthermore, both Parties are signatories to the Convention, which they have also ratified. The question now is whether these provisions are binding on both of them; in my view, there is no doubt about that. Before instituting an application in this Court, it is a condition precedent that both Parties ought to attempt genuinely to agree on the settlement of their maritime boundary dispute, failing which such a matter could be brought before the Court. These are mandatory provisions for both Parties. Cameroon, for its part, contends that there was no compelling reason to negotiate nor reach an agreement before filing an application before the Court, and went further to state that attempts were made to reach an agreement but failed. While it may be true to say that there was an attempt to negotiate and agree on their maritime boundary delimitation up to point G, there is however no evidence to indicate that there was any attempt to reach such an agreement regarding their maritime disputes beyond that point. To institute therefore an action in the Court without compliance with the provisions set out above, under the Law of the Sea Convention, is a fatal omission which makes such an application inadmissible. In any case, the Court, pursuant to Article 38 of the Statute, must apply international law and "international conventions, whether general or particular …" (para. 1 *(a)*). This has always been the position under general international law and it was first affirmed by the Court in 1969 in the *North Sea Continental Shelf* cases, which emphasize the need for parties to be given the opportunity to negotiate, when it held that

> "the parties are under an obligation to enter into negotiations with a view to arriving at an agreement, and not merely to go through a formal process of negotiation as a sort of prior condition for the automatic application of a certain method of delimitation in the absence of agreement; they are under an obligation so to conduct themselves that the negotiations are meaningful …" (*North Sea Continental Shelf, Judgment, I.C.J. Reports 1969*, p. 47).

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

A clear guideline was expressed in the *Gulf of Maine* Chamber case that first an agreement must be sought, following negotiations which should be conducted in good faith with a clear and honest intention of achieving a successful result. And the Chamber went on to state in its Judgment that:

> "Where, however, such agreement cannot be achieved, delimitation should be effected by recourse to a third party possessing the necessary competence." (*Delimitation of the Maritime Boundary in the Gulf of Maine Area, I.C.J. Reports 1984*, p. 299.)

It is therefore immaterial to determine whether this is a procedural or a substantive issue. What is clear is that the process of negotiation and attempt to reach an agreement in good faith must precede any reference to a third–party adjudication. In any event, I strongly believe that without complying with the prerequisite condition of negotiation and attempt to reach an agreement, Cameroon failed to comply with a requirement of substance and not just a merely procedural one. This is not a question of jurisdiction under Article 36 (2) of the Statute, but one of admissibility. My conclusion is that the Applications of Cameroon are not admissible as regards a dispute over the maritime boundary.

VII. The Eighth Preliminary Objection

79 The last preliminary objection of Nigeria appears to me to be a sound one, which ought to be upheld by the Court. Unfortunately the Court also rejects it. Here, Nigeria argues "that the question of maritime delimitation necessarily involves the rights and interests of third States and is to that effect inadmissible" (Preliminary Objections of Nigeria, Vol. I, p. 133). It states that there are five States involved within the Gulf, which is "distinctly concave". These States are Equatorial Guinea, Gabon, Sao Tome and Principe, and the two Parties in the present case. Nigeria, in its argument, tries to distinguish and differentiate the situation of this particular case from other cases like those of the *Frontier Dispute,* the *Continental Shelf (Libyan Arab Jamahiriya/Malta)* as well as the *Continental Shelf (Tunisia/Libyan Arab Jamahiriya)*. Cameroon, on its part, argues to the contrary, that all these cases are relevant and that they should be followed in the present case. Besides, it invokes the provision of Article 59 to the effect that a judgment in this case would be binding on no other States than the Parties.

80 The subject–matter of this preliminary objection concerns maritime delimitation beyond point G, which relates to the exclusive economic zone. Agreed, that a delimitation exercise between the Parties may not affect the interests of third States as such, but, in this particular case, it is difficult to effect any maritime delimitation beyond point G without calling into question the interests of other States, particularly Equatorial Guinea and Sao Tome and Principe. In accordance with the jurisprudence of the Court, it cannot decide a dispute between two parties without the consent of those States whose interests are directly affected, unless they intervene in such a matter.

81 It is for all these reasons that the Court ought to refuse the Application of Cameroon based on maritime delimitation of the area beyond point G and uphold the eighth preliminary objection of Nigeria.

VIII. The Second Preliminary Objection and the First Part of the Seventh Preliminary Objection

82 However, I agree with the decision of the Court in rejecting the second preliminary objection of Nigeria, whereby it maintains that for a period of 24 years prior to the filing of Cameroon's Application both Parties had accepted a duty to settle all boundary disputes through "the existing boundary machinery" and that this constitutes an implied agreement and that Cameroon is thereby estopped from invoking the jurisdiction of the Court. I believe that, having regard to all the facts presented by both Parties in this case, Cameroon is not estopped from invoking the jurisdiction of the Court and that this duty cannot override the provision in Article 33 of the Charter which permits

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

parties to seek the settlement of their disputes by "negotiation, enquiry, mediation, conciliation, arbitration, judicial settlement … or other peaceful means of their own choice". In addition, Nigeria referred its grievance concerning the armed incident of 1981 to the Organization of African Unity. In the circumstance, it is difficult to agree with Nigeria that this is a case of *pacta sunt servanda* or estoppel.

83 Furthermore, I agree with the decision of the Court, as already mentioned above, that the first part of Nigeria's seventh preliminary objection deals with the matter of methodology and as such the objection, which in my opinion is unconvincing, has been rightly rejected by the Court.

Conclusion

84 The general conclusion I have reached with regard to the eight preliminary objections filed by Nigeria is that, whereas I agree generally with the decisions of the Court on the second and the first part of the seventh preliminary objections, I do however disagree with the decisions reached by the Court on the first, third, fourth, fifth, sixth and the second part of the seventh and the eighth preliminary objections respectively.

85 As already mentioned, the most important objection raised by Nigeria is the first one, which deals with Article 36 of the Statute, particularly its paragraphs 2 and 4. Needless to say that there would have been no need for the Court to consider the remaining seven preliminary objections if the first one had been upheld.

86 I am also of the view that the *Right of Passage over Indian Territory* case is no longer good case–law. In 1957, when the Court had the first opportunity of interpreting the provision in Article 36 (4), the decision, while positively and effectively asserting the legal position as to the *deposit* of the declaration of acceptance as a condition precedent to invoking the jurisdiction of the Court, failed to do the same with regard to the second prerequisite condition: that copies of such instruments must be *transmitted* to all member States. That precisely is what the Court is called upon to regularize in this case, which it failed to do. This is a unique opportunity for the Court to do so, in order not to drag an unwilling Respondent to Court without its *real* consent. To do so may not be in the interests of peace within that enclave. Most cases of this nature that have come to the Court have come by way of Special Agreement and it would have been better for the Parties to be persuaded by the Court to bring the case in this manner. That would not be a unique attempt, having regard to what happened in the case concerning the *Maritime Delimitation and Territorial Questions between Qatar and Bahrain*. There are other considerations of a compelling nature to warrant an exercise of caution on the part of the Court. If one considers the fact that Cameroon is seeking the delimitation of the entire maritime and land boundary between it and Nigeria, the fact that there had been allegations and counter–allegations of border incidents and the fact that the Parties have on the ground various commissions to effect demarcation, delimitation and pacific settlement of disputes — all these facts are cogent reasons why the Parties should be enjoined to come to Court by way of Special Agreement.

87 Furthermore, it is essential that the Court should handle this matter with care to ensure that peace will reign within that region at the end of this litigation. In this regard there is also need for caution to ensure that the jurisdiction of the Court will not be an exercise in futility if, for example, what is required of the Court is ultimately accomplished by the Lake Chad Boundary Commission.

88 Finally, in dealing with cases between States, adherence to the general principles of international law as expressed in Article 2, paragraph 1, of the Charter (regarding the principle of the sovereign equality of Members) must be observed. As stated above, the jurisdiction of the Court is based on genuine consent of the parties and nothing should be done to derogate from this basic principle. As observed in the dissenting opinion of Judge Chagla in the *Right of Passage over Indian Territory* case:

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

"I should like to make one general observation with regard to the question of the jurisdiction of the Court. It has been said that a good judge extends his jurisdiction. This dictum may be true of a judge in a municipal court; it is certainly not true of the International Court. The very basis of the jurisdiction of this Court is the will of the State, and that will must clearly demonstrate that it has accepted the jurisdiction of the Court with regard to any dispute or category of disputes. Therefore, whereas a municipal court may liberally construe provisions of the law which confer jurisdiction upon it, the International Court on the other hand must strictly construe the provisions of the Statute and the Rules and the instruments executed by the States in order to determine whether the State objecting to its jurisdiction has in fact accepted it." (*I.C.J. Reports 1957,* p. 180.)

(Signed) Bola Ajibola.

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

Footnotes:

1 Shabtai Rosenne, *The Law and Practice of the International Court, 1920–1996*, 1997, p. 519.

2 *Op. cit.,* p. 519.

1 *Right of Passage over Indian Territory, Preliminary Objections, Judgment, I.C.J. Reports 1957*, p. 125.

2 *The Law and Practice of the International Court of Justice, 1920–1996*, 1997, Vol. II, p. 759.

3 *I.C.J. Reports 1957*, p. 146.

4 *Right of Passage over Indian Territory, Preliminary Objections, Judgment, I.C.J. Reports 1957*, p. 157.

5 *I.C.J. Yearbook 1959–1960*, p. 255.

6 *Ibid.*, p. 242.

7 E.g., a rare exception, which studies of comparative law note as atypical, is the Löfte doctrine of the Scandinavian countries, under which obligations stem not from the agreement of parties but from the duty undertaken by each party in its contractual declaration. See K. Zweigert and H. Kötz, *An Introduction to Comparative Law*, 2nd ed., 1984, trans. Tony Weir, p. 382. It has never been suggested that Article 36, paragraph 2, followed such a conceptual model.

8 *Ibid.* pp. 381 et seq.

9 See P. de Cruz, *Comparative Law in a Changing World*, 1995, pp. 302 *et seq.*, regarding the general rule of revocability of offers in the common law, the general rule of irrevocability in German law, and the somewhat intermediate position of French law. See, also, S. A. Nussbaum, "Comparative Effects of the Anglo–American Offer and Acceptance Doctrine", (1936) *Columbia Law Review*, Vol. 36, p. 920.

10 Rudolf B. Schlesinger (ed.), *Formation of Contracts: A Study of the Common Core of Legal Systems*, 2 vols., 1968.

11 *Ibid.*, Vol. 1, pp. 7–8.

12 *Ibid.*, p. 8.

13 *Ibid.*

14 *Op. cit.,* p. 71.

15 *Ibid.*, p. 74. The exceptional circumstances, which are rare, are dealt with in Part Two, Section C1, of Schlesinger's work.

16 *Ibid.*, p. 147.

17 *Ibid.*, note 2.

18 Where a standing offer is made on standard terms, e.g., by a public carrier, it becomes a contract upon acceptance of the act of service, as when a passenger boards a bus. There is no room for negotiation or for individual variations of terms in such a situation, and the meeting of minds is deemed to take place when the relevant act is performed. There is no analogy between

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

such situations and offers of acceptance of the Court's jurisdiction, which are infinitely variable in their terms.

19 *Right of Passage over Indian Territory, Preliminary Objections, Judgment, I.C.J. Reports 1957*, dissenting opinion, pp. 157–158.

20 A variety of theories have evolved in relation to acceptance of postal offers — the declaration theory (that the contract is complete as soon as the offeree has made a declaration of his acceptance), the expedition theory (that the contract is formed when a letter or telegram has been despatched accepting the offer), and the information theory (that communication of the acceptance must be received by the offeror). See de Cruz, *op. cit.*, p. 308. All of these are fashioned to meet the varied practical difficulties that arise in the context of postal offers. See also the reference to these theories in the dissenting opinion of Vice–President Badawi in *Right of Passage over Indian Territory, Preliminary Objections, Judgment, I.C.J. Reports 1957*, p. 156).

21 As in the classic common law case of *Carlill* v. *Carbolic Smoke Ball Co.*, where an act prescribed by the offeror was considered without more to constitute acceptance. Even that case affirmed, however, that "One can not doubt that, as an ordinary rule of law, an acceptance of an offer made ought to be notified to the person who makes the offer, in order that the two minds may come together" ([1893] 1 QB 256; 62 LJQB 257). See the reference to this case in Schlesinger, *op. cit.*, Vol. II, p. 1309.

22 Preliminary Objections of Nigeria, Vol. I, p. 40, para. 1.23.

23 Schlesinger, *op. cit.*, Vol. I, p. 148.

24 Hugo Grotius, *De Jure Belli ac Pacis*, Kelsey (trans.), 1925, Vol. II, Bk. II, p. 338.

25 For this and other references reaching back to discussions by the mediaeval glossators upon the subject of communication of acceptance, see Weeramantry, *The Law of Contracts*, 1967, Vol. I, pp. 121–124.

26 *The Law and Practice of the International Court of Justice, 1920–1996*, *op. cit.*, Vol. II, p. 753.

27 *Ibid.*, p. 755, footnote 56.

28 See *Yearbook of the International Law Commission*, 1965, Vol. II, p. 73, doc. A/CN.4/L.108.

29 *Ibid.*

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

CLA-000052

ENCYCLOPEDIA OF PUBLIC INTERNATIONAL LAW

PUBLISHED UNDER THE AUSPICES OF THE
MAX PLANCK INSTITUTE FOR COMPARATIVE
PUBLIC LAW AND INTERNATIONAL LAW
UNDER THE DIRECTION OF
RUDOLF BERNHARDT

ADVISORY BOARD

RUDOLF L. BINDSCHEDLER · THOMAS BUERGENTHAL · KARL DOEHRING
JOCHEN ABR. FROWEIN · GÜNTHER JAENICKE · HERBERT MIEHSLER
HERMANN MOSLER · FRITZ MÜNCH · DANIEL P. O'CONNELL
KARL JOSEF PARTSCH · PIERRE PESCATORE · HENRY G. SCHERMERS
ULRICH SCHEUNER · HANS-JÜRGEN SCHLOCHAUER · MAX SØRENSEN
HELMUT STREBEL

ASSISTANT GENERAL EDITOR

PETER MACALISTER-SMITH

VOLUME TWO

EAST AFRICAN COMMUNITY TO
ITALY–UNITED STATES AIR TRANSPORT
ARBITRATION (1965)

1995
NORTH-HOLLAND

ELSEVIER
AMSTERDAM–LAUSANNE–NEW YORK–OXFORD–SHANNON–TOKYO

favoured passing under Spanish sovereignty. Then Great Britain again enlarged the powers of the local Gibraltarian authorities by issuing an Order in Council entitled The Gibraltar Constitution Order (1969). Spain promptly terminated all communications between Gibraltar and the mainland, which remained closed until they were partially reopened in December 1982.

5. *Conclusion*

When Spain became a member of the → North Atlantic Treaty Organization, the former made sovereignty over Gibraltar a major issue. However, a subsequent Spanish Government removed the barriers to access from Spain to Gibraltar and negotiations have been initiated for the joint operation of the Gibraltar airport. With the advent in 1992 of further changes in the European Economic Community, of which Spain is now a member, Gibraltar once again is looking forward to becoming the "Hong Kong of the Mediterranean", particularly in financial matters.

There are many problems to be resolved before there can be a final settlement between Spain and Great Britain with respect to the problem of Gibraltar. The only really viable solution appears to be the transfer of sovereignty to Spain, with appropriate agreed provisions to protect both the Gibraltarians and Great Britain.

LOPEZ DE AYALA, História de Gibraltar (1782).
J.M. DE AREILZA and F.M. CASTIELLA, Reivindicaciones de España (1941).
J. PLA CARCELES, Gibraltar (1955).
G. HILLS, Rock of Contention: A History of Gibraltar (1974).
T. FRANCK and P. HOFFMAN, The Right of Self-Determination in Very Small Places, New York University Journal of International Law and Politics, Vol. 8 (1975–1976) 331–386.
E. BRADFORD, Gibraltar: The History of a Fortress (1977).
H. LEVIE, The Status of Gibraltar (1983).

[1990] HOWARD S. LEVIE

GOOD FAITH

1. *Notion*

The principle of good faith requires parties to a transaction to deal honestly and fairly with each other, to represent their motives and purposes truthfully, and to refrain from taking unfair advantage that might result from a literal and unintended interpretation of the agreement between them (→ Interpretation in International Law). The concept figures prominently in the → Vienna Convention on the Law of Treaties, which by virtue of its careful draftsmanship and wide ratification has assumed an authoritative place in international law on questions relating to the interpretation and enforcement of → treaties. Art. 31(1) of that Convention provides: "A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose." These references to context and purpose demonstrate that the substance of the principle of good faith is the negation of unintended and literal interpretations of words that might result in one of the parties gaining an unfair or unjust advantage over another party.

A secondary notion of good faith in the context of explicit agreements pertains to the duties of signatories to a treaty prior to ratification. The early rule of international law to the effect that States had an obligation to ratify treaties that their diplomatic agents had signed has been replaced since the 18th century by the concept of discretionary ratification (→ Treaties, Conclusion and Entry into Force). This change came about as a result of the growth of parliamentary institutions within States that adopted constitutional checks and balances against the acts of the executive branch or its diplomatic agents abroad (→ Diplomatic Agents and Missions). Yet the new concept of discretionary ratification carried over the old notion to the extent that the executive branch, having signed the treaty through its agents, now had an obligation to make every effort in good faith to obtain the consent of the sovereign, and not to act in the interim period in such a way as to prejudice the unperfected rights of the signatories to the treaty. Art. 18 of the Vienna Convention on the Law of Treaties, while not explicitly referring to the principle of good faith, summarizes its substance by providing that a signatory, prior to ratification, "is obliged to refrain from acts which would defeat the object and purpose" of the treaty.

Finally, the principle of good faith may be said to apply, apart from treaties or other agreements, to the general performance of a State's obligations under international law. According to a significant

CLA-000053

OXFORD PUBLIC INTERNATIONAL LAW

Oxford Scholarly Authorities on International Law

Part II Substantive Issues, Ch.16 Regulatory Transparency

Akira Kotera

From: The Oxford Handbook of International Investment Law
Edited By: Peter T Muchlinski, Federico Ortino, Christoph Schreuer

Content type: Book Content
Series: Oxford Handbooks in Law
ISBN: 9780199231386
Product: Oxford Scholarly Authorities on International Law [OSAIL]
Published in print: 26 June 2008

Subject(s):

Fair and equitable treatment standard — Transparency

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

(p. 617) Chapter 16 Regulatory Transparency

(1) **Significance of Transparency 619**

(2) **The Expansion of Transparency Obligations in IIAs 625**

(3) **Transparency and 'Fair and Equitable Treatment' 628**

Concluding Remarks 634

(p. 618) Nowadays it is understood that transparency should be observed in numerous types of organizations, including in particular governments and other public bodies. In the contemporary field of international investment, transparency has begun to be characterized as a fundamental principle. Initially required of the host country, it may also come to be required of the home (investing) country and the investor (investing corporation), according to research conducted by the United Nations Conference on Trade and Development (UNCTAD).[1] The Declaration of the Doha Development Agenda of the World Trade Organization (WTO), which sought to draft a multilateral investment agreement in the section entitled 'Relationship between trade and investment', indicated that transparency would be one of the basic elements of future WTO Investment Rules. It stipulates as follows: 'In the period until the Fifth Session, further work in the Working Group on the Relationship Between Trade and Investment will focus on the clarification of: scope and definition; transparency; and non-discrimination …'.[2]

However, early bilateral investment treaties (BITs) concluded in the late 1950s to 1960s did not contain a provision for transparency. Articles on transparency first appeared in the early US BITs, which were concluded in the 1980s. Furthermore, even recent books on investment treaties have neither a chapter on transparency nor do they include transparency as a term in the index.[3]

Furthermore, with respect to the international economic field, transparency is argued for not only in the area of investment but also in trade. As transparency is to be required widely in relation to the organization in general, it is natural that transparency is required in respect of the importing countries as the main addressee of obligations in the trade field.[4] Transparency is widely discussed, so we need to take its particular meaning into account in the context of investment.

The present chapter will offer an overview of transparency issues as follows. It begins with a discussion of the significance of the concept in the investment field, asking why transparency is being increasingly characterized as a fundamental (p. 619) principle and considering why it was neglected for a long time, bearing in mind early investment treaty practice. It then goes on to review the development of specialized transparency obligations in more recent international investment agreements (IIAs), highlighting their principal features. Thirdly, the chapter will analyse the interrelationship between the transparency obligations of the state and the principle of fair and equitable treatment, taking into account developments in international investment arbitrations in this regard. Finally, the chapter will conclude by considering the role that transparency has to play in investment protection more generally. The chapter does not cover issues of corporate transparency through disclosure rules, which is done elsewhere in this volume.[5]

(1) Significance of Transparency

Transparency is covered in many WTO agreements and in the General Agreement on Trade in Services (GATS) is ranked as a basic principle alongside the principle of most-favoured-nation treatment.[6] One reason why transparency has obtained the position of a fundamental principle in the international economic field, including international investments, was the impact of its treatment in GATS. Transparency within the GATS treaty is covered in the preambles as follows.

> Wishing to establish a multilateral framework of principles and rules for trade in services with a view to the expansion of such trade under conditions of *transparency* and progressive liberalization and as a means of promoting the economic growth of all trading

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

partners and the development of developing countries …. (Emphasis added)

In the text of GATS, transparency, which is stated as its main purpose in the preamble, is defined as a 'basic principle'.[7] The main obligations contained in Article 3 are as follows: (1) the obligation to make publicly available all relevant measures (p. 620) of general application, that are all relevant national laws, such as by their publication; (2) the obligation promptly to inform the Council for Trade in Services of the introduction of any new, or any changes to existing, laws and other regulations; (3) the obligation to respond promptly to all requests by other members for specific information on a member's measures of general application or international agreements and to establish enquiry points to provide specific information to other members.

Article 3 of GATS indicates that the core element of transparency is that all relevant measures of general application be made publicly available. To ensure this availability, importing countries need to meet the three obligations as stated above. It should be noted that this requirement of public availability does not always require the publication of these measures. Publication is one means by which the measures of relevant laws may be made publicly available. Furthermore, with respect to the exchange of information as the means of securing the public availability of all relevant laws, only the obligations to inform the Council for Trade in Services and to respond to all requests by other countries are included. The obligation to respond is not placed on any individual entity but only on countries themselves. The scope of information which is exchanged is more restricted than that which is to be publicly available.

Other WTO agreements in addition to the GATS emphasize transparency. For example in the following, though transparency is not designated as a basic principle, it is still addressed:

- Article 10 of GATT;
- Article 7 of the Agriculture Agreement;
- Article 7 of the SPS Agreement;
- Articles 2, 5 and 15 of the TBT Agreement;
- Article 6 of the TRIM Agreement;
- Article 12 of the Customs Evaluation Agreement;
- Article 2 of the Agreement on Preshipment Inspection; (p. 621)
- Articles 2(g) and 3(e) of the Agreement on Rules of Origin;
- Appendices 2 and 3 of the Understanding on Rules and Procedures Governing the Settlement of Disputes;
- Sections B and D of the Trade Policy Review Mechanism;
- Article 9 of the Agreement on Trade in Civil Aircraft; and
- Article 17 of the Agreement on Government Procurement.

The inclusion of transparency obligations in the WTO Agreements carries on the precedent set by the General Agreement on Tariffs and Trade (GATT) 1947. The ensuring of public availability of all relevant national laws applied as the basic element of transparency came into existence in Article 10 of the GATT, which provides obligations for the publication of laws, regulations, judicial decisions, and administrative rulings of general application. Article 10 of GATT does not include the obligation of information exchange which nowadays is one of the means of realizing transparency.[8] On the other hand, Article 3 includes other obligations which are not included in Article 3 of GATS. Those obligations are: (1) the obligation not to enforce a measure before such a measure has been officially published, (2) the obligation to administer in a uniform, impartial, and reasonable manner all its laws etc, as stated above (fair administration), (3) the obligation to maintain or institute independent judicial, arbitral, or administrative tribunals or procedures (independent tribunals). These last two obligations are common to the contemporary US criteria of transparency as stated below.

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

But it was not recognized that Article 10 of GATT included transparency as it was viewed only as a technical provision.[9] This means that this article was not considered important in the GATT. Therefore Article 10 cannot be characterized as the origin of the transparency obligation in current international economic regulations, although it might appear so on the surface when we compare Article 10 with the present provisions. Article 10 of GATT is only a forerunner to these present manifestations of transparency.

The concept of transparency came into existence in the GATT Tokyo Round codes. The Preamble to the Government Procurement Agreement reads, 'Recognizing that it is desirable to provide transparency of laws, regulations, procedures and practices regarding government procurement; …'. On the other hand, in the text of the Agreement there is no article specifically entitled 'transparency'. Article 6, 'Information and Review', includes only the obligation to publish any law and procedure regarding government procurement but does not include the obligation of information exchange. We can presume that transparency in the preamble is used (p. 622) in connection with Article 6, but it is not clear whether or not it can be considered to be limited to the content contained in Article 6. However, in order to achieve national treatment and non-discrimination as the main purposes of the agreement on government procurement, open tendering procedures, as well as regulations of technical specifications, are stressed. The emphasis on open tendering procedures indicates the importance of transparency in this area.[10] In the history of the WTO and GATT, we have to realize that the concept of transparency emerged as an important principle at the time of the Tokyo Round and finds its most developed contemporary expression in the GATS.

In the field of trade, the importance of the general availability of relevant laws was formerly recognized, but it is only in recent times that it has been viewed as important from the standpoint of transparency. The initial practice of BITs did not include a specific transparency provision. The first BIT was between West Germany and Pakistan in 1959 and certain Western European countries followed this practice. The purpose of BITs at that time was to secure prompt, adequate, and effective compensation provided against expropriation by states. At that time, the notable case where the issue of expropriation and compensation emerged was the expropriation of natural resources-related investments in developing states. Developing states strongly argued that natural resources should be entirely controlled based upon the state in which they were located under the title of 'permanent sovereignty over natural resources', and the means of compensating for expropriation should be decided entirely by the states themselves. The initial BITs were in response to such a situation and were called 'investment protection agreements'. Such BITs did not include the principle of transparency, neither mentioning the word 'transparency' nor containing any provision concerning the general availability of laws of the countries concerned. Such agreements continue even today. One example is the most recent UK BIT with Vanuatu in 2004.[11] Thus, this type of investment protection attaches no importance to transparency.

On the other hand, in the late 1970s the prevailing opinion in the USA was that the conventional programme of freedom of commerce and navigation treaties (FCN) had not responded to the needs of investors and traders. First, as GATT regulations widely covered trade, the significance of disciplines imposed by FCN treaties was weakened. Secondly, with respect to international investment, it was recognized that FCN rules were not sufficient to respond to the needs of that time. The conventional FCN treaty did not include a clause covering issues such as the prohibition of (p. 623) performance requirements or the free entry of key foreign personnel in connection with the establishment and operation of an investment. Thirdly, as the FCN programme was built on the premise that partners were advanced states, it was difficult for developing states to commit to obligations that were capable of full compliance only for advanced states. Given this situation, much attention was paid by the USA to the European practice of concluding BITs and, in due course from the early 1980s, the US government constructed a BIT programme to conclude such treaties with developing countries.

The purpose and structure of the US BIT programme was, however, different from its European counterpart. Although the main purpose of European BITs was to guarantee adequate, prompt, and

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

effective compensation against expropriation, the US government set as its main aims the improvement of the investment environments of host states as well as investment protection. The improvement of the investment environment in host countries enabled the acquisition of national treatment or most-favoured-nation treatment. The securing of transparency was one form of treatment of investment for which improvement was sought.

Article 2 (Treatment of Investments), paragraph 9 of the first US Model BIT, drafted in 1983, states,

> Each Party and its political subdivisions shall make public all laws, regulations, administrative practices and procedures, and adjudicatory decisions that pertain to or affect investments in its territory of nationals or companies of the other Party.[12]

This includes securing the public availability of relevant laws in the treatment of investments. The US BITs with Bangladesh and Haiti from the 1980s adopted this model to make publicly available the relevant laws of host states. Furthermore, the BITs with Turkey, Grenada, and Congo adopted the model of the 1984 or 1987 draft. (The BIT with Panama did not contain such a provision because in this case, in the view of the US Department of State, such public availability of relevant laws had already been realized.[13]) At that time, the US BIT included only the obligation of public availability of relevant laws of host states and did not use the concept of transparency. This obligation was characterized as one of the treatment of investment standards.

(p. 624) After the end of the Cold War, the USA began to conclude BITs with Eastern European countries. On the one hand, this was for the purpose of maintaining a market economy system after the collapse of the former socialist regimes and on the other hand it indicated to the wider world the change of economic regimes of the former socialist countries. One such pioneering agreement was the Treaty with Poland Concerning Business and Economic Relations, a comprehensive agreement that included not only investment but also trade. At that time, Poland was not a member of GATT. By Article VIII of that agreement,

Exchange of Information and Transparency

> **1**. Each Party acknowledges the desirability of facilitating the collection and exchange of all non-confidential, non-proprietary information relating to investments and commercial activities within its territory.
>
> **2**. Each Party shall make publicly available all non-confidential, non-proprietary information which may be useful in connection with investment and commercial activities. In addition, each Party shall promptly make public all laws, regulations, administrative practices and procedures, and adjudicatory decisions having general application that pertain to or affect commercial activities or investments.
>
> **3**. The Parties shall disseminate to their respective business communities such information made available under paragraph 2 which will assist their nationals and companies in pursuing the most expeditious and equitable settlement of any dispute affecting them which may arise under this Treaty. Such information may be related to timeliness of decisions and vindication of rights under the Treaty.[14]

In this article, the word 'transparency' is applied clearly, which means securing the public availability of all laws with the added obligation to make information public and for information exchange. In this sense, this provision appears similar to Article 3 of GATS. However, the obligation to make information public was not specifically equated with publication as in GATS. With respect to information exchange, it mentions only its desirability. On this point, the obligations are less strict than those in GATS.

The Treaty on Business and Economic Relations with Poland had the political and economic functions of showing the transition of the former socialist regime beyond the mere improvement of investment environments through legal forms.[15] Such a document was highly symbolic of the

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

functions of the concept of transparency. Transparency was viewed as an inevitable requirement of a free market economy. From the historical viewpoint, transparency that ensured the public availability of relevant laws as its basic element was definitely born at that moment, and led to GATS.

(p. 625) (2) The Expansion of Transparency Obligations in IIAs

NAFTA realized the next stage of transparency. The aim of NAFTA is included in Article 102, paragraph 1 as follows: 'The objectives of this Agreement, as elaborated more specifically through its principles and rules, including national treatment, most-favored-nation treatment and transparency, are to …'. Herein transparency is positioned as a basic principle and rule on a par with national treatment and most-favoured-nation treatment. As the concrete definition of transparency, Chapter 18, 'Publication, Notification and Administration of Laws', stipulates its core meaning as securing the public availability of relevant information on laws. The structure of Chapter 18 is as follows: Article 1801: Contact Points; Article 1802: Publication; Article 1803: Notification and Provision of Information; Article 1804: Administrative Proceedings; Article 1805: Review and Appeal. Chapter 18 of NAFTA stipulates the involvement of related parties in administrative procedures and obligations to establish an impartial review agent, such as a court, in addition to the public availability of information on relevant laws. However, it is not indicated in the text that transparency is to be secured by these articles. This point has been clearly demonstrated in US practice in the 21st century.

The new US Model BIT of 2004 includes the following transparency-related articles: Article 10, entitled 'Publication of Laws and Decisions Respecting Investment' and Article 11 entitled 'Transparency'.[16]

(p. 626) The concept of transparency was greatly expanded in the US Model BIT of 2004. First, the publication of laws and other regulations is separated from the principle of transparency itself. The term transparency covers the following items: (1) to make contact points for facilitation of communications; (2) to publish in advance any relevant measure that a Contracting Party proposes to adopt and to provide the opportunity to comment on proposed measures; (3) to respond to questions pertaining to any actual proposed measure; (4) to institute administrative proceedings; (5) to establish or maintain administrative tribunals or procedures for the purpose of the prompt review.

Transparency was expanded to include the institution of a prior comment upon the proposed laws and administrative decisions as stipulated in (1), that is, a commitment concerning the enactment of laws and administrative decisions beyond the mere provision of information of relevant laws to be publicly available and the review of the related administrative decisions by an impartial agent such as a court. Such broad transparency appeared in the US-Uruguay BIT.[17] In more recent US Free Trade Agreements with investment provisions, a commitment to transparency in (p. 627) administrative proceedings has been introduced.[18] In addition, in a number of other BITs a general right for any interested person to have available to them information on relevant laws, regulations, and procedures can be found, as well as permission to comment on proposed measures.[19]

Transparency was expanded in this way because its purpose had shifted from mere improvement of investment environments to public control of policy-making or of the implementation and dispute settlement process of host states. A new philosophy has emerged that transparency is to ensure the accountability of host states with a view to good and effective governance.[20] Transparency from the standpoint of accountability is compatible with that of the improvement of investment environments. Investors not only obtain merit from the public availability of information on relevant laws, but this can also reinforce the accountability of host states. Furthermore, the realization of such accountability guarantees good and effective governance in host states as a means of improving their investment environment.

Deep analysis of the purpose of transparency leads to an increase in the number of actors for

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

which transparency would be requested. The research on BITs by UNCTAD which positioned transparency as an emerging principle in international investment law examines transparency not only towards host countries but also towards home countries and investors themselves.[21] The basic philosophy of UNCTAD's research is that BITs should be desirable for all relevant actors, including host states, home states, and investors, and that home countries as well as investors should be requested to release relevant information on request. In practice, BITs have demanded transparency from neither home states nor investors. But it is important that such an idea on transparency has emerged. Currently, the basic purpose of transparency has been shifting from mere improvement of investment environments to pursuit of the accountability of all actors concerned.

This new philosophy on BITs, in practice, has been adopted only by the US government, which further has only applied such transparency to host states' measures. Governments other than the USA have not requested such transparency in making BITs.[22] Taking this situation into account, one may conclude that the (p. 628) currently prevailing idea is that transparency should be viewed only as securing public availability of information on relevant laws by their open release and information exchange in order to improve the investment environment. The transparency provided in the BITs and Economic Partnership Agreements concluded by Japan belong to such a category.[23] But it is necessary to pay attention to the new philosophy of transparency and the gradual increase in the number of its supporters.[24]

(3) Transparency and ‘Fair and Equitable Treatment’

Since around 1980 the number of BITs that include the obligation of fair and equitable treatment of investors by host states has been increasing. The purpose of this provision is to ensure a certain level of treatment of investors and investments by host states. The concept of fair and equitable treatment has not been clearly defined and the abstract views on the topic have been divided into two main factions. The first view is that it means the minimum standard that should be given to foreign investors under international customary law and the second is that it means a degree above the minimum standard.[25] We may suppose that transparency could be included in fair and equitable treatment, so such an idea should be discussed.

Whether such a relationship exists between fair and equitable treatment and transparency has been considered in a number of recent investment arbitrations. One of the most important legal grounds of claim alleged by investors in such cases has been a breach of the obligation of fair and equitable. As a result, the definition of fair and equitable treatment has come to attract attention.[26] In this process, arbitral awards have emerged where the relationship between fair (p. 629) and equitable treatment and transparency was the most controversial issue. The *Metalclad* case, based on NAFTA Chapter 11 (chapter on Investment), was the first of these recent cases in which fair and equitable treatment came into contact with issues of transparency.

In the *Metalclad* case,[27] the Metalclad Corporation had planned to operate a waste disposal facility in Mexico on the invitation of the Mexican government, but, faced with the opposition of local government authorities in Mexico, Metalclad abandoned its plan. In response, it brought the case to arbitration to pursue the responsibility of the Mexican government to provide compensation for the loss of investment. The arbitration tribunal considered that the Mexican government had not provided fair and equitable treatment to Metalclad, contrary to Article 1105 of NAFTA. The arbitration award states:

> An underlying objective of NAFTA is to promote and increase cross-border investment opportunities and ensure the successful implementation of investment initiatives … Prominent in the statement of principles and rules that introduces the Agreement is the reference to ‘transparency’ (NAFTA Article 102(1)). The Tribunal understands this to include the idea that all relevant legal requirements for the purpose of initiating, completing and successfully operating investments made, or intended to be made, under the

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

> Agreement should be capable of being readily known to all affected investors of another Party …. Once the authorities of the central government of any Party (whose international responsibility in such matters has been identified in the preceding section) become aware of any scope for misunderstanding or confusion in this connection, it is their duty to ensure that the correct position is promptly determined and clearly stated so that investors can proceed with all appropriate expedition in the confident belief that they are acting in accordance with all relevant laws.[28]

The Mexican government's denial of a municipal construction permit was considered improper. Metalclad, relying on representations by Mexican government officials, acted in good faith and fully expected to be granted the permit. Therefore,

> Mexico failed to ensure a transparent and predictable framework for Metalclad's business planning and investment. The totality of these circumstances demonstrates a lack of orderly process and timely disposition in relation to an investor of a Party acting in the expectation that it would be treated fairly and justly in accordance with the NAFTA.[29]

In the view of the arbitral tribunal, the policies of the Mexican Federal Government and local governments were not clearly made known to Metalclad, which created confusion and therefore the lack of transparency created Metalclad's hardships. The tribunal acknowledged the responsibility of the Mexican government.

(p. 630) Mexico sought judicial review of this award before the courts of Canada as the designated place of arbitration in this case.[30] With respect to the issue of fair and equitable treatment, the arbitration award was nullified by the judgment of the Supreme Court of British Columbia[31] on the grounds that the tribunal had read transparency into fair and equitable treatment:

> In its reasoning the Tribunal discussed the concept of transparency after quoting Article 1105 and making reference to Article 102. It set out its understanding of transparency and it then reviewed the relevant facts. After discussing the facts and concluding that the Municipality's denial of the construction permit was improper, the Tribunal stated its conclusion which formed the basis of its finding of a breach of Article 1105; namely, Mexico had failed to ensure a transparent and predictable framework for Metalclad's business planning and investment. Hence, the Tribunal made its decision on the basis of transparency. This was a matter beyond the scope of the submission to arbitration because there are no transparency obligations contained in Chapter 11.[32]

It seems that the tribunal read transparency (Art 102 NAFTA) into fair and equitable treatment and made the award. In the view of the Supreme Court, the issues an investor can bring to arbitration were limited to Chapter 11 under NAFTA. Therefore, it was beyond the scope of NAFTA's authority for the tribunal to make a decision based on Article 102.

From the viewpoint of the arbitration tribunal, it can be argued that it did not have the intention of directly applying Article 102. Indeed, the tribunal acknowledged that the Mexican government lacked transparency and affirmed the responsibility of the Mexican side. Yet in the view of the tribunal, the investor suffered damages from the measures of the Mexican government which were contrary to the obligation of fair and equitable treatment. To define the measures of the Mexican government which lacked fair and equitable treatment in precise terms, the tribunal argued there was a lack of transparency. Article 102, which includes transparency, covers myriad fields, including investment, but is not found in Chapter 11 of NAFTA, which the arbitration between investors and states covers. To interpret the arbitral award in such a way is in effect to exclude any transparency obligation from the fair and equitable treatment standard in Article 1105 of NAFTA, which is what the decision of the Supreme Court of British Columbia did.

Such a narrow approach to the fair and equitable treatment standard was not accepted in the subsequent *Tecmed* case, where a different approach to interpretation was taken not involving

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

Article 102 of NAFTA. In the *Tecmed* case,[33] the tribunal (p. 631) considered that the fair and equitable treatment provision in the BIT between Spain and Mexico was an element of good faith recognized under international law and stated:

> (T)his provision of the Agreement, in light of the good faith principle established by international law, requires the Contracting Parties to provide to international investments treatment that does not affect the basic expectations that were taken into account by the foreign investor to make the investment.
>
> The foreign investor expects the host State to act in a consistent manner, free from ambiguity and totally transparently in its relations with the foreign investor, so that it may know beforehand any and all rules and regulations that will govern its investments, as well as the goals of the relevant policies and administrative practices or directives, to be able to plan its investment and comply with such regulations ….The foreign investor also expects the host State to act consistently, i.e. without arbitrarily revoking any preexisting decisions or permits issued by the State that were relied upon by the investor to assume its commitments as well as to plan and launch its commercial and business activities.[34]

The view of the tribunal was that investors held a certain expectation in concluding the BIT and that this led the definition of fair and equitable treatment to be one that ensures the protection of such investor expectations. The expectation held by investors, according to the tribunal, was that host states should act in a consistent manner, free from ambiguity and totally transparent in its relations with the foreign investor. This tribunal rephrased fair and equitable treatment in accordance with the principle of good faith and read transparency into it. Such an approach was also followed in the *Saluka* case.

The *Saluka* case[35] developed and clarified the *Tecmed* decision. In the *Saluka* case, the actions of the Czech government were the object of the complaint by Saluka Investments BV, a Netherlands-registered affiliate of the Japanese financial group Nomura. In the case, whether the actions taken by the Czech government violated the 'fair and equitable treatment' standard became an important issue. To interpret the 'fair and equitable treatment' standard, the tribunal examined first its ordinary meanin; secondly, the context, and finally, the object and purpose of the Czech Republic-Netherlands BIT. With regard to the ordinary meaning, the tribunal, quoting the *SD Myers* decision,[36] stated that 'the infringement of the standard requires treatment in such an unjust or arbitrary manner that the treatment rises to the level that is unacceptable from the international perspective'.[37] Regarding the context, this tribunal said that 'the "fair and equitable treatment" standard is linked directly to the stimulation of foreign investment and to the economic development of both (p. 632) Contracting Parties'.[38] Concerning the object and purpose, its overall aim is considered to be to encourage foreign investment, and extend and intensify the parties' economic relations. Based on these interpretations, the tribunal considered that the 'fair and equitable treatment' standard requires the host state to assume an obligation 'to treat foreign investors so as to avoid the frustration of investors' legitimate and reasonable expectations'.[39] Theoretically, a foreign investor may expect that the government's conduct does not manifestly violate the requirements of transparency as well as those of consistency, even-handedness, and non-discrimination as this tribunal said. Thus the tribunal connects the 'fair and equitable treatment' standard with transparency.[40]

Thus, transparency has been considered as an element of fair and equitable treatment in recent arbitration awards. Is this view compatible with the concept of fair and equitable treatment? With regard to fair and equitable treatment, there has been controversy over whether it would mean the minimum standard under customary international law or beyond the minimum, as stated above. Such controversy is related to the argument as to why transparency should be read into fair and equitable treatment standard in any case. Taking into account the current situation of developing states, and the prevailing view that each country is required to provide treatment for foreign investors that is equivalent to that for nationals,[41] it is difficult to say that transparency, even the

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

public availability of information of relevant laws, should be a minimum standard towards foreign investors under customary international law.

The arbitral tribunal of *Metalclad* assumed that an underlying objective of NAFTA is to promote and increase cross-border investment opportunities and interpreted the fair and equitable treatment not as a standard of international law but as a standard of NAFTA. The tribunal in the *Pope and Talbot* case[42] clearly stated that fair and equitable treatment should be a NAFTA standard beyond the minimum under customary international law in the language, '[a]nother possible interpretation of the presence of the fairness elements in Article 1105 is that they are *additive* to the requirements of international law. That is investors under NAFTA are entitled to the international law minimum *plus* the fairness elements'.[43] Such interpretations (p. 633) of fair and equitable treatment as a NAFTA standard exclude the idea that it should be a standard under customary international law. However, in later arbitration awards under NAFTA, the tribunals considered that fair and equitable treatment does not mean anything other than the minimum standard under international law and in fact dismissed the *Pope and Talbot* interpretation. The implication of this may be that transparency might not be an additional element to fair and equitable treatment in NAFTA as it goes beyond the minimum standard under customary international law.

On the other hand, the interpretation of the *Tecmed* tribunal uses a very subtle expression as follows: '(T)he commitment of fair and equitable treatment included in Article 4(1) of the Agreement is an expression and part of the *bona fide* principle recognized in international law'.[44] How should we interpret this expression? If fair and equitable treatment indicates the standard under customary international law, the fair and equitable treatment clause in a BIT has little significance as this obligation would be complied with by countries without the clause.

First, we should be reminded that fair and equitable treatment clauses differ from agreement to agreement. Accordingly, the purpose and interpretation of this clause will be different in each agreement. For example, Article 1105 of NAFTA provides as follows:

> Each Party shall accord to investments of investors of another Party treatment in accordance with international law, including fair and equitable treatment and full protection and security.

Article 3.1 of the Czech Republic-Netherlands BIT, upon which *Saluka's* claim was brought, provides as follows:

> Each Contracting Party shall ensure fair and equitable treatment to the investments of investors of the other Contracting Party ….

Comparing these two clauses, their styles are completely different. On the one hand, it might be appropriate for the fair and equitable standard of NAFTA to be interpreted under customary international law as it explicitly mentions international law. On the other hand, it might be reasonable that Article 3.1 of the Czech Republic-Netherlands BIT, which does not mention international law, should be interpreted as an autonomous standard as in the *Saluka* decision.

We have to note that as the same concept of fair and equitable treatment has been applied to different BITs, it is important to seek a common element in this concept. From this perspective, the *MTD Equity* case[45] gives us helpful guidance. In that case the tribunal states that it follows the *Tecmed* decision on this issue,[46] and borrows (p. 634) Professor Schwebel's words to indicate the meaning of fair and equitable treatment as 'a broad and widely-accepted standard encompassing such fundamental standards as good faith, due process, nondiscrimination, and proportionality'.[47] The tribunal then paraphrases, 'In their ordinary meaning, the terms "fair" and "equitable" used in Article 3(1) of the BIT mean "just", "even-handed", "unbiased", "legitimate"'.[48] The tribunal, upon such an assumption, concludes that the host state's approval of an investment which was clearly against its own urban development policy is a breach of the obligation of fair and equitable treatment. Thus 'minimum' is the common element of fair and equitable treatment and includes good faith, due process, non-discrimination, and proportionality. The *Tecmed* and *Saluka* decisions

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

have added transparency to this list of good governance criteria.

As the above-mentioned arbitration awards show, the common meaning of fair and equitable treatment is the minimum standard to act in good faith under customary international law or under each BIT. Its concrete meaning should be adapted according to both the contents of each BIT, such as the purpose of the BIT, and the political and economic situations of the host states to which it applies.[49] Based on applicable situations, transparent action might be required as a principle of good faith. In other words, even if a BIT does not contain a provision for transparency, the core element of transparency might emerge if a clause on the fair and equitable treatment obligation resides within it and its application calls for such a reading. Yet, we cannot define the concrete meaning of transparency as an element of fair and equitable treatment in each BIT by understanding the specific contents of the BIT and investment environments, although the obligation of public availability of information on relevant laws could be included in the meaning.

Concluding Remarks

As stated above, transparency originated in the concept of the improvement of the investment environment, but it is not clear what relationship transparency should (p. 635) have with investment protection. One could presume that the obligation of transparency has no relation to the protection of investments. But to read transparency into fair and equitable treatment gives a basis for compensation towards investments that have suffered injuries, such as where an investor was led into making a bad decision to invest due to lack of information on relevant laws. Thus, transparency might have a significant bearing on the aspect of investment protection in this sense. Transparency may require the host state not only to secure the public availability of relevant laws but also to compensate investors who have suffered because of the lack of transparency by host states.[50] Indeed, depending on the particular interpretation that a tribunal might place on the precise meaning of fair and equitable treatment in a given case, transparency may be regarded as an element of fair and equitable treatment and so require a degree of accountability by host states.

In the 1980s, transparency came to be known as the securing of the public availability of information on relevant laws. This trend was followed by the WTO Agreements, which ranked transparency as a basic principle. Furthermore, transparency has developed in US BITs as a tool to pursue the accountability of host states and to charge host states with corresponding obligations so as to establish an impartial review mechanism. From the same viewpoint, it has come to be argued that accountability should also be required of investors and host states in BITs. This proposal indicates a change in the theoretical basis not only of transparency but also of the fundamental functions of BITs. Until now, BITs have been treaties that lay out obligations concerning areas such as investment protection or improvements in investment environments in host states in favour of investors and investments. But the new argument could intend to shift the obligations upon both investors and home states in favour of host states. In this sense, this argument proposes changing the paradigm of what BITs should be.

Select Bibliography

Brownlie, Ian, *Principles of Public International Law* (Oxford, Oxford University Press, 6th edn, 2003)

Dolzer, Rudolf, and Stevens, Margrete, *Bilateral Investment Treaties* (The Hague, Nijhoff, 1995)

Foy, Patrick G, and Deane, Robert J, 'Foreign Investment Protection under Investment Treaties: Recent Developments under Chapter 11 of the North American Free Trade Agreement', 16 ICSID Rev-FILJ 299 (2001)

Jackson, John H, *World Trade and the Law of GATT* (Indianapolis, Bobbs-Merill Company, 1969)(p. 636)

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

Mann, Howard, 'The IISD Model International Agreement on Investment for Sustainable Development: An Introductory Note', 20 ICSID Rev-FILJ 84 (2005)

Mavroidis, Petros C, *The General Agreement on Tariffs and Trade: A Commentary* (Oxford, Oxford University Press, 2005)

Muchlinski, Peter, '"Caveat Investor?" The Relevance of the Conduct of the Investor under the Fair and Equitable Treatment Standard', 55(3) ICLQ 527 (2006)

__, *Multinational Enterprises and the Law* (Oxford, Oxford University Press, 2nd edn, 2007)

OECD, *Public Sector Transparency and International Investment Policy* (Paris, OECD, 2003)

Reich, Arie, *International Public Procurement Law* (The Hague, Kluwer Law International, 1999)

Sornarajah, M, *The International Law on Foreign Investment* (Cambridge, Cambridge University Press, 2nd edn, 2004)

__, *International Investment Agreements: Key Issues* (New York and Geneva, United Nations, 2004)

__, *Investment Provisions in Economic Integration Agreements* (New York and Geneva, United Nations, 2006)

UNCTAD, *Bilateral Investment Treaties 1995–2006: Trends in Investment Rulemaking* (New York and Geneva, United Nations, 2007)

Vandevelde, Kenneth J, *United States Investment Treaties* (Deventer, Kluwer Law and Taxation Publishers, 1992)

Vasciannie, Stephen, 'The Fair and Equitable Treatment Standard in International Investment Law and Practice', 70 BYIL 99 (1999)

Winham, Gilbert R, *International Trade and the Tokyo Round Negotiations* (Princeton, Princeton University Press, 1986)

Footnotes:

∗ I wish to express my heartful thanks to Ms Loretta Malintoppi, who improved my English considerably.

[1] See UNCTAD, *International Investment Agreements: Key Issues* (New York and Geneva, United Nations, 2004) ch 10, 'Transparency' at 281–314. Also published separately as UNCTAD, *Transparency*, Series on issues in international investment agreements (New York and Geneva, United Nations, 2004), available at <http://www.unctad.org/iia>.

[2] WTO, Ministerial Conference, Fourth Session, Doha, 9–14 November 2001, Ministerial Declaration, WT/MIN(01)/DEC/1. Negotiations over investment rules were dropped from the Doha Development Agenda (DDA) in 2004.

[3] See M Sornarajah, *The International Law on Foreign Investment* (Cambridge, Cambridge University Press, 2nd edn, 2004); Rudolf Dolzer and Margrete Stevens, *Bilateral Investment Treaties* (The Hague, Nijhoff, 1995). Muchlinski states, 'Among other, less common, specific standards to be found in BITs are: … transparency obligations', citing the US-Uruguay BIT of 25 October 2004, Art 8: 44 ILM 268 (2005) and the above UNCTAD study (n 1), but he does not elaborate further: Peter T Muchlinski, *Multinational Enterprises and the Law* (Oxford, Oxford University Press, 2nd edn, 2007) at 693. But see below n 22.

[4] The main purpose of the trade facilitation negotiation now in progress in the DDA is enhancing transparency in trade.

[5] See further Peter Muchlinski, 'Corporate Social Responsibility', ch 17 below.

[6] National treatment and market access are also basic principles, but these are applied to matters

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

to which contracting states have made commitments. Therefore the ambit of the application of national treatment and market access is very restrictive. On the contrary, transparency and MFN are applied to all matters in principle. See General Agreement on Trade in Services 1994, available at <http://www.wto.org>.

[7] GATS Article III: Transparency:

> '**1**. Each Member shall publish promptly and, except in emergency situations, at the latest by the time of their entry into force, all relevant measures of general application which pertain to or affect the operation of this Agreement. International agreements pertaining to or affecting trade in services to which a Member is a signatory shall also be published.
>
> **2**. Where publication as referred to in paragraph 1 is not practicable, such information shall be made otherwise publicly available.
>
> **3**. Each Member shall promptly and at least annually inform the Council for Trade in Services of the introduction of any new, or any changes to existing, laws, regulations or administrative guidelines which significantly affect trade in services covered by its specific commitments under this Agreement.
>
> **4**. Each Member shall respond promptly to all requests by any other Member for specific information on any of its measures of general application or international agreements within the meaning of paragraph 1. Each Member shall also establish one or more enquiry points to provide specific information to other Members, upon request, on all such matters as well as those subject to the notification requirement in paragraph 3. Such enquiry points shall be established within two years from the date of entry into force of the Agreement Establishing the WTO (referred to in this Agreement as the "WTO Agreement"). Appropriate flexibility with respect to the time-limit within which such enquiry points are to be established may be agreed upon for individual developing country Members. Enquiry points need not be depositories of laws and regulations.
>
> **5**. Any Member may notify to the Council for Trade in Services any measure, taken by any other Member, which it considers affects the operation of this Agreement.'

[8] See UNCTAD, above n 1 at 36–7.

[9] John H Jackson, *World Trade and the Law of GATT* (Indianapolis, Bobbs-Merill Company, 1969) 461. Nowadays Art 10 of GATT is interpreted as the obligation of transparency. See Petros C Mavroidis, *The General Agreement on Tariffs and Trade: A Commentary* (Oxford, Oxford University Press, 2005) 270–2.

[10] See Arie Reich, *International Public Procurement Law* (The Hague, Kluwer Law International, 1999) 117–25; Gilbert R Winham, *International Trade and the Tokyo Round Negotiations* (Princeton, Princeton University Press, 1986) 358.

[11] Agreement between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the Republic of Vanuatu for the Promotion and Protection of Investments (Port Vila, 22 December 2003) Vanuatu No. 1 (2004) (the Agreement is not in force) Cm 6169, available at <http://www.fco.gov.uk/Files/kfile/Cm6169,0.pdf>.

[12] See eg the US-Senegal BIT of 6 December 1983 entered into force 25 October 1990, <http://www.state.gov/documents/organization/43585.pdf>. Art II(10): 'Each party shall make public by existing official means all laws, regulations, administrative practices and procedures, and adjudicatory decisions that pertain to or affect investments in its territory of nationals or companies of the other Party. 11. The treatment accorded by a Party to nationals or companies of the other Party under the provisions of paragraphs 1 and 2 of this Article shall in any State, Territory, possession, or political or administrative subdivision of the Party be the treatment accorded therein to companies incorporated, constituted or otherwise duly organized in other States, Territories, possessions, or political or administrative subdivisions of the Party.'

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

[13] US-Panama BIT of 27 October 1982, entered force 30 May 1991, available at <http://www.state.gov/documents/organization/43582.pdf>.

[14] The Treaty between the Republic of Poland and the United States of America concerning Business and Economic Relations of 21 March 1990, available at <http://tcc.export.gov/static/doc_exp_005367.asp> or <http://www.unctad.org/sections/dite/iia/docs/bits/us_poland.pdf>.

[15] See Kenneth J Vandevelde, *United States Investment Treaties* (Deventer, Kluwer Law and Taxation Publishers, 1992) 235–44.

[16] See US Model BIT of 2004 at <http://ita.law.uvic.ca/documents/USmodelbitnov04.pdf>:

‘Article 10 : Publication of Laws and Decisions Respecting Investment

1. Each Party shall ensure that its: (a) laws, regulations, procedures, and administrative rulings of general application; and (b) adjudicatory decisions respecting any matter covered by this Treaty are promptly published or otherwise made publicly available.

2. For purposes of this Article, “administrative ruling of general application” means an administrative ruling or interpretation that applies to all persons and fact situations that fall generally within its ambit and that establishes a norm of conduct but does not include: (a) a determination or ruling made in an administrative or quasi-judicial proceeding that applies to a particular covered investment or investor of the other Party in a specific case; or (b) a ruling that adjudicates with respect to a particular act or practice.

Article 11 : Transparency

1. Contact Points

(a) Each Party shall designate a contact point or points to facilitate communications between the Parties on any matter covered by this Treaty. (b) On the request of the other Party, the contact point(s) shall identify the office or official responsible for the matter and assist, as necessary, in facilitating communication with the requesting Party.

2. Publication

To the extent possible, each Party shall: (a) publish in advance any measure referred to in Article 10(1)(a) that it proposes to adopt; and (b) provide interested persons and the other Party a reasonable opportunity to comment on such proposed measures.

3. Provision of Information

(a) On request of the other Party, a Party shall promptly provide information and respond to questions pertaining to any actual or proposed measure that the requesting Party considers might materially affect the operation of this Treaty or otherwise substantially affect its interests under this Treaty. (b) Any request or information under this paragraph shall be provided to the other Party through the relevant contact points. (c) Any information provided under this paragraph shall be without prejudice as to whether the measure is consistent with this Treaty.

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

4. Administrative Proceedings

With a view to administering in a consistent, impartial, and reasonable manner all measures referred to in Article 10(1)(a), each Party shall ensure that in its administrative proceedings applying such measures to particular covered investments or investors of the other Party in specific cases: (a) wherever possible, covered investments or investors of the other Party that are directly affected by a proceeding are provided reasonable notice, in accordance with domestic procedures, when a proceeding is initiated, including a description of the nature of the proceeding, a statement of the legal authority under which the proceeding is initiated, and a general description of any issues in controversy; (b) such persons are afforded a reasonable opportunity to present facts and arguments in support of their positions prior to any final administrative action, when time, the nature of the proceeding, and the public interest permit; and (c) its procedures are in accordance with domestic law.

5. Review and Appeal

(a) Each Party shall establish or maintain judicial, quasi-judicial, or administrative tribunals or procedures for the purpose of the prompt review and, where warranted, correction of final administrative actions regarding matters covered by this Treaty. Such tribunals shall be impartial and independent of the office or authority entrusted with administrative enforcement and shall not have any substantial interest in the outcome of the matter. (b) Each Party shall ensure that, in any such tribunals or procedures, the parties to the proceeding are provided with the right to: (i) a reasonable opportunity to support or defend their respective positions; and (ii) a decision based on the evidence and submissions of record or, where required by domestic law, the record compiled by the administrative authority. (c) Each Party shall ensure, subject to appeal or further review as provided in its domestic law, that such decisions shall be implemented by, and shall govern the practice of, the offices or authorities with respect to the administrative action at issue.'

[17] See the US-Uruguay BIT of 25 October 2005 in 44 ILM 265 (2005) Arts 10 and 11.

[18] See UNCTAD, *Investment Provisions in Economic Integration Agreements* (New York and Geneva, United Nations, 2006) at 88, citing the US-Singapore FTA Art 19.5. See too US-Chile FTA of 6 June 2003 Art 10.20, available at <http://www.unctad.org/sections/dite/iia/docs/Compendium//en/290%20volume%2012.pdf>.

[19] See eg the Canadian Model BIT 2004 Art 19, available at <http://ita.law.uvic.ca/documents/Canadian2004-FIPA-model-en.pdf>.

[20] OECD, *Public Sector Transparency and International Investment Policy* (Paris, OECD, 11 April 2003) at 5.

[21] UNCTAD, *Key Issues*, above n 1 at 285–9.

[22] See further UNCTAD, *Bilateral Investment Treaties 1995–2006: Trends in Investment Rulemaking* (New York and Geneva, United Nations, 2007) at 76–80. The study concludes: 'only a small—albeit growing—number of BITs of the last decade include provisions on transparency. However, to the extent that BITs deal with this issue, there have been significant developments concerning the content of the clause. Transparency is no longer perceived as a matter of the contracting parties exchanging investment-related information. In addition, a few recent BITs grant information rights to "all interested persons" and even allow them to comment upon draft legislation. Some BITs also enhance investor rights in administrative and judicial proceedings and provide for third-party participation'.

[23] See eg Japan-Vietnam BIT 2003 Art 7 in UNCTAD, above n 22 at 77.

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

[24] Howard Mann, 'The IISD Model International Agreement on Investment for Sustainable Development: An Introductory Note', 20 ICSID Rev-FILJ 84 ff (2005).

[25] See Stephen Vasciannie, 'The Fair and Equitable Treatment Standard in International Investment Law and Practice', 70 BYIL 99 (1999) at 102–5.

[26] When the arbitration under NAFTA started in the 1990s, the issue whether damage to investments might arise from expropriation by host states was highly controversial. Following that, the definition of fair and equitable treatment has come to be a central topic of discussion as it has been shown that the theory of regulatory expropriation is not so easily confirmed: on which see further August Reinisch, Ch 11 above and Todd Grierson-Weiler and Ian A Laird, ch 8 above.

[27] *Metalclad Corporation v The United Mexican States*, ICSID Case No. Arb(AF)/97/1, 40 ILM 36 (2001).

[28] Ibid at paras 75–6.

[29] Ibid at para 99.

[30] See Patrick G Foy and Robert J Deane, 'Foreign Investment Protection under Investment Treaties: Recent Developments under Chapter 11 of the North American Free Trade Agreement', 16 ICSID Rev-FILJ 299 at 325–9 (2001).

[31] The *United Mexican States v Metalclad Corporation*, 2001 BCSC 664.

[32] Ibid at paras 70–2.

[33] *Técnicas Medioambientales Tecmed, SA v United Mexican States*, ICSID Case No. Arb(AF)/00/2 (Spain/ Mexico BIT), Award, 29 May 2003, 43 ILM 133 (2004).

[34] Ibid at para 154.

[35] *Saluka Investments BV (The Netherlands) v The Czech Republic (Dutch/Czech BIT)*, Partial Award, 17 March 2006 at <http://ita.law.uvic.ca/documents/Saluka-PartialawardFinal.pdf>.

[36] *Myers (SD) Inc v Canada*, NAFTA Arbitration, UNCITRAL Award of 12 November 2000, 40 ILM 1408 (2001) para 263.

[37] *Saluka*, above n 35 at para 297.

[38] Ibid at para 298.

[39] Ibid at para 302.

[40] According to the tribunal, 'A foreign investor whose interests are protected under the Treaty is entitled to expect that the Czech Republic will not act in a way that is manifestly inconsistent, non-transparent, unreasonable (*i.e.* unrelated to some rational policy), or discriminatory (*i.e.* based on unjustifiable distinctions). In applying this standard, the Tribunal will have due regard to all relevant circumstances.' Ibid at para 309.

[41] Note Ian Brownlie, *Principles of Public International Law* (Oxford, Oxford University Press, 6th edn, 2003) at 501–2.

[42] *Pope and Talbot v Canada*, UNCITRAL; Award on the Merits of Phase 2, 10 April 2001 at <http://ita.law.uvic.ca/documents/PopeandTalbot-Merit.pdf>.

[43] Ibid at para 110.

[44] *Tecmed*, above n 33 at para 153.

[45] *MTD Equity Sdn Bhd & MTD Chile SA v Chile*, ICSID Case No. Arb/01/7 Final Award, 25 May 2004, 44 ILM 91 (2005).

[46] Ibid at paras 114–15.

[47] Ibid at para 109.

[48] Ibid at para 113.

[49] See eg *Genin v Estonia*, ICSID Case No. Arb/99/2 Award of 25 June 2001, 17 ICSID Rev-FILJ 395

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

(2002) where the reality of administering financial sector supervisory functions in a transitional economy was thought relevant to determining whether the investor had been unfairly and inequitably treated. Indeed, the tribunal noted that the investor had been less than fully transparent towards the regulatory authorities as to the precise ownership structure of their investment in that country, which led in part to their decision to revoke his licence to operate. See further Peter Muchlinski, '"Caveat Investor?" The Relevance of the Conduct of the Investor under the Fair and Equitable Treatment Standard', 55(3) ICLQ 527 (2006) at 540–1.

50 But note that the investor may also have responsibilities to act reasonably in assessing the commercial viability of the investment: see *MTD Equity*, above n 45 and Muchlinski, above n 49 at 542–7.

From: Oxford Public International Law (http://opil.ouplaw.com). (c) Oxford University Press, 2015. All Rights Reserved. Subscriber: Dechert LLP Paris; date: 02 October 2015

CLA-000054

THE GOVERNMENT AT THE STANDARDS BAZAAR

Stacy Baird*

In recent years, there has been heightened interest in having government intervene in what has become primarily a market activity to mandate information technology standards. This article will provide an analytical framework by which government can consider such actions. I premise my proposal on the conclusion that government should be reluctant to intervene in the setting of information technology standards (and particularly, to mandate a particular standard that has not been developed and/or widely adopted by the market) because: (1) the relevant industries are sophisticated in regard to standards setting and have many well-developed types of standards, and forums in which to develop standards; (2) the U. S. government has a strong preference for market-developed information technology standards and promotes this preference as a matter of both domestic law and policy and foreign trade policy; (3) international trade agreements limit the degree to which participating governments can mandate standards; and (4) in contrast to the sophistication of the marketplace, government is rarely as informed, sophisticated in its understanding of the market, or nimble enough to respond to market conditions; therefore, the risk of government failure is significant, and indeed greatest where the market is young and dynamic, as is the case with regard to the current market affected by information technology standards.

Based on these premises, this article proposes the following test, which appears as a flow chart in the Appendix. First, the government should identify which of three categories describe the instant circumstances: (1) clear cases for intervention, those where there is a government responsibility to meet a critical public interest objective and the standard is essential for the government to meet that objective; (2) "gray area" cases, where the standard is relevant to either (a) meeting a public interest objective arising in the context of a non-critical issue in the area of national security, defense, public safety, health or

---

* Mr. Baird was Senior Policy Advisor to U.S. Senator Maria Cantwell and Brookings Institution Legislative Fellow advising Rep. Howard Berman on intellectual property and technology issues. He is now a consultant to entertainment and information technology companies. This article was written in the course of consulting for Microsoft. The views expressed herein are solely those of the author. Mr. Baird would like to thank Grace Koh for her invaluable assistance and contribution.

welfare, or (b) providing an essential but non-critical government service; and (3) cases that are clearly not circumstances for government intervention. As to determining whether to intervene in a case arising within the first category, where a critical public interest objective is at stake and a standard is essential to meet the objective, the government should take all necessary measures to address the objective. That said, pursuant to clear government policy, even in these cases government should be predisposed to implement market-developed standards and may apply the same test as described for "gray area" cases. In a "gray area" case, there must be a significant and substantial market failure to develop a standard to meet the important public interest objective before the government should consider mandating a particular standard. "Significant and substantial" means the market failure has proved to be a barrier to government action to address the important public interest objective. The government should further consider mitigating factors, such as whether the market has had a reasonable time, relative to the circumstances, to develop, approve, and implement the standard and whether there is cohesiveness among the stakeholders (i.e., whether stakeholders have adequate forums in which to act in the specific situation). The government and industry should support credible and informed non-governmental public interest (e.g., consumer-oriented) representation to potentially obviate the need for direct government action later on.

Where a government decides to intervene, intervention should be reasonably tailored to rectify the identified market failure and to achieve the particular public interest objective. The government should limit the scope of intervention and define objectives. In order to assure the most narrowly tailored intervention, government should clearly articulate: (a) the specifics of the important public interest objective in the establishment of a particular information technology standard; (b) the purpose and scope of the government intervention; and (c) defined objectives for government intervention to achieve. The government should proceed incrementally with intervention. The first step should be to encourage market behavior through incentives. As a second step, the government should use its leverage as a major market participant and potential regulator to influence market behavior; however, the government should behave as a rational consumer, and it should consider not only the public interest objective at issue, but also the general public good. At each stage of intervention, the government should consider how best to mitigate the risk of harm of "non-market failure." To this end, where the government does intervene, intervention should reflect the market norms and market behaviors to the greatest extent possible.

I. INTRODUCTION

In recent years, there has been heightened interest in having the state or federal government (or a corresponding foreign governing body) intervene in

the information technology standards-setting process to mandate a particular standard.[1] The question of whether the government should mandate a particular information technology standard has arisen in several contexts, including entertainment content protection (e.g., efforts to implement standardized copy protection measures such as the broadcast flag, digital rights management, etc.), access to government services (e.g., state government requirement of the open-standard formats for all government documents), and efforts to achieve greater interoperability for data exchange in the areas of law enforcement, national security, and healthcare. The question of the government's proper role in setting standards has spurred substantial debate. However, to date there has been no objective analysis by which the need for and nature of government action may be determined. It is up to government policymakers to determine the best course in the public interest. This Article will outline a framework to

---

1. For the purpose of this discussion, I define the term "standard" as a written specification that facilitates interoperability between information technology networks, applications, or services, enabling such components to exchange and use information. In simple terms, an information technology standard enables software, hardware, or information technology services to "talk" to each other. More specifically, a standard is a technical description of the functionality or features necessary for interoperability; it is a description of the *requirements* to achieve interoperability, not a specific implementation of such a "description." For example, a standard for automobiles might be the technical requirement that the engine would run on gasoline with an octane rating ranging from 86 to 92. An implementation might be the General Motors design of a piston engine, or a Mazda design of a Wankel rotary engine. In the information technology sphere, one example of a standard is the XML file format that enables the creation of documents that can be read, revised, managed, saved, and stored across a broader array of applications and platforms. In terms of interoperability, this is not the same as "interchangeability," which is the ability to substitute one product or system for another to perform the same functions (i.e., the creation of a piece of software or an information technology system that functions in the same manner as another product and is used to replace such other product). As two U. S. courts have concluded, describing "interoperability" in this manner would be overly broad. *See* Massachusetts v. Microsoft Corp., 373 F.3d 1199, 1225 n.16 (D.C. Cir. 2004); New York v. Microsoft Corp., 224 F. Supp. 2d 76, 122 (D.D.C. 2002). Interoperability, in the meaning I give the term, allows information technologies to provide differing features and characteristics, while at the same time ensuring that such different technologies can communicate to exchange data with one another.

I use the terms "government intervention in the setting of information technology standards" and "government-mandated standards" to describe a government action to establish or mandate by law or policy a particular information technology standard in cases where the market/industry has not developed and/or approved a standard. I do not mean to include in my definition the government's participation in the standard-setting process as a full participant in standards-setting organizations, or as a potential customer for (or even developer of) a standard. I also do not mean to necessarily frown upon situations where governments simply "ratify," "bless," or "codify" in their rules for enforcement purposes information technology standards that have previously been developed, tested, and approved by industry (assuming the government action provides an opportunity to expeditiously adapt or revise the standard as technology evolves). I also take the liberty of conflating computing technology with consumer electronics, and discuss them collectively as "information technology." Finally, I will feel free to take examples from each sector, given their ongoing convergence.

guide government policy when the following question arises: should the government intervene in the market to mandate an information technology standard?

II. BACKGROUND

The past decade has been a dynamic period in the information technology standards-setting world. The explosive growth of the role of information technology in our society and as a component of our economy has dramatically elevated the importance of information technology interoperability. Interoperability may be achieved in a number of ways, through intellectual property licensing and cross-licensing, relatively simple technical means (for instance, in information technologies and consumer electronics, converters and translators are commonplace in both software and hardware), through industry collaboration with companies working to facilitate interoperability among their products, through a company designing its product to interoperate with the products of other companies, and through consulting services that facilitate interoperability among otherwise non-interoperable technologies. And indeed, as I suggest above, interoperability between modern technologies is often a far simpler task than during previous eras of technological evolution wherein inventors were limited by physical characteristics and mechanical interactions. This said, I will be focusing on standards and standard setting, as standards have been the focal point for government action and significantly, an integral part of some commercial competitive strategies.

The increased need for interoperability has in turn resulted in enormous demand for standards at a pace that challenges traditional standards-setting processes. Concurrently, government programs have transitioned from reliance on government-specific standards, such as MilSPEC/MilStandards, to voluntary standards developed in the private sector, placing an additional burden on standards-setting forums.[2] As a result of these factors, the information technologies industries are in an extremely competitive commercial environment, one that is also reliant on standards that facilitate interoperability among increasingly heterogeneous products and services. The high demand for interoperability is in turn creating an environment wherein stakeholders are more likely to turn to government to intervene in the market to aid in achieving particular goals more rapidly than may occur in the natural course of market activity.

In some cases, the government is being asked by one business sector or

2. MilSPEC and MilStandards are respectively the "military specifications" and "military standards" developed by Department of Defense engineers and technicians to describe the products to be made by contractors. *See* U.S. GEN. ACCOUNTING OFFICE, GAO/NSIAD-95-14, ACQUISITION REFORM: DOD BEGINS PROGRAM TO REFORM SPECIFICATIONS AND STANDARDS (Oct. 1994), *available at* http://www.gao.gov/archive/1995/ns95014.pdf.

another to play a role in, or even to take responsibility for, setting information technology standards, the development of which were vexing the industry with conflicting interests, or identified by one proponent or another to need government assistance to accelerate the advancement of one technological solution, business model, or corporate venture over another. Throughout this dynamic period, governments have been asked by stakeholders, or have independently pursued mandating particular information technology standards, in several areas:

Copyright protection and digital rights management for copyrighted works. This has been a technical, legal, and political issue for years. Examples include recent efforts to seek a government mandate, such as legislation introduced by U.S. Senator Hollings that set a deadline for market action, the failure of which would precipitate a government mandate for digital rights management standards.[3] There have been efforts by both Congress[4] and the Federal Communications Commission (FCC)[5] to establish a "broadcast flag" with specific technical standards for digital broadcast television.[6]

Open Source Software. There is an ongoing debate as to whether governments should mandate standards that are implemented with open source code software over proprietary software because, proponents of open source argue, open source software has characteristics that are better aligned with the needs of government (e.g., Massachusetts's selection of open standards formats for all state government documents[7]) and government adoption would accelerate broader market adoption of open source applications.

National security information sharing. Subsequent to the events of September 11, 2001, there has been heightened attention given to improving data interoperability to facilitate better information sharing between law enforcement, intelligence, immigration, and foreign service agencies, to better

---

3. Consumer Broadband and Digital Television Promotion Act, S. 2048, 107th Cong. (2002), *available at* http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=107_cong_bills&docid=f:s2048is.txt.pdf.

4. *See* Perform Act of 2007, S. 256, 110th Cong. (2007); Digital Transition Content Security Act of 2005, H.R. 4596, 109th Cong. (2005); Communications Opportunity, Promotion, and Enhancement Act of 2006, H.R. 5252, 109th Cong. (2005).

5. *See infra* notes 149-151, 166-168 and accompanying text.

6. The term "broadcast flag" refers to a digital "marker" encoded into a digital television program that triggers compliance rules in a broadcast flag-compliant digital television receiving device (that which is designed to recognize and comply with the flag). These rules instruct the device as to how to treat the content, for instance, whether to allow copying or not. The term "broadcast flag" is often used to describe in the collective the marker, compliance rules, and a statutory or regulatory requirement that the technology be incorporated into receiving devices. *See* CTR. FOR DEMOCRACY & TECH., IMPLICATIONS OF THE BROADCAST FLAG: A PUBLIC INTEREST PRIMER (VERSION 2.0) (2003), *available at* http://www.cdt.org/copyright/20031216broadcastflag.pdf#search=%22cdt%20broadcast%20flag%22.

7. *See infra* notes 153-157 and accompanying text.

protect our borders and U.S. citizens. The USA PATRIOT Act[8] and its progeny addressed this and related issues.

Emergency communications interoperability. Also subsequent to the events of September 11th, there has been greater interest in improving radio and data communications interoperability for fire, law enforcement, and other "first responders." The USA PATRIOT Act and its progeny took steps to accomplish improvements, and several bills in Congress seek to provide spectrum and other resources to fully execute an interoperability strategy.[9]

Electronic medical records. Since the early 1990s, research has shown that conversion from paper to interoperable electronic health care records and prescription systems, would save thousands of lives and billions of dollars annually. Recently, the government has given significant attention to this problem. Numerous bills have been introduced in Congress and the President has made this a priority.[10]

Law enforcement interception of electronic communications. With voice-over-internet-protocol (VoIP) gaining popularity, early in the development of VoIP, the FBI sought legislation to require VoIP service providers to comply

---

8. Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism (USA PATRIOT Act) Act of 2001, Pub. L. No. 107-56, 115 Stat. 272.

9. Including, in the 109th Congress, see 21st Century Emergency Communications Act, H.R. 5852, 109th Cong. (2006), *available at* http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=109_cong_bills&docid=f:h5852rfs.txt.pdf; Communications, Consumer's Choice, and Broadband Deployment Act, S. 2686, 109th Cong. (2006), *available at* http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=109_cong_bills&docid=f:s2686is.txt.pdf; SAVE LIVES Act, S. 1268, 109th Cong. (2005), *available at* http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=109_cong_bills&docid=f:s1268is.txt.pdf.

10. Also in the 109th Congress, see Electronic Health Information Technology Act, H.R. 4832, 109th Cong. (2006), *available at* http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=109_cong_ bills&docid= f:h4832ih.txt.pdf; Information Technology for Health Care Quality Act, S. 1223, 109th Cong. (2005), *available at* http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=109_cong_bills&docid=f:s1223is.txt.pdf; Patient Safety and Quality Improvement Act, S. 554, 109th Cong. (2005), *available at* http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=109_cong_bills&docid=f:s544is.txt.pdf; Healthy America Act, S. 1503, 109th Cong. (2005), *available at* http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=109_cong_bills&docid=f:s1503is.txt.pdf; Affordable Healthcare Act, S. 16, 109th Cong. (2005), *available at* http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=109_cong_bills&docid=f:s16is.txt.pdf; Health Technology to Enhance Quality Act, S. 1262, 109th Cong. (2005), *available at* http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=109_cong_bills&docid=f:s1262is.txt.pdf; Health Information Technology Act, S. 1227, 109th Cong. (2005), *available at* http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=109_cong_bills&docid=f:s1227is.txt.pdf; 21st Century Health Information Act, H.R. 2234, 109th Cong. (2005), *available at* http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=109_cong_bills&docid=f:h2234ih.txt.pdf.

with Communications Assistance for Law Enforcement Act (CALEA)[11] requirements to make the providers' facilities accessible to law enforcement for the interception of VoIP communications. The FCC ultimately published a rulemaking describing the requirements.[12]

III. SUBSTANTIAL BASIS FOR GOVERNMENT RELUCTANCE IN MANDATING INFORMATION TECHNOLOGY STANDARDS

There are several premises upon which I base my conclusion that government should be reluctant to mandate an information technology standard. The first is that the information technology industries are generally sophisticated and well structured to develop standards. The second is that U.S. law and public policy guides government, particularly the U.S. federal government, to a preference for market-developed standards. Third, trade agreements may preclude government from setting technology standards that may impact international trade. The fourth factor is the high risk of government failure, or "non-market failure." Upon this substantial basis for government reluctance, I base the analytic process described herein.

A. THE RELEVANT INDUSTRIES ARE WELL STRUCTURED TO DEVELOP STANDARDS

One of the first set of factors for the government in analyzing an apparent market failure is to consider how sophisticated the market participants are and how well-developed the market is. In the context of standards development, the questions to consider might include: is the industry mature; are the participants sophisticated in their ability to develop standards; are there well-developed institutional structures to facilitate standards development. The industries this article describes as the information technology sector include the computing and software industries, the entertainment industry, and consumer electronics industry, and, in some instances, telecommunications and broadcast industries. Each of these industries has a long and successful history of standards setting. In relation to each industry and the broad convergence of these industries, there are many now well-trodden paths the market can take to establish an information technology standard. Indeed, these are sophisticated participants in mature industries, experienced in developing standards. As evidence of this, there are a number of approaches and institutions, well-established and newly-

11. 47 U.S.C. §§ 1001-10 (1994).

12. *In re* Communications Assistance for Law Enforcement Act & Broadband Access & Services, 20 F.C.C.R. 14,989 (Sept. 23, 2005); *In re* Communications Assistance for Law Enforcement Act & Broadband Access & Services, 19 F.C.C.R. 15,676 (Aug. 9, 2004). Congress and the FCC recently imposed CALEA requirements on VoIP providers. *See* Communications Assistance for Law Enforcement Act, 47 U.S.C. § 1001-10 (1994); *In re* Communications Assistance for Law Enforcement Act & Broadband Access & Services, 21 F.C.C.R. 5360 (May 12, 2006).

evolving, in which these industries develop standards. Further, there are many and varied types of standards used by these industries.

1. MANY AVENUES AND FORUMS EXIST FOR INFORMATION TECHNOLOGY STANDARDS DEVELOPMENT

There are numerous forums for the development of information technology standards. The traditional courses for standards development are voluntary consensus forums including formal standards development organizations such as Institute of Electrical and Electronics Engineers (IEEE), International Electrotechnical Commission (IEC), International Telecommunications Union (ITU), industry or sector-specific standards-setting organizations (e.g., InterNational Committee for Information Technology Standards (INCITS), Internet Engineering Task Force (IETF), Telecommunications Industry Association (TIA), Organization for the Advancement of Structured Information Standards (OASIS), European Computer Manufacturers Association (ECMA), Association of Computing Machinery (ACM), Audio Engineering Society (AES), and Society of Motion Picture and Television Engineers (SMPTE)), and trade associations (e.g., Consumer Electronics Association (CEA) and the National Association of Broadcasters (NAB)). These forums have produced an endless list of standards, including: IEEE 802.11 (popularly known as Wi-Fi, a wireless digital interconnect); IEEE 1394 (also known as Sony iLink or Apple Firewire high bandwidth digital interconnect), and TCP/IP Internet communications protocol (IETF). These standards development organizations are exceedingly credible and common to all industries that rely on standards. At the most formal end of standards setting are standards development organizations accredited by ANSI, the American National Standards Institute. ANSI is the only accredited U.S. entity that is a member of the International Standards Organization and the International Electrotechnical Commission (IEC). A standard set by an ANSI-accredited standards development organization may be approved by ANSI as an American National Standard. Several of the formal standards development organizations listed above are ANSI accredited.

There is also a robust ecosystem for informal standards development. A now common approach to standards setting is where the relevant industries or businesses develop and support a standard by mutual agreement through a consortium. Consortia are organizations formed by companies interested in developing a standard to serve their mutual interests. Typically, because these organizations are formed to meet the specific standards needs of the interested companies, the process can be more efficient.[13] Consortia come in many

13. In fact, although it may, to the uninitiated, appear that fewer participants with a greater commonality in interest would result in a less contentious process, participants often have as many competing interests as those in common, so often consortia can be as rigorous a process as formal standards development organizations.

flavors, from very informal to very formal, having very similar processes and characteristics as a traditional standards development organization. Consortia-developed standards examples abound including video standards such as VGA and SXGA analog computer display standards (VESA); digital transmission standards such as digital subscriber line, or DSL (DSL Forum); Internet-related developer standards such as HTML (W3C), XML (W3C and OASIS), SOAP (W3C) and Synchronized Multimedia Integration Language (SMIL, W3C); OpenCable Application Platform (or OCAP, a set of standards that will facilitate interactive video interoperability, i.e., a unified developers platform for set-top boxes, consumer electronics devices, game devices, digital video recorders, portable devices, PCs, etc.),[14] the Advanced Access Content System

---

14. OpenCable is the result of the work of FCC authorized consortium, CableLabs. OCAP uses some patented software that are licensed to users of the standard. Numerous diverse companies have agreed to license OCAP from CableLabs. *See* Press Release, CableLabs, Twenty-eight Firms Demonstrate Interoperability on OCAP and eTV Platforms at CableLabs Event (Aug. 17, 2005), *available at* http://www.cablelabs.com/news/pr/2005/05_pr_ocap_interop_081705.html. *See, e.g.*, Press Release, CableLabs, Funai Licenses CableLabs® Technology for Interactive Digital Cable Products (Oct. 17, 2006), *available at* http://www.cablelabs.com/news/pr/2006/06_pr_funai_chila_101706.html. In addition, see generally OpenCable press releases describing several major licensing agreements at http://www.opencable.com/news/archive.html. There have been concerns over the specifics of OpenCable standards and the credibility of the organization developing the standards, CableLabs. The FCC designated the standard development authority to CableLabs, an organization created by cable companies. Initially, CableLabs worked with consumer electronics companies and excluded participation by the computer and software industries. There was (and continues to be) consternation that CableLabs was developing standards that implicated industries other than cable and consumer electronics without allowing for the input from these other industries. In 2003, the FCC agreed with the commenters that raised these concerns and issued an order requiring CableLabs to consider the input of these sectors. *See In re* Implementation of Section 304 of the Telecommunications Act of 1996, 18 F.C.C.R. 20,885, 20,919 ¶ 78 (Oct. 9, 2003). The FCC further established an interim rule creating a route for companies to appeal CableLabs decisions, placing the burden on CableLabs to prove their objectivity in denying the recommendations by these participants. The order stated:

> Any interested party, including but not limited to consumer electronics manufacturers, content providers, information technology companies or consumers, may appeal an initial decision by CableLabs to the Commission. CableLabs shall bear the burden of proof that its initial determination, whether an approval or disapproval, was justified. In any responsive pleading to an appeal before the Commission, CableLabs will specify each of the objective criteria used to evaluate the proposed output and copy protection technology and articulate in detail how such proposed output and copy protection technology met or failed to meet each of the criteria. Should CableLabs disapprove a particular output or content protection technology, we expect that CableLabs will articulate in detail the reasons for its disapproval. The Commission will review *de novo* both the reasonableness and necessity of the objective criteria, as well as CableLab's application thereof to the proposal under consideration. We clarify that parties seeking Commission review may file a petition for special relief pursuant to our normal procedures under Section 76.7 of the Commission's rules. The Commission will address such petitions on an expedited basis.

Licensing Administrator (AACS LA) digital rights management for high-definition videodisk standards (adopted into both HD-DVD and BluRay standards), Universal Plug-N-Play developed by Microsoft and numerous third-party equipment manufacturers (UPnP Forum) ostensibly to simplify and automate an end-user's installation of hardware on a computer that uses the Windows operating system.

Although consortia can be less transparent or open in their processes than traditional standards development organization, they have their important place in the standards arena. As Oliver Smoot, then Chairman of the Board of ANSI, testified before Congress:

> The information technology industry does have a special challenge because it uses every kind of standardization process imaginable, ranging from the most informal meeting possible to the very formal processes that result in an American National Standard. However these challenges do not impair their ability to compete domestically or internationally. Now, even within the subset of standards development, and it is this very flexibility that makes them useful. . . . Because they meet real needs, consortia-developed standards are fully acceptable to, and widely used by, industry and the U.S. Government to procure and use advanced technologies and, in fact, to procure and use technologies of all kinds. . . .[15]

As Gerald Ritterbusch, the Director of Standards for Catapiller, observed at that same hearing:

> [T]he IT industry needs the right mix of standards that are developed in both the formal and those that can develop through the consortia process. The IT industry has a definite need for speediness in bringing standards to the market so they can be used. Consortia provide the speed while the formal standards system, through its openness and balance, takes a little longer, but I believe that there needs to be the right mix of using both the formal and the consortia and that needs to be chosen by the users of the standards and the players in the process. [16]

Some have expressed the concern that consortia are potentially at risk of capture by the largest of industry players. Standards expert and Director of

---

Id. at ¶ 79 (footnotes omitted).

Recently, the consumer electronic industry, with support from the computer and software industry, filed a joint proposal with the FCC to withdraw support from OCAP. *See* Letter from Michael T. Williams, Executive Vice President, Sec'y & Gen. Counsel, Sony Electronics Inc., et al. to the Hon. Kevin J. Martin, Chairman, Federal Commc'n Comm'n, CS Docket No. 97-80 (Nov. 7, 2006), *available at* http://gullfoss2.fcc.gov/prod/ecfs/retrieve.cgi?native_or_pdf=pdf&id_document=6518539866.

15. *Standards-setting and United States Competitiveness: Hearing Before the H. Subcomm. on Environment, Technology & Standards*, 107th Cong. 23 (2001) (statement of Oliver Smoot, Chairman of Board, American National Standards Institute), *available at* http://commdocs.house.gov/committees/science/hsy73317.000/hsy73317_0f.htm [hereinafter Standards-Setting Hearing].

16. *Id.* at 26 (statement of Gerald H. Ritterbusch, Director of Standards, Catapiller, Inc.).

Standards for Sun Microsystem, Carl Cargill, in testifying before Congress, observed, "Very rarely do you get a captive consortia that is trying to prejudice the market in its own favor. Normally, consortia benefit the entire market. That is one of the requirements."[17] In regard to mitigating the risk of antitrust issues in the context of standards setting, as the FTC's David Balto observed, "where the standard setting process is dominated by users or other vertically related firms, rather than rival producers, competitive injury is unlikely. The involvement of buyers in the design of standards may reduce competitive concerns."[18]

One mechanism that is used to address complex patent licensing issues surrounding standards in an efficient manner is the "patent pool." A "patent pool" is the sharing, or pooling, of patent ownership interests to benefit the market at large. There is a long history of the use of "patent pools" in connection with the development of standards, or the adoption of a proprietary technology into a standard; the broadcasting, consumer electronics and information technology industries have long been part of that history. Often it is the pioneers in an industry or technical achievement that take this approach. An early example in the information technology sphere was the Associated Radio Manufacturers, later renamed the Radio Corporation of America. Formed in 1924, the Associated Radio Manufacturers brought together the radio interests of American Marconi, American Telephone and Telegraph (AT&T), General Electric and Westinghouse, to develop standards for radio parts, spectrum management, and television transmission standards.[19] Fast forward to 1998, when Sony, Philips, and Pioneer developed the DVD-Video and DVD-ROM standard specifications, and 1999, when Hitachi, Matsushita, Time-Warner, Toshiba, and others pooled patents for DVD compliant products. Modern computing technology standards using patent pools include MPEG, MPEG-2 AAC audio codec, DVI, and USB. Even as recently as last year, RFID vendors formed a patent pool to resolve intellectual property rights ownership issues.[20] The U.S. Patent and Trademark Office has clearly stated its

---

17. *Id.* at 31 (statement of Carl Cargill, Director of Standards, Sun Microsystems).

18. David Balto, Assistant Dir., Office of Policy & Evaluation, Bureau of Competition, Fed. Trade Comm'n, Address at the Cutting Edge Antitrust Law Seminars International (Feb. 17, 2000), *available at* www.ftc.gov/speeches/other/standardsetting.htm (citing 13 HERBERT HOVENKAMP, ANTITRUST LAW: AN ANALYSIS OF ANTITRUST PRINCIPLES AND THEIR APPLICATION 367 ¶ 2233 (1999)).

19. *See* JEANNE CLARK ET AL., PATENT POOLS: A SOLUTION TO THE PROBLEM OF ACCESS IN BIOTECHNOLOGY PATENTS? 4 (2000), *available at* http://www.uspto.gov/web/offices/pac/dapp/opla/patentpool.pdf (citing The Radio Manufacturers Association, http://www.terracom.net/~john_b/radiodocs/RETMA/ccodeindex.htm (Aug. 5, 1998) (Radio Manufacturers Association Website is no longer available.)).

20. *See* CPTech, Collective Management of IP Rights: Patent Pool, http://www.cptech.org/cm/patentpool.html (providing a useful discussion of patent pools and from which I have drawn several of these examples), ; *see also* Suzanne Deffree, *NFC Jumps in the Patent Pool,* ELECTRONIC NEWS, Feb. 1, 2006, *available at* http://www.reed-

support for patent pools, as has the Federal Trade Commission and the Department of Justice, providing guidelines for antitrust enforcement in regard to such collective rights management.[21]

It is important as a matter of background to understand that the federal government has endorsed consortia, informal multi-company standards development activities (including those that implicate "patent pools"), and even single-enterprise standards-setting activities as on the same footing as formal standards-setting organizations in meeting federal government requirements for "voluntary consensus standards." The National Technology Transfer and Advancement Act (NTTAA) sets out the mandate that federal government agencies use commercially developed "voluntary consensus standards" unless doing so would be against the law or otherwise impractical.[22] The revised Office of Management and Budget Circular A-119, which provides detailed guidance to federal agencies regarding this statutory mandate, is clear that standards developed by any private sector standards-setting enterprise would meet the meaning of voluntary consensus standards for the purposes of the requirements of Circular A-119.[23] The *Eighth Annual Report on Federal*

---

electronics.com/electronicnews/article/CA6303827.html; Mark Johnson, *The RFID Patent Pool: Playing Poker—RFID Consortium Charts Its Next Move*, MORERFID, Dec. 23, 2005, *available at* http://morerfid.com/details.php?subdetail=Report&action=details&report_id=1081&print=true; Mark Roberti, *RFID Vendors to Launch Patent Pool*, RFID J., Aug. 9, 2005, *available at* http://www.rfidjournal.com/article/articleprint/1786/-1/1/; Mark Roberti, *The RFID Patent Pool: Next Steps*, RFID J., Aug. 10, 2005, *available at* http://www.rfidjournal.com/article/articleprint/1798/-1/1/.

21. *See* JEANNE CLARK ET AL., *supra* note 19; Letter from Charles A. James, Assistant Att'y Gen., Antitrust Div., Dep't of Justice, to Ky P. Ewing, Vinson & Elkins L.L.P. (Nov. 12, 2002) (DOJ opinion letter on 3GPP), *available at* http://www.usdoj.gov/atr/public/busreview/200455.htm; Letter from Joel I. Klein, Assistant Att'y Gen., Antitrust Div., Dep't of Justice, to Carey R. Ramos, Paul, Weiss, Rifkind, Wharton & Garrison (June 10, 1999) (DOJ opinion letter on DVD), http://www.usdoj.gov/atr/public/busreview/2485.htm ; Letter from Joel I. Klein, Assistant Att'y Gen., Antitrust Div., Dep't of Justice, to Garrard R. Beeney, Sullivan & Cromwell (Dec. 16, 1998) (DOJ opinion letter on DVD), *available at* http://www.usdoj.gov/atr/public/busreview/2121.htm ; Letter from Joel I. Klein, Assistant Att'y Gen., Antitrust Div., Dep't of Justice, to Garrard R. Beeney, Sullivan & Cromwell (June 26, 1997) (DOJ opinion letter on MPEG-2), *available at* http://www.usdoj.gov/atr/public/busreview/215742.htm ; *see also* U.S. DEP'T OF JUSTICE & FED. TRADE COMM'N, ANTITRUST GUIDELINES FOR THE LICENSING OF INTELLECTUAL PROPERTY § 5.5 (1995), *available at* http://www.usdoj.gov/atr/public/guidelines/0558.pdf; Abbot B. Lipsky, Jr., *Special Considerations Concerning International Patent and Know-How Licensing and Joint Research and Development Activities: Current Antitrust Division Views on Patent Licensing Practices*, 50 ANTITRUST L.J. 515 (1981).

22. National Technology Transfer and Advancement Act of 1995, Pub. L. No. 104-113, § 12(d), 110 Stat. 775, 783 (1996) (codified at 15 U.S.C. § 272 (2006)).

23. The OMB emphasized that it is "not the intent of the Circular to create the basis for discrimination among standards developed in the private sector, whether consensus-based or, alternatively, industry-based or company-based." OFFICE OF MGMT. & BUDGET, EXECUTIVE OFFICE OF THE PRESIDENT, OMB CIRCULAR A-119, FEDERAL PARTICIPATION IN

Agency Use of Voluntary Consensus Standards and Conformity Assessment, issued in May 2005 by NIST, reinforced this reading of the law:

> In reporting the full measure of their efforts at minimizing reliance on government-unique standards, Federal agencies have historically reported the use of private sector standards including other than voluntary consensus standards. The OMB Circular classifies these other private sector standards as non-consensus standards, industry standards, company standards, or de facto standards. The Circular also states that it does not establish a preference among standards developed in the private sector. Consequently, the information contained in this report, as received from the agencies, includes the use of standards by, and participation in standards development activities of, both consensus and non-consensus standards developing organizations.[24]

It is clear, too, that formal standards bodies such as ANSI and ISO acknowledge the importance of the use of the full range of standards-setting forums including those that incorporate proprietary technologies, as well.[25]

The final avenue for the development of a standard is where a technology is so widely adopted by consumers or users that it becomes a de facto standard. Examples of de facto information technology standards include the mini-DV videocassette format, Adobe PDF file format, Apple iTunes's AAC audio file format, Microsoft Windows Media Player WMP file format, Hewlett-Packard's Printer Control Language (PCL), and Sun Microsystem's JAVA programming language, among numerous others.

THE DEVELOPMENT AND USE OF VOLUNTARY CONSENSUS STANDARDS AND IN CONFORMITY ASSESSMENT ACTIVITIES (1998) (revised to conform to NTTAA standards) [hereinafter OMB Circular A-119].

24. KEVIN L. MCINTYRE & MICHAEL B. MOORE, NAT'L INST. OF STANDARDS AND TECH., EIGHTH ANNUAL REPORT ON FEDERAL AGENCY USE OF VOLUNTARY CONSENSUS STANDARDS AND CONFORMITY ASSESSMENT 2 (2005), *available at* http://www.whitehouse.gov/omb/inforeg/reports/8th_annual_nist_rpt_2004.pdf [hereinafter NIST Annual Report].

25. While ANSI generally espouses the consensus model of standards development, it has no objections to the use of proprietary technologies within standards that have undergone canvassing. *See* AM. NAT'L STANDARDS INST., ANSI ESSENTIAL REQUIREMENTS: DUE PROCESS REQUIREMENTS FOR AMERICAN NATIONAL STANDARDS 9 § 3.1 (2006), *available at* http://publicaa.ansi.org/sites/apdl/Documents/Standards%20Activities/American%20National%20Standards/Procedures,%20Guides,%20and%20Forms/ER0106.doc ("There is no objection in principle to drafting a proposed American National Standard in terms that include the use of a patented item, if it is considered that technical reasons justify this approach."). Moreover, ANSI will accredit standards that have been developed initially on a proprietary basis. For example, the C programming language was developed by Bell Labs in the early 1970s, and was not officially standardized until the early 1980s by the ANSI X3J11 committee, which then issued today's standard: ANSI X3.159-1989. *See* Dennis Ritchie, *Development of the C Language, in* HISTORY OF PROGRAMMING LANGUAGES (Thomas J. Bergin, Jr. & Richard G. Gibson, Jr. eds., 2d ed. 1996), *available at* http://cm.bell-labs.com/cm/cs/who/dmr/chist.html. ISO has also approved Microsoft's C# and Common Language Interface (CLI). *See also* Press Release, ECMA Int'l, ISO/IEC Finishes Fast-Track Standardization of Ecma Standards for C# Programming Language And Common Language Infrastructure (Apr. 2, 2003), *available at* http://www.ecma-international.org/news/ECMA%20ISO%20CSharp%20Final.pdf.

There are also circumstances in which consumers or other users (i.e., industry members or segments) embrace multiple competing standards that then co-exist in the market. Some examples of widely adopted, yet competing standards include the various flavors of high speed communications standards such as IEEE 802.11 (a/b/g/n and so on), USB-2, IEEE 1394, and DVI; the competing digital video disc formats, DVD+ and DVD-; the competing EISA v. MCA, current multiple format standards for digital video (i.e., progressive, interlaced formats in various resolutions: 480p, 480i, 720p, 720i, 1080p, 1080i), and in earlier days, the Ethernet architecture as it competed with IBM's Token Ring. Notable cases where competition between standards resulted in consumer confusion and a delay in consumer interest in the overall commercial offering include the competition between Betamax and VHS, SuperAudio CD and DVD-Audio, and potentially Blu-ray and HD DVD.[26] On the upside, such market behavior results in user choice. Competing standards that survive in the market may each meet users' differing needs even at the expense of true interoperability. Similarly, if multiple standards develop and are each adopted by the market, the result may be standards-agnostic platforms (devices) or multi-standard platforms that are interoperable through conversion or gateway tools or otherwise (this is a less difficult matter, and therefore more common, in regard to software as compared to hardware). The downside is the potential for inefficiency or consumer confusion that could forestall widespread adoption.

Eventually, where there is a viable commercial market (the convergence of a mature technology or standard and the conditions where consumers are truly interested in having the products made possible by the standard), either the market formally adopts a standard or multiple standards (and those standards coexist), or a de facto choice evolves.

---

26. Note that slow market adoption could be the result of an absence of consumer interest in the product because the technology is not adequately mature and the market recognizes this fact. Some technologies that failed to become standards in the marketplace because the technology was immature include early WAP implementation from providers such as AT&T (Wireless Pocketnet) and Nextel, many consumer electronics technologies, such as RCA SelectaVision video disc and Philips/MCA VideoDisc, Phillips Interactive CD-I, and the competing and incompatible early matrix four-channel surround audio phonograph technologies offered by CBS and Sansui, confusingly named Quadraphonic and Quadrasonic, respectively. Regardless of the maturity of the technology, the failure to establish a standard may quite simply highlight another kind of failure: market research failure. There may be little consumer interest in having the standard, or even in having the particular type of technology. In other words, the public may not be interested in the overall commercial offering, let alone interested enough to choose between one technology and another to establish a standard. Examples of the market not being ready include the Phillips/Sony Compact Disc (it took ten years for the compact disc to supplant the Phillips audio cassette in the market); and the recordable Sony MiniDisc format.

2. WELL-DEVELOPED DIFFERING TYPES OF STANDARDS REFLECT A SOPHISTICATED STANDARDS-SETTING ENVIRONMENT

As evidence of the sophistication of the information technology standards-setting marketplace, there are numerous and highly differentiated types of market-developed standards that can achieve interoperability: open standards developed through formal standards-setting organizations; proprietary standards developed by informal standards bodies, consortia or by individual or groups of companies; de facto standards, i.e., a technology, usually proprietary, so widely adopted it effectively becomes a standard; or technologies which may have initially been a proprietary or a de facto standard yet are subsequently submitted to a formal standards-setting organization and become an open standard.

The two most prominent types of standards are "open standards" and "proprietary standards." There are many definitions for the term or concept of an "open standard." I will offer the following as a guideline for comparison. An open standard is a technical specification that has the following characteristics:

(a) It is developed, maintained, approved, or affirmed by rough consensus, in a voluntary private-sector (i.e., non-governmental) standards-setting organization that is transparent in its process and open to all interested and qualified participants;

(b) It is published (i.e., made available openly to the public) including specifications and supporting material providing sufficient detail to enable a complete understanding of the scope and purpose of the standard;

(c) The documentation of the standard is publicly available without cost or for a reasonable fee for adoption and implementation by any interested party; and

(d) Any patent rights necessary to implement the standard are made available by those developing the standard to all implementers on reasonable and non-discriminatory (RAND) terms (either with or without payment of a reasonable royalty or fee).[27]

---

27. This definition is very similar to and is drawn from the definitions of "open standards" adopted by leading standards development organizations and industry associations. *See* AM. NAT'L STANDARDS INST., CURRENT ATTEMPTS TO CHANGE ESTABLISHED DEFINITION OF "OPEN STANDARDS" (2005) *available at* http://public.ansi.org/ansionline/Documents/Standards%20Activities/Critical%20Issues%20 Papers/Open-Stds.pdf; BUS. SOFTWARE ALLIANCE, BSA STATEMENT ON TECHNOLOGY STANDARDS (2005), http://www.bsa.org/usa/policy/loader.cfm?url=/commonspot/security/getfile.cfm&pageid=2 2407&hitboxdone=yes; GLOBAL STANDARDS COLLABORATION (GSC-10) (2005), *available at* http://portal.etsi.org/docbox/workshop/gsc/gsc10archive/GSC10_Closing_Plenary/gsc10_clo sing_12%20Resolution%2004%20Open%20Standards.doc; TSB Dir.'s Ad Hoc Group on IPR, Int'l Telecomm. Union (ITU), Definition of "Open Standards" (2005), http://www.itu.int/ITU-T/othergroups/ipr-adhoc/openstandards.html;. I have also drawn from the definition provided in BERKMAN CTR. FOR INTERNET AND SOC'Y AT HARVARD LAW SCH., ROADMAP FOR OPEN ICT ECOSYSTEMS 6, *available at*

Well-known and widely implemented open standards include TCP/IP, HTML, HTTP, 802.11, MPEG, XML, SNMP, and SMTP.

"Proprietary standards" are technical specifications developed and maintained by a single entity or more typically by a private, small group of cooperating entities. Standards are by their nature intellectual property and, thus, are potentially subject to ownership protected by copyright or patent law. Since proprietary standards are created by a small group of private parties, often working ad hoc, they are typically not subject to the formalized rules of a traditional standards-setting organization; and thus, the owners of the underlying intellectual property may control implementation of such a standard more tightly through the licensing terms. The key reason proprietary standards are developed is that working in small groups without many of the procedural issues of an open standards-setting organization (particularly issues having to do with consensus among many and the openness of the process) is more efficient, and thus, interoperable products can be developed and brought to market more quickly.

The status of a proprietary standard may change over time. Commonly, proprietary standards are technologies developed by groups of companies working in consortia, less formal efforts with the use of "patent pools" or cross-licensing, or even by a single company, and emerge as de facto standards.[28] Some of these proprietary standards are subsequently submitted to formal standards-setting organizations to become de jure, or formal open standards. For example, it may be a good business decision for only a few companies to work together to develop a standard for their mutual benefit, since doing so can be done more quickly than in a formal setting. Eventually, more adopt the standard to achieve interoperability and the standard becomes a de facto standard. At this point, the standard may be submitted to a standards-setting organization, such as TIA, IEEE, ITU, or ISO, for formal adoption as an open standard (de jure standard) to encourage yet wider adoption. Examples include Bell Laboratories C Programming Language;[29] ANSI CAT-5 Cable (and other such cable specifications developed by the Telecommunications Industry Association, a trade association and ANSI-accredited standards developing organization) and hundreds of information technology standards (many designated as ISO or ANSI standards) developed by International Committee for Information Technology Standards (INCITS, an ANSI-accredited standards development organization supported by the Information Technology Industry Council (ITI), a trade association), Adobe's PDF format (various parts of which have been submitted to ISO for adoption as an open standard) and Microsoft's

http://cyber.law.harvard.edu/epolicy/roadmap.pdf.

28. I will discuss each of these various modes of developing proprietary standards in detail *infra* at Part III.A.1.

29. *See* CHRISTINE R. DEVAUX, U.S. DEP'T OF COMMERCE, A GUIDE TO DOCUMENTARY STANDARDS, NISTIR 6802, at 16-17 (2001), *available at* http://ts.nist.gov/Standards/Conformity/upload/ir6802.pdf.

open XML file formats (which have been submitted for adoption as an open standard).

Many, if not most, information technology standards, including open standards, have patented components that are owned or controlled by one or a few companies. Whether open standards or proprietary standards are involved, entities that develop standards and own the associated patents typically license the technology on RAND terms, either with or without a reasonable royalty, and therefore facilitate the wider adoption of the standard.[30]

---

30. Although there is ongoing debate as to how RAND royalties should be calculated and when those terms can be disclosed in the standards-setting process, the overwhelming consensus by leading international standards and industry organizations such as ANSI, ITU, BSA, and others is that RAND licensing strikes the proper balance between the interests of patent holders on the one hand and implementers of standards on the other. *See, e.g.*, AM. NAT'L STANDARDS INST., *supra* note 27. This perspective is held by a broad international coalition. For example, several of the world's leading standards organizations (including the European Telecommunications Standards Institute, International Telecommunication Union (United Nations-based), Association of Radio Industries and Businesses (Japan), Telecommunications Industry Association (United States), among others), acting as part of the "Global Standards Collaboration," recently resolved to: (1) "strongly support the adoption of effective intellectual property rights policies that are transparent, widely accepted and encourage broad-based participation and the contribution of valuable technical solutions by respecting intellectual property rights, including the right of the intellectual property holder to receive reasonable and adequate compensation for the shared use of its technology;" (2) "strongly support definitions of 'open standards' that reflect the following characteristics: such standards are (i) made available to the general public, (ii) developed (or approved) and maintained via a collaborative and consensus driven process, and (iii) subject to a RAND/FRAND intellectual property rights policy;" and (3) "strongly voice their opposition to policies that mandate compensation-free licensing provisions." GLOBAL STANDARDS COLLABORATION, GSC #10 MEETING: PARTNERS FOR COLLABORATION, *available at* http://www.gsc.etsi.org/GSC_10.htm (follow "GSC #10 Final Resolutions"; then open "Resolution 15, Intellectual Property Rights and Policies"). This was also reiterated in the new IPR and open standards resolution from GSC-11 in June, 2006. *See* GLOBAL STANDARDS COLLABORATION, RESOLUTION GSC-11/04: (JOINT) OPEN STANDARDS (2006), *available at*
http://webapp.etsi.org/meetingDocuments/ViewDocumentDetails.asp?DOCId=86936.

U.S. technology transfer laws exemplify the public interest in commercializing intellectual property in a competitive marketplace, producing innovation protected by intellectual property laws. *See* Stevenson-Wydler Technology Innovation Act of 1980, Pub. L. No. 96-480, 94 Stat. 2311 (codified at 15 U.S.C. §§ 3701-3714); Small Business Innovation Development Act of 1982, Pub. L. No. 97-219, 96 Stat. 217 (codified at 15 U.S.C. §§ 631-638); National Cooperative Research Act of 1984, Pub. L. No. 98-462, 98 Stat. 1815 (codified at 15 U.S.C. §§ 4301-4306); Federal Technology Transfer Act of 1986, Pub. L. No. 99-502, 100 Stat. 1785 (codified at 15 U.S.C. §§ 3710a-3710d); Malcolm Baldrige National Quality Improvement Act of 1987, Pub. L. No. 100-107, 101 Stat. 724 (codified at 15 U.S.C. § 3711a); Bayh-Dole Act of 1980, Pub. L. No. 96-517, 94 Stat. 3015 (codified at 35 U.S.C. §§ 202-211); Exec. Order No. 12,591, 52 Fed. Reg. 13,414 (Apr. 10, 1987).

As a general proposition, the adoption of intellectual property into a standard should not diminish the value of intellectual property. In a copyright context, the Supreme Court noted that "[i]t is fundamentally at odds with the scheme of copyright to accord lesser rights in those works that are of greatest importance to the public. Such a notion ignores the major premise of copyright and injures author and public alike." Harper & Row Pub., Inc. v.

3. EACH RELEVANT INDUSTRY HAS A LONG AND WELL-DEVELOPED HISTORY OF STANDARDS SETTING

Each industry converging in the information technology environment has unto itself a long history of success relying on these many avenues for standards setting in the commercial marketplace. That success continues to this day. Although not without substantial discord, the early radio and television industry standards were developed by only a few competing companies under the auspices (and occasionally mediation) of the FCC, its predecessor, the Federal Radio Commission (and in the case of television standards, the National Television Systems Committee (NTSC)), and these were subsequently adopted as government-mandated standards (e.g., NTSC-adopted 525 line/30 frames per second monochrome broadcast standards and the RCA-developed electronic color standards selected by the NTSC and the FCC over Columbia's color-wheel).[31] More recently, digital television standards have been developed in the marketplace and ratified by the FCC.[32] The movie and music industries share similar histories (and really, the same companies have long been involved in both industries), but entertainment standards have generally been market-driven de facto standards. Take, for instance the Edison cylinder which competed with the Berliner phonograph disk, Columbia's patented 33-1/3 R.P.M. LP that co-existed in the market with the RCA's 45 R.P.M. disk and the many film format standards (and now digital cinema standards) that have facilitated international film distribution over the years.[33] The consumer electronics industry shares much history with the entertainment industry, but is also often subject to government mandates (T.V. and radio standards, again typically standards developed by the consumer electronics and broadcast industries and then ratified and mandated by the FCC for enforcement purposes). But consumer electronics standards have also been substantially

---

Nation Enter., 471 U.S. 539, 558 (1985). The Court's conclusion is equally applicable to standards and patents.

All of this is not to say that a creator of a standard cannot make a standard available for free under extremely flexible terms. In fact, even single-company created standards are often made available for free and with few restrictions. Doing so often is ultimately valuable in expanding the adoption of the standard.

31. *See* DONALD FINK, THE FORCES AT WORK BEHIND THE NTSC STANDARDS (1981), *available at* http://www.ntsc-tv.com/ntsc-main-01.htm; EDWIN HOWARD REITAN JR., THE FOLLOWING PROGRAM IS BROUGHT TO YOU IN LIVING COLOR (1997), *available at* http://novia.net/~ereitan/NTSC_overview.html.

32. *In re* Advanced Television Systems and Their Impact Upon the Existing Television Broadcast Service, 11 F.C.C.R. 17,771 (Dec. 27, 1996).

33. The list goes on with obvious examples including Philips's compact cassette versus the Lear 8-Track, the compact disc which eventually eviscerated the compact cassette market, Dolby's patented noise reduction (which competed, yet briefly coexisted, with DBX in analog audio devices), multi-channel audio formats (currently Dolby standards coexisting with DTS), Panasonic and Sony's MiniDV video media format, the Toshiba/Warner (and others) DVD and of course, HD DVD and Blu-ray.

driven by consumer behavior.[34] And, of course, the computer industry utilizes patent pools and cross-licensing and the full range of forums, those being informal groups, consortia, and formal standards-development organizations to an extent similar to that of the broadcast and consumer electronics industries. Computer standards include the twisted nematic liquid crystal display (invented by James Fergason, which lead to the LCD of modern computer and television monitors), the Kensington security socket (the mechanical connector used to physically secure a computer to a desk by a cable), the ISO-adopted Moving Picture Experts Group (MPEG) digital audio and video compression specifications including MPEG-2, MPEG-4, Thompson's MPEG-1, Layer III (AKA MP3), Apple's IEEE 1394 digital communication specification, the joint ITU-ISO/IEC specification AVC/H.264 video codec (a mandatory specification of both Blu-ray and HD DVD), Small Computer System Interface (SCSI), Universal Serial Bus (USB and USB2), AT Attachment (ATA), a digital transport standard, accelerated graphics port (AGP), Peripheral Component Interconnect bus (PCI) and an alphabet soup of other standards.

As the NIST Acting Director testified before Congress in 2005, there are over 450 U.S. standards-setting organizations and an additional 150 consortia standards-development activities ongoing. Approximately twenty standards-setting organizations develop about eighty percent of the standards in the United States. Although the U.S. standards system is highly decentralized and naturally partitioned into industrial sectors, ANSI alone is composed of more than 700 companies, 30 government agencies, 20 other institutions and 260 professional, technical, trade, labor, and commercial organizations. There are more than 13,000 private sector standards in use by the federal government. "Our decentralized, private sector, demand-driven U.S. standards system has many strengths. U.S. companies derive significant advantage from the system's flexibility and responsiveness. The government also derives great benefit from the system, both as a customer and user of standards."[35]

As is the case with most human endeavors, there is no assurance of success. Indeed, some standards are not successful even if they are adopted by formal means. Furthermore, standards setting through any one of the numerous means available does not assure the greatest efficiency in standards development, although given the several paths standardization, efficiencies are more likely than where there may be limited fora to develop a standard.

Given the facts I have described, it is well established, through the long history and up-to-date practices of formal and informal standards-setting

---

34. Consider again, LPs, cassettes, and CDs, but also such devices as the RCA/phono connector and the Sony-Phillips-developed Digital Optical connector.

35. *China, Europe, and the use of standards as trade barriers: How should the U.S. respond?: Hearing Before the H. Comm. on Science & H. Subcomm. on Environment, Technology and Standards*, 109th Cong. (2005) (statement of Hratch G. Semerjian, Acting Director, National Institute of Standards and Technology), *available at* http://www.nist.gov/testimony/2005/hs_house_science_ets_intl_stds_5-11.html [hereinafter Semerjian Testimony].

organizations, the vibrancy of ad hoc standards setting or adoption through consortia and the use of "patent pools," and marketplace adoption of both open standards and proprietary standards, that the information technology industries are well suited to develop standards in the marketplace.

B. U.S. FEDERAL LAW AND POLICY PREFERS THAT STANDARDS BE DEVELOPED IN THE MARKETPLACE

It almost goes without saying that as a general matter, because the United States is a market-oriented economy (i.e., a free market, or "bazaar" where goods are freely exchanged for value with little government involvement), the government is restrained in interfering with the operation of the market. As Alan Greenspan recently observed in discussing the importance of Adam Smith and his theory of a market freedom to modern economic growth in the United States:

> By the 1980s, the success of that strategy in the United States confirmed the earlier views that a loosening of regulatory restraint on business would improve the flexibility of our economies . . . . Enhanced flexibility has the advantage of enabling market economies to adjust automatically and not having to rest on policymakers' initiatives, which often come too late or are misguided. Such views . . . clearly have been paramount in a renewed twenty-first century appreciation of Adam Smith's contributions.[36]

In the context of standards setting, there is a substantial early history of the government as the exclusive or predominant standards-setting entity, rooted in its British heritage dating back many hundreds of years.[37] However, over the course of the last two centuries, U.S. government policy has reflected an appreciation that industry is typically the most efficient and informed, as well as the most capable of developing standards. And as our system has evolved, the U.S. federal government policy has come to reflect a strong preference for developing standards in the private sector with a concomitant aversion to government-unique standards.

1. U.S. DOMESTIC LAW AND POLICY

In December of 2005, ANSI published *The United States Standards Strategy* (USSS). The Strategy is approved by the Board of Directors of ANSI and is endorsed by the U.S. Department of Commerce.[38] As the introduction to

---

36. Alan Greenspan, Chairman, Fed. Reserve, Remarks at the Adam Smith Memorial Lecture, (Feb. 6, 2005), *available at* http://www.federalreserve.gov/boarddocs/Speeches/2005/20050206/default.htm.

37. *See* JOHAN RAMSEY MCCULLOCH, A TREATISE ON THE PRINCIPLES, PRACTICE, & HISTORY OF COMMERCE 111-12 (1833).

38. U.S. DEP'T OF COMMERCE, STANDARDS AND COMPETITIVENESS—COORDINATING FOR RESULTS: REMOVING STANDARDS-RELATED TRADE BARRIERS THROUGH EFFECTIVE

the USSS states,

> Voluntary consensus standards are at the foundation of the U.S. economy . . . . The United States is a market-driven, highly diversified society, and its standards system encompasses and reflects this framework . . . . [A] standards system is strengthened whenever standards developers share a common vision for meeting stakeholders needs . . . . Standards are essential to a sound national economy and to the facilitation of global commerce.[39]

Congress has expressed statutorily a strong preference for private sector-developed standards and restraint in government mandating standards. In enacting the National Technology Transfer and Advancement Act of 1995 (NTTAA), Congress formally adopted into law what had since 1980 been the policy of the Executive Branch and embodied in guidance to federal agencies issued by the Office of Management and Budget Circular A-119.[40] With the NTTAA, Congress required federal agencies to abide by a preference for voluntary standards over government-specific standards. The preference for market-developed standards is evident in the report language that accompanied the NTTAA. To assure absolute clarity, the House Committee Report stated: "It is . . . the intent of the Committee to make private sector-developed consensus standards the rule, rather than the exception."[41] As I have described in detail above, the 1998 revision of OMB Circular A-119 emphasized that it had "not been the intent of the Circular to create the basis for discrimination among standards developed in the private sector, whether consensus-based or, alternatively, industry-based or company-based."[42] Thus, it is clear that the federal government preference is not only to rely on private sector-developed standards, but those standards developed in the full range of private sector forums.[43]

The results of the enactment of the NTTAA are noteworthy. During fiscal year 2004, federal agencies reported using 4559 private sector standards developed by the private sector.[44] In contrast, during the same year, they reported using only seventy-one government-unique standards.[45] The impact of

---

COLLABORATION 17 (2004), *available at* http://www.ita.doc.gov/td/standards/Final%20Site/Standards%20and%20Competitiveness.pdf

39. U.S. STANDARDS STRATEGY COMM., UNITED STATES STANDARDS STRATEGY 4 (2005), *available at* http://publicaa.ansi.org/sites/apdl/Documents/Standards%20Activities/NSSC/USSS-2005%20-%20FINAL.pdf [hereinafter USSS].

40. *See* National Technology Transfer and Advancement Act of 1995, Pub. L. No. 104-113, § 12(d), 110 Stat. 775 (1996) (codified at 15 U.S.C. § 272 Note). *But see* OMB Circular A-119, *supra* note 23.

41. H.R. REP. NO. 104-390, at 25 (1995).

42. OMB Circular A-119, *supra* note 23.

43. This is evidenced by the implementation of the NTTAA and revised OMB Circular A-119. *See* NIST Annual Report, *supra* note 24.

44. *Id.* at 1.

45. *Id.*

the NTTAA can be observed in regard to many key federal agencies that rely on standards. The FCC has also articulated a preference that standards be developed in the marketplace rather than by governmental fiat.[46] The Communications Act of 1934 requires that the FCC regularly review all of its regulations to determine whether they are still necessary, given the current state of competition.[47] These Biennial Reviews of Regulations have reflected a deregulatory approach. For example, in 2000, the Commission eliminated some 130 pages of technical specifications in the FCC rules for telephone terminal equipment. Instead, the FCC articulated the principles it sought to serve and left standards development to the private sector.[48]

An example of the FCC's approach to market-developed information technology standards can be found in their management of the development of the standards to facilitate interoperability among digital cable devices:

> [W]e have emphasized our reliance on market forces to bring innovation, choice and better prices to consumers. It is the work of private entities and the economic incentives motivating the participants in the OpenCable process that provide the most immediate opportunity for a degree of standardization that will both create scale economies reducing the cost of equipment and developing interfaces allowing the equipment to be readily sold through retail outlets.[49]

---

46. *In re* Year 2000, 19 F.C.C.R. 3239, 3259 ¶ 48 (Feb. 12, 2004) ("We prefer, as a general policy, to allow market forces to determine technical standards wherever possible, and to avoid mandating detailed hardware design requirements for telecommunications equipment, except where doing so is necessary to achieve a specific public interest goal.").

47. 47 U.S.C. § 161(a) (2007).

48. *See In re* 2000 Biennial Regulatory Review of Part 68 of Comm'n's Rules and Regulations, 15 F.C.C.R. 24,944, 24,946 (Dec. 21, 2000). The Commission stated,

> In the *Notice*, we tentatively concluded that the public interest would be better served if private industry, rather than the Commission, developed the technical criteria that are necessary to protect the public switched telephone network from harms. We therefore proposed in the *Notice* to use one of several potential industry standards-setting processes. To ensure that the public interest is adequately protected, we proposed to provide for *de novo* Commission review and enforcement, where necessary, of the industry-established technical criteria in the event of an appeal regarding the criteria. We noted our expectation, however, that such Commission involvement would be extremely limited.

Id. at 24,950 ¶ 18 (footnotes omitted).

The Order concluded that the FCC would rely on market-developed standards, stating

> industry rather than Commission development of technical criteria will decrease development time and allow manufacturers to bring innovative consumer products, especially for the provision of advanced services, to the market on an expedited basis. This expedited process should benefit consumers by lowering the costs of terminal equipment and by ensuring that new technologies are widely available.

Id. at 24,952 ¶ 21. *See also* 47 U.S.C. § 161 (2002).

49. *In re* Implementation of Section 304 of the Telecommunications Act of 1996, 13 F.C.C.R. 14,775, 14,821 ¶ 117 (June 24, 1998). However, see also *supra* note 14 (discussing the successes and failures in the navigational devices standards-setting process).

Similarly, HDTV standards were developed in a consortium standards-setting process (humbly named the Grand Alliance) under the auspices of the standards-setting organization, the Advanced Television Systems Committee, and subsequently ratified by the FCC.[50]

Another example of the impact of the OMB Circular A-119 and the NTTAA can be found in examining the Department of Defense policies on standards. In 1994, Secretary of Defense William Perry issued a memorandum entitled "Specifications and Standards—A New Way of Doing Business" (often referred to as "MilSPEC Reform"). The memo set out as a priority for the Department of Defense the increase in use of commercial technologies and the use of performance standards and commercial specifications and standards in "in lieu of military specifications and standards, unless no practical alternative exists to meet the user's needs."[51] MilSPEC Reform evidences the importance the federal government placed on taking the government out of the technical specifications-setting role. In announcing the new policy, the Secretary stated: "'We're going to rely on performance standards . . . instead of relying on [MilSPECS] to tell our contractors how to build something. . . .'"[52] A Defense Department newsletter described remarks by Secretary Perry delivered at a conference in November of 1996: "acquisition reform encompasses more than just saving money—it also deals with the quality of the things we buy . . . actually speeding up access to rapidly evolving commercial technologies."[53]

---

50. *See In re* the Matter of Advanced Television Systems and Their Impact Upon the Existing Television Broadcast Services, 11 F.C.C.R. 17,771 (Dec. 27, 1996).

51. *See* Memorandum from William Perry, Sec'y of Def., to the Secretaries of the Military Departments et al. (June 29, 1994), *reprinted in* THE IMPACT OF ACQUISITION REFORM ON DEPARTMENT OF DEFENSE SPECIFICATIONS AND STANDARDS FOR MATERIALS AND PROCESSES: REPORT OF THE WORKSHOP ON TECHNICAL STRATEGIES FOR ADOPTION OF COMMERCIAL MATERIALS AND PROCESSING STANDARDS IN DEFENSE PROCUREMENT 37-38 (2000), *available at* http://www.nap.edu/catalog.php?record_id=10345 [hereinafter MilSPEC Reform].

52. THE STANDARDIZATION NEWSLETTER (Defense Standardization Program, Washington, D.C.), Oct. 1994, at 2 (quoting William Perry, Sec'y of Def., Remarks at Press Conference (June 29, 1994)), *available at* http://www.dsp.dla.mil/newsletters/archive/news9410.pdf.

53. *See* Trudie Williams, *Secretary of Defense Perry Recognized at Joint Industry Conference*, THE STANDARDIZATION NEWSLETTER (Defense Standardization Program, Washington, D.C.), Dec. 1996, at 3, *available at* https://www.dsp.dla.mil/newsletters/archive/news9612.pdf. The transition from MilSPEC/MilStandards reform was not without its challenges. A workshop report undertaken at the request of the Department of Defense by the National Materials Advisory Board in 2000 stated: "The key barrier to military use of commercial materials and process specification appears to be a lack of DoD participation in [standards-setting organizations], which poses a significant risk that specifications may not meet military needs." NAT'L ACAD. OF SCIENCES, THE IMPACT OF ACQUISITION REFORM ON DEPARTMENT OF DEFENSE SPECIFICATIONS AND STANDARDS FOR MATERIALS AND PROCESSES: REPORT OF THE WORKSHOP ON TECHNICAL STRATEGIES FOR ADOPTION OF COMMERCIAL MATERIALS AND PROCESSING STANDARDS IN DEFENSE PROCUREMENT 3 (2002). The Defense Department's response to the concern was an increase in resources dedicated to standards-setting organizations, strengthening their performance. *See* Gregory E. Saunders, *Director's Forum*,

Thus, the Department of Defense, with a long history of setting government-specific standards (highly regarded standards, at that) shifted policy dramatically to participation in the free market development of standards and, in fact, more frequent adoption of off-the-shelf solutions.

A third federal agency that long relied on government-specific standards is the National Aeronautics and Space Administration (NASA). As with the Department of Defense, NASA has shifted policy and in compliance with Circular A-119:

> approximately fifty-four percent of all standards utilized by NASA over the past four years were derived from the private sector. The balance are MilSPECS (25.84 percent), NASA unique (Center Developed - 10.31 percent, or NASA Preferred - 5.54 percent), or other government standards (4.39 percent) . . . . NASA's standards program has adopted (or is in the process of adopting) some 3,400 standards, only 60 of which were developed by NASA internally for agency-wide use (although there are other Center-unique standards in use as well).[54]

Even where public safety and law enforcement are concerned, the government does not commonly mandate standards. For example, pursuant to CALEA, the FBI is to have technical access to intercept telephone communications through what are commonly known as "wiretaps."[55] Compliance requires that carriers develop their networks to ensure that they can deliver specific types of information to law enforcement agencies. However, the FCC did not mandate a particular technology or methodology for compliance. Instead, the statute requires the FCC to designate a standard as a "safe harbor" for compliance,[56] which it did by endorsing standardized interception technologies, developed through a private-sector "voluntary

---

DEFENSE STANDARDIZATION PROGRAM J., Oct./Dec. 2003, at 1, *available at* http://www.dsp.dla.mil/newsletters/journal/DSPJ-10-03.pdf (stating

> [u]sing [non-government standards (NGSs)] is not a cheap alternative for DoD. To participate effectively in NGS development, our engineers and scientists must spend some of their valuable time writing standards for the committees, researching technical information, reviewing draft standards, and resolving issues among a wide array of users and manufacturers. They also must spend both time and travel dollars to attend meetings. And, once the document is completed, DoD has to buy it, and so do our suppliers and their suppliers. Oddly, travel dollars and purchase price are often identified as cost drivers, but the largest dollar investment is the burdened cost of our experts. The roughly $100-per-hour expert who spends 3 or 4 weeks per year—at his desk, in the air, or at committee meetings—working on standards represents an investment of $12,000 to $16,000, exclusive of travel costs.).

54. Andrew Updegrove, *Trends: Standard Setting at NASA: An Interview With Paul Gill*, CONSORTIUM STANDARDS BULLETIN, July 2005, *available at* http://www.consortiuminfo.org/bulletins/july05/standardatnasa.php.

55. *See* Communications Assistance for Law Enforcement Act, 47 U.S.C. § 1001-10 (1994).

56. 47 U.S.C. § 1006(a)(2).

consensus process."[57] Telephone service carriers and manufacturers are presumptively in compliance when they implement those standards.

Harmonious with the intent of Congress, the USSS, published in 2005, is intended to guide American standards policies and U.S. trade relations as they implicate standards. The USSS sets as its cornerstone the process of sector-specific, market-driven, private sector led standards, not a top-down, one-size-fits-all approach as found in some other countries.[58] It is based on the proposition that the U.S. standards system is the most innovative

- . . . through alliances and processes provided by companies, associations, standards developing organizations, consortia, and collaborative projects.
- This market-driven, private sector-led approach to global standardization is substantially different from the top-down approach favored in many other countries. . . .
- [Stakeholders] continue to explore new modalities of standards development. Organizations such as consortia and Internet-based processes that enable worldwide participation of stakeholders are creating an innovative environment that is becoming increasingly important in the global marketplace.[59]

Regardless of the specific process used, formal standards should be developed according to globally accepted principles of transparency, openness (participation by all stakeholders), impartiality, consensus, coherence to avoid overlapping or conflicting standards, and due process so that all views are considered. The development process should also include assistance to stakeholders that may not have adequate technical expertise, particularly those in foreign countries, and should be performance-based.[60] "[T]he process should be [f]lexible, allowing the use of different methodologies to meet the needs of different sectors; [t]imely so administrative matters do not result in a failure to meet market expectations; and [b]alanced among all affected interests."[61] Governments should encourage flexible standards solutions and rely on standards from diverse sources, including consortia and forums.[62] According to the USSS, as a matter of its strategic vision, the standards community is committed to the notion that "[g]overnments rely on voluntary consensus standards as much as possible in regulation and procurement rather than creating additional regulatory requirements."[63] Thus, it is clear that the federal

57. *In re* Communications Assistance for Law Enforcement Act, 14 F.C.C.R. 16794, 16794 ¶ 1 (Aug. 31, 1999).

58. *See* USSS, *supra* note 39, at 8.

59. *See* USSS, *supra* note 39, at 5.

60. *Id.* at 6.

61. *Id.*

62. *Id.* at 5.

63. *Id.* at 7. As previously noted, OMB Circular A-119 describes the U.S. government position as not favoring voluntary consensus standards over industry-developed or even company-developed standards, but considering each on equal footing as the others. OMB Circular A-119, *supra* note 23.

government is generally opposed to government intervention into the standards marketplace and such an intervention would be contrary to both the spirit of the policy and, potentially, the law.

C. U. S.TRADE POLICY PLACES SUPPORT FOR MARKET-DEVELOPED STANDARDS AS FUNDAMENTAL TO ELIMINATING TECHNICAL BARRIERS TO TRADE

The USSS articulates clearly that from the U.S. government perspective, standards are at the core of U.S. trade policy. Then-Secretary of Commerce Donald L. Evans prefaced the USSS stating, "[t]he international language of commerce is standards . . . . Without standards, it would be difficult to imagine the tremendous volume and complexity of international trade."[64] A goal of foreign trade policy is to unify the approach governments take to develop standards, encouraging foreign governments to adopt the approach of using voluntary consensus-developed standards. Further, "the U.S. government should work with other WTO members to seek full implementation of the Technical Barriers to Trade (TBT) Agreement and annexes . . . [and to] identify and eliminate or minimize the effect of technical barriers to trade that result from technical standards and their application."[65] The USSS outlines

64. *See* USSS, *supra* note 39, at 3.

65. *Id.* at 12. *See also* Agreement on Technical Barriers to Trade, Multilateral Agreements on Trade in Goods, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1A, Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations, Apr. 15, 1994, 33 I.L.M. 1125, 1154 (1994), *available at* http://www.wto.org/english/docs_e/legal_e/17-tbt.pdf [hereinafter TBT Agreement]. The TBT Agreement encourages the use of international standards in order to minimize technical barriers to trade. Pursuant to the TBT Agreement, when a government prepares a technical regulation to achieve a certain policy objective, whether protection of human health, safety, or the environment, the negotiations shall not be more trade-restrictive than necessary to fulfill the legitimate objective. The TBT Agreement encourages governments to specify, whenever appropriate, product regulations in terms of performance rather than design or descriptive characteristics, as doing so will also help in avoiding unnecessary obstacles to international trade. *Id.* at art. 2.8. The obligation to avoid unnecessary obstacles to trade applies also to conformity assessment procedures. An unnecessary obstacle to trade could result from stricter or more time-consuming procedures than are necessary to assess that a product complies with the domestic laws and regulations of the importing country. *Id. at* arts. 5.2.3 and 5.2.6. The Agreement encourages Members to use existing international standards for their national regulations, or for parts of them, unless "their use would be ineffective or inappropriate" to fulfill a given policy objective. This may be the case, for example, "because of fundamental climatic and geographical factors or fundamental technological problems." *Id.* at art. 2.4. As explained previously, technical regulations in accordance with relevant international standards are rebuttably presumed "not to create an unnecessary obstacle to international trade." *Id.* at art. 2.5. Similar provisions apply to conformity assessment procedures: international guides or recommendations issued by international standardizing bodies, or the relevant parts of them, are to be used for national procedures for conformity assessment unless they are "inappropriate for the Members concerned for, inter alia, such reasons as national security requirements, prevention of deceptive practices, protection of human health or safety, animal or plant life

recommendations that will encourage the U.S. standards community to continue to fully engage the global standards community to recognize the strength of the public-private partnership of the U.S. standards system and embrace the sector-specific approach to standards development.[66]

As Dr. Hratch G. Semerjian, Acting Director of the National Institute of Standards and Technology testified before Congress in 2005, the Department of Commerce intends "to partner with U.S. industry and standards developers to more effectively promote the virtues of an open, transparent and impartial approach to standards development and implementation."[67] He continued, "[b]oth U.S. standards interests and policy objectives will be served when the governments of our most important export markets are convinced of the strengths of this approach versus alternatives that are less open and transparent, and more subjective."[68]

The clearly articulated U.S. government domestic policy preference for market-developed standards, and the success of this policy, is a critical argument in support of U.S. government opposition to the use of government-established standards by foreign governments. Correspondingly, government intervention in the U.S. market to establish or mandate a particular information technology standard undercuts the U.S. position in this context. An action by the U.S. government or a government in the United States to intervene in the market to mandate a standard would be perceived by foreign governments as, at a minimum, hypocritical to U.S. foreign policy, and more likely, support for similar behavior by the foreign government.

D. RISK OF "GOVERNMENT FAILURE" SHOULD GIVE GOVERNMENT CAUSE TO PAUSE

It is often observed that the market is more well-informed, efficient, flexible, and capable than government in developing information technology standards. In general, this observation leads to a concern that one major consequence of government intervention to address a market failure is the high risk of "non-market failure," also called "government failure." A non-market failure can be defined as the unintended and undesirable consequences of

---

or health, or protection of the environment; fundamental climatic or other geographical factors; fundamental technological or infrastructural problems." *Id.* at art. 5.4. Widespread participation in international standardizing bodies can ensure that international standards reflect country-specific production and trade interests. The TBT Agreement encourages Members to participate, within the limits of their resources, in the work of international bodies for the preparation of standards, *id.* at art. 2.6, and guides or recommendations for conformity assessment procedures, *id.* at art. 5.5.

66. *See* USSS, *supra* note 39, at 11-12 (providing an extensive outline of the recommendation).

67. Semerjian Testimony, *supra* note 35 (including comments supporting this position as stated by the U.S. representative to ISO and IEC).

68. *Id.*

government failure where it intervenes to address a market failure.[69] Economist Thomas Sowell observed, "Markets are indeed imperfect, as everything human is imperfect. But 'market failure' is not a magic phrase that automatically justifies government intervention, because the government can also fail—or can even make things worse."[70]

In setting information technology standards, the risk of getting it wrong is very high and the consequences may be very large because technology that has broad economic and social impact advances rapidly. Standards development in the area of information technology requires eloquence in incorporating flexibility into a standard to accommodate technical advances and changes in the marketplace. The market itself generally has the most sophisticated expertise in establishing standards (technical knowledge, institutional knowledge, standards-setting bodies, etc.) and the ability to revise standards as appropriate.

Federal Reserve Bank of Chicago senior economist Victor Stango observed:

> [Early literature examining the economics of standards reflects] that even in instances where the market would move too swiftly or slowly between standards, a policymaker will have difficulty improving upon the market. For instance, when there is uncertainty regarding the benefits that would accrue from adoption, or which standard will achieve adoption first, a policymaker can improve on the market outcome only if it possesses superior information. Moreover, little is known about the positive aspects of standard-setting. For example, a policymaker may resolve uncertainty more quickly than would be the case in a standards war but also might be more likely to choose the "wrong" standard.[71]

An example of a "government failure" in what was in part essentially a standards setting can be found in the U.S. government policy in regard to encryption. In the early 1990s, a public debate erupted with the creation of software called "Pretty Good Privacy," or PGP. PGP allowed a user to encrypt e-mail messages so that only the intended recipient could unlock the message with a pre-assigned key. This scheme (and the strength of the encryption) prevented law enforcement access to these encrypted e-mail messages. In 1993, the federal government proposed the "Clipper Chip." The Clipper Chip was a National Security Agency (NSA) developed encryption device that could be attached by a user to phone lines. The Clipper Chip encrypted communications using a system called "key escrow." Key escrow allowed the recipient to decrypt a message, but also placed into "escrow" a second key that could be

---

69. *See* Charles Wolf, Jr., *A Theory of Nonmarket Failure: Framework for Implementation and Analysis*, 22 J.L. & ECON. 107 (1979).

70. THOMAS SOWELL, BASIC ECONOMICS: A CITIZEN'S GUIDE TO THE ECONOMY 300 (rev. and expanded ed. 2004) (1930). Although I do not agree with Professor Sowell on many points, as to this, he is charmingly eloquent.

71. Victor Stango, *The Economics of Standards Wars*, 3 REV. OF NETWORK ECON. 1, 9-10 (2004) (citing S.J. Liebowitz and S.E. Margolis, *Path Dependence, Lock-In and History*, 11 J.L. ECON. & ORG. 205 (1995)).

used by law enforcement to access the message with proper authorization.[72] This "back door" to individuals' computers was viewed as an invasion of privacy and critics thought it was preposterous to expect criminals to use the technology by choice. At the same time the government proposed the Clipper Chip, it restricted the export of U.S.-made encryption products.[73]

Indeed, while at the time America was at the forefront of encryption technology, the industry predicted that were the government to limit American encryption to the Clipper Chip and preclude export of U.S. encryption products, industrious developers around the world would advance encryption technology and surpass the United States in this area. Commercial business would be lost to foreign competitors and the law enforcement advantages of the Clipper Chip would be lost at the same time. And this is exactly what happened. With export restrictions in place, and a long debate ongoing regarding the Clipper Chip, foreign software developers took substantial encryption market share from U.S. companies. Ultimately, the government succumbed to the critics, relented regarding the Clipper Chip, and eventually relaxed export controls on encryption products.[74] As Oliver Smoot, Director of the ANSI Board stated in a congressional hearing in 2001, "[o]ver the past decade, our government export policies squelched new encryption technologies, which in turn, gave rise to a robust encryption industry in other countries."[75] This view is now widely held; despite the best of intentions regarding the preservation of national security, the government attempt to mandate the Clipper Chip failed. The Clipper Chip and encryption export controls were intended to limit public access to encryption technology (without a government back door), thereby making it harder for criminals and terrorists to communicate using encryption. We know now that criminals often communicate in the open (for example, using cell phones), or if

---

72. In announcing the "Clipper Chip," the White House touted,

> [a] state-of-the-art microcircuit called the "Clipper Chip" has been developed by government engineers. The chip represents a new approach to encryption technology. It can be used in new, relatively inexpensive encryption devices that can be attached to an ordinary telephone. It scrambles telephone communications using an encryption algorithm that is more powerful than many in commercial use today.

Press Release, The White House, Statement by the Press Secretary (Apr. 16, 1993), *available at* http://www.cdt.org/crypto/admin/041693whpress.txt. The Clipper Chip used an NSA-developed 80-bit algorithm they named Skipjack. Upon announcement of the Clipper Chip, the government made available Skipjack to industry for review. Even as they were announcing the Clipper Chip, the government was preparing the successor, "Capstone," and "MYK-80" developed by Mykotronx. The government was essentially going into the business of developing commercial software.

73. *See* Jay P. Kesan, & Rajiv C. Shah, *Shaping Code*, 18 HARVARD J. L. TECH 319, 330 n. 53 (2005) (citing Peter H. Lewis, *Privacy For Computers?: Clinton Sets the Stage For a Debate on Data Encryption*, N.Y. TIMES, Sept. 11, 1995, at D7).

74. *Id.* at 323 n. 18 (citing John Markoff, *White House Eases Exports*, N.Y. TIMES, Jan. 11, 2001, at C4).

75. Standards-Setting Hearing, *supra* note 15, at 21-24 (statement of Oliver Smoot, Chairman of the Board, American National Standards Institute).

they use encryption, they can get it off the shelf in any country. The proposed U.S. policy really did not solve the identified problem.

Justice Stephen Breyer, prior to his appointment to the U.S. Supreme Court, described "government failure" in his seminal book, *Regulation and its Reform.*[76] Breyer posited that regulatory failure occurs because of "mismatches," i.e., the failure "to correctly match the [regulatory] tool to the problem at hand."[77] Sidney Shapiro succinctly describes this situation: "A mismatch can occur because government can mis-diagnose the problem that it is attempting to solve and apply the wrong regulatory approach as a result, or even if a problem is correctly identified, government chooses a regulatory tool that is less effective and more expensive than other options."[78] The U.S. federal policy toward encryption in the 1990s represented such a mismatch.

Government failure is most likely to occur when a market is new. As the FCC observed, it is a perilous time to regulate "when consumer demands, business plans, and technologies remain unknown, unformed or incomplete."[79] In information technologies, rapid innovation is driven by industrial creativity, a healthy economy, commercial and government need, and enthusiastic consumer appetite. Standards are central to this innovation. Although the several industries that constitute the evolving information technology sector are established and sophisticated, in some regards the sector is relatively young in that we are seeing a paradigm-changing convergence of these industries, the confluence of which is in progress and advancing swiftly. It is counterintuitive to inject the government into such a highly dynamic environment.

Stanley M. Besen and Leland L. Johnson, two prominent experts on technological standards, have long argued that when industry is in a period of high innovation and volatility, the likelihood that a government standard will result in inefficient and/or artificial technological decisions is particularly

---

76. STEPHEN BREYER, REGULATION AND ITS REFORM (1982).

77. *Id.* at 191.

78. Sidney A. Shapiro, *American Regulatory Policy: Have We Found the "Third Way"?*, 48 U. KAN. L. REV. 689, 698 (2000).

79. *In re* Implementation of Section 304 of the Telecommunications Act of 1996, 13 F.C.C.R. 14,775, 14,781 ¶ 15 (June 24, 1998). *See also In re* Telecommunications Relay Services and Speech-to-Speech Services for Individuals with Hearing and Speech Disabilities, 21 F.C.C.R. 5442 ¶ 51, 56 (May 9, 2006) (stating

> [i]n declining to mandate the provision of VRS [or any particular VRS standard protocol] in the *Improved TRS Order*, the Commission stated because VRS was in its early stages of technological development the Commission would "permit market forces, not the Commission, to determine the technology and equipment best suited for the provision of [VRS], and allow[] for the development of new and improved technology.").

However, the FCC is currently seeking comment on whether it should mandate specific Internet protocols that VRS providers must use to receive and place VRS calls. *In re* Telecommunications Relay Services and Speech-to-Speech Services for Individuals with Hearing and Speech Disabilities, 21 F.C.C.R. 5,442, ¶¶ 51-57 (May 9, 2006).

acute.[80] Thus, formal standard-setting in rapidly changing industries should always be avoided. When the technology "settles down," the advantages of standards will present themselves, resulting in de facto standards being established by the market or industry bodies. As Besen and Johnson conclude:

> [T]he government should refrain from attempting to mandate or evaluate standards when the technologies themselves are subject to rapid change. A major reason for the Commission's difficulty in establishing the first color television standard was the fact that competing technologies were undergoing rapid change even during the Commission's deliberations. It is only after the technologies have "settled down" that government action is most likely to be fruitful.[81]

This perspective is reflected in the FCC's thinking in regard to regulatory intervention in telecommunications standard-setting. For example, the Commission adopted this market-based approach in the licensing of Personal Communications Service (PCS) spectrum, concluding that the rapid technological change in PCS development demanded a flexible regulatory approach to technical standards:

> [M]ost parties recognize that PCS is at a nascent stage in its development and that imposition of a rigid technical framework at this time may stifle the introduction of important new technology. We agree, and find that the flexible approach toward PCS standards that we are adopting is the most appropriate approach.[82]

The FCC recognized that telecommunications is currently in a highly dynamic period, and, given the dynamic environment, it is both an opportune and a perilous time for government regulation, as the FCC described in regard to interoperability standards for video navigation devices:

> The markets involved [for navigational devices] are in the early stages of becoming competitive, and the participants in these markets are on the precipice of a change from analog to digital communications. Because of these changes, this is both a particularly opportune and a particularly perilous time for the adoption of regulations. . . . It is perilous because regulations have the potential to stifle growth, innovation, and technical developments at a time when consumer demands, business plans, and technologies remain unknown, unformed or incomplete.[83]

However, it may be that the FCC's role in developing navigational devices will serve as evidence of the perils of government intervention. The FCC is adopting the work of CableLabs, a consortium of cable service providers and equipment manufacturers, and others, to develop interoperability standards for navigational devices. "[C]ommercial interests, fueled by consumer demand,

---

80. STANLEY M. BESEN & LELAND L. JOHNSON, COMPATIBILITY STANDARDS, COMPETITION, AND INNOVATION IN THE BROADCASTING INDUSTRY (1986).

81. *Id.* at 135.

82. *In re* Amendment of the Commission's Rules to Establish New Personal Communications Services, 73 Rad. Reg. 2d (P & F) 1477, ¶ 137 (report and order Oct. 22, 1993).

83. *In re* the Matter of Implementation of Section 304 of the Telecommunications Act of 1996, 18 F.C.C.R. 14,775, 14,781 ¶ 15 (June 24, 1998).

will agree on specifications . . . ."[84] It is worth noting that even in the context of CableLabs, which was initiated by cable companies in a process blessed by the FCC, the FCC had to intervene to make possible greater participation by computer, software, and entertainment companies; yet in 2006, concerns remain.[85] It appears that the cable companies dominated the process early on to the exclusion of these other key market sectors. It is probably safe to characterize the FCC's selection of the cable industry to lead this effort as short-sighted and made with insufficient attention to the dynamics of the market environment. Arguably, the problems with the process the FCC established are rooted in the initial decision to give a single highly interested industry a dominant role in the standards-setting process.

The government is typically not as nimble, efficient, or informed as the private sector at developing and advancing technology standards. Indeed, government may behave more like a tourist than an experienced local would in the bazaar, failing to understand or even perceive the nuances of each potential transaction, or failing to distinguish a good deal from a bad one. It is not overstating the truth to say that even those within the industry are often surprised by market behavior. But faced with that surprise, a business or sector is more rapidly able to adapt and take advantage of the turn of events than is government.

By contrast, the process of creating or changing a government-mandated standard typically takes years to accomplish. If a government mandates a standard, it is difficult to replace dated technologies embodied in the standard. For example, it took the FCC over two years to amend its ISDN rules to accommodate new technology.[86] Of course, such time frames are inconsistent with the current rapid pace of innovation in the digital media distribution marketplace. The Commission acknowledged that by imposing a standard it "could reduce the incentive to conduct the research and development that leads to innovation."[87]

In a notable example of "government failure," in the early 1980s, Japan

---

84. *Id.* at 14,780-81 ¶ 14. *See also supra* note 14 (discussing the successes and failures in the navigational devices standards-setting process).

85. *See supra* note 14 (discussing the successes and failures in the navigational devices standards-setting process).

86. *See In re* Petition to Amend Part 68 of the Commission's Rules to Include Terminal Equipment Connected to Basic Rate Access Service Provided via Integrated Services Digital Network Access Technology & Public Switched Digital Service, 11 F.C.C.R. 5091 (Mar. 7, 1996).

87. *In re* Advanced Television Systems & Their Impact Upon the Existing Television Broadcast Service, 11 F.C.C.R. 6235, 6251 ¶ 42 (May 20, 1996). In fact, this is precisely why very few innovations have been implemented in the NTSC transmission standard. *Id.* at 6248, ¶ 34. It is worth mentioning that these same problems could occur where the government codifies a market-developed standard for enforcement purposes and should stand as a warning that, when doing so, government should incorporate expeditious means for a government-blessed standard to be revised as technology evolves.

established a government-mandated analog HDTV standard.[88] At the time, the FCC had been considering the need to develop a high-definition standard. In fact, one early FCC requirement for the new standard was backwards compatibility to standard definition, a requirement later dropped.[89] But high-definition technology in the 1980s was immature, equipment was large, and it required a great deal of maintenance and consumed enormous amounts of power, and the U.S. industry and FCC recognized this fact. Ultimately, with advances in digital technology that would result in more efficient use of spectrum and a higher quality picture, the United States and other countries chose to pursue digital for their high definition television standards. Very simply put, the Japanese government's standard was premature and essentially failed before it was launched.

A more recent situation in which some have questioned whether government intervention in standards-setting is appropriate or instead the path to non-market failure is the case of France's parliament proposing legislation addressing standards in digital rights management (DRM). In March 2006, the French Assemblée Nationale passed legislation that required digital rights management interoperability to improve consumer choice in music and video entertainment devices.[90] The legislation's intent was to require vendors to make available to third parties adequate information about their technology so the third parties could provide interoperability. The bill required disclosure of all technical documentation and programming interfaces necessary to facilitate interoperability. For example, market leader Apple would have had to provide enough information to competitors so they could make their music and video files play on an iPod, or make devices that would play songs downloaded from iTunes. The bill also provided that the publication of the source code and technical documentation of an interoperating independent software is permissible.[91]

The point of the bill was to make iPods accessible to competitors and to allow competitors' players to play songs downloaded from iTunes. A major problem, critics observed, was in the approach. The legislation would have had the effect of opening to competitors the use of Apple's FairPlay DRM (the bill did not name any specific technology, so it would have applied to any system such as the Sony Walkman using Sony's proprietary ATRAC3 DRM, or any other proprietary DRM). But it appeared to critics that the bill undermined the functional protections of the subject DRM. As one observer noted when the bill

88. Sony/NHK Hi-Vision, a 1125-line analog technology, was first used in broadcasting in 1991. *See* David E. Sanger, *Few See Japan Make TV History*, N.Y TIMES, Nov. 26, 1991, at D6.

89. *See* William F. Schreiber, *The FCC Digital Television Standards Decision in* THE ECONOMICS, TECHNOLOGY AND CONTENT OF DIGITAL TV 37, 38-39 (ed. Darcy Gebarg 1999).

90. Bill Rosenblatt, *French Parliament Passes DRM Interoperability Legislation*, DRM WATCH, Mar. 23, 2006, *available at* http://www.drmwatch.com/legal/article.php/3593841.

91. *Id.*

was under consideration, "the problem is that the type of information necessary to achieve interoperability is also precisely the information necessary to render DRM useless: the encryption algorithms, keys, content metadata, and so on."[92] The bill was lauded by some who claimed this a victory for consumers, but the information technology industry and the U.S. government were highly critical.

In May of 2006, the Sénat, the upper house of the French Parliament, declined to pass the same legislation, passing instead a bill that establishes a government tribunal to adjudicate DRM interoperability issues. Some observers saw this as a complete backtrack from the initial legislation and one noted "one wonders if the French parliament should not just leave well enough alone and remove all of the interoperability-related sections of the legislation."[93] Indeed, it is likely these two versions of the legislation reflect the push and pull of advocates for competing interests upon government officials, and not sophisticated public policy analysis by government experts.

As further evidence of the difficulties at the intersection of technology and law, and the potential for government failure, in August 2006, the French Conseil Constitutionnel vacated as unconstitutional provisions of the new law that permitted circumvention of DRM to accomplish interoperability, concluding that the definition of "interoperability" was too vague.[94]

The situation in France exemplifies why government should be reluctant to intervene in information technology standards-setting. At a minimum, the case supports the notion that such government intervention carries with it substantial risk of the government getting it wrong. Potentially in this case, the result of the government action could have been precisely contrary to the stated public policy goals. Setting aside the question of whether there is an adequate public interest objective in requiring government intervention, it is uncertain that government could have accomplished its stated goal of interoperability by statutorily requiring DRMs to be opened for competitors in the manner the French government undertook. Some have observed that in the long-term, giving competitors the keys to Apple's DRM could have strengthened Apple's position in the market, as other content services sell to the iPod market and neglect competitive technologies. Indeed, the proposed law was designed to foster competition, but one must wonder if the legislative solution was a mismatch to the problem of iTunes market dominance. Competitors in this case have certainly not given up on the market for music downloads. The success of iTunes and the iPod *should* encourage competitors to work harder to compete for a rapidly growing market.[95] This is a situation in which competitors should

---

92. *Id.*

93. Bill Rosenblatt, *French Parliament Backs Off from DRM Interoperability*, DRM WATCH, May 3, 2006, *available at* http://www.drmwatch.com/legal/article.php/3603486.

94. *See* Estelle Dumout & Jo Best, *French DRM-busting law strokes Apple, hurts P2P*, SILICON.COM, July 31, 2006, http://management.silicon.com/government/0,39024677,39161055,00.htm.

95. Indeed, interoperability between entertainment technologies, including DRM interoperability, would be of benefit to consumers, particularly given the growing market

aggressively pursue greater and more successful competition, but it requires heightened creativity in technological innovation and consumer offerings, rather than government intervention. Time (and far greater analysis) will tell whether digital rights management interoperability is appropriate fodder for a legislative solution or whether the market will produce technological solutions. Regardless, the French experience illustrates the risk of legislating in the area of an information technology standard, i.e. the risk of non-market failure.

Given the dynamic conditions in the markets impacted by information technology standards, the balance of expertise favoring commercial developers over the government, the ability of industry to be more nimble in reacting to market conditions, and the open acknowledgement of these factors by government in the information technology standards-setting context, it is critical to recognize that as a general matter, the risk of and potential harm from government failure, as compared to a market failure, is substantial.

It is worth mentioning at this point that the market has also had its failures in standards-setting. Even a standard that becomes formalized by a standards developing organization may not meet with market success. I'm sure it has been said elsewhere that the roads of the information superhighway are littered with discarded standards. Businesses, like governments, often may try to anticipate the direction of the market and fail to do so. But when a company or industry fails with a particular standard, they can simply abandon it. When the government makes this type of mistake, it takes time to undo it through either legislative or regulatory action.

To summarize, governments should be reluctant to intervene in information technology standards because: (1) the relevant industries are sophisticated in regard to standards setting and have many well-developed types of standards and forums and avenues to develop standards; (2) the U.S. government has a strong preference for market-developed information technology standards and promotes this preference as a matter of both domestic law and policy and that of foreign trade; (3) international trade agreements limit the degree to which government can mandate standards; and (4) in contrast to the sophistication of the marketplace, government is rarely as informed or sophisticated in its understanding of the technology or market, or nimble enough to respond rapidly to market conditions. Therefore, the risk of government failure is significant, and indeed greatest where the market is young and dynamic, as is

---

and the number of different types of devices that now and in the future will play music and video. It would appear that the industry recognizes this and is working in at least two forums to develop just such interoperability standards. Coral, whose members include Hewlett-Packard, Sony Corporation, NBC Universal, Phillips, 20th Century Fox, LG Electronics and Matsushita Electric, is developing a standard using Intertrust technologies, and Microsoft, Time-Warner, and Thompson are working to establish what would be a competing standard. Apple is not participating in either effort. There are several other standards being developed as well, some for cross-platform interoperability, some exclusively for portable devices. *See* Bill Rosenblatt, *2005 Year in Review: DRM Standards*, DRM WATCH, Jan. 2, 2006, http://www.drmwatch.com/standards/article.php/3574511.

the case with regard to the current market affected by information technology standards. Based on these premises, a test to evaluate whether government should intervene in setting an information technology standard should be biased toward avoiding intervention.

IV. THE TEST (PART ONE): THREE TYPES OF CASES FOR ANALYSIS

To help understand government's role in setting standards, I will divide the universe of possible circumstances into three broad categories: clear cases for government intervention; cases in a large "gray area" where analysis will determine whether the government should intervene, and if so, in what manner; and finally, those circumstances in which it is generally inappropriate for the government to intervene.

A. CLEAR CASES FOR GOVERNMENT INTERVENTION

Cases in which there is a government responsibility to meet a *critical public interest objective*, and *the information technology standard is essential* for the government to meet that objective are clear cases for government intervention. These cases are clear, in that the government responsibility to the public interest is of paramount import and may only be met if the essential standard exists.[96]

First, there must be a *critical public interest objective* at stake, that is, the public interest in question must involve a critical issue in the area of national security, defense, public safety, health, or welfare. By "critical," I mean urgently affecting government's responsibilities such as protecting life, the safety of the public, national security or defense and is therefore of the absolutely highest priority for government action. For example, subsequent to the events of September 11, 2001, federal, state, and local governments

96. In some cases, however, a government requirement may be met by the market *before* a government mandated standard is in place. Such market response may foreclose the need for a government mandate or may simply require a government blessing or other limited government action. This is the case with radio interoperability for first-responders (i.e., local law enforcement and fire departments). Radio manufacturer Motorola was among those that developed the technology to facilitate interoperability between current generation radio systems and new technologies. It is only a question of the federal government allocating adequate spectrum and deployment of the necessary new equipment. *See The Spectrum Needs of Our Nation's First Responders: Hearing Before the Subcomm. on Telecommunications and the Internet of the H. Comm. on Energy and Commerce*, 108th Cong. 40-56 (2003) (statement of Gregory Q. Brown, Executive Vice President, Motorola, President & Chief Executive Officer, Commercial, Government, & Industrial Solutions Sector), *available at* http://republicans.energycommerce.house.gov/108/action/108-34.pdf; *In re* Development of Requirements for Meeting Public Safety Agency Communication Requirements Through the Year 2010, 14 F.C.C.R. 152 (Sept. 29, 1998); *In re* Development. of Requirements for Meeting Public Safety Agency Communication Requirements Through the Year 2010, 15 F.C.C.R. 16,899 (Aug. 2, 2000).

examined the circumstances and identified several issues related to standards that adversely affected preparation for and response to a terrorist attack. Among the problems cited even in the earliest examinations were failures in inter-agency communications.[97] It was determined that the government needed to improve radio interoperability to facilitate emergency inter-agency communications and data interoperability to improve information sharing between local, state, and federal law enforcement, intelligence, emergency preparedness, and response agencies. It was also clear after examination that there were inadequate standards in place in data systems used for immigration background checks. To address these issues, the USA PATRIOT Act and its progeny addressed several communications interoperability issues.[98] The law now requires that spectrum be made available for radio communications and that newly-interoperable radio systems be deployed.[99] It also requires that new standards be developed to facilitate inter-agency data exchange; standards that include biometrics and immigration document technologies to facilitate background checks on individuals entering the United States from foreign countries.[100] Some of these standards were to be developed under the auspices of NIST, coordinating the activities of other federal agencies.[101]

The second element of the test is that the technology standard is essential to the government's ability to meet its obligation to address the critical public interest objective. In each example I have described, the critical public interest objective can only be addressed through technical interoperability, and the technology standard itself is *essential* to ensuring such interoperability.[102]

---

97. *See, e.g.* H.R. REP. NO. 107-792, at 231-47 (2002).

98. *See, e.g.*, USA PATRIOT Act of 2001, Pub. L. No. 107-56, 115 Stat. 272; Intelligence Reform and Terrorism Prevention Act of 2004, Pub. L. No. 108-458, 118 Stat. 3638; Enhanced Border Security and Visa Entry Reform Act of 2002, Pub. L. No. 107-173, 116 Stat. 543; Homeland Security Act of 2002, Pub. L. No. 107-296, 116 Stat. 2135;.

99. Digital Television Transition and Public Safety Act of 2005, Title III of the Deficit Reduction Act of 2005, Pub. L. No. 109-171, 120 Stat. 4, 21-27.

100. USA PATRIOT Act of 2001 §§ 403(c), 1005(b), *amended by* Enhanced Border Security and Visa Entry Reform Act of 2002; Enhanced Border Security and Visa Entry Reform Act of 2002 §§ 201-204..

101. USA PATRIOT Act of 2001 § 403(c).

102. It is notable that even in such highly critical circumstances, the federal government looks to marketplace solutions to meet the government's needs. For instance, in the case of the USA PATRIOT Act requirements, NIST worked with commercial vendors to identify the technologies best suited to the requirements and where appropriate, conformed final requirements to the available technologies. However, there are examples where government set out interoperability requirements to meet critical public interest objectives. One such example can be found in the reform of the public emergency warning system. In 1994, FEMA and the FCC replaced the Emergency Broadcast System with the Emergency Alert System (EAS). The EAS serves two purposes. First, it is to provide a means for the president to address all Americans in the time of an emergency; second, it is to allow state and local officials to issue warning messages of imminent or ongoing emergencies through broadcast stations in specific regions. National alerts are issued via the telephone system to thirty-four U.S. radio stations, which cover in theory approximately ninety percent of the country and its territories. The EAS message is subsequently relayed by television, cable,

But let me emphasize the point that, given the statutory requirement that the federal government give preference to market-developed standards unless doing so would violate law or would be "otherwise impractical,"[103] and the other previously described national and international legal and practical arguments favoring market-developed standards over government-mandated standards, it is incumbent on government to work with the private sector to develop the appropriate standards to meet government needs. And indeed, this is what government almost invariably does. Even in circumstances where there is heightened urgency to meet the public interest needs, possibly even a critical public interest objective (such as meeting critical needs of the Department of Defense or law enforcement), government typically looks to industry to develop standards to satisfy the government requirements. Therefore, it is likely appropriate to apply the test herein described to apply to "gray area cases" even in the situation of a critical public interest objective, and apply it with constant awareness of the aforementioned practical constraints and legal preferences.

B. THE "GRAY AREA" CASES

In the "gray area" are cases where *the information technology standard is relevant to an important public interest objective.* I define "relevant" for the purpose of this examination to mean having an objectively reasonable connection to the important public interest objective. Although this is seemingly a broad category, this is only a threshold criterion that should trigger an analysis to determine whether government intervention of any nature is appropriate. Once this criterion is met, the analysis would guide a

---

and satellite television broadcasters to their audiences. EAS equipment sends and receives messages using a standardized format referred to as the EAS digital protocol, which was developed by the government in coordination with manufacturers. EAS equipment implements manufacturer developed standards for reception and transmission of the EAS digital protocol, and must be certified by the FCC. *See* EAS Protocol, 47 C.F.R. § 11.31 (2007); *In re* Review of the Emergency Alert System, 20 F.C.C.R. 18,625 (Nov. 10, 2005); *see generally* Emergency Alert System , 47 C.F.R. § 11 (2006).

Another example can be found in the 9-1-1 emergency call system. The goal of the 9-1-1 system is to be accessible to all individuals in the United States with a telephone. The notion is that one can dial 9-1-1 to report an emergency, and the 9-1-1 dispatcher will be able to identify the location of the caller and dispatch the appropriate emergency service. However, wireless carriers were not required to obtain or provide customer location information. The system is administered through 7000 local Public Safety Answering Points (PSAPs). As the use of wireless telephones grew, the system was challenged by the need to locate wireless 9-1-1 callers. To address this interoperability problem, the FCC adopted a rule in 1996 to require wireless carriers to provide location information for all wireless 9-1-1 calls by 2005, provided that the local PSAP is equipped to receive and use the information. *See* Federal Communications Commission, Enhanced 911-Wireless Services (2006), http://www.fcc.gov/911/enhanced/; *see also* Wireless Communications and Public Safety Act of 1999 (911 Act), Pub. L. No. 106-81, 113 Stat. 1286 (establishing 9-1-1 as the universal emergency telephone number).

103. National Technology Transfer and Advancement Act of 1995, Pub. L. No. 104-113, 110 Stat. 775, 783 (1996).

determination as to whether, given the legal, policy and practical constraints I have described, intervention *is* appropriate, and, if so, how that intervention should proceed.

There are two categories by which I define an *important public interest objective*. First, cases where an information technology standard may be relevant (but may not be essential) to the government's ability to meet its obligation to address a *non-critical* issue in the area of national security, defense, or public safety, health, and welfare. A second category is where *the information technology standard is relevant to providing an essential but non-critical government service* (e.g., access to public records). These are rough characterizations intended to distinguish important government responsibilities from those that I have described previously as critical and further, to distinguish circumstances wherein the standard *itself* may not be essential to government's ability to meet the public interest objective.

The first example illustrates the case where the government has a responsibility to protect the health and welfare of its citizens. Although it may be rare that an information technology standard is central to addressing an important public interest objective (and obviously this centrality weighs heavily in the determination of whether government should intervene in the event of a market failure to produce such a standard), there is at least one example where the implementation of an information technology standard will significantly contribute to improving healthcare outcomes *and* reducing a major burden on the U.S. budget and the economy as a whole: healthcare data standards.

The federal government is the largest "customer" paying for healthcare in the United States. In 2000, federal spending constituted approximately half of U.S. healthcare spending.[104] Medicare plus Medicaid alone constitutes approximately 19.5% of the federal budget.[105] Department of Defense healthcare spending has doubled from $19 billion in 2001 to $38 billion in 2006, constituting 12% of the DOD budget.[106] Healthcare costs are nearly 15% of GDP.[107] The costs are not only in dollars; there is substantial data that indicates the cost in lives. Between 44,000 and 98,000 Americans die as a result of medical errors each year,[108] about 7000 from medication errors

104. Cathy Cowan et al., *National Health Expenditures 2002*, 25 HEALTH CARE FIN. REV. 143, 146 (2004). The authors are employed by U.S. Department of Health and Human Services Centers for Medicare and Medicaid Services, Office of the Actuary.

105. OFFICE OF MGMT. & BUDGET, EXECUTIVE OFFICE OF THE PRESIDENT, HISTOICAL TABLES, BUDGET OF THE UNITED STATES GOVERNMENT, FISCAL YEAR 2006, 308 tbl.16.1, *available at* http://www.whitehouse.gov/omb/budget/fy2006/pdf/hist.pdf. Including spending on healthcare for defense, the total percentage is estimated at 26.3%. *Id.*

106. Bob Brewin, *DOD Eyes Changes in Healthcare Benefits*, GOV'T HEALTH IT, Jan. 30, 2006, *available at* http://www.govhealthit.com/article92143-01-30-06-Web.

107. NAT'L CTR. FOR HEALTH STATISTICS, HEALTH, UNITED STATES, WITH CHARTBOOK ON TRENDS IN THE HEALTH OF AMERICANS 30 (2005).

108. COMM. ON QUALITY OF HEALTH CARE IN AM., INST. OF MED., TO ERR IS HUMAN: BUILDING A SAFER HEALTH SYSTEM 1 (Linda T. Kohn et al. eds., 2000) [hereinafter TO ERR IS HUMAN].

alone,[109] with an estimated 770,000 injured due to adverse drug events; up to 70% of these events may be avoidable.[110] The Institute of Medicine estimates that medical errors cost the United States approximately $37.6 billion per year; about $17 billion are associated with preventable errors.[111] This is both an economic and health issue of enormous magnitude.

There is broad consensus among experts that the absence of a unified set of open information technology standards for healthcare data is a significant barrier to substantially reducing the cost of healthcare and improving healthcare outcomes. A recent study estimates that adoption of electronic patient records and an open-standard health information technology network could yield $78 billion in annual savings.[112] Further, it is widely acknowledged that there has been a market failure to address the problem in a reasonable time frame (in that information technology companies in the healthcare field have not implemented open standards after having many years to do so).[113] Leading proponents of the development of standards to accomplish creating a health information technology environment have recommended that the role of government should be to encourage market-developed standards by creating incentives that are "predicated on improving quality of care through [information technology], [by] investing (with the private sector) in the creation of" a public-private collaborative entity to establish and administer standards and policy rules, identify and recommend for implementation technical standards for interoperability developed among stakeholders (among other responsibilities), and "provid[e] seed funding to define and disseminate the . . .

---

109. *Id.* at 2.

110. *See* Jason Lazarou et al., *Incidence of Adverse Drug Reactions in Hospitalized Patients: A Meta-analysis of Prospective Studies*, 279 J. AM. MED. ASS'N 1200, 1200-05 (1998); *see also* D.C. Classen et al., *Adverse Drug Events in Hospitalized Patients*, 277 J. AM. MED. ASS'N 301 (1997).

111. TO ERR IS HUMAN, *supra* note 108, at 41.

112. Jan Walker et al., *The Value of Healthcare Information Exchange and Interoperability*, HEALTH AFF. WEB EXCLUSIVE, January 19, 2005, at W5-10, http://content.healthaffairs.org/cgi/reprint/hlthaff.w5.10v1?maxtoshow=&HITS=10&hits=10&RESULTFORMAT=&fulltext=The+Value+of+Healthcare+Information+Exchange+and+Interoperability&andorexactfulltext=and&searchid=1&FIRSTINDEX=0&resourcetype=HWCIT (discussing CTR. FOR INFO. TECH., THE VALUE OF HEALTHCARE INFORMATION EXCHANGE AND INTEROPERABILITY (Jan Walker et al. eds., 2004)).

113. *See* MARKLE FOUND., DATA STANDARDS WORKING GROUP, CONNECTING FOR HEALTH, REPORT AND RECOMMENDATIONS (2003), *available at* http://www.markle.org/downloadable_assets/dswg_report.pdf [hereinafter REPORT AND RECOMMENDATIONS]; *see also* MARKLE FOUND., CONNECTING FOR HEALTH, ACHIEVING ELECTRONIC CONNECTIVITY IN HEALTHCARE: A PRELIMINARY ROADMAP FROM THE NATION'S PUBLIC AND PRIVATE-SECTOR HEALTHCARE LEADERS (2004), *available at* http://www.connectingforhealth.org/resources/cfh_aech_roadmap_072004.pdf; U.S. GEN. ACCOUNTING OFFICE, AUTOMATED MEDICAL RECORDS: LEADERSHIP NEEDED TO EXPEDITE STANDARDS DEVELOPMENT (1993), *available at* http://archive.gao.gov/t2pbat5/149267.pdf; U.S. GEN. ACCOUNTING OFFICE, MEDICAL ADP SYSTEMS: AUTOMATED MEDICAL RECORDS HOLD PROMISE TO IMPROVE PATIENT CARE (1991), *available at* http://archive.gao.gov/t2pbat8/143217.pdf.

profiles for interoperability."[114] This is in contrast to requiring the market to deploy government-mandated standards.[115] Indeed, in 2005, ANSI established the Healthcare Information Technology Standards Panel, a public-private forum to address healthcare data interoperability issues.[116]

In the second category, a government may have to examine whether to intervene in the market to develop or mandate an information technology standard where the information technology standard is relevant to providing an essential, although not critical, government service. For example, governments have the responsibility to assure that official government documents and public records are readily accessible by their citizens for examination and use in perpetuity. Beyond the practical implications for those touched by government action, there is the need for transparency in governing in the United States, and governments have a responsibility to maintain records reflecting the operation of the government for current and future generations. Governments have long recognized the challenges of converting official records from a paper-based system to one of digital creation, storage, and retrieval. Given the rapid evolution of digital technology, there is a concern that government records created in a digital format available today will not be accessible by the public in perpetuity. Many in both the public and private sectors have sought to address this issue. Factors such as file format standards, record retention policies and strategies, and public access to electronic files are critical issues to be addressed in the standards-setting context.[117]

---

114. MARKLE FOUND. ET AL., CONNECTING FOR HEALTH: A PUBLIC-PRIVATE COLLABORATIVE, COLLABORATIVE RESPONSE TO ONCHIT REQUEST FOR INFORMATION 42 (2005), http://www.connectingforhealth.org/resources/collaborative_response/collaborative_response.pdf (a consensus response to the U.S. Department of Health and Human Services Office of the National Coordinator for Health Information Technology Request for Information, developed by thirteen leading health and information technology organizations under the auspices of Connecting For Health, a collaborative of representatives of over 130 health and information technology organizations, providing recommendations for a national health information network) [hereinafter PUBLIC-PRIVATE COLLABORATIVE].

115. *See* REPORT AND RECOMMENDATIONS, *supra* note 113; *see also* PUBLIC-PRIVATE COLLABORATIVE, *supra* note 114.

116. *See New Healthcare Information Technology Standards Panel Formed Under Contract from DHHS: ANSI Partners with HIMSS, ATI and Booz Allen Hamilton to Lead Initiative*, ANSI NEWS & PUBLICATIONS, Oct. 6, 2005, http://www.ansi.org/news_publications/news_story.aspx?menuid=7&articleid=1054.

117. *See Electronic Records Management and Preservation Pose Challenges: Hearing Before the Subcomm. on Technology, Information Policy, Intergovernmental Relations, and the Census of the H. Comm. on Government Reform*, 108th Cong. (2003) (statement of Linda D. Koontz, Director, Information Management Issues, Government Accounting Office), *available at* http://www.gao.gov/new.items/d03936t.pdf; James A. Jacobs et al., *Government Information in the Digital Age: The Once and Future Federal Depository Library Program*, 31 J. ACAD. LIBRARIANSHIP 198 (2005), *available at* http://repositories.cdlib.org/cgi/viewcontent.cgi?article=2377&context=postprints (arguing that the traditional roles of the Federal Joint Committee on Printing, Government Printing Office, and the Federal Depository Library Program libraries in selecting, acquiring,

There are other "gray area" cases that warrant consideration. In rare cases, the government has intervened to modify market behavior to enhance competition. In such cases, the government has often not developed a particular standard itself, but rather mandated interoperability, and ultimately ratified a market-developed standard. For example, the FCC's cable TV "plug-and-play" technical standards were developed and agreed to through voluntary consensus by the cable TV and consumer electronics industries, which then asked the FCC to codify them in its rules to ensure interoperability going forward. The rules in general were adopted to benefit consumer electronics manufacturers and retailers that compete with cable operators in providing customer equipment.[118]

Some advocate that the government is the best positioned to promote leading edge or untested technologies that may bring about substantial change in the market that is favorable to society. They argue that the government is uniquely positioned to encourage or require the use of such technology where others would avoid adoption due to the risks of uncertainty or costs associated with implementing such technologies. For example, some proponents of open source software argue that only the government, as consumer, is positioned to encourage widespread adoption of open source applications.[119] In some instances, they advocate that the government mandate such a procurement requirement.[120] Some extend the argument to advocating that governments should implement new technologies simply because the technology may not get "fair" opportunity to compete in the marketplace. However, such is the case with every type of product from cars to television shows. Although there may be merit to a product, sometimes consumers will overlook the product in favor

organizing, preserving, and providing access to and services for government information are more important than ever in the digital age).

118. *See* 47 C.F.R. § 76.602 (2006); 47 C.F.R. § 76.640 (2006); *In re* Implementation of Section 304 of the Telecommunications Act of 1996, Commercial Availability of Navigation Devices, 18 F.C.C.R. 20,885 (Oct. 9, 2003).

119. *See* Andy Updegrove, Editorial, *Governments as Accelerators*, CONSORTIUM STANDARDS BULL., Sept. 2005, *available at* http://www.consortiuminfo.org/bulletins/sep05.php#editorial. Some proponents of open source software argue that government has an interest in using software that is not potentially subject to control of a single vendor. Although this may be a valid argument regarding open standards, I would distinguish open standards from open source software in this regard: Whereas the use of software that *implements* open standards (or possibly even broadly accessible and licensed proprietary standards) may meet the goal of protecting government from control by a single vendor, open source software does not necessarily do so, since an open source implementation may be unique to a particular company, and, but for that company's product, the use of the implementation by government may be impractical. Moreover, most open source software has been commercialized and is acquired under specific terms and conditions.

120. This is to say a procurement requirement that would not only mandate a particular technology, but mandates the use of the licensing scheme and development model. It is important to understand that the term "open source software" does not define the utility or functionality of a particular software, but rather a development scheme, i.e., who writes the code, and very often, particular licensing terms embodied in what is called a General Public License, or GPL.

of known quantities, regardless of the projected benefits of the new product. It is not unusual for the market to simply favor the incumbent over a new, untested product. This is not to say that where the best business case for the government as consumer urges the use of a new or untested technology standard, the government should refrain. The point is that even in this situation the business case must still be made, and good judgment as a rational consumer must be relied upon.[121]

C. CASES THAT ARE CLEARLY NOT CIRCUMSTANCES FOR GOVERNMENT INTERVENTION

Under the third category, as a general matter government should not intervene in the setting of information technology standards in circumstances where the competitive market is vibrant (i.e., there is market competition and viable means to set the relevant information technology standards) and where (1) the market is not clearly failing to meet an important public interest objective, or (2) there is no important public interest objective or creating the standard is tangential to an important public interest objective. By tangential, I mean that creating the standard is not the only way to achieve the public interest objective; thus, even in a case of market failure, such would not be a barrier to the government in accomplishing the important public interest objective.

Let me step back at this point to be clear as to what constitutes the public interest. For the purpose of examining the government's role in setting standards, policymakers must keep a broad view of what the public interest is—that is, to maintain proper perspective, they should examine the narrow issue at hand in light of the greater public good. Indeed, this may be a difficult task. However, given the strong preference for government restraint in mandating standards, and given the extremely small likelihood that the setting of any particular standard will negatively impact the public at large, it is an extremely important consideration. Where there may be a more narrowly defined public interest sector impacted by the setting of a standard, it is important to have the relevant public interest representation informed and meaningfully involved in the standard-setting process, as I describe in Part VI.

---

121. *See* Dep't of Def., Open Systems Joint Task Force Frequently Asked Questions, *available at* http://www.acq.osd.mil/osjtf/faqs.html#dejure [hereinafter OSJTF FAQ] (describing the Defense Department's decision-making process in regard to standards implemented in open systems: "Overall, you should select the standard that provides the best business case, whether it's *de facto* or *de jure*, and that provides your program the best chance for success over the life of the program . . . . Selecting a standard that is too immature may not satisfy functional/performance requirements."). Thus it is clear that the Department of Defense is not opposed to selecting emerging standards over a standard that is in widespread use; however, the policy mandates that the choice be made on the best business case. The OSJTF FAQ emphasizes that "market analysis is key to making the best choice (a key risk mitigation technique)." *Id.*

One circumstance not warranting government action would be intervention absent a market failure that is detrimental to the public interest.[122] For example, in a situation in which a standard has not evolved, the government need not intervene for the sole reason that adoption of a standard would provide a consumer benefit unto itself. Keep in mind the long history of "would-be" standards rejected by the public described at the outset of this article. Although there are many roads that can lead to the development of a standard, some dead-end because, as I have described, the technology is not mature, affected industries are unresolved as to the appropriate standard, the standard-in-waiting is superceded, or the market simply is not ready or interested. In these cases, and even where competing technologies flummox the market, delaying the adoption of a standard, consumer rejection of a standard as such is not rationale enough for government intervention.

A frequently cited example where some argue the market is failing to meet an important public interest objective is in the context of consumer access to, and use of, works protected by copyright. Major aspects of the current debate are whether or how government should address the competing interests of various stakeholders (e.g., relative competitive advantage of an incumbent technology or commercial interest),[123] the preservation of the fair use doctrine,[124] and whether the law and the industries are meeting consumer expectations regarding the use of copyrighted works.[125] Without a doubt, important public interests are at stake. However, it is not so certain that standards are essential to achieving these public interest objectives. Indeed, standards are possibly only tangential to achieving these objectives. Other laws and behaviors are implicated and may be regulated pursuant to non-technical (i.e., not standards-related) means.

As to the fair use issues, clearly important public interest objectives are

---

122. I distinguish consumer benefit from consumer protection, which would certainly fall under other areas of law such as antitrust or general consumer protection laws rather than the government intervening in the standards-setting process per se.

123. *See* Peter Cohen, *Disney Boss Accuses Apple of Fostering Piracy*, MACWORLD MAGAZINE, Mar. 1, 2002, *available at* http://www.macworld.com/news/2002/03/01/eisner/. For evidence of congressional attention given competing interests in regard to the distribution of music, see *Protecting Content in a Digital Age-Promoting Broadband and the Digital Television Transition*: *Hearing of the S. Comm. on Commerce, Science & Transportation*, 107th Cong. (2002), *available at* http://commerce.senate.gov/hearings/hearings0202.htm; *Online Entertainment: Coming Soon to a Digital Device Near You: Hearing of the S. Judiciary Comm.*, 107th Cong. (2001), *available at* http://judiciary.senate.gov/hearing.cfm?id=198.

124. *See* FRED VON LOHMANN, ELEC. FRONTIER FOUND., FAIR USE AND DIGITAL RIGHTS MANAGEMENT: PRELIMINARY THOUGHTS ON THE (IRRECONCILABLE?) TENSION BETWEEN THEM (2002), *available at* http://www.eff.org/IP/DRM/cfp_fair_use_and_drm.pdf; Pamela Samuelson, *Anti-Circumvention Rules Threaten Science,* 293 SCIENCE 2028 (2001); Pamela Samuelson, *DRM {And, Or, Vs.} the Law*, 46 COMM. ACM 4 (2003), *available at* http://www.ischool.berkeley.edu/~pam/papers/acm_v46_p41.pdf; .

125. Elec. Frontier Found., The Customer Is Always Wrong: A User's Guide to DRM in Online Music (2006), *available at* http://www.eff.org/IP/DRM/guide/.

implicated (e.g., the protection of the public interest limitations on the otherwise exclusive rights in intellectual property protection such as disclosure in the context of patents and preservation of the fair use doctrine in the context of copyright). However, even if the market is failing, it is not the actual information technology standard that is at issue, but rather the operation of copyright law (or the enforcement of that law). The applicable law in this case is the Digital Millennium Copyright Act (DMCA). The DMCA amended the Copyright Act barring circumvention of digital rights management protecting copyrighted works.[126] The DMCA also authorizes the Librarian of Congress to periodically review the impact on fair use of the anti-circumvention provisions of the DMCA, and "exempt certain classes of works from the prohibition against circumvention of technological measures that control[s] access to copyrighted works."[127] Proceedings have taken place in 2000, 2003 and again in 2006.[128] Although in early years, the Copyright Office determined that no revision to the law was necessary, in 2006, the Registrar of Copyrights exempted persons making non-infringing uses of six classes of copyrighted works from the circumvention prohibition.[129] Thus, the government is addressing the issue of preserving fair use without requiring alteration of information technology standards. There may be an argument about whether the statutory approach of exemptions is a correct one (some may argue that all works should be exempted), but this is a statute regulating behavior, not technology standards. Copyright law is, as it is often said, a perpetual balancing between the public interest in protecting the rights of the creator and the public interest in the use of a work.

As to the competing commercial interests, the presumption should be that the government should not intervene merely to skew the competitive playing field.[130] In this case, the market is young and the participants, copyright owners and the competing information technology companies are only beginning to develop business models. As I have described, this is a circumstance that argues against the need for government intervention.[131]

---

126. 17 U.S.C. § 1201(a)(1)(A) (2000).

127. U.S. COPYRIGHT OFFICE, RULEMAKING ON EXEMPTIONS FROM PROHIBITION ON CIRCUMVENTION OF TECHNOLOGICAL MEASURES THAT CONTROL ACCESS TO COPYRIGHTED WORKS (2006), http://www.copyright.gov/1201/index.html. *See also* 17 U.S.C. § 1201(a)(1)(C) (2000).

128. U.S. COPYRIGHT OFFICE, *supra* note 127.

129. *Id.*

130. Of course, if there are anticompetitive behaviors, such can be addressed by antitrust law.

131. *See supra* notes 93-95 and accompanying text (discussing France's recent legislative efforts to mandate interoperable entertainment digital rights management). Interoperability among digital audio players has been at issue since the market success of the proprietary Apple AAC file format and their Fairplay DRM. *See also*, *Hearing Before the Subcomm. on Courts, The Internet, and Intellectual Prop. of the H. Comm. on the Judiciary*, 109th Cong. (2005) (statement of Raymond Gifford, President, The Progress & Freedom Foundation) ("Furthermore, these markets usually trend toward interoperability, as that is

As to the consumer issues, there are important market questions regarding the delta between commercial offerings and consumer expectation, and these questions are not an issue of the setting of an information technology standard. In other words, the standard will implement the access rules that the copyright holder or content distributor imposes. It is worth noting that where an industry uses a technology that "goes too far" to the detriment of a public interest in protecting consumers, or for that matter, too far in regard to consumer expectation, the public outcry and press reaction tend to quell the adverse actions and even litigation may ensue. Recently, Sony BMG incorporated First4Internet XCP copy protection into CDs and DVDs, which install without a user's permission on a user's PC as a rootkit, creating security vulnerabilities. Consumer advocates and the Department of Homeland Security sought legislation to prohibit this technology and the Electronic Frontier Foundation brought a class action suit against Sony/BMG (relying on current law protecting computers), obtaining a settlement in January 2006.[132]

Finally, in some cases, there may be an important public interest objective in helping a nascent industry develop. The most obvious example is the early evolution of the Internet. Although there has been much debate, and there are a few exceptions, the government has been hesitant to regulate the Internet for all the reasons regarding government failure aforementioned. In the few instances in which the government has regulated the Internet, there have been problems fitting the solution to the problem. Although these are not examples of "standards" per se, one can look to the examples of the CAN SPAM Act and efforts to protect children from pornography, the Communications Decency Act (CDA) and the Children's Online Privacy Protection Act (COPPA) for a mismatch of regulatory approach to the problem at hand.[133]

---

usually where consumer preference directs them. By contrast, government mandated interoperability sacrifices the dynamic competition for the standard for competition within the standard."); *Id.* (statement of William E. Pence, Ph.D., Chief Technology Officer, Napster) (stating

> [m]arketplace forces will continue to drive innovation in the DRM arena with attendant consumer benefits, new ways to enjoy digital music at a variety of different price points, while also gradually 'solving' the interoperability problem . . . . Napster believes that allowing the iPod to work with multiple service offerings would benefit consumers . . . . I do not see government intervention as the solution, as it would stifle competition and innovation that will benefit consumers and copyright owners at a very early stage of the market's development . . . . It does not seem prudent for government to pick a winner in the continuing . . . marketplace battle between Apple's FairPlay DRM and its competitors.)

132. *See In re* Sony BMG CD Technologies Litigation, No. 1:05-CV-09575-NRB, (S.D.N.Y. Nov. 21, 2005). The Final Order was signed on May 22, 2006. *See also* Sony BMG CD Technologies Settlement, www.sonybmgcdtechsettlement.com (last visited Apr. 2, 2007); Electronic Frontier Foundation, Sony BMG Litigation Info, http://www.eff.org/IP/DRM/Sony-BMG/ (last visited on Apr. 2, 2007).

133. The Controlling the Assault of Non-Solicited Pornography and Marketing Act of 2003 (CAN SPAM Act) requires commercial e-mail to be identified as advertisements, bans

Each house of France's parliament would argue that they are encouraging growth and competition in a nascent online music industry with their proposed DRM law.[134] The market can certainly be described as nascent. Although Apple is clearly the current market leader, it leads in a small part of the *potential* market, which is growing rapidly.[135] There is significant consumer interest in online music,[136] and there are many major companies focusing significant investment to compete with Apple, including Sony, Creative, Dell, Microsoft, Panasonic, Phillips, Toshiba, Samsung, Sandisk, and others. Indeed, in this case, where there are several viable competing technologies in the marketplace (i.e., Microsoft's Windows Media Player format, RealPlayer's format, and, of course, MP3), it has been argued that a government mandate may have the effect of foreclosing competition. As I have noted, some have observed that rather than leveling the playing field, such a law could tilt the

---

misleading header and subject line information, and gives consumers the right to ask e-mailers to stop spamming them in an effort to halt spam. 15 U.S.C. §§ 7701-7713 (2003). However, American legislation can only accomplish but so much, given that spammers can simply move their operations off shore and the FTC has no legal mechanism to bring actions against spammers located abroad. The Children's Online Privacy Protection Act of 1998 (COPPA) prohibits website operators from collecting personal information from children under thirteen years of age without the verifiable consent of the parent. 15 U.S.C. §§ 6501-6506 (1998). However, among other things, privacy advocates argue that the FTC has yet to clarify what constitutes "actual knowledge" that minors are using a website. *See* EPIC Complaint and Request for Injunction, Investigation and for Other Relief, *In re* Amazon.com, Inc. (filed Apr. 23, 2003), *available at* http://www.epic.org/privacy/amazon/coppacomplaint.html; Comments of Electronic Privacy Information Center, Center For Digital Democracy, Kathryn C. Montgomery, National Institute on Media and the Family, Consumer Action, Privacy Rights Clearinghouse, Consumer Federation of America, and Robert Ellis Smith of Privacy Journal, *In re* COPPA Rule Review 2005, (filed June 27, 2005), *available at* http://www.ftc.gov/os/comments/COPPArulereview/516296-00014.pdf; *see also* FTC decision to retain the Children's Online Privacy Protection Rule without modification (Mar. 15, 2006), *available at* http://www.ftc.gov/os/2006/03/P054505COPPARuleRetention.pdf. The Communications Decency Act (CDA) imposed broadcast-style content regulations on Internet content, prohibiting posting of "indecent" or "patently offensive" materials in a public forum on the Internet. Pub. L No. 104-104, §§ 501-509, 551-552, 561, 110 Stat. 56, 133-43 (1996), *invalidated by* Reno v. ACLU, 521 U.S. 844 (1997). This would have included the texts of classic fiction such as the "Ulysses" and other materials that, although offensive to some, enjoy the full protection of the First Amendment if published in a newspaper, magazine, or a book, or in the public square. The CDA was struck down by the Supreme Court in Reno v. ACLU, 521 U.S. 844 (1997).

134. *Supra* notes 91-95 and accompanying text.

135. Some might even argue the sector has crossed the threshold of "nascent." In.Stat, a leading Internet research firm, reports that online sales of digital music constituted nearly five percent of the total worldwide music market in 2005, representing $41.5 billion in sales, which is up from zero percent in 2003. Press Release, In.Stat, The Online Music Market: Downloaded Music Will Outpace Physical Media Bought Online in 2007 (Mar. 2006), *available at* http://www.instat.com/catalog/Ccatalogue.asp?id=212#IN0602972CM. In.Stat expects that download revenues will exceed revenues from physical products purchased online by 2007. *Id.*

136. *Id.*

field toward the current market leader, Apple, growing its market share and creating a disincentive for others to compete. The essence of the situation is that a sector is nascent and it is questionable at best whether the market has failed let alone whether the public interest (that of consumer's choice of online music vendors and devices) rises to the level of warranting government intervention.

V. THE TEST (PART TWO): SIGNIFICANT AND SUBSTANTIAL MARKET FAILURE

In the context of information technology standards, and for the purposes of identifying the government's role in regard to setting such a standard, I define market failure as circumstances where an information technology standard essential to meet a critical public interest objective, or relevant to an important public interest objective, has not developed in the market in a reasonable time frame and, thus, has proven a barrier to government action to address the identified public interest objective.[137] Market failures may occur for various reasons, such as: underinvestment by the private sector to develop and deploy the appropriate standards; a lack of proposed standards or conflicting standards such that no single standard has emerged to meet the critical or important public interest objective; systemic inefficiencies that result from competitive efforts to develop standards that function to impair the development of the standard (i.e., competing companies or standards-setting organizations develop conflicting standards to meet the same need causing increased market expenditure on the development of the standard or market uncertainties that cause consumer confusion); or intractable discord between industries or participants in the standards-setting process (i.e., the standard-setting process has apparently irrevocably broken down). In this last case, there must be such a high level of discord between participants that the system fails to deliver standards to meet the essential or important public interest objective in a reasonable time frame.[138] Under any of these circumstances, the government

137. To assess what a reasonable time frame is, the government would consider the urgency or criticality of the need for a standard and to what extent, if any, the pace of market behavior is operating to the detriment of the public. Consider for example the possibility of a standard that is established as a result of widespread user adoption, i.e. a de facto standard. Such may take considerable time to emerge in the marketplace, but the timing is often coincidental to the market need as its establishment is precipitated by the scale and scope of market need.

138. Indeed, there may be other market behaviors that operate to the detriment of the public, such as collusion among a few in the standards-setting process, market allocation, boycotts of a particular company or standard, the problems of "hold up" or that of "submarine patents." But, there are other legal theories and remedies to address these market failures, such as laws applying to intellectual property protection in copyright or patents, contracts or antitrust. The government should consider these means in the appropriate circumstances, before intervening in the standards-setting process in a manner of "selecting" the standard.

Take, for example, the *Rambus* case, in which Rambus, while participating in a

may be asked to intervene by stakeholders or may, as a stakeholder, independently consider intervening.

---

standards-setting effort within the Electronic Industries Association-established Joint Electron Devices Engineering Council (JEDEC), failed to disclose patents. Rambus v. Infineon Techs. AG, 164 F. Supp. 2d 763, 764 (E.D. Va., 2001), *rev'd in part*, 318 F.3d 1081 (2003). Subsequent to the development of the standard, Rambus sought royalties on the patents from companies that implemented the standard. The FTC unsuccessfully brought an administrative action against them. In concurrent litigation, Rambus was held not liable for allegedly misleading JEDEC's standards-setting activity. However, the Virginia District Court on remand found that Rambus was guilty of evidence spoliation, which, in part, provided the basis for a bench ruling that Rambus could not enforce its patents on a theory of "dirty hands." In 2004, the District Court found that Rambus had spoliated evidence, warranting the piercing of Rambus' attorney-client and work-product privileges. This permitted the subsequent discovery in the federal civil case. Rambus, Inc. v. Infineon Techs. AG, 222 F.R.D. 280 (E.D. Va. 2004). In February 2005, in a bench trial, the court found that Rambus was liable for "unclean hands," which would estop Rambus from pursuing its patent claims. *See* Samsung Elecs. Co. v. Rambus, Inc., 398 F.Supp. 2d 470, 473 (E.D. Va. 2005). *See also* Rambus, Inc. v. Infineon Techs. AG, 222 F.R.D. 280, 282 (E.D. Va. 2004). There is no record of the bench trial to which the *Samsung* case refers. After this ruling, Rambus and Infineon settled out of court before the court finally ruled in the matter. In May 2005, the FTC re-opened the record upon discovering that Rambus's attorneys had likely tampered with evidence. The full Commission is hearing the matter and is considering the new evidence. *In re* Rambus, Inc., FTC Docket No. 9302 (2004), *available at* http://www.ftc.gov/os/adjpro/d9302/index.htm Although the case is ongoing, the facts have thrown into question how a standards-setting organization can enforce its intellectual property rights policy and whether courts can resort to equity as an appropriate remedy..

Another example can be found in the FTC Consent Order in Dell Computer Co., FTC Docket No. C-3658 (May 20, 1996) (Commissioner Azcuenaga dissenting), where Dell was alleged to have intentionally failed to disclose claimed intellectual property to VESA during the standards-setting process. The Consent Order required Dell to refrain from enforcing its patents. *Id.* Were such a circumstance to become endemic, it might be appropriate for government to intervene. *See*, The Vital Role of Standard-Setting Organizations and the Necessity of Good Faith and Fair Play Among Participants, The Future of Standards-Setting 2004 Symposium Paper, *available at* http://www.standardsconference.org/docs/WhitePaper_1-14-05.pdf; Deborah Platt Majoras, Chairman, Fed. Trade Comm'n, Remarks, For Standardization And The Law: Developing The Golden Mean For Global Trade (Sept. 23, 2005), *available at* http://www.ftc.gov/speeches/majoras/050923stanford.pdf.

But mitigating factors that lead to self-correction may prevail. Indeed, even where there is fear of potential market power abuse, as has been expressed in the context of standards setting (in regard to certain companies, or particular development schemes, such as proprietary as compared to open source), "most networks consist of several manufactures supplying complementary products that must interconnect in order for the network to function efficiently." David Balto, Assistant Dir., Office of Policy and Evaluation, Bureau of Competition, Fed. Trade Comm'n, Remarks at the Cutting Edge Antitrust Law Seminars International (Feb. 17, 2000), *available at* http://www.ftc.gov/speeches/other/standardsetting.htm.

Further, such a risk is substantially eliminated when the standards-setting process enters formal stages and transparency, consensus, good faith, and fair play work to preclude unfair advantage by any single participant. Although this view may appear idealistic, the risks of assault on a standards-setting proceeding are most notably that of the imposition of a "submarine patent" or of patent royalty "hold up" risks, which are concerns as to behavior but are not attributable to the size of the perpetrator.

In a case that falls within the first category, the standard is essential to meet a critical public interest objective; the government should certainly take all necessary measures to remedy the failure as rapidly as possible. That said, as previously noted, the government's strong preference for voluntary consensus standards has led the government to be reluctant to set a mandate where the market has not decided, and thus the test described herein for "gray area" cases may well be appropriate.

As to "gray area" cases, given the well-articulated reluctance of the government to intervene in the market to set standards as a general matter, it is appropriate to set a high bar for failure before the government should intervene, that of *significant and substantial market failure.* A significant and substantial market failure would be where the market failure has proved to be a barrier to the government's ability to address the important public interest objective. Even where there is a significant and substantial market failure, one must consider a number of *mitigating factors.* The first may be posed as a question: if given a reasonable period of time without government intervention, will the market rectify the failure? With regard to the *reasonableness* of the time frame in which a standard may emerge in the market, the examination must consider whether the magnitude of the need corresponds with the availability of the standard. Typically, the market sorts out technical standards well in advance of the time where the majority of users needs to make a technology choice. By this time, the standard reaches wider market acceptance, it is generally well understood, and the methods of interoperability are mature enough to be relied upon.

An example in the standards-setting context of where government appropriately delayed action to allow the market to work can be found in the evolution of consortia. This was a question of the viability and legitimacy of this particular approach to standards setting in general, rather than the development of an individual standard, but the correlation will become apparent, as this debate could have taken place as to any single consortium-developed standard. At the advent of consortia, some critics were concerned that standards set by consortia harmed the standards-setting process because, it was argued, consortia did not adhere to the due process guidelines of formal standards development organizations such as those relating to transparency and inclusiveness. Therefore, the argument went, standards set by consortia were not truly voluntary and consensus based, i.e., not valid. These criticisms were brought to the government's attention.[139] But the government did not intervene and only a few years later it became apparent that the use of consortia to develop standards has revealed itself in many cases to be a better allocation of resources than circumstances where individual companies compete to develop a standard or the market endures a lengthy formal standards-setting process. The consortium significantly reduces both redundancy in the creative process

139. Standards-Setting Hearing, *supra* note 15, at 19.

(similar tasks being undertaken by different people at different companies) and provides a forum for more efficient consensus building. Even where a proposed standard is developed at a single company, the process of creating a consortium or acquiring consortium approval is an exercise in building consensus, and providing efficiencies otherwise unavailable. In fact, many consortia take on the characteristics and processes of traditional, formal standards-development organizations.[140]

Although there may be concern that single-company, or small-consortium developed standards create a risk to the overall standard-setting scheme, it would be premature to conclude that the government should intervene into a particular standard-setting merely because a single company or a small consortium is proposing the standard. In fact, reviewing the history of standards, one sees many standards developed by a single (even dominant) company or small groups of companies working together.[141] There would have to be much more substantive grounds for government intervention.

Another mitigating factor that the government must evaluate in determining the significance of an apparent market failure is the cohesiveness of the stakeholders, i.e., the degree to which there are existing avenues of interchange, agreement or dispute resolution, such as customary channels for negotiation, forums such as trade associations, cross-industry working groups and so on. The greater the cohesiveness, the less likely government intervention is warranted even where there is a market failure. Keep in mind the enumeration of the vast number of forums for standard-setting, channels of communication between stakeholders, and constant reinvigoration of the development of standards through new forums such as consortia. For example, the entertainment industry and computer industries have been somewhat at odds over business models for, and intellectual property protection in, distribution of the entertainment industry's products using the computer industry's (and consumer electronics) products as the means of distribution. There are numerous avenues for discussion, including private negotiations regarding the terms for distribution, through ad-hoc organizations such as the Content Protection Technology Working Group (CPTWG), and in that case

140. Although consortia are formed for a wide range of reasons, some of which are purely strategic in regard to competitors, as a market-accepted tactical approach and not presumptively deleterious to the market, they may even enhance competition.

141. Leading examples include Adobe's PDF, Hewlett Packard's PCL, IBM's VGA, Microsoft's open XML file formats, Intel's x86 architecture, and Hayes' Standard AT Command Set. As I have described in detail in Part III.B.1, during the process of revising OMB Circular A-119 to conform with the NTTAA, comments were received seeking clarification as to whether a standard developed by a private-sector business or consortium qualify as a "voluntary," "consensus" standard. OMB made this clarification, stating "It has not been the intent of the Circular to create the basis for discrimination among standards developed in the private sector, whether consensus-based or, alternatively, industry-based or company-based." OMB Circular A-119, *supra* note 23.

more narrowly, the 5C companies (a consortium) that, for example, developed the "encoding rules" to insert into specific "bits" left open for the "broadcast flag" by ATSC (a formal, ANSI-accredited standards developing organization) in its DTV standard, trade associations (e.g., Recording Industry Association of America ("RIAA"), Motion Picture Association of America ("MPAA"), Information Technology Association of America ("ITAA"), Business Software Alliance ("BSA"), Consumer Electronics Association ("CEA"), National Association of Broadcasters ("NAB") and others), issue- or technology-specific consortia, and so on. Similarly, Internet-related companies, non-profit public interest groups, and standards organizations that are organized to address Internet-specific standards (i.e., W3C, IEEE, IETF, ITU-T, INCITS, etc.) provide still more possible avenues for greater cohesiveness. So too is the case with computer and software architecture and consumer electronics. These are sophisticated, evolved businesses with numerous means to resolve differences and conclude standards setting even in a dynamic, relatively young marketplace of convergence (CEA, IEEE, ITU, ICITS, etc.).

To conclude, there must be a significant and substantial market failure before the government should consider intervening, and even where such a failure exists, the government should consider several mitigating factors before acting.

VI. THE TEST (PART THREE): GOVERNMENT INTERVENTION MUST BE REASONABLY TAILORED

Where the government concludes that intervention in the standards-setting process is warranted, *it should reasonably tailor its intervention to rectify the identified market failure and to achieve the particular public interest objective.* The government should limit the scope of intervention and define objectives in acting to address a critical or important public interest objective. In order to assure the most narrowly tailored government intervention, where government elects to intervene, it should be able to clearly articulate: (a) the specifics of the important public interest objective in the establishment of a particular information technology standard; (b) the purpose and scope of the government intervention; and (c) identifiable objectives for government intervention to achieve.

Because the government is substantially predisposed not to intervene and the risk of government failure is of substantial concern, *the government should, where it determines it must, proceed incrementally in its intervention,* respectful of the guiding premises that, first, the information technology market is generally well equipped to develop standards, second, government prefers market-developed information technology standards to government mandates, and, third, the risk of government failure is significant. By incremental intervention, I mean that which initially produces minimal non-market behavior, and with each step, imposes greater degree of intervention. With this in mind, the first step in intervention should be to encourage market activity;

government should first encourage the market to undertake and develop the needed standards. Typically, the government uses incentives such as taxation incentives or government funding through grants or loans to encourage market behavior and the same could be true in regard to the development of information technology standards. In the event of disputes between stakeholders that delay standards to the extent of a market failure, the government could facilitate something akin to mediation to mitigate the need for more direct government intervention.

As a first step prior to direct intervention, and to potentially obviate the need for the government to even entertain the question of directly intervening in the setting of a standard, the government and the private sector should endeavor to strengthen non-governmental public interest representation in the particular standards setting. Government and industry share a responsibility to assure that non-governmental public interest representatives are, or become adequately informed and fully engaged through funding, education and technical assistance where necessary.

By public interest representation, I mean entities that are known to be credible advocates representing the views of the general public (or segments thereof) on issues of public concern and that are accountable to the public for their advocacy. They may represent consumers or consumer sectors such as the elderly as represented by the American Association of Retired Persons (AARP), or have constituencies such as patients in the healthcare arena or the disabled in areas such as accessibility or healthcare. The key factors are that they credibly and genuinely represent the public interest, are informed, meaningfully involved and are accountable.[142]

There are three categories of interested parties represented in the standards-setting process representing diverse opinions: industry (often many companies or trade associations with differing interests); government, as both a customer for standards and as a regulator of industries that use standards, and non-governmental public interest groups (e.g., consumer advocacy organizations). Each set of interested parties have a seat at the standards-development table, but depending on the importance of the standard to each, the credibility and appropriateness of the participation, and other factors, differing weight is given each depending on the circumstances.

Involvement of public interest representatives in these circumstances adds to the diversity of stakeholders and gives greater assurance that the public interest will be served without the direct intervention of government. It is to the

142. In the context of information technologies, there are many flavors of "public interest" representatives, many of which actually represent industry sectors or even individual companies and have neither accountability to the public nor genuine credibility at stake in the public eye. I do not mean to imply that these enterprises should be excluded from a standards-setting process, as they may well be legitimate stakeholders. However, they do not fulfill the role of a true "public interest" representative, as organizations such as the Consumer's Federation of America, National Consumers League, AARP or the Disabled American Veterans would, and their viewpoint should be given appropriate consideration.

benefit of industry, government and the public to have such representation to inform the standards-setting process and integrate into the process greater consideration of public interest matters. Further, such representation will be valuable in the event government elects to intervene, representatives participating in the process can inform government decisions, and support or refute with transparency positions taken by the government. As it is described by ANSI in the United States Standards Strategy:

> The representation of consumer interests in the U.S. standards system is essential to ensure that the individual's needs are being considered and addressed. Today's consumers are concerned about such issues as product compatibility; quality of products and services; ease of use and accessibility . . . . With its emphasis on . . . openness, and transparency, the U.S. standards system provides a valuable forum for the consumer voice to be heard. . . .
>
> - *Standards developers* should identify, encourage and support appropriate consumer representation on their committees . . . .
> - *Industry* should use consumer research as a basis for standardization initiatives and decisions.
> - *Government* should strengthen its consumer-related programs and initiate standards information and participation programs as appropriate.
> - *ANSI* should work with consumer organizations to educate them about standardization and encourage and support their participation in standards development.[143]

Beyond this first step, a government response might include taking the role of broker or mediator, or assigning such a role to a neutral third party, providing a setting for dispute resolution or the establishment of an informal or formal forum to assist the private sector in developing the needed standard. For example, to mitigate a government mandate and the associated risk of government failure, NIST or the FCC can function as a convener, drawing all appropriate interested parties together.[144] As Carl Cargill testified

> NIST has a unique opportunity . . . the ability to call on its own right a meeting of people engaged in standardization . . . and because they are neutral, that is, they don't have their own technical agenda to push, it is phenomenally helpful . . . . It can be a source of information, a source of knowledge about what is going on [in an area of standards-setting.][145]

ANSI has performed this role ably, as has the FCC. The FCC has provided opportunities for consensus building and brokering resolutions in standard-setting where telecommunications standards are at issue. For example, in its proceeding regarding set-top boxes for cable systems, the FCC has on several occasions deferred its deadline for eliminating integrated set-top boxes,[146] the

---

143. USSS, *supra* note 39, at 10 (footnote omitted).

144. Notably, to some extent ANSI standards planning panels serve this function as well, and being a private-sector enterprise, should be considered as a possible and less government-intrusive alternative avenue.

145. Standards-Setting Hearing, *supra* note 15, at 48 (statement of Mr. Carl Cargill, Director of Standards, Sun Microsystems).

146. The initial deadline for phasing out the integrated set-top box was set for Jan. 1,

latest one, until July 1, 2007, to afford the industry more time to develop a downloadable security solution. The FCC concluded that downloadable security was likely to produce more competitive and interoperable digital devices, which would consequently foster the DTV transition. The Order, however, also imposed reporting requirements on the cable industry in order to ensure that negotiations for development of technical standards and licensing agreements were not unnecessarily delayed.[147]

Similarly, the FCC has also adopted performance requirements and permitted various technical methods to fulfill those requirements. In the "Broadcast Flag" proceeding, the Commission concluded that, absent some content protection mechanism, the potential threat of mass indiscriminate redistribution would deter content owners from making high-value digital content available through broadcasting outlets. To help curb this threat, the Commission adopted the ATSC flag-based system, which signals DTV receiving devices to limit redistribution of the broadcasted content.[148] It is key to understand that the FCC, however, did not prescribe a specific content protection or recording technology that equipment manufacturers must use in producing flag-compliant devices. Rather, the Commission set forth an interim process by which a manufacturer could certify to the FCC that their technology is compliant in giving effect to the ATSC flag, giving life to competing technologies to meet the flag requirements.[149] Even though the Commission acknowledged that it was not mandating a single federal standard, it stated that it would review the standards for licensing terms and compliance.[150] The FCC

2005, but it has been deferred several times by the FCC, and the current deadline is July 1, 2007. *See In re* Implementation of Section 304 of the Telecommunications Act of 1996, 20 F.C.C.R. 6794 (Mar. 17, 2005). The FCC sought to phase out navigation devices for cable consumers that performed both conditional access functions and other functions in a single integrated device. The goal was to foster competition in the navigational devices market, by enabling unaffiliated manufacturers, retailers, and other vendors to commercially market host devices while allowing cable operators and other video programming providers to retain control over their system security.

147. *Id.* at 6814-6815, ¶ 39. *See also supra* note 14 (discussing the successes and failures in the navigational devices standards setting process). This situation also exemplifies the risks associated with government intervention.

148. *In re* Digital Broadcast Content Protection, 18 F.C.C.R. 23,550 (Nov. 4, 2003), *rev.'d in part & vacated in part,* 406 F.3d 689 (D.C. Cir. 2005).

149. That is, the device would recognize the broadcast flag, which instructs the device as to what the device may do with the protected content, whether the content may be distributed freely, distributed to an unlimited number of other devices (but only those that recognize the flag), copied only once to another compliant device, or never copied. *Id.* at 23,575 ¶ 53.

150. *In re* Digital Output Protection Technology and Recording Method Certifications, 19 F.C.C.R. 15,876, 15,916 ¶¶ 90-91 (Aug. 12, 2004). Although the D.C. Circuit ultimately struck down the FCC's broadcast flag requirements, the Commission's expectation that approved content protection technologies be licensed on a "reasonable and non-discriminatory basis" is still instructive in terms of how the FCC addresses the issue of mandatory technical standards. *See* Am. Library Ass'n v. FCC, 406 F.3d 689 (D.C. Cir. 2005).

has fostered the development of standards in the private sector in many other situations, at times adopting those standards as a federal standard[151] and at other times simply providing approval for compliance with an established industry standard, as in the broadcast flag instance or the cable TV plug-and-play context described above.

As a second step in intervention, the government can use its leverage as a *potential* market participant and *potential* regulator to influence the marketplace. The government is very effective at manipulating market behavior by threatening to undertake regulation, or, as a major market participant, by driving commercial decisions (particularly by government vendors). This step is descriptive of typical situations in which stakeholders seek to put pressure on competing stakeholders by urging Congress or the executive branch to pursue a change in the law to meet the advocate's parochial needs. And indeed, this is common enough behavior. However, the government should only take this step where it is in the broader public interest to do so, and doing so can be and should be accomplished without "taking sides." The goal for the government should be to encourage, cajole, and incite the market to resolve differences impairing the development of a standard.

Even where the government is participating in the market primarily to influence the market, it should do so as a *rational consumer*. The government's decision to participate in the market must be in the broader public interest and part of that analysis must be a determination of the best business case for the government. The government should undertake the traditional cost-benefit analysis of acquisition of a product or service by the government and consider factors such as suitability of the product for the purpose intended, interoperability, reliability, security, functionality and usability, and total cost of ownership (acquisition, training, and conversion costs, and service costs over the life of the product). For example it is not in the best public interest for the government to commit to purchase a non-existent product, or products that are not market-tested and mature (unless, of course, it is supporting research and development). In its *Roadmap for an Open ICT Ecosystem*, the Harvard Berkman Center recommends that policymakers and stakeholders in information and communications technology platforms

> [c]onsider a hierarchy of standards with priority given to mature, widely used, open standards. Where open standards do not exist, favor industry-driven, consensus-oriented standards with as many of the elements of an open standard as possible (see Section I). This will help balance the use

151. *See, e.g.*, *In re* Digital Audio Broadcast Systems and Their Impact on the Terrestrial Radio Broadcast Service, 17 F.C.C.R. 19,990, 20,002 ¶ 34 (Oct. 11, 2002). In this proceeding, the FCC sought to encourage the development of digital broadcasting by AM and FM radio broadcasters. To that end, the FCC selected iBiquity's in-band, on-channel (IBOC) transmission standard. The IBOC standard was supported by most of the largest broadcast group owners, as well as the CEA and the NAB. *See also In re* Advanced Television Systems and Their Impact upon the Existing Television Broadcast Servics, 7 F.C.C.R. 3340, 3358 ¶ 69 (May 8, 1992).

> of open standards with the dynamics of the market and emerging technologies.[152]

In support of the 1994 Department of Defense Memo reforming the Defense Department standards acquisition to implement the Department's transition to open systems, the Department of Defense Open Systems Joint Task Force guidance provided that,

> Overall, you should select the standard that provides the best business case, whether it's de facto or de jure, and that provides your program the best chance for success over the life of the program. . . . Selecting a standard that is too immature may not satisfy functional/performance requirements.[153]

So although there is a willingness to consider immature or untried technologies, there seems to be a widely held preference for more mature and time-tested technologies and standards.

As I have noted, governments have recognized the challenges of converting official records from a paper-based system to that of digital storage and retrieval. Many in both the public and private sectors have sought to address this issue. One solution has become very controversial through the actions of the Commonwealth of Massachusetts and other states as well as national governments outside the United States. In the case of Massachusetts, the Commonwealth has developed a policy to require the OpenDocument file format (recently ratified by OASIS and approved by ISO and IEC), as well as Adobe's PDF (portable document format),[154] as the standard formats for all office documents in certain state agencies as of January 1, 2007.[155]

The policy acknowledges that most documents generated by the government are in Microsoft Word, Lotus Notes, and WordPerfect proprietary formats.[156] Among the policy goals the government is seeking is to shift from these formats to the use of open standard formats for government documents, to gain efficiencies in data management, and to avoid vendor lock-in.[157] Although there are many issues surrounding the development of this policy, one question the government must ask specifically regarding the choice of a format, a central question in the development of the policy, is whether the required format has matured adequately to meet the specific requirements that Massachusetts sets

---

152. BERKMAN CTR. FOR INTERNET AND SOC'Y AT HARVARD LAW SCH., ROADMAP FOR OPEN ICT ECOSYSTEMS 24, *available at* http://cyber.law.harvard.edu/epolicy/roadmap.pdf.

153. DOSJTF FAQ, *supra* note 121.

154. It is more than simply rhetorically ironic that Adobe refused to license the PDF format to Microsoft for inclusion in Microsoft's Office applications to the same extent it is licensed to other application vendors. Depending on the specifics of this situation, it may place into question whether the PDF format is truly an open standard, available to all qualified potential users on RAND terms.

155. *See* Massachusetts Enterprise Technical Reference Model, Version 3.5, at 18 (Sept. 21, 2005), *available at* http://www.mass.gov/Aitd/docs/policies_standards/etrm3dot5/etrmv3dot5informationdomain.pdf.

156. *Id.*

157. *Id.*

out, particularly the public interest in long-term accessibility to government documents. Are there software manufacturers that will maintain applications in the marketplace that will read documents created by government employees generations earlier, and is it reasonable to expect that those products will be in widespread popular use? Is this the best decision the government can make in regard to meeting the important public interest need to assure government documents are available to the public in perpetuity or is this, as author Stephen Breyer put it, a mismatch between an identified problem and its proposed government solution?[158]

As a final consideration in the context of government as market participant, the government should not incur extraordinary costs to the government or the public uncommensurate with the benefit bestowed upon the general public good. In sum, the government can and should consider using its market power and position as regulator to encourage market behavior, but in doing so, the government must act in the context of the general public good.

As a third step in intervention, the government could consider intervening by imposing a mandatory information technology standard, but doing so through a transparent, neutral process. Failing to cajole the market to meet the important government interest, regulatory steps could be taken to mandate a standard to accomplish interoperability. But the government should do so still with an eye to minimal intervention, allowing for market flexibility, and with attention to mitigating the risk of government, or non-market, failure.

A government mandate should set out requirements to achieve interoperability, i.e., *performance standards*, as opposed to specifying a particular *implementation* of an interoperability requirement (some would call this a "design" requirement). Thus, the law would not describe the specific technical means to achieve interoperability, but would have an objective means to assure that the mandated objective ("performance") of interoperability is met. Federal government mandates such as e-911, the Emergency Alert System, and the broadcast flag take this approach. And as is the case of the FCC approach to the broadcast flag, the law should establish a neutral process to determine whether a particular implementation satisfies the objective.

The mandate should also be sufficiently flexible to incorporate efficient means to renew or revise the standard, once established, to assure improvement and compatibility as technology evolves.[159] Generally, "performance"

---

158. BREYER, *supra* note 76. This is an immense issue for the information technology sectors, governments and all record-dependent industries. Imagine a banking industry where customer records do not survive a deceased customer, or an architect or aircraft designer whose documentation disappears before the final product of their work. Much was learned from a 2200-year-old map carved into panels of wood recently found in China. *See Over 2,200-Year-old Map Discovered in N/W China*, PEOPLE'S DAILY, Apr. 30, 2002, *available at* http://english.people.com.cn/200204/30/eng20020430_95013.shtml. It would be a shame if the very technology that enables the storage of vast volumes of data is the ultimate cause of the disappearance of "information age" historical records.

159. Government-imposed design standards are likely to create the greatest

standards yield the best implementations through marketplace competition.[160] For example, where the public interest objective in healthcare records is to ensure universal accessibility by healthcare providers and patients alike, it may be in the public interest that electronic medical records be maintained in a manner that allows for data exchange and access among all authorized healthcare providers and that the records be readily accessible in an electronic format to the patient. It may be appropriate for the government to mandate interoperability so that health care records can be exchanged in this manner. However, to specifically mandate that all records be maintained in a particular digital file format, preempting the market development of standards, may not be.[161]

There are circumstances wherein a government mandate of a specific implementation would be appropriate. These would be circumstances where a standard that is developed and adopted through voluntary, market-driven means needs a government "blessing" to provide for an enforcement mechanism. For example, once industry standards were set for high definition television, it was in the public interest that all televisions sold in the U.S. conform to those standards precisely, lest a consumer purchase a high-definition television without being certain that she will be able to receive and display high-definition channels broadcast in her locale or purchase a video camera with certainty that it will be compatible with other television equipment in her home. Therefore, it is incumbent on the FCC to incorporate into law requirements that all television equipment sold in the United States conform to specific standards.

Even in such circumstances, the government must still act cautiously to avoid ratifying or "blessing" a standard without corresponding ability for the standard to be updated, revised, or otherwise improved upon. In its *DTV Tuner Order*, the FCC demonstrated its willingness to update standards incorporated into its rules to reflect recent marketplace developments:

> We also acknowledge the likelihood that there will be further improvements made to the DTV standards over time and indeed, encourage ATSC and other interested parties to continue their work and efforts in these areas. In this regard, we reaffirm our intention to give significant weight to proposed changes that reflect the kind of broad industry consensus developed through ATSC's standards-making procedures. While it will be necessary to conduct rule making activity to incorporate such changes in the rules, we nonetheless will endeavor to pursue such rule making as quickly as possible, either through our periodic review of the DTV transition or through separate proceedings as

---

opportunity for "government failure," as they are hard to revise quickly, a necessary feature of standards deployed into the rapidly changing information technology landscape.

160. *See* Charles Wolf, Jr., *A Theory of Nonmarket Failure: Framework for Implementation Analysis,* 22 J.L. & ECON. 107, 112-32 (1979) (discussing the variety of ways in which nonmarket interventions raise costs that overwhelm the benefits sought).

161. This is another situation where it may well be that the market develops standards for data exchange that subsequently must be ratified (i.e., mandated) by government to provide for an enforcement mechanism.

may be appropriate.[162]

As I have described, in the cable TV plug-and-play context, the FCC, in the interest of encouraging competition and innovation, put CableLabs, a consortium created by the cable industry, in charge of making initial determinations regarding the use of new output or content protection technologies.[163] In fact, after significant controversy and additional FCC action, many sectors are represented in the CableLabs process[164] and the FCC reserved a greater role for the Commission, creating a process for FCC review ". . . when disputes arise. Any interested party, including but not limited to consumer electronics manufacturers, content providers, information technology companies or consumers, may appeal an initial decision by CableLabs to the Commission. CableLabs shall bear the burden of proof that its initial determination, whether an approval or disapproval, was justified."[165]

The FCC's effort to balance government intervention with marketplace innovation is also evident in the case of the FCC orders addressing the "broadcast flag" content protection technology. The "broadcast flag," a concept approved by the FCC in 2003, is itself a product of marketplace efforts. The initial development of what became the "ATSC flag system occurred in the Broadcast Protection Discussion Subgroup ('BPDG') under the auspices of the Copy Protection Technical Working Group ('CPTWG')," and "[f]rom November 2001 to June 2002, more than 80 representatives from the consumer electronics, information technology, motion picture, cable and broadcast industries took part in the BPDG discussions."[166] Rather than ratifying a specific design standard that was developed in BPDG (the proposed "5C standard" flag), the FCC adopted a performance standard that required devices follow the content-protection rules described by the "flag" on digital content.[167] Corresponding to the development of new products or the entry of new technologies or companies into the marketplace, the FCC periodically approves proprietary technologies that meet the performance requirements of respecting the broadcast flag coding.[168]

The government must reasonably tailor its intervention to address the

---

162. *In re* Review of the Commission's Rules and Policies Affecting the Conversion to Digital Television, 17 F.C.C.R. 15,978, 16001 ¶¶ 50, 51 (Aug. 9, 2002).

163. *See supra* notes 84-85 and accompanying text.

164. *See also supra* note 14 (discussing the successes and failures in the navigational devices standards setting process).

165. *In re* Implementation of Section 304 of the Telecommunications Act of 1996, 18 F.C.C.R. 20,885, 20,919-20,920 ¶ 79 (2003).

166. *In re* Digital Broadcast Content Protection, 18 F.C.C.R. 23,550, 23,556 ¶ 12 (2003) (citing FINAL REPORT OF THE CO-CHAIRS OF THE BROADCAST PROTECTION DISCUSSION SUBGROUP TO THE COPY PROTECTION TECHNICAL WORKING GROUP (BPDG FINAL REPORT) 4 (2002)), *rev'd in part & vacated in part,* 406 F.3d 689 (D.C. Cir. 2005).

167. *See In re* Digital Broadcast Content Protection, 18 F.C.C.R. 23,550, 23,574-76, ¶¶ 50-57 (Nov. 4, 2003).

168. *See id.*; *In re* Digital Output Protection Technology and Recording Method Certifications, 19 F.C.C.R. 15,876 ¶¶ 90-91 (Aug. 12, 2004).

market failure and to meet the public interest objective. What constitutes reasonable is something that must be established on a case-by-case basis. However, an incremental and flexible approach as described above will minimize the degree of intervention and give government the ability to first work within the context of the market before overriding the market with a government mandate. In such cases where the government is acting in its capacity as market participant to encourage market behavior, it should do so as a rational participant, examining the business case in support of its market decisions and giving consideration to addressing both the specific public interest at issue and the general public interest responsibilities of the government. Government and industry should act in the first instance to assure adequate public-interest representation within the standards-setting process to potentially obviate the need for direct government intervention.

VII. THE TEST (PART FOUR): MITIGATE THE RISK OF "GOVERNMENT FAILURE"

Even taking an approach of incremental intervention, at each step, the government must consider the potential negative implications of government intervention. Thus, as a final element of the test, in any case where the government is considering intervening into standard-setting, the government must balance the benefit of the intervention against the risk of harm to the public interest and the marketplace should it chose to intervene. In intervening, it must do so in a manner to mitigate and minimize the risk of such harm. The "incremental intervention" approach will minimize the opportunity for harm while maximizing the opportunity for the market to work. Any government intervention must be taken with a close eye on encouraging the market, and failing that, emulating a working marketplace, rather than deviating excessively from the norms of the market.[169] As I have noted, government failure is a risk

169. For example, government should consider the intellectual property rights policies of standards-setting organizations and incorporate such policies into any intervention. *See, e.g.*, AM. NAT'L STANDARDS INST., ANSI ESSENTIAL REQUIREMENTS: DUE PROCESS REQUIREMENTS FOR AMERICAN NATIONAL STANDARDS 9 § 3.1.1 (2006), *available at* http://publicaa.ansi.org/sites/apdl/Documents/Standards%20Activities/American%20National%20Standards/Procedures,%20Guides,%20and%20Forms/ER0106.doc (stating that essential patent holders may indicate that a license will be made available to implementers either on a compensation-free basis or "under reasonable terms and conditions that are demonstrably free of any unfair discrimination"); ECMA, CODE OF CONDUCT IN PATENT MATTERS, § 1.2, *available at* http://www.ecma-international.org/memento/codeofconduct.htm ("A written statement from the patentee is required, according to which he is prepared to grant licenses on a reasonable, non-discriminatory basis."); ETSI INTELLECTUAL PROP. RIGHTS POLICY, 2, *available at* http://www.etsi.org/legal/documents/ETSI_IPRPolicy.pdf (stating that holders of essential IPR must be "prepared to grant irrevocable licenses on fair, reasonable and non-discriminatory terms and conditions under such IPR"); IEEE-SA STANDARDS BD. BYLAWS, *available at* http://standards.ieee.org/guides/bylaws/sect6-7.html#6

> (IEEE standards may include the known use of essential patents and patent applications provided the IEEE receives assurance from the patent holder or

whenever government intervenes in the market, but especially where there are highly technical, interrelated markets, such as in the case of standards setting. Before intervention, the government should examine the potential risk of non-market failure and proceed accordingly.

Should it choose to intervene, the government should mirror market behavior as closely as possible. Intervention should follow, to the greatest extent possible, the norms and guidelines of formal standards-setting organizations. There are many variations on standards-settings processes, even a substantial ongoing evolution. But even in this state of flux, fundamental norms are fairly well-defined, the benefits of working within the traditional processes and organizations are well-defined, and risks of working outside those processes and organizations are well-defined. To generalize briefly,

---

> applicant with respect to patents whose infringement is, or in the case of patent applications, potential future infringement the applicant asserts will be, unavoidable in a compliant implementation of either mandatory or optional portions of the standard [essential patents] . . . . This assurance shall be either (a) A general disclaimer to the effect that the patentee will not enforce any of its present or future patent(s) whose use would be required to implement either mandatory or optional portions of the proposed IEEE standard against any person or entity complying with the standard; or (b) A statement that a license for such implementation will be made available without compensation or under reasonable rates, with reasonable terms and conditions that are demonstrably free of any unfair discrimination. This assurance is irrevocable once submitted and accepted . . . .);

INTELLECTUAL PROP. RIGHTS IN IETF TECH., § 6.5, *available at* http://www.ietf.org/rfc/rfc3979.txt?number=3979

> ([A]ll persons will be able to obtain the right to implement, use, distribute and exercise other rights with respect to an Implementing Technology a) under a royalty-free and otherwise reasonable and non-discriminatory license, or b) under a license that contains reasonable and non-discriminatory terms and conditions, including a reasonable royalty or other payment, or c) without the need to obtain a license from the IPR holder.);

ISO/IEC DIRECTIVES, PART 1, § 2.14.1(b), *available at* http://www.iec.ch/tiss/iec/Directives-Part1-Ed5.pdf

> (If the proposal is accepted on technical grounds, the originator shall ask any holder of such identified patent rights for a statement that the holder would be willing to negotiate worldwide licenses under his rights with applicants throughout the world on reasonable and non-discriminatory terms and conditions. Such negotiations are left to the parties concerned and are performed outside ISO and/or IEC.);

INT'L TELECOMM. UNION, COMMON PATENT POLICY FOR ITS-T/ITU-R/ISO/IEC, § 2.2, *available at* http://www.itu.int/ITU-T/dbase/patent/patent-policy.html ("The patent holder is willing to negotiate licenses with other parties on a non-discriminatory basis on reasonable terms and conditions. Such negotiations are left to the parties concerned and are performed outside the ITU-T/ITU-R/ISO/IEC."); OPEN MOBILE ALLIANCE, LICENSING DECLARATION 1, *available at* http://www.openmobilealliance.org/docs/Member_IPRGuidelines_v53006.pdf ("Upon disclosure of an Essential IPR, the Open Mobile Alliance shall ask the relevant Member to give a declaration that it will license such essential IPR in accordance with the Application Form (i.e. on fair, reasonable and non-discriminatory terms).").

standards-setting organizations adhere to the norms of transparency, openness (participation by all stakeholders), impartiality, rough consensus, voting or another means to identify consensus, a dispute resolution mechanism, avoidance of overlapping or conflicting standards, due process so all views are considered, provision of technical assistance to stakeholders that may not have adequate technical expertise, parties acting in good faith, and fair play. Government action should employ these same principles and processes to the greatest extent possible.

VIII. CONCLUSION

There should be reluctance on the part of government to intervene in the setting of information technology standards (and particularly to mandate a standard that has not been developed and/or widely adopted by the marketplace) because (1) the relevant industries are sophisticated in regard to standards-setting and have many well-developed types of standards, and forums in which to develop standards; (2) the U.S. government has a strong preference for market-developed information technology standards and promotes this preference as a matter of both domestic law and policy and foreign trade policy; (3) international trade agreements limit the degree to which participating governments can mandate standards; and (4) in contrast to the sophistication of the marketplace, the government is rarely as informed, sophisticated in its understanding of the market, or nimble enough to respond to market conditions. Therefore, the risk of government failure is significant, and indeed greatest where the market is young and dynamic, as is the case with regard to the current market affected by information technology standards.

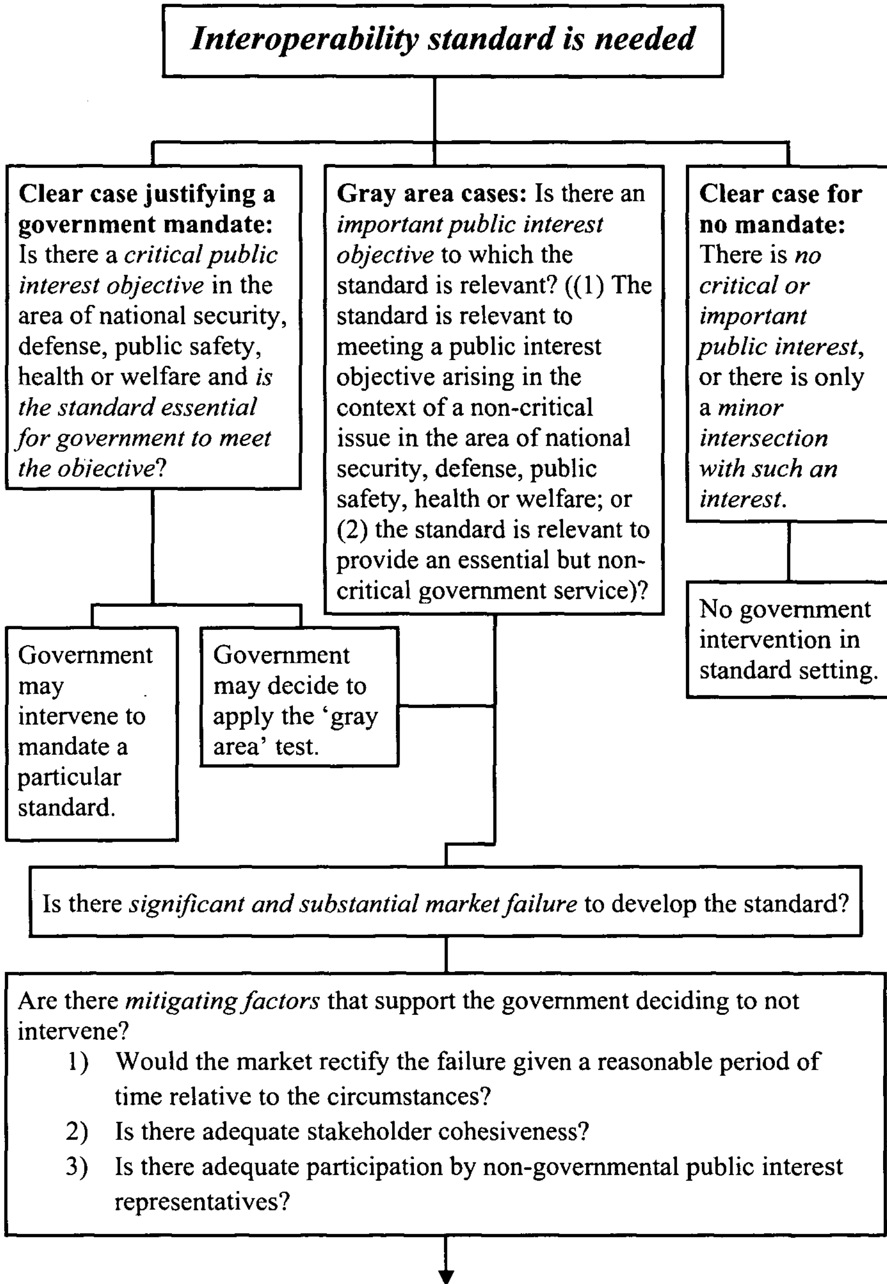
Should the government consider intervening, a substantial analysis should be undertaken. First, the government must determine the category that best characterizes the circumstances at hand. Clear cases for intervention are those in which there is a government responsibility to meet a critical public interest objective and the standard is essential for the government to meet that objective. "Gray area" cases are those in which the information technology standard is relevant to an important public interest objective. Finally, there are some cases that clearly do not present circumstances for government intervention. As to determining whether to intervene, clear cases warrant government intervention if such is needed to address the critical public interest. However, even in the circumstances described herein as a "clear case," the U.S. government, in compliance with federal law and policy would typically adopt a market-developed standard. Given this fact, further analysis, as described for "gray area" cases, may be warranted. In a "gray area" case, there must be a significant and substantial market failure before the government should intervene in the market to meet the important public interest objective. "Significant and substantial" means the market failure has to be proved a barrier to government action to address the important public interest objective.

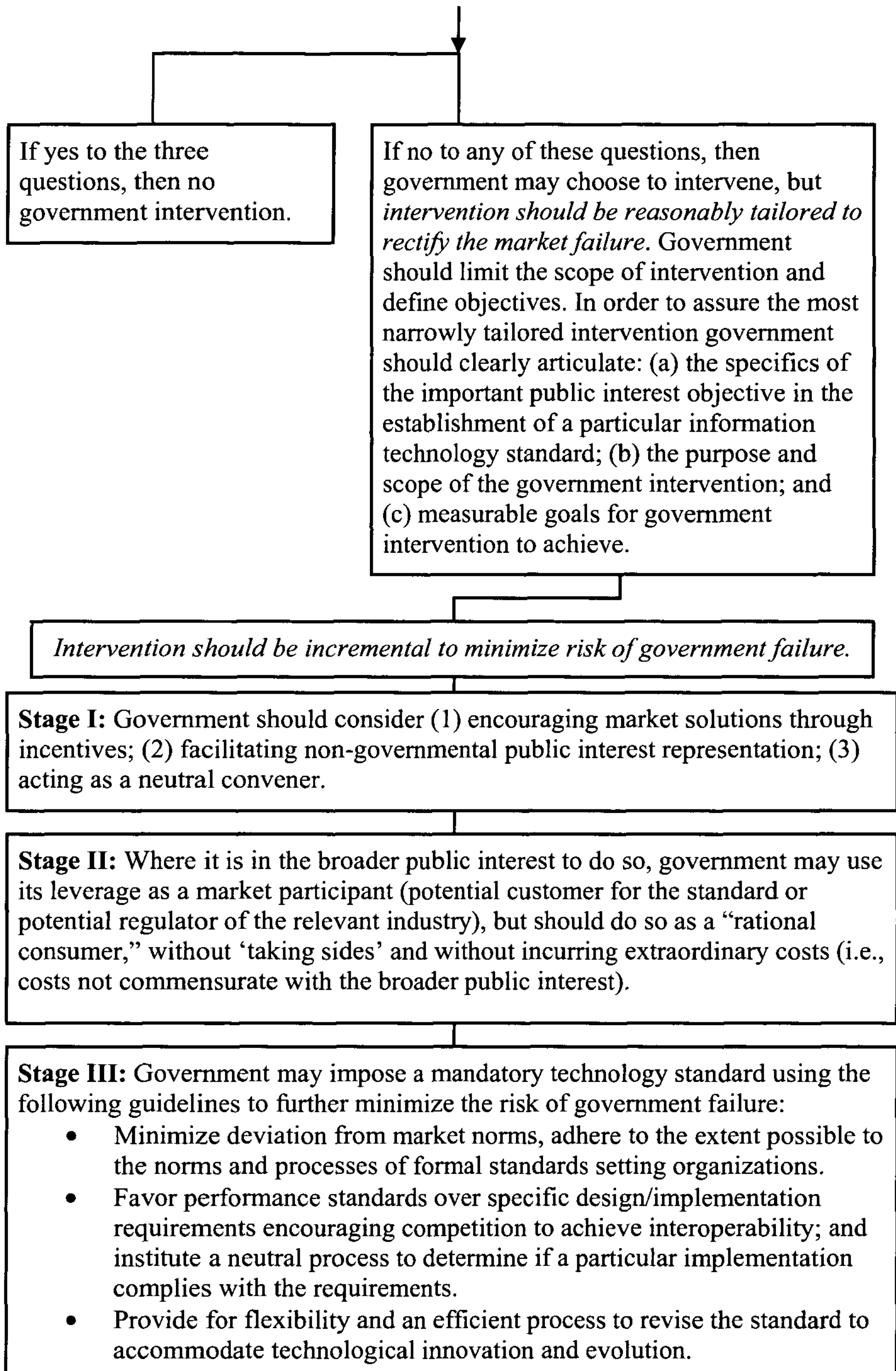
Before intervening, the government should consider mitigating factors, such as whether the market has had a reasonable time to develop the standard and whether stakeholders have adequate avenues for interchange, i.e., adequate forums to act in the specific situation. To minimize the need for direct government intervention in the first instance, government and industry should support credible, informed and engaged non-governmental public interest (i.e., consumer-oriented) representation. This could include financial, technical and organizational support.

Where a government decides to intervene, the intervention must be reasonably tailored to rectify the market's failure to develop a standard that would address the important public interest objective. In the interest of limiting intervention to the degree necessary, the government should intervene using incremental steps. The first step should be to encourage market behavior through incentives. As a second step, the government can use its leverage as a major market participant and potential regulator to influence market behavior; however, government should behave as a rational consumer, balancing the public interest at issue against the general public good. The government should consider at each stage of intervention how best to mitigate the risk of harm of "non-market" or "government failure." Finally, where government does intervene, intervention should reflect the market norms to the greatest extent possible.

In my examination of this topic, there have been very few circumstances that qualify as a potential significant and substantial market failure in the development of a new standard where the standard would be essential to the government's ability to meet its obligation to address a critical public interest objective, or where the standard would be relevant to an important public interest objective. Given the well-established premises I have outlined, there will be very few information technology standards-setting situations that will justify government intervention. Even under circumstances where there is a critical or important public interest objective at stake, once the government examines the role of the particular standard to that public interest objective, and the market behavior regarding the setting of the standard, the government will likely conclude that the circumstances do not call for government intervention. Even so, in light of the growth of the economic and social significance of standards, there will be many opportunities for government to consider its role in this context. But like the bazaar, government's role is typically to police the pickpockets and thieves, and not intervene in the transactions between merchant and customer.

APPENDIX




If yes to the three questions, then no government intervention.
If no to any of these questions, then government may choose to intervene, but *intervention should be reasonably tailored to rectify the market failure.* Government should limit the scope of intervention and define objectives. In order to assure the most narrowly tailored intervention government should clearly articulate: (a) the specifics of the important public interest objective in the establishment of a particular information technology standard; (b) the purpose and scope of the government intervention; and (c) measurable goals for government intervention to achieve.
Intervention should be incremental to minimize risk of government failure.
Stage I: Government should consider (1) encouraging market solutions through incentives; (2) facilitating non-governmental public interest representation; (3) acting as a neutral convener.
Stage II: Where it is in the broader public interest to do so, government may use its leverage as a market participant (potential customer for the standard or potential regulator of the relevant industry), but should do so as a "rational consumer," without 'taking sides' and without incurring extraordinary costs (i.e., costs not commensurate with the broader public interest).
Stage III: Government may impose a mandatory technology standard using the following guidelines to further minimize the risk of government failure:
• Minimize deviation from market norms, adhere to the extent possible to the norms and processes of formal standards setting organizations.
• Favor performance standards over specific design/implementation requirements encouraging competition to achieve interoperability; and institute a neutral process to determine if a particular implementation complies with the requirements.
• Provide for flexibility and an efficient process to revise the standard to accommodate technological innovation and evolution.

CLA-000055

NAFTA Article 1105 and the Principles of International Economic Law

TODD WEILER*

Recognizing that it is common practice by international lawyers to cite the decisions of other international tribunals in support of their cases, this Article sets forth an analytical framework for doing so within the area of international economic law. For the purposes of the Article, international economic law is construed as the quasi-constitutional regulation of the actions of public authorities pursuant to obligations undertaken by States through treaty or custom. The Article explains how certain basic principles can be drawn from various sources of international economic law which would allow for different tribunals, interpreting similar provisions in different treaties, to arrive at a coherent conclusion. Using NAFTA Article 1105 as an example, the author demonstrates how this approach will provide clarity and certainty for the operation of what may seem to be amorphous treaty terms.

I. INTRODUCTION 36
II. METHODOLOGY 37
A. *International Economic Law* 37
B. *IEL Principles* 40
C. *The Inductive Approach* 49
III. APPLYING THE INDUCTIVE APPROACH 53
A. *WTO Law and its Interpretation* 53

* M.A., LL.B., LL.M. (Ottawa), LL.M. (Michigan). Todd Weiler teaches international economic law at the University of Windsor Law School in Windsor, Canada and the Centre for Energy, Petroleum & Mineral Law & Policy in Dundee, Scotland. He has been involved as expert or counsel in more than one dozen NAFTA investment disputes and maintains a leading web site on NAFTA law: http://www.naftaclaims.com. The views expressed in this article are his alone, and in no way reflect the views or interests of any of his clients, past or present. Todd Weiler can be reached at: www.naftalaw.org.

B. *The WTO Appellate Body's Approach and the Inductive Approach* 56
C. *Application to the Work of NAFTA and Mixed-Claim Tribunals* 67
IV. NAFTA ARTICLE 1105 74
A. *Transparency* 77
B. *Due Process* 79
C. *Good Faith* 81
V. CONCLUSION 84

I. INTRODUCTION

Institutionalized dispute settlement has become a ubiquitous fixture of public international law, particularly within the realm of economic affairs. As the number of trade and investment treaty platforms has rapidly increased over the past forty years, the opportunities to gain access to institutionalized dispute settlement mechanisms have also increased. As the number of international economic law obligations has grown, observers have begun to note how convergence trends are emerging with respect to the adjudication of disputes that cross over treaty platforms.

The goal of this Article is to demonstrate how these convergence trends actually reveal the existence of a unified body of international economic law ("IEL") principles. These principles permit one to speak of IEL as a coherent set of norms, rather than a loosely associated set of treaty rules focused primarily on the regulation of trade in goods. By focusing on the substantive character of these principles, this Article explains how they should be used to inform interpretation of similar treaty provisions across different platforms, thereby encouraging coherence regardless of the economic activity being regulated (be it trade in goods, intellectual property, trade in services, or investment).

There is no better place to witness these convergence trends in substantive IEL than in investor-state arbitrations, which have become an increasingly common fact of economic and regulatory life within the three countries party to the North American Free Trade Agreement ("NAFTA"). This is partly because the same lawyers who have plied their trade in the General Agreement on Tariffs and Trade ("GATT") have found a new venue for the expression of the same legal principles in NAFTA arbitrations. The new venue can be found in arbitral processes that have been the mainstay of international

commercial arbitration for many decades. These processes have been made available to foreign investors because of a unilateral promise made by each NAFTA Party, in NAFTA Article 1122, to arbitrate disputes relating to investors and investments in their respective territories.

Part II of this Article explains how IEL principles should be identified, employing the inductive approach developed four decades ago by Professor Georg Schwarzenberger. Part III looks to WTO law to demonstrate how such principles can indeed be found in the IEL context. Finally, the Article explains how these principles can be used so that the jurisprudence of NAFTA investor-state arbitration remains within the mainstream of international economic law and contributes to its purposive development. NAFTA Article 1105, which requires the NAFTA governments to provide foreign investments with "treatment in accordance with international law,"[1] provides the subject-matter for this exercise.

II. METHODOLOGY

A. *International Economic Law*

There are probably as many definitions of international economic law as there are commentators on it. Ignaz Seidl-Hohenveldern has noted that, in its widest meaning, IEL refers to any rules of public international law which directly concern economic exchanges between the subjects of international law. A more narrow approach would consider IEL to be a mere subset of public international law norms that relate to economic issues. Perhaps because the meaning of the term "economic" is itself so indeterminate, Seidl-Hohenveldern prefers the broader approach, and would include within IEL what some refer to as the modern law merchant (the *lex mercatoria*), even though it essentially represents a form of customary international law amongst non-state actors that regulates their transactions. He would also include the regulation of contracts between individuals and sovereigns, as well as what he refers to as "transnational economic law"— i.e., conflict of laws rules

1. North American Free Trade Agreement, Dec. 17, 1992, U.S.–Can.–Mex., art. 1105, 32 I.L.M. 289, 639 [hereinafter NAFTA].

emanating from the domestic level.[2]

Writing four decades ago, Schwarzenberger considered IEL to be a branch of public international law that was "concerned with the ownership and exploitation of natural resources, production and distribution of goods, invisible international transactions of an economic or financial character, currency and finance, related services," and the actors engaged in such activity.[3] More recently, Jeff Atik has embraced a similar definition, but added international competition law, intellectual property law, and development law to the mix. In fact, Atik has gone even further by suggesting that IEL theory should embrace interdisciplinary approaches and critiques, and concern itself with issues such as "the distribution of wealth and justice and with the preservation of culture, the environment and peace."[4]

Frieder Roessler appears to have avoided defining IEL altogether by focusing instead on three normative models that provide a structure for the "international economic system."[5] Roessler's interdisciplinary approach is also shared by Asif Qureshi, who seems to embrace a very broad definition of IEL—one that encompasses any branch of international or domestic law which is concerned with economic phenomena of international concern.[6]

Much like Schwarzenberger, Joel Trachtman starts with the proposition that IEL is a branch of public international law. He does so, however, in order to focus upon the constitutional character of IEL norms, noting that IEL "provides the functional basis for a new era of international constitutionalization."[7] In Trachtman's view, IEL is an

---

2. IGNAZ SEIDL-HOHENVELDERN, INTERNATIONAL ECONOMIC LAW 1–2 (3d ed. 1999).

3. GEORG SCHWARZENBERGER, ECONOMIC WORLD ORDER? A BASIC PROBLEM OF INTERNATIONAL ECONOMIC LAW 4 (1970).

4. Jeffery Atik, *Uncorking International Trade, Filling the Cup of International Economic Law*, 15 AM. U. INT'L L. REV. 1231, 1232 (2000).

5. FRIEDER ROESSLER, THE LEGAL STRUCTURE, FUNCTIONS AND LIMITS OF THE WORLD TRADE ORDER 20–22 (2000).

6. ASIF QURESHI, INTERNATIONAL ECONOMIC LAW 5–8 (1999).

7. Joel P. Trachtman, *The International Economic Law Revolution*, 17 U. PA. J. INT'L ECON. L. 33, 49 (1996). He provides an additional definition of IEL from Jackson: "This phrase can cover a very broad inventory of subjects: embracing the law of economic transactions; government regulation of economic matters; and related legal relations including litigation and international institutions for economic relations." John H. Jackson, *International Economic Law: Reflections on the "Boilerroom" of International Relations*, 10 AM U.J. INT'L L. & POL'Y 595, 596 (1995). Trachtman also provides a broader definition from Petersmann:

> [IEL] presents itself as a conglomerate of private law (including 'law merchant' and 'transnational commercial law'), state law (including 'conflict of laws') and public international law (including supranational integration law as in the EEC)

instrumentality of public international law and depends upon this basis for its constitutional character. Unlike international business law, which Trachtman uses to describe the wider class of norms included by many under the rubric of "international economic law," IEL is composed of sets of norms that are essentially employed to effectively regulate the regulator. Accordingly, the underpinnings of public international law are helpful in that they represent the discourse through which states have long surrendered some element of their sovereign discretion in exchange for whatever collective benefit can be derived by a similar surrender by other states.

However, the character of IEL obligations differs from those of public international law. IEL normally involves the protection of individual rights and/or interests, vis-à-vis actions of the state. States agree (expressly or tacitly) to refrain from exercising their sovereignty in a manner that would be prejudicial to these individual interests because they expect to derive collective benefits from these protections. IEL can thus be seen as firmly grounded in public international law, albeit with a focus on protection of individual rights and interests, which is qualitatively different from many other public international law obligations.[8]

This Article adopts the narrower, more "constitutional," conception of IEL by defining it as that which conditions the exercise of sovereign authority as it affects the economic activities of state and non-state actors, particularly the latter. For the purposes of this Article, IEL obligations are those international rules that are aimed at the protection of individual economic interests. These obligations do not encompass rules that only indirectly affect individual economic interests or that are aimed at the protection or promotion of other interests, such as the closely related areas of international environmental or international labor law.

> with a bewildering array of multilateral and bilateral treaties, executive agreements, 'secondary law' enacted by international organizations, 'gentlemen's agreements' central bank arrangements, declarations of principles, resolutions, recommendations, customary law, general principles of law, de facto-orders, parliamentary acts, governments decrees, judicial decisions, private contracts or commercial usages.

Ernst-Ulrich Petersmann, *International Economic Theory and International Economic Law: On the Tasks of a Legal Theory of International Economic Order*, *in* THE STRUCTURE AND PROCESS OF INTERNATIONAL LAW: ESSAYS IN LEGAL PHILOSOPHY DOCTRINE AND THEORY 227, 251 (R. St. J. MacDonald & Douglas M. Johnston eds., 1983).

8. This is not to say that there are not other fields of public international law possessing obligations designed to protect individual rights and interests. International human rights law, including international labor law, is similarly situated with IEL within the broader field of public international law.

The primary instrument of IEL is the treaty, particularly multi- and bilateral trade and investment protection treaties. These instruments are both the primary source of substantive IEL obligations and the exclusive means through which any IEL obligations, whether derived from treaty or another source of law, such as custom, can be vindicated. Vindication is achieved through recourse to institutionalized dispute settlement.

As Professor Joseph Weiler has recently observed, it would appear that there is "a convergence trend" between various IEL treaty regimes, such as the treaties of the European Union, the WTO, and the NAFTA. Apart from the institutional characteristics which these regimes share (along with their notable differences), Weiler builds a case for the existence of these convergence trends on the level of substantive norms. He suggests that at some point, it may be possible to speak of a "common law of international trade."[9]

As stated above, this Article attempts to show how international economic law can be considered as a coherent body of law, united by a set of shared principles. While this Article focuses on the substantive principles, procedural principles, including those found in evidentiary rules and the conduct of the arbitration, could similarly be applied by various tribunals in conducting the dispute before them.

B. IEL Principles

Schwarzenberger taught that legal principles are "abstractions and generalizations from legal rules or individual cases."[10] Professor Bin Cheng has taught that a legal principle is expressive of a general truth that can be used to guide one's actions, contrasted against legal rules, which are essentially more targeted, practical, and binding.[11] Precisely because they exist at a more general level of abstraction, Qureshi only devotes a paragraph of his book to the subject of IEL principles, concluding that, while their time may one day come, there is simply too much potential "latitude" inherent in their use. Such latitude, Qureshi believes, would provide an IEL tribunal with so

---

9. Joseph H. Weiler, *Epilogue, in* THE EU, THE WTO, AND THE NAFTA: TOWARDS A COMMON LAW OF INTERNATIONAL TRADE? (Joseph H. Weiler ed., 2000).

10. GEORG SCHWARZENBERGER, THE INDUCTIVE APPROACH TO INTERNATIONAL LAW 50 (1965).

11. BIN CHENG, GENERAL PRINCIPLES OF LAW 24 (1987).

much discretion as to be too readily "prone to abuse."[12]

However, there is a significant difference between the international legal principles of which Schwarzenberger and Cheng have written and the general principles of international law mentioned by Qureshi. The latter are of a different character, and serve a different role, than the former. Qureshi's principles are a source of law, as recalled in Article 38(1) of the Statute of the International Court of Justice ("ICJ Statute"). The principles discussed by Schwarzenberger and Cheng are not sources of law. Rather, they are abstractions from sources of law.

Article 38(1) of the ICJ Statute is the starting point for any analysis of the sources of international law. It provides:

> The Court, whose function is to decide in accordance with international law such disputes as are submitted to it, shall apply:
>
> (a) international conventions, whether general or particular, establishing rules expressly recognized by the contesting States;
>
> (b) international custom, as evidence of a general practice accepted as law;
>
> (c) the general principles of law recognized by civilised nations;
>
> subject to Article 59, judicial decisions and the teachings of the most highly qualified publicists of the various nations, as subsidiary means for the determination of rules of law.[13]

Article 38(1) not only specifies the applicable law in disputes adjudicated before the International Court of Justice ("ICJ"), but is generally considered to be an authoritative statement as to the applicable sources of international law to be used in the resolution of any international dispute, unless the parties to the dispute have specified otherwise.[14]

---

12. Qureshi finds support for his position in the work of Ignaz Seidl-Hohenveldern and Georg Schwarzenberger. *See* SEIDL-HOHENVELDERN, *supra* note 2, at 36; GEORG SCHWARZENBERGER, THE FRONTIERS OF INTERNATIONAL LAW (1962). However, as we shall see, a closer reading of Schwarzenberger tells a different tale.

13. Statute of the International Court of Justice, June 26, 1945, art. 38, 59 Stat. 1055, T.S. No. 993, 3 Bevans 1179.

14. *Id.* For example, as Article 38(2) provides, the parties may agree to have their

Some commentators regard the general principles of law, which are referred to in Article 38(1)(c), as a subsidiary source of international law. This is because such principles exist in the abstract and, accordingly, have not been explicitly relied upon by international tribunals.[15] Such thinking explains why Qureshi devotes so little time to the question. Cheng, however, cautions that Article 38(1)(c) was never intended to provide tribunals with specific rules formulated for practical purposes. Instead, it was intended to permit the ICJ to consider general propositions that underlie various rules and thus, "express the essential qualities of juridical truth itself, in short of law."[16] Cheng also notes that the drafters of the ICJ Statute expressly considered and rejected language that would have imposed any hierarchy on the three primary sources of law.[17]

The principles of Article 38(1)(c) also enjoy certain advantages over other primary sources of law. Any determination of custom requires both proof of intent by a sufficient number of states to be bound by rules, and a sufficient demonstration of general practice supporting such beliefs by those states. In contrast, there is no requirement to demonstrate that any general practice of states exists for the determination of general principles of law. The importance of recognizing such a norm lies not within its legal character implied in international usage, but in the existence of certain fundamental principles that are intrinsically legal in character.[18]

While there are notable dissenters,[19] most commentators acknowledge that tribunals can identify general principles of law, either by conducting a comparative analysis of a representative sample of domestic legal systems or by recourse to international law and practice.[20] Cheng appears to have embraced both approaches, and Cherif Bassiouni notes that the ICJ has done so as well, by drawing on a wide array of international law instruments and techniques in the

---

dispute decided on a more general standard of what they apprehend to be just and fair under the circumstances (i.e., on an *ex aequo et bono* basis).

15. GENNADII MIKHAILOVICH DANILENKO, LAW-MAKING IN THE INTERNATIONAL COMMUNITY 181–85 (1993).

16. CHENG, *supra* note 11, at 24.

17. *Id.* at 20. Accordingly, Cheng concludes that the order in which the three principles appear merely reflects the normal process of thought employed by a decision-maker; however, the three can certainly be considered simultaneously.

18. *Id.* at 23–24.

19. DANILENKO, *supra* note 15, at 186–87. Danilenko seems to dismiss the practice as a "new approach" that is nothing short of an excuse to engage in an international version of judicial activism.

20. M. Cherif Bassiouni, *A Functional Approach to "General Principles of International Law,"* 11 MICH. J. INT'L L. 768, 769 (1990).

process.[21]

Once one determines that the general principles of law do exist on an equal—albeit different—footing with treaty and custom, and once one determines the acceptable methods for articulating their existence, one must still find a role for their application. Qureshi correctly concludes that not much of a role exists in the IEL context. Regardless of whether their role is that of a mere interpretative aid,[22] or as the bedrock norms of international law (and thus their constitutional superstructure), the role of the general principles of international law in any given IEL dispute is likely to be less significant than that of treaty rules or customary international law rules.

A crucial distinction needs to be drawn, however, between the existence and role of "IEL principles," and the existence and role of the general principles of international law in IEL disputes. Principles, as understood by Schwarzenberger, are "abstractions or generalizations from the products of one or several law-creating processes (or 'formal' sources) of international law which are enumerated in Article 38(1)(a)-(c) of the Statute of the World Court."[23] He accordingly taught that legal principles could be abstracted from any of the primary sources of international law, including the more fundamental principles referred to in Article 38(1).

In other words, IEL principles can be based upon custom, treaty, *or* the fundamental general principles of law contained within Article 38(1)(c). They may also be evidenced in the subsidiary sources of international law, the writings of distinguished scholars, and the findings of international tribunals. In order for legal principles to be relevant to any given controversy, they must be abstracted from a relevant source of international law. For example, Schwarzenberger noted that for a legal principle to be relevant to the international lawyer, or to the resolution of an international dispute, it must bear the "hallmark" of one of the three law-creating processes

21. *Id.* at 789.

> 'General Principles' have been identified [by the ICJ and the Permanent Court of International Justice] by examining State conduct, policies, practices, and pronouncements at the international level, which may be different from domestic legal principles. Thus, States' foreign policies, bilateral and multilateral treaties, international pronouncements, collective declarations, writings of scholars, international case law, and international customs, even where unperfected, are valid areas of inquiry from which to determine the existence of 'principles' within the international context.

22. *See id.* at 775; CHENG, *supra* note 11, at 4–5.

23. SCHWARZENBERGER, *supra* note 10, at 73–74.

memorialized in Article 38(1) of the ICJ Statute.[24] Nevertheless, it was also clear to Schwarzenberger that the term "source of law" was merely a metaphor used to encapsulate the basic elements of international law. The practice of the subjects of international law as evidenced through treaty and custom, the decisions of international tribunals, and doctrine, are what practically form the means for the determination of rules of international law.[25] It is from the products of these various law-determining agencies that the primordial matter of IEL principles, i.e., the three "sources of international law," is actually derived.

Regardless of whether one is referring to the principles of IEL or to the general principles of international law, it is fair to say that, because of their level of abstraction, their role in dispute settlement differs from that of a more precise legal rule, such as a treaty obligation. The roles of a principle are to fill the lacunae that exist between more determinative rules and to assist the decision-maker in interpreting more particularized rules properly. The general principles of international law perform these functions as a complement to the application of customary international law,[26] particularly in the absence of a governing treaty rule. IEL principles perform only the latter function because the vast majority of IEL disputes involve the interpretation and application of discrete treaty rules.

IEL principles are best understood as being based upon a mixture of doctrine, judicial decisions, and state practice, as well as being representative of the doctrine to be applied by a tribunal in the instant case. The extent to which any given tribunal may rely upon IEL principles will depend upon the degree to which the area of law in question can be considered more or less "organized." Schwarzenberger observed that when international society is characterized by a lack of systematic organization, tribunals will be less likely to base their decisions on doctrine, as opposed to a strict interpretation of the obligations in question. Alternatively, tribunals will tend to act more "boldly" within the context of an organized legal order because the very fact that a dispute had been submitted to them under such circumstances is "positive evidence of the confidence inspired by the dispute settlement body as a living repository of *lex*

24. *Id.* at 50.

25. *Id.* at 44. Schwarzenberger refers to the creation of these practical sources of law as "law determining agencies."

26. Christopher A. Ford, *Judicial Discretion in International Jurisprudence: Article 38(1)(c) and "General Principles of Law,"* 5 DUKE J. COMP. & INT'L L. 35, 63 (1994).

lata."[27]

Of course, such confidence can be fleeting. Schwarzenberger warned that if international tribunals "show too pronounced a tendency to depart from the appointed task of applying international law, and indulge in the deduction of rules from questionable principles of international law, they risk that States will fight even shyer than they have done in the past of submitting disputes to their decision."[28]

Tribunals have referred to these fundamental principles for centuries. They have thus enunciated legal rules which were relevant to each dispute, but often already latent in the firmament of international law. In other words, they were not "new." The drafters of the ICJ Statute deliberately empowered the Court to "develop and refine the principles of international jurisprudence."[29] As Cheng explained, states "did not intend to add to the armory of the international judge a new adjunct to existing international law,"[30] however, for decades the ICJ has followed an approach to Article 38 under which fundamental principles play an important part in enunciating the applicable legal rules, even if they are not always expressly recognized for their service.[31]

But what of the use of IEL principles? Unlike the general principles of law, IEL principles cannot be used as a substantive source of "new" or even "latent" legal rules. They are restricted exclusively to an interpretative role, to be used in the identification of appropriate legal doctrine which will aid tribunals in interpreting the treaty text. With IEL principles restricted to an interpretative role, there is less potential that their use will generate the kind of consternation described above, although some risk undoubtedly still remains. Such consternation can nonetheless remain when tribunals are seen, usually by the unsuccessful parties in a dispute, as having

27. SCHWARZENBERGER, *supra* note 10, at 66. Schwarzenberger was writing at a time when the institutional role of arbitral panels was in its relative infancy in the field of international economic law. Thus, he was primarily referring to the confidence inspired by the ICJ, as opposed to the plethora of international tribunals operating today. For a list of active international tribunals, visit http://www.pict-pcti.org (last visited Oct. 20, 2003).

28. *Id.* at 74–75.

29. IAN BROWNLIE, PRINCIPLES OF PUBLIC INTERNATIONAL LAW 16 (1998).

30. CHENG, *supra* note 11, at 19.

31. IAN BROWNLIE, THE RULE OF LAW IN INTERNATIONAL AFFAIRS 23 (1998). Bassiouni notes that in the *Chorzow Factory* and *SS Lotus* cases, the PCIJ relied upon both international practice and past international tribunal decisions to identify fundamental principles of law from which it then derived rules that were applied in the cases before it. Bassiouni, *supra* note 20, at 794.

overstepped the bounds of their authority in relying upon a concept that cannot "clearly," or perhaps strictly, be found in the text before them. In such cases, it will undoubtedly be claimed that the tribunal, at the very least, failed to execute its duties by improperly relying on a rule of precedent or, worse yet, created an obligation that simply did not exist.

One example of this phenomenon was the award of a NAFTA tribunal chaired by Sir Eli Lauterpacht, which noted the existence and applicability of the principle of transparency in a dispute between Mexico and an American investor, Metalclad Corporation.[32] NAFTA Article 102(1) sets out the objectives of NAFTA "as elaborated more specifically through its principles and rules, including national treatment, most favored nation ("MFN") treatment and transparency."[33] Recalling a litany of procedural flaws in the process which eventually led to the loss of Metalclad's investment, the tribunal concluded that Mexico had failed to meet its NAFTA Article 1105 obligation to provide "treatment in accordance with international law, including fair and equitable treatment . . . ."[34] Thus, the tribunal stated:

> Mexico failed to ensure a transparent and predictable framework for Metalclad's business planning and investment. The totality of these circumstances demonstrates a lack of orderly process and timely disposition in relation to an investor of a Party acting in the expectation that it would be treated fairly and justly in accordance with the NAFTA.[35]

Lawyers for the governments of Mexico and Canada were able to convince a local Vancouver judge that the *Metalclad* tribunal exceeded its jurisdiction in concluding that an utter lack of transparency can constitute a breach of "fair and equitable treatment," as the term is understood in international law.[36] They were able to do so despite the explicit reference to the transparency principle as an

32. Metalclad Corp. v. United Mexican States (U.S. v. Mex.), 5 ICSID (W. Bank) Reports 209 (2001).

33. NAFTA, *supra* note 1, art. 102, 32 I.L.M. at 297. The NAFTA objectives identified in Article 102(1) include: the promotion of "conditions of fair competition in the free trade area" and increasing "substantially investment opportunities in the territories of the Parties." *Id.*

34. *Metalclad,* 5 ICSID (W. Bank) Reports at 226–29.

35. *Id.* at 229.

36. United Mexican States v. Metalclad Corp., [2001] B.C.S.C. 664, 5 ICSID (W. Bank) Reports 236 (2001).

interpretative device in NAFTA Article 102(1) and the fact that great deference was supposed to be shown to expert tribunals under the applicable arbitration review statute.[37] The *Metalclad* review thus stands as a cautionary tale about the dangers of a tribunal being seen as applying principles, rather than treaty rules, even though the local judge was wrong in substituting his uninformed opinion for that of the tribunal.[38]

Schwarzenberger also cautioned that his inductive approach to international law, upon which this theory of IEL principles is based, was not intended to establish a "cult of precedent" in international law.[39] He suggested only that both diplomats and the ICJ had been known to observe past practice whenever appropriate, and that Article 38(1)(d) of the ICJ Statute certified that the past decisions of international tribunals were a part of the law-determining process. In this regard he is joined by Sir Kenneth Keith, who has observed that Article 59 of the ICJ Statute (which provides that "the decision of the Court has no binding force except between the parties and in respect of that particular case"[40]) was never intended to affect the value of earlier cases as authoritative statements of law.[41]

Provisions similar to Article 59 of the ICJ Statute exist in numerous IEL treaty platforms. For example, NAFTA Article 1136 provides that "an award made by a Tribunal shall have no binding force except between the disputing parties in respect of the particular case."[42] To date, NAFTA tribunals have made frequent reference to previous awards, but have never indicated that previous awards were binding as a matter of legal precedent.[43] Similarly, in the WTO

---

37. The applicable statute was the British Columbia International Commercial Arbitration Act ("ICAA"), which enacts the UNCITRAL Model Law on International Commercial Arbitration ("Model Law"). Article 34(2) of the Model Law stipulates very narrow grounds for the review of an award under any Model Law statute. *See* United Nations Commission on International Trade Law ("UNCITRAL") Model Law on International Commercial Arbitration, art. 34(2), 24 I.L.M. 1302, 1359 (1985), *available at* http://www.uncitral.org/english/texts/arbitration/ml-arb.htm (last visited Oct. 20, 2003).

38. Todd Weiler, *Metalclad v. Mexico: A Play in Three Parts*, 2 J. WORLD INV. 685 (2001).

39. SCHWARZENBERGER, *supra* note 10, at 38–39.

40. Statute of the International Court of Justice, *supra* note 13, art. 59, 59 Stat. 1055, T.S. No. 993, 3 Bevans 1179.

41. KENNETH JAMES KEITH, THE EXTENT OF THE ADVISORY JURISDICTION OF THE INTERNATIONAL COURT OF JUSTICE 29 (1971).

42. NAFTA, *supra* note 1, art. 1136, 32 I.L.M. at 646.

43. Methanex Corp. v. United States, Preliminary Award on Jurisdiction and Admissibility, paras. 141–43 (Aug. 7, 2002), (NAFTA/UNCITRAL), *available at* http://www.state.gov/documents/organization/12613.pdf.

context, the Appellate Body has stated that the reasoning contained within previously adopted WTO panel and Appellate Body reports is not binding upon future panels, and has made explicit reference to Article 59 of the ICJ Statute by analogy.[44]

Of course, a previous panel report may be useful or relevant, even if it is not legally binding upon future panels. In fact, the Appellate Body has clarified that past reports cannot be disregarded by future panels because they generate "legitimate expectations" among WTO members, as well as individual economic actors, concerning how WTO obligations will be interpreted in the future.[45] The significance of the Appellate Body's approach to past decisions has been chronicled extensively by Raj Bhala, who has observed that this informal rule of precedent is consistently observed by WTO panels and the Appellate Body.[46] David Palmeter and Petros Mavroidis have reached a similar conclusion, noting that the WTO experience mirrors that which has been ongoing in the ICJ for decades, in which panels will never "lightly" consider reversing statements of law contained within previous decisions.[47]

As Palmeter and Mavroidis note, continuity and consistency are essential elements of any legal system.[48] This is especially true for an international dispute settlement body whose decisions may not enjoy the benefit of the same kinds of enforcement mechanisms that are available for domestic courts and tribunals. The legitimacy of a tribunal, and of the treaty regime through which it gains jurisdiction to resolve any given dispute, rests heavily upon the quality of its decision-making process. Accordingly, it should not be surprising that most international tribunals have developed rules of informal precedent, under which both substantive and procedural law doctrines can flourish.

In this regard, Seidl-Hohenveldern has voiced disagreement with the ICJ for its conclusion in the *Barcelona Traction* case that

---

44. WTO Appellate Body Report: Japan—Taxes on Alcoholic Beverages, WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, 13–14 & n.30 (Oct. 4, 1996) [hereinafter WTO Appellate Body Report: *Alcoholic Beverages*]. This and the other WTO decisions referenced in this article are available online at http://www.wto.org.

45. *Id.* at 14.

46. Raj Bhala, *The Myth About Stare Decisis and International Trade Law (Part One of a Trilogy)*, 14 AM. U. INT'L L. REV. 845 (1999); Raj Bhala, *The Precedent Setters: De Facto Stare Decisis in WTO Adjudication (Part Two of a Trilogy)*, 9 J. TRANSNAT'L. L. & POL'Y 1 (1999).

47. David Palmeter & Petros C. Mavroidis, *The WTO Legal System: Sources of Law*, 92 AM. J. INT'L L. 398, 400–01 (1998).

48. *Id.* at 402.

arbitral jurisprudence could be considered a subsidiary source of law under Article 38(1)(d) of the Statute of the ICJ.[49] A majority of the Court determined that because past arbitral awards were normally based upon each tribunal's interpretation of specific treaty provisions before them, their reasoning could not be considered in future cases. Seidl-Hohenveldern concludes that the same objections could be raised against the ICJ itself or any international tribunal. The more appropriate approach is to determine whether, in any given case, the teachings of a past case are relevant and analogous to the present case. This prescription is even more appropriate for the field of IEL, in which the basic obligations contained within most treaty platforms, such as national treatment and MFN treatment, are substantially similar, and in which multiple tribunals are responsible for repeated applications of the same kinds of treaty provisions.

C. *The Inductive Approach*

The first task in adopting an inductive approach to IEL is to identify the kinds of adjudicators upon whose reasons doctrine should be based. Schwarzenberger wrote that the value of any law-determining mechanism must be based upon objective and intrinsic criteria. He suggested that partiality makes for bad law, myopia makes for bad law, and the degree of skill and technical expertise of the decision-maker matters. Accordingly, Schwarzenberger concluded that the reasoning of an independent, impartial, and tenured adjudicator is to be valued over that of an ad hoc arbitrator whose appointment is measured by less strict standards of independence and impartiality. He notes that an adjudicator's reasons for a decision in one area of law may not be as useful when analogized to another context; he also acknowledges that in cases in which the adjudicator is possessed of a particular expertise, her reasons for decision are also to be valued more highly than those of an arbitrator with a lesser reputation or lacking in experience.[50]

Schwarzenberger advised that "the less these criteria are fulfilled in the case of any particular court or tribunal, the more humbled must be its place in the hierarchy inside its own group."[51] Based upon these considerations, he found that the ICJ and the

49. SEIDL-HOHENVELDERN, *supra* note 2, at 34, citing Barcelona Traction, Light & Power Co. (Belg. v. Spain), 1970 I.C.J. 3, at 40 (Feb. 5).

50. SCHWARZENBERGER, *supra* note 10, at 22–23.

51. *Id.* at 23.

Permanent Court of International Justice ("PCIJ") have "pride of place" in the hierarchy of the adjudicatory international law-determining agencies. Judges were (and are) impartial and independent, and have enjoyed long tenures. ICJ judges operate at the highest of technical standards and possess the greatest level of experience. By contrast, Schwarzenberger posited that ad hoc mixed-claim tribunals would be comparably inferior in terms of the value of their public international law decisions.[52]

However, Schwarzenberger wrote at a time when IEL dispute settlement was in its relative infancy. He also considered what kinds of adjudicators were best suited to generate international law doctrine, rather than a more specific body of law such as IEL. Using his criteria, one can readily appreciate that the WTO Appellate Body has achieved "pride of place" within the field of IEL. It is the only standing tribunal, and it is composed of expert judges and supporting legal staff. The appointment of Appellate Body members is regulated by strict rules that ensure relative independence and impartiality.[53] Finally, the Appellate Body is responsible for the adjudication of a vast array of international trade rules, as well as investment obligations covering the fields of intellectual property and the provision of services. Accordingly, it is possible to consider the Appellate Body as the "Supreme Court" of IEL, in terms of the quality of its decisions (rather than in terms of *stare decisis*).

Given that most other IEL tribunals are established on an ad hoc basis, they cannot possess the same degree of legitimacy as the WTO Appellate Body. However, most treaty-based IEL tribunals are regulated by procedurally fair standards which ensure impartiality and independence, and these tribunals are called upon to consider similar, if not functionally identical, obligations. They are often staffed by academics and practitioners of the highest quality and expertise. Accordingly, their reasons for decision may still be useful in articulating IEL principles.

Having identified the appropriate law-determining agencies (and keeping in mind that treaties themselves are also evidence of law-determining agencies), it is possible to identify the main task of inductive analysis. It is a constant and unremitting process of evaluation and re-evaluation of legal principles. These principles are

---

52. *Id.*

53. *See* Understanding on Rules and Procedures Governing the Settlement of Disputes, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 2, LEGAL INSTRUMENTS—RESULTS OF THE URUGUAY ROUND, vol. 31, 33 I.L.M. 112 (1994) [hereinafter DSU].

articulated and refined by reference to the ever-growing body of material provided by a rapidly increasing number of law-determining agencies.[54]

Even though he was only writing in the shadow of the GATT Kennedy Round, Schwarzenberger identified IEL as one of the areas which held the most promise for application of his inductive approach to particular fields of international law. At a time before the WTO or the NAFTA, he envisaged that an inductive analysis could uncover "a series of optional principles of considerable theoretical significance and practical importance."[55]

Schwarzenberger also appears to have considered some of the dangers inherent in an improper adoption of an inductive approach. First, he was concerned that an inductive approach to international law would be based upon the norms found within a domestic legal system. He considered these legal orders to be "incomparably stronger," with more depth and diversification than could be found on the international plane.[56] For example, while some of the basic norms contained within the European Community's system of laws may be similar, if not identical, to those contained within the WTO or NAFTA context, its level of depth and sophistication is far beyond that of IEL legal orders, and one should accordingly be extremely careful about deriving IEL principles from it.[57]

Schwarzenberger also provided what he clearly considered to be an important caveat for those interested in putting his inductive analysis to use. International lawyers, he wrote, must only be concerned with the evidence for any asserted principle. If the evidence exists, the principle must be laid out in its entirety. If it does not exist, the alleged principle must be rejected. "Aggressive descriptions are no proof of the non-existence of a legal principle, and laudatory epithets no substitute for evidence."[58] Lawyers must accordingly "move behind the law and cannot pretend to lead it."[59] This does not mean that they cannot engage in mapping out the future for the field, merely that a healthy dose of circumspection must be

54. SCHWARZENBERGER, *supra* note 10, at 23.

55. *Id.* at 55. Schwarzenberger identified such would-be principles as "optional" in contrast to the fundamental principles of Article 38(1)(c), which are of a mandatory nature.

56. *Id.* at 137–38.

57. As Joseph Weiler notes, the European legal order is of a far more constitutional character, having moved beyond the creation of a customs union, and is much less a free trade zone or liberalized trade and investment regime.

58. SCHWARZENBERGER, *supra* note 10, at 84.

59. *Id.* at 40.

added to any attempt to apply an inductive analysis to the field of international law.

There is also the lingering concern that even if principles are identified in a sufficiently conservative manner, they might be applied by tribunals in a less than circumspect manner. The following guidelines can be found in the work of the International Law Commission. They appear equally appropriate for any IEL principles derived from application of the inductive method:

> Their suitability for use in any given case hinges on a variety of considerations which have first to be appreciated by the interpreter of the document; the particular arrangement of the words and sentences, their relation to each other and to other parts of the document, the general nature and subject matter of the document, the circumstances in which it was drawn up, etc. Even when a possible occasion for their application may appear to exist, their application is not automatic but depends on the conviction of the interpreter that it is appropriate in the particular circumstances of the case. In other words, recourse to many of these principles is discretionary rather than obligatory and the interpretation of documents is to some extent an art, not an exact science.[60]

Another concern dealt with the relative dearth of international adjudication, which would be required to provide the raw fuel for Schwarzenberger's analysis. His reply was that whether a sufficient number of tribunals exist could not detract from the quality of the approach itself. Moreover, he appeared to anticipate that there would come a time when states would be willing to surrender more of their sovereign discretion, in return for the mutual benefits of international cooperation.[61] Forty years later, states have repeatedly agreed to that bargain, resulting in the establishments of numerous IEL treaty platforms and their respective dispute resolution mechanisms. The time is accordingly ripe to take the inductive approach out for a "test drive."

Before testing the inductive approach by extracting principles from the law-determining agencies of IEL, it is necessary to explain how IEL principles can be used in particular IEL contexts. This

---

60. Report of the International Law Commission on the Work of its Eighteenth Session, 2 Y.B. INT'L L. COMM'N 218 (1966), UN Doc. A/CN.4/Ser.A/1966/Add.I.

61. SCHWARZENBERGER, *supra* note 10, at 117.

Article focuses first on the WTO regime, by providing examples of how principles can be extracted and applied. Second, it considers the mixed-claim process, including the NAFTA.

III. APPLYING THE INDUCTIVE APPROACH

A. *WTO Law and its Interpretation*

The WTO Appellate Body has proved itself to be particularly concerned about the development of doctrine and the relationship of that doctrine to the wider system of public international law. With its very first decision, *U.S.—Reformulated Gasoline*, it announced that the WTO Agreement was "not to be read in clinical isolation from public international law."[62] Former Appellate Body Judge Ehlermann has noted that "the significance of this statement can hardly be overestimated . . ." and that "the true importance of the interrelationship between the WTO Agreements and public international law will become apparent . . ." only when certain special questions of substantive law, particularly those relating to state responsibility, arise.[63]

Shortly after announcing that a connection exists between public international law and WTO law, the Appellate Body made known its apparently abiding concern about the state of the GATT "*acquis*," in *Japan—Alcohol.*[64] The expression "*acquis*" may be more familiar to European Community lawyers than common lawyers. Essentially, the GATT *acquis*, which is but a part of the larger WTO *acquis*, is the regime of law which underpins the decisions of its law-determining agencies. The WTO *acquis* is not the "common law of world trade," although it clearly bears a close relationship to the methodology of doctrinal development which would normally be associated with the development of the common law. In fact, the Appellate Body's first mention of the *acquis* was a qualifying statement intended to authoritatively confirm that the reports issued by previous GATT and WTO panels, and the Appellate

62. WTO Appellate Body Report: United States—Standards for Reformulated and Conventional Gasoline, WT/DS2/AB/R, 17 (Apr. 29, 1996) [hereinafter WTO Appellate Body Report: *Gasoline*].

63. Claus-Dieter Ehlermann, *Six Years on the Bench of the World Trade Court*, 36 J. WORLD TRADE 605, 617–18 (2002).

64. WTO Appellate Body Report: *Alcoholic Beverages, supra* note 44, at 14.

Body, were not binding precedent, even if adopted by all GATT members (prior to the establishment of the WTO) or by all WTO members through their participation in the WTO Dispute Settlement Body. Rather, past reports were acknowledged as being "an important part of the GATT *acquis*," which generate "legitimate expectations" about the resolution of future disputes and may be considered by future panels.

It seems that the primary purpose for which the expressions GATT and WTO *acquis* have been coined by the Appellate Body was for the development of doctrine. The Appellate Body has thus far made reference to the WTO *acquis* on five occasions. In *U.S.—Shrimp*, the Appellate Body made reference to its initial statement concerning the WTO *acquis* in *U.S.—Reformulated Gasoline*. The Panel in *U.S.—Reformulated Gasoline* considered whether the United States had complied with its original report and recommendations, as modified by the Appellate Body, and "relied" upon the report of the Appellate Body to make its findings. The Appellate Body concluded that the Panel "was right to use it, and right to rely on it."[65] It stated that the Panel was obliged to consider the Appellate Body's views because they were issued in overruling the original panel and, "more important . . . [they were] . . . intended to provide interpretative guidance for future panels."[66] Clearly, the Appellate Body has drawn a very fine line between the binding nature of previous reports and their doctrinal value, particularly in cases where the previous report emanated from the Appellate Body itself.

In *U.S.—Antidumping Act of 1916*, the Appellate Body went so far as to state that a body of "case law" had indeed developed under the GATT and the WTO, permitting a panel to consider and rule upon a measure relating to commerce, which had been enacted, but not yet applied, and which would affect the rights of another member state. The Appellate Body referred to this practice as forming part of the GATT *acquis*, "which, under Article XVI:1 of the *WTO Agreement*, provides guidance to the WTO and therefore, to panels and the Appellate Body."[67] This is an example of the Appellate Body tacitly approving the development of doctrine within the WTO system.

65. WTO Appellate Body Report: *Gasoline, supra* note 62.

66. WTO Appellate Body Report: United States—Import Prohibition of Certain Shrimp and Shrimp Products, Recourse to Article 21.5 of the DSU by Malaysia, WT/DS58/AB/RW, paras. 107–08 (Oct. 22, 2001).

67. WTO Appellate Body Report: United States—Anti-Dumping Act of 1916, WT/DS136/AB/R, WT/DS162/AB/R, para. 61 (Aug. 28, 2000).

The Appellate Body has also taken the opportunity to pass upon a case where, in its opinion, a Panel incorrectly dipped into one stream of jurisprudence that apparently runs through the WTO *acquis*. In *India—Patents II*, the Appellate Body faulted a Panel for incorrectly articulating what the panel referred to as "a well established GATT principle."[68] While some might see the Appellate Body's repudiation of the Panel's reasoning as indicative of a discomfort with the explicit development of WTO doctrine, a closer look at its reasoning suggests that the Appellate Body's concern was with the quality of the Panel's analysis, rather than the fact that it engaged in such an exercise. The Panel had concluded that the "protection of legitimate expectations of Members regarding the conditions of competition is a well-established GATT principle."[69] The Appellate Body disagreed with this conclusion because it was seen as the merging, and confusion, of two separate concepts which *could* be drawn from past decisions. The preservation of the conditions of competition is a market-access concept related to the principle of nondiscrimination. The protection of legitimate expectations is derived from the principle of good faith and arises out of the jurisprudence of non-violation complaints. While the Appellate Body did not use the appropriate principles in identifying these two separate concepts, it gave no indication that it disapproved of the panel's approach—only the quality of its analysis. It stated:

> Article 64.1 of the TRIPS Agreement incorporates by reference Article XXIII of the GATT 1994 as the general dispute settlement provision governing the TRIPS Agreement. Thus, we have no quarrel in principle with the notion that past GATT practice with respect to Article XXIII is pertinent to interpretation of the TRIPS Agreement. However, such interpretation must show proper appreciation of the different bases for action under Article XXIII.[70]

Thus, the Appellate Body can be seen as having endorsed a doctrinal process which not only permits panels to rely upon past practice, but may even require them to consider the relevance of past Appellate Body reports. It permits them to identify rules of conduct based upon this past practice, and to do so across the various sub-

68. WTO Panel Report: India—Patent Protection for Pharmaceutical and Agricultural Chemical Products, WT/DS50/R, para. 7.20 (Sept. 5, 1997).

69. *Id.*

70. WTO Appellate Body Report: India—Patent Protection for Pharmaceutical and Agricultural Chemical Products, WT/DS50/AB/R, para. 37 (Dec. 19, 1997).

agreements of the WTO—e.g., where GATT practice can inform interpretation and application of the TRIPS Agreement. It even grounds this approach to the WTO *acquis* in the customary international law rules of interpretation,[71] as codified in the Vienna Convention on the Law of Treaties ("VCLT"),[72] which is the approach that appears to have been universally applied in the GATT, WTO, and other IEL tribunals.

B. *The WTO Appellate Body's Approach and the Inductive Approach*

The aforementioned approach is both commendable and understandable, given the tasks assigned to the law-determining agencies of the WTO. In their role as interpreters of the WTO texts, panels and the Appellate Body are obliged to consider the entire *corpus* of WTO obligations as a whole and in a coherent manner.[73] The inductive approach developed by Schwarzenberger overlays the Appellate Body's response to this obligation. As the case law grows and becomes more complex, it will become necessary for adjudicators to employ explicitly an inductive approach to the articulation of principles that can be extracted from it.

The IEL principles drawn from individual cases can naturally be used to inform interpretation of similar treaty text lying within different sections of the WTO Agreements. Building upon this established pattern, one of the most useful applications of the inductive approach will be in consideration of new obligations governing different forms of economic activity, other than trade in goods. For example, the Appellate Body has already chided a panel for attempting to apply a "goods analysis" to the MFN obligation contained within Article II of the General Agreement on Trade in Services ("GATS").[74] However, the Appellate Body did not complete

---

71. WTO Panel Report: United States—Definitive Safeguard Measures on Imports of Circular Welded Carbon Quality Line Pipe from Korea, WT/DS202/AB/R, para. 174 (Feb. 15, 2002) [hereinafter WTO Panel Report: *Line Pipe*].

72. Vienna Convention on the Law of Treaties, *opened for signature,* May 23, 1969, art. 31, 1155 U.N.T.S. 331, *reprinted in* 8 I.L.M. 679 (1969) [hereinafter VCLT].

73. Gabrielle Marceau, *WTO Dispute Settlement and Human Rights,* 13 EUR. J. INT'L L. 753, 773 (2002), citing WTO Appellate Body Report: Korea—Definitive Safeguard Measures on Imports of Certain Dairy Products, WT/DS98/AB/R, para. 74 (Dec. 14, 1999).

74. WTO Appellate Body Report: Canada—Certain Measures Affecting the Automotive Industry, WT/DS139/AB/R, WT/DS142/AB/R, paras. 181–84 (May 31, 2000) [hereinafter WTO Appellate Body Report: *Automotive Industry*]. The Appellate Body refers to this obligation as being grounded in the fundamental international law principle of

the analysis and accordingly, the WTO legal community must continue to wait for its first "true" nondiscrimination case in the investment/services context. Ehlermann has also identified the related question of how to treat measures which are touched upon by overlapping WTO obligations as one of the most challenging interpretative issues with which future panels will be faced.[75]

Ehlermann notes that critics of the Appellate Body's recourse to public international law in interpretation of the WTO texts will indicate that one should not have recourse to legal principles (fundamental or otherwise) because they are simply too vague and imprecise. However, the same can often be said of the treaty text. A principled approach grounds the interpretative exercise in the logic of continuity and consistency. Accordingly, while he says that WTO adjudicators will need to be careful not to exceed their jurisdiction in employing such methods, they would likely be forced to turn to them even if they were not explicitly authorized to do so.[76]

The jurisdiction of WTO panels, and of the Appellate Body, to settle disputes which arise between member states, can be found in Articles 3.2, 11 and 19.1 of the WTO Dispute Settlement Understanding ("DSU"), which provide:

> Article 3.2:
>
> The dispute settlement system of the WTO is a central element in providing security and predictability to the multilateral trading system. The Members recognize that it serves to preserve the rights and obligations of Members under the covered agreements, and to clarify the existing provisions of those agreements in accordance with customary rules of interpretation of public international law. Recommendations and rulings of the DSB cannot add to or diminish the rights and obligations provided in the covered agreements.[77]
>
> Article 11:
>
> The function of panels is to assist the DSB in

---

effectiveness, as well as in Articles 3.2, 7 and 19.2 of the DSU.

75. Ehlermann, *supra* note 63, at 630.

76. *Id.* at 618.

77. For greater certainty, this admonition is repeated in Article 19.2, which provides: "In accordance with paragraph 2 of Article 3, in their findings and recommendations, the panel and Appellate Body cannot add to or diminish the rights and obligations provided in the covered agreements."

> discharging its responsibilities under this Understanding and the covered agreements. Accordingly, a panel should make an objective assessment of the matter before it, including an objective assessment of the facts of the case and the applicability of and conformity with the relevant covered agreements, and make such other findings as will assist the DSB in making the recommendations or in giving the rulings provided for in the covered agreements. Panels should consult regularly with the parties to the dispute and give them adequate opportunity to develop a mutually satisfactory solution.
>
> Article 19.1:
>
> Where a panel or the Appellate Body concludes that a measure is inconsistent with a covered agreement, it shall recommend that the Member concerned bring the measure into conformity with that agreement. In addition to its recommendations, the panel or Appellate Body may suggest ways in which the Member concerned could implement the recommendations.[78]

Numerous commentators have correctly noted that these provisions constitute a limited grant of authority for WTO adjudicators to interpret and apply the WTO text.[79] WTO panels and the Appellate Body have been explicitly directed to make recommendations concerning the conformity of member states with the obligations contained within the covered agreements. For greater certainty, they have been admonished twice not to engage in a process of adjudication that might "add to or diminish" the rights and obligations contained within those agreements.

Article 11 of the DSU also focuses adjudicators on the task of undertaking the necessary analysis to assist member states in resolving how the covered agreements apply to the conduct in question. Schoenbaum suggests that because Article 11 also authorizes panels and the Appellate Body, to "make such other

78. DSU, *supra* note 53, arts. 3.2, 11, 19.1.

79. *See, e.g.*, Gabrielle Marceau, *A Call for Coherence in International Law: Praises for the Prohibition Against "Clinical Isolation" in WTO Dispute Settlement*, 33 J. WORLD TRADE 87, 110 (1999); Joel P. Trachtman, *The Domain of WTO Dispute Resolution*, 40 HARV. INT'L L.J. 333, 342 (1999).

findings as will assist the [Dispute Settlement Body ("DSB")]," they are accordingly invested with some kind of residual or implied authority to consult and apply other international instruments as they deem necessary.[80] Pauwelyn supports this approach, suggesting that the applicable international law, unlike an adjudicator's jurisdiction, is not limited under these provisions.[81] Bartels arrives at a similar conclusion by construing Articles 3.2 and 19.2 as mere "conflict rules" that would apply only in cases of direct conflict between international law obligations and WTO obligations.[82]

These arguments do not recognize the general principles of international law as being fundamental in an overriding sense. However, while they are certainly important, and there is a place for their application in interpretation of the WTO texts, there is simply no support in the text of the DSU or in the WTO *acquis* for these propositions. The Appellate Body's reference to public international law in *Japan—Alcohol* was made within the context of its interpretative role under DSU Article 3.2, not Article 11. As Marceau suggests, the role of the phrase "make other findings" is simply to permit the adjudicator to make whatever findings of fact are necessary to properly execute its task.[83]

Marceau's approach to dealing with what are essentially the meta-constitutional arguments of those who would require WTO adjudicators to interpret and apply all international law obligations, rather than only those which appear in the covered agreements, is to characterize the WTO regime as a *lex specialis*, i.e., a self-contained regime.[84] As a self-contained regime, Marceau contends that the WTO would fall outside of the customary rules of state responsibility. This invocation of the concept of a self-contained regime is compelling, but it may go too far. When Marceau states that such

---

80. Thomas J. Schoenbaum, *WTO Dispute Settlement: Praises and Suggestions for Reform*, 47 INT'L & COMP. L.Q. 647, 653 (1998).

81. Joost Pauwelyn, *The Role of Public International Law in the WTO: How Far Can We Go?*, 95 AM. J. INT'L L. 535, 560–61 (2001).

82. Lorand Bartels, *Applicable Law in WTO Dispute Settlement Proceedings*, 35 J. WORLD TRADE 499, 505–09 (2001). An example of such a conflict can be found in WTO Panel Report: Canada—Patent Protection of Pharmaceutical Products, WT/DS114/R, para. 4.38 (Mar. 17, 2000). In that case, the Panel rejected Canada's argument that the NAFTA provisions governing the length of patent terms in any way impacted its interpretation of Article 30 of the TRIPS Agreement.

83. Marceau, *supra* note 73, at 763–64. This would include making findings of fact concerning the existence and relevance of other treaties, not to be applied in favor of WTO obligations, but only to be construed in order to properly apply them. Marceau also disputes the arguments made by Schoenbaum, Bartels and Pauwelyn. *Id.* at 767, 776–77.

84. *Id.* at 756, 766–72.

regimes have "specific rights and obligations that provide for effective remedies in the case of their violation,"[85] one might accordingly consider the WTO to be something more like a closed regime, instead of one which has limited access points. Instead of drawing this conclusion, one should save the *lex specialis* analysis for the compliance structure of the WTO, rather than the substantive and procedural norms it shares with so many other IEL sources.

Accordingly, the only means through which public international law and IEL principles should concern WTO adjudicators is through the application of the customary rules of interpretation under public international law. These rules are received into the WTO solely for the purpose of interpreting a WTO provision in accordance with the express wording of DSU Article 3.2. The WTO Appellate Body has unequivocally stated on numerous occasions that it regards Articles 31 and 32 of the VCLT to be a codification of the applicable rules of customary international law.

VCLT Article 31 is to be applied first, with the subsidiary tools of Article 32 to be employed if the application of Article 31 results in textual ambiguity or absurdity.[86] Article 31 provides:

> 1. A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.
>
> 2. The context for the purpose of the interpretation of a treaty shall comprise, in addition to the text, including its preamble and annexes:
>
>   (a) any agreement relating to the treaty which was made between all the parties in connexion with the conclusion of the treaty;
>
>   (b) any instrument which was made by one or more parties in connexion with the conclusion of the treaty and accepted by the other parties as an instrument related to the treaty.
>
> 3. There shall be taken into account together with the context:

85. *Id.* at 774.

86. *See* WTO Appellate Body Report: *Gasoline, supra* note 62, at 17; WTO Appellate Body Report: *Alcoholic Beverages, supra* note 44, at 10.

(a) any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions;

(b) any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation;

(c) any relevant rules of international law applicable in the relations between the parties.

4. A special meaning shall be given to a term if it is established that the parties so intended.[87]

It should be stressed that while Article 31 contains a laundry list of tools for the interpretation of treaty text, rarely will a tribunal make explicit reference to all of them in deciding a case. In fact, the Appellate Body itself has frequently been attacked for its heavy reliance on literal, textual analyses.[88] Nonetheless, there have been numerous occasions when reliance has been placed on other sources of international law for the interpretation of WTO texts, including the GATT *acquis*. The route for invocation of these sources of law is VCLT Article 31(3)(c).[89] Numerous WTO member states have argued as much, typically for the extraction of relevant rules from applicable international treaties.[90] This approach has been endorsed by Marceau, Howse, and Pauwelyn.

Marceau states that any international law obligations, such as those contained within treaties governing environmental or human rights law, can be considered by a WTO Panel or the Appellate Body using Article 31(3)(c). However, she stresses that such consideration would only be undertaken "to the extent necessary to interpret the covered agreements and to assess compliance with WTO law."[91]

---

87. VCLT, *supra* note 72, 1155 U.N.T.S. at 340.

88. Ehlermann has acknowledged an attempt to defend against these attacks, but the perception remains that the Oxford English Dictionary is all too often the favorite legal source of Appellate Body members. *See* Ehlermann, *supra* note 63, at 615, 638.

89. Marceau considers VCLT Article 31(3)(b) to be the route for reception of other treaties between groups of member states, but it is not clear that such undertakings constitute "subsequent practice" in relation to the "WTO," rather than the independent, unrelated practice of such members. *See* Marceau, *supra* note 73, at 782.

90. *See* WTO Panel Report: United States—Import Prohibition of Certain Shrimp and Shrimp Products, WT/DS58/R (May 15, 1998) [hereinafter WTO Panel Report: *Shrimp*]; *see also* WTO Panel Report: European Communities—Measures Affecting Importation of Certain Poultry Products, WT/DS69/R (Mar. 12, 1998).

91. Marceau, *supra* note 73, at 784.

Pauwelyn acknowledges as much, but asserts that the role of public international law extends deeper into the WTO context. While this approach fails to acknowledge the basic jurisdictional limitations of WTO dispute settlement, it nonetheless recognizes that the relevant "international law" in question is broader than just treaty law.[92]

While implicitly acknowledging the jurisdictional limitations borne by WTO adjudicators, Howse also recognizes the breadth of the applicable "international law" under Article 31(3)(c). In criticizing a WTO Panel for not availing itself of the relevant rules which may be drawn from the applicable international law on hand, he stresses that the "applicable" international law in any given case is that which contains "relevant" rules. This includes rules that can be abstracted from international "soft law."[93] It should also include IEL principles that can be abstracted from the work of law-determining agencies.

In order to maintain intellectual consistency, it would always be useful to explain from which source of "international law" the relevant principles are drawn. The three primary sources of law, as identified in the ICJ Statute, are treaties, customary international law, and the general principles of law. A fourth source of international law is "soft law." While not on par with the primary sources of international law, it nonetheless may provide the material from which principles or rules can be abstracted. IEL principles are derived primarily from the substance of relevant IEL treaties and the jurisprudence of IEL tribunals, although they may also be derived from fundamental principles such as good faith.

To date, there have been five types of principles or general rules to which the WTO Appellate Body and panels have had recourse. Occasionally, reference has been made to Article 3.2 of the DSU and Article 31(3)(c) of the VCLT, but more frequently the connection has been implicit. These types of principles or rules are: (1) interpretative rules; (2) procedural principles; (3) substantive principles; (4) rules specific to the GATT/WTO *acquis*; and (5) IEL principles.

WTO panels and the Appellate Body have made frequent recourse to interpretative principles previously employed in other public international law contexts. Palmeter and Mavroidis note that

92. Pauwelyn, *supra* note 81, at 543.

93. Robert Howse, *The Canadian Generic Medicines Panel: A Dangerous Precedent in Dangerous Times* 3 J. WORLD INTELL. PROP. 493, 504 (2000). Soft law is not really law at all. Rather, it is the "primordial goo" of international law. It can be found in the non-binding declarations of states and international organizations, or in non-binding codes which nonetheless possess a normative element. Soft law is not a source of law, but can be relied upon as evidence to establish the existence of custom or general principles of law.

the principle that an exception to a general rule should be interpreted narrowly has been utilized several times by GATT panels, but rejected more recently by the Appellate Body in *EC—Hormones*.[94] Another panel has considered the applicability of the presumption against the retroactive effect of treaties, contained within VCLT Article 28,[95] while other panels have applied the interpretative principle, stating that a treaty provision should be construed in a manner which avoids conflicts between it and another treaty provision.[96]

Marceau records how numerous procedural principles have been applied by panels and the Appellate Body that have their source in customary international law and practice as well as the general principles of international law.[97] For example, in concluding that private counsel could make submissions on behalf of member states, the Appellate Body made reference to the absence of any prohibition on such activity before other public international law adjudicatory bodies or in customary international law.[98] It also adopted the fundamental principle that the burden of proof rests on the party which asserts a claim or defense for use in the WTO context.[99]

Marceau also notes that in *Brazil—Desiccated Coconut*, the Appellate Body recalled the fundamental principle of due process in explaining the significance of the terms of reference set out for panels under DSU Article 11.[100] Another example of the Appellate Body's

---

94. *See* WTO Appellate Body Report: EC—Measures Concerning Meat and Meat Products, WT/DS26/AB/R, WT/DS48/AB/R, 104 (Jan. 16, 1998). *See also* Howse, *supra* note 93, at 497. The interpretative principle, *dubio mitius*, was employed for the conclusion that an obligation must be interpreted in the least restrictive fashion in terms of the derogation of sovereignty required to ensure its performance.

95. WTO Appellate Body Report: Canada—Term of Patent Protection, WT/DS170/AB/R, 71–74 (Sep. 18, 2000). The panel ultimately decided that the presumption was not effective within the context of compliance with the TRIPS Agreement.

96. *See* WTO Panel Report: Indonesia—Measures Affecting the Automotive Sector, WT/DS54/R, WT/DS55/R, WT/DS59/R, WT/DS64/R, para. 14.28 (July 2, 1998); WTO Panel Report: Turkey—Restrictions on Imports of Textile and Clothing Products, WT/DS34/R, paras. 9.92–.95 (May 31, 1999).

97. Marceau, *supra* note 73, at 765.

98. *See* WTO Panel Report: European Communities—Regime for the Importation, Sale and Distribution of Bananas, WT/DS27/R/USA (May 22, 1997) [hereinafter WTO Panel Report: *Bananas*].

99. *See* WTO Appellate Body Report: United States—Measures Affecting Woven Wool Shirts and Blouses from India, WT/DS33/AB/R, 14 (Apr. 25, 1997). The Appellate Body adopts an abbreviated comparative approach to the articulation of this particular principle such that it can fairly be regarded as a general principle of law under Article 38(1) of the ICJ Statute. *See* Statute of the International Court of Justice, *supra* note 13, 38(1), 59 Stat. 1055, T.S. No. 993, 3 Bevans 1179.

100. WTO Appellate Body Report: Brazil—Measures Affecting Desiccated Coconut,

recourse to the practice of international tribunals can be found in *Canada—Aircraft*, in which it noted that WTO panels, much like permanent and ad hoc international tribunals, have the authority to draw an adverse factual inference when evidence, which rests exclusively within the hands of one party, is not surrendered at the request of another.[101]

In addition to procedural principles, GATT and WTO panels have also considered the application of substantive principles, such as *estoppel*.[102] The principle of *res judicata* has also been considered by four panels, including one WTO Panel which was asked by India to dismiss a claim that it argued was already determinatively addressed by a previous WTO panel. The panel devoted considerable attention to the issue and ultimately determined that it had the authority to consider and apply the principle in its interpretation of the relevant texts, although it concluded that the principle did not apply in the particular case before it.[103] The Appellate Body has also made reference to the customary international law rules on state responsibility on two separate occasions, in order to interpret and apply a principle of proportionality in the imposition of countermeasures within the context of interpreting Article 5 of the WTO Safeguards Agreement.[104]

As indicated earlier, the WTO Appellate Body has also identified principles from the GATT *acquis* from which rules have been extracted. The first such principle is that of effectiveness. Although this principle is derived from the general approach to interpretation recalled in VCLT Article 31(1), it is nonetheless a hallmark of the Appellate Body's approach to interpretation and thus,

---

WT/DS22/AB/R, 19 (Feb. 21, 1997).

101. WTO Appellate Body Report: Canada—Measures Affecting the Export of Civilian Aircraft, WT/DS70/AB/R, 58 (Aug. 2, 1999).

102. *See* WTO Panel Report: Guatemala—Definitive Antidumping Measures of Grey Portland Cement from Mexico, WT/DS156/R, paras. 8.23–8.24 (Oct. 24, 2000) [hereinafter WTO Panel Report: *Antidumping Measures*]; WTO Panel Report: European Communities—Measures Affecting Asbestos and Asbestos-Containing Products, WT/DS135/R, para. 8.60 (Sept. 18, 2000); WTO Panel Report: India—Measures Affecting the Automotive Sector, WT/DS146/R, WT/DS175/R, para. 7.115, n.364 (Dec. 21, 2001) [hereinafter WTO Panel Report: *Automotive Sector*].

103. WTO Panel Report: *Automotive Sector*, *supra* note 102, paras. 7.54–.104; *see also* United States—Section 337 of the Tariff Act of 1930, GATT Panel Report, L/6439-36S/345 (Nov. 7, 1989), *available at* http://www.worldtradelaw.net/reports/gattpanels/sec337.pdf.

104. *See* WTO Panel Report: *Line Pipe, supra* note 71, paras. 259–60. *See also* WTO Appellate Body Report: United States—Transitional Safeguard Measure on Combed Cotton Yarn from Pakistan, WT/DS192/AB/R, paras. 67, 76–79 (Nov. 5, 2001).

a fundamental element of the WTO *acquis*.[105]

In another case, Guatemala claimed that there existed a rule of international law which had allegedly been accepted by previous GATT panels and would accordingly have formed part of the GATT *acquis*. The claim was considered by the Panel under the rubric of VCLT Article 31(3)(c), but the Panel ultimately rejected it as being unsupported in customary international law and unadopted in the GATT *acquis*.[106] The alleged principle was "harmless error," which would have precluded a finding of noncompliance with Article 5.5 of the Antidumping Agreement because of the likelihood that the matter was of an extremely minor character and caused no harm.[107]

Numerous panels and the Appellate Body have also considered and applied one of the basic principles of IEL—the principle of good faith. The IEL principle of good faith is grounded in all three of the primary sources of international law, as well as the secondary sources identified in Article 38(1)(d) of the ICJ Statute. The IEL principle is more discrete than the general principle of law upon which it is based, and the method of refining it is executed through recourse to more specific IEL treaty provisions and jurisprudence.

WTO adjudicators have provided ample fodder for such an exercise. The Appellate Body has remarked that GATT Article XX is a manifestation of the principle of good faith. It has made similar remarks about other WTO provisions,[108] and it has reached the same conclusion about Article 3.1 of the DSU.[109] In *U.S.—Shrimp*, the Appellate Body explained the significance of good faith as a relevant WTO principle in the following manner:

> The chapeau of Article XX is, in fact, but one expression of the principle of good faith. This principle, at once a general principle of law and a general principle of international law, controls the

105. The principle was first enunciated in WTO Appellate Body Report: *Alcoholic Beverages, supra* note 44, at 23 and, most recently, in WTO Appellate Body Report: European Communities—Trade Description of Sardines, WT/DS231/AB/R, 212 (Sept. 26, 2002).

106. WTO Panel Report: *Antidumping Measures, supra* note 102, para. 8.22. Guatemala was 11 days late in providing notice to a Mexican company under its antidumping statute.

107. *See also* Philip M. Nichols, *GATT Doctrine*, 36 VA. J. INT'L L. 379 (1996).

108. WTO Appellate Body Report: United States—Continued Dumping and Subsidy Offset Act of 2000, WT/DS217/AB/R, WT/DS234/AB/R, paras. 295–98 (Jan. 16, 2003).

109. WTO Appellate Body Report: United States—Tax Treatment for "Foreign Sales Corporations," WT/DS108/AB/R, para. 166 (Feb. 24, 2000).

> exercise of rights by states. One application of this general principle, the application widely known as the doctrine of *abus de droit*, prohibits the abusive exercise of a state's rights and enjoins that whenever the assertion of a right 'impinges on the field covered by [a] treaty obligation, it must be exercised bona fide, that is to say, reasonably.' An abusive exercise by a Member of its own treaty right thus results in a breach of the treaty rights of the other Members and, as well, a violation of the treaty obligation of the Member so acting. Having said this, our task here is to interpret the language of the chapeau, seeking additional interpretative guidance, as appropriate, from the general principles of international law.[110]

Another panel has also considered Article 7 of the TRIPS Agreement as an embodiment of the good faith principle, [111] while yet another has considered application of the principle in interpretation of Article 5.4 of the Antidumping Agreement and Article 11.4 of the Subsidies and Countervailing Measures Agreement.[112] Still another panel has considered the principle of good faith within the context of a nullification and impairment claim under Article 26 of the DSU.[113] Finally, a Panel has even applied teachings from the principle of good faith in application of Article 21.5 of the DSU.[114]

This extensive amount of jurisprudence on the principle of good faith demonstrates that it is widely considered to be a principle of the WTO *acquis*. This jurisprudence can also provide significant guidance as to how it can be employed in other IEL contexts. However, before the principle can be employed in other contexts, it must be demonstrated that other IEL adjudicators are capable of receiving and making use of it in a manner similar to WTO adjudicators.

---

110. WTO Panel Report: *Shrimp, supra* note 90, para. 158 (citation omitted).

111. WTO Panel Report: United States—Section 211 of the Omnibus Appropriations Act of 1998, WT/DS176/R, para. 8.57 (Aug. 6, 2001).

112. WTO Panel Report: United States—Continued Dumping and Subsidy Offset Act of 2000, WT/DS217/R, WT/DS234/R, para. 7.63–.64 (Sept. 16, 2002), *available at* http://www.worldtradelaw.net/reports/wtopanelsfull/us-byrd(panel)(full).pdf.

113. WTO Panel Report: Korea—Measures Affecting Government Procurement, WT/DS163/R, paras. 7.93–.101 (May 1, 2000).

114. WTO Panel Report: United States—Import Prohibition of Certain Shrimp and Shrimp Products, Recourse to Article 21.5 by Malaysia, WT/DS58/RW, paras. 5.56–.66 (June 15, 2001).

C. *Application to the Work of NAFTA and Mixed-Claim Tribunals*

While the WTO deserves particular attention as the first-among-equals of IEL, it is but one of many regimes from which it could be said that the greater "IEL *acquis*" is drawn. The WTO regime holds pride of place because of the incredible amount of jurisprudence that it is producing, as well as for the institutional quality of its standing Appellate Body. There are a number of other multilateral trade and investment regimes, however, which deserve further consideration. The NAFTA has generated some trade panel jurisprudence, including one case addressing the MFN treatment standard in the services and investment areas, an issue that arguably has yet to transpire in the WTO context.[115]

More significantly, the NAFTA has also acted as the catalyst for an explosion of investment claims. These claims have been brought under investor-state dispute settlement mechanisms, but many have involved a fusion of legal arguments based upon both international trade and investment jurisprudence. This explosion is not limited to the NAFTA. Over the past few years, the International Centre for the Settlement of Investment Disputes at the World Bank ("ICSID") has seen a torrent of new claims made under Bilateral Investment Treaties ("BITs").[116]

In order for these various kinds of adjudicators to also take part in the iterative process that contributes to the formation and the subsequent application of IEL principles, they must have sufficient jurisdiction under their respective regimes. This jurisdiction is often explicitly set out in the relevant treaty. For example, the NAFTA provides:

> Article 102(2):
>
> The Parties shall interpret and apply the provisions of this Agreement in the light of its objectives set out in paragraph 1 and in accordance with the applicable rules of international law. . . .

---

115. United States—In the Matter of Cross Border Trucking Services, USA–MEX–98–2008–01 (Feb. 6, 2001), *available at* http://www.sice.oas.org/DISPUTE/nafta/english/U98081ae.asp [hereinafter *Cross Border Trucking*].

116. The ICSID is responsible for the administration of two sets of arbitral rules under which disputes arising from both BIT claims and contracts between states and individuals are arbitrated. The disputes are adjudicated through ad hoc arbitrations conducted by arbitrators appointed either by the disputants or by the ICSID.

Article 1131(1)(A):

> Tribunals established under this Section shall decide the issues in dispute in accordance with this Agreement and applicable rules of international law.[117]

NAFTA panels and investment tribunals have consistently determined that the "applicable rules of international law" are the customary international law rules of treaty interpretation, which have been codified in Articles 31 and 32 of the VCLT.[118] Similar language can be found in numerous other BITs and bilateral trade treaties,[119] and there does not appear to be a single decision by any international trade panel or international investment tribunal that contradicts the VCLT approach adopted by the NAFTA and WTO adjudicators.

Article V of the Claims Settlement Declaration for the Iran-U.S. Claims Tribunal, which has produced a significant jurisprudence on both procedural and substantive IEL issues, provided this Tribunal with discretion to apply "such choice of law rules and principles of commercial and international law as the Tribunal determines to be applicable."[120] Mapp has noted that by virtue of Article V, and the "international nature" of the Tribunal, whenever there was an issue related to state responsibility, the governing law was necessarily international law.[121]

John Collier and Vaughan Lowe report that recourse to "general principles of law" or the "general principles of international law" is commonly provided for in contracts between individuals and sovereigns, at times in combination with recourse to the relevant domestic law.[122] Christstopher Schreuer adds that, regardless of whether the contract or treaty is silent as to choice of law or provides a mixed choice of law clause, tribunals have inevitably employed the

117. NAFTA, *supra* note 1, arts. 102, 1131, 32 I.L.M. at 297, 645.

118. *See, e.g.*, *Cross Border Trucking*, *supra* note 115, para. 221 (including reference to VCLT Art. 31(3)(c)); *see also* Ethyl Corp. v. Canada, Award on Jurisdiction, para. 61, (June 24, 1998), (NAFTA/UNCITRAL), *reprinted in* 38 I.L.M. 708, para. 51 (1999).

119. Similar provisions can also be found in various international agreements, including the Energy Charter Treaty, Dec. 17, 1994, art. 26, 1994 O.J. (L 380) 24, 40, 34 I.L.M. 381, 400, and the Agreement on the Promotion and Protection of Investments, Jan. 25, 1995, Austl.-Phil., art. 12(9), 1995 Austl. T.S. No. 28, which provides that "generally recognized principles of international law" shall be used in interpretation of the treaty text.

120. Iran-United States Claims Tribunal, Claims Settlement Agreement, 20 I.L.M. 230 (1981).

121. WAYNE MAPP, THE IRAN-UNITED STATES CLAIMS TRIBUNAL: THE FIRST TEN YEARS, 1981–1991, at 113 (1993).

122. JOHN COLLIER & VAUGHAN LOWE, THE SETTLEMENT OF DISPUTES IN INTERNATIONAL LAW: INSTITUTIONS AND PROCEDURES 244–45 (1999).

customary international law rules of interpretation and substantive international law principles when rendering their awards.[123] In fact, he goes as far as to suggest that international law principles can find their way into a tribunal's deliberations even when the contract or *compromis* contains a clause which purports to oust international law from being applicable to any given dispute.[124]

Article 42 of the ICSID Convention sets out the governing law for any tribunal, which is necessary given that the choice of law is not always set out in the contract or *compromis*. It provides:

> (1) The Tribunal shall decide a dispute in accordance with such rules of law as may be agreed by the parties. In the absence of such agreement, the Tribunal shall apply the law of the Contracting State party to the dispute (including its rules on the conflict of laws) and such rules of international law as may be applicable.
>
> (2) The Tribunal may not bring in a finding of *non liquet* on the ground of silence or obscurity of the law.
>
> (3) The provisions of paragraphs (1) and (2) shall not prejudice the power of the Tribunal to decide a dispute *ex aequo et bono* if the parties so agree.[125]

Sir Eli Lauterpacht has remarked that tribunals hearing investor-state disputes are often called upon to dispose of matters on the basis of the applicable rules of international law, rather than domestic rules.[126] Others have agreed, although they have not gone so far as to suggest that substantive international law should "trump" domestic law in the event of a conflict between them.[127] Nonetheless, a more recent tribunal, of which Sir Eli Lauterpacht was a member, has concluded that "international law must prevail" to the extent that

---

123. CHRISTOPHER H. SCHREUER, THE ICSID CONVENTION: A COMMENTARY 588 (2001).

124. *Id.*

125. Convention on the Settlement of Investment Disputes Between States and Nationals of Other States, *opened for signature*, Mar. 18, 1965, 17 U.S.T. 1270, 575 U.N.T.S. 159 (entered into force Oct. 14, 1996) [hereinafter ICSID Convention].

126. Elihu Lauterpacht, *International Law and Private Foreign Investment*, 4 IND. J. GLOBAL LEGAL STUD. 259, 272 (1997).

127. Okezie Chukwumerije, *International Law and Article 42 of the ICSID Convention*, 14 J. INT'L ARB. 79, 95–101 (1997); Ibrahim F.I. Shihata & Antonio R. Parra, *Applicable Substantive Law in Disputes Between States and Private Parties: The Case of Arbitration Under the ICSID Convention*, 9 ICSID REV.-FOREIGN INVEST. L.J. 183, 191–95 (1994).

there may be some inconsistency between applicable domestic and international norms.[128]

Relying on the negotiating history of the ICSID Convention, Schreuer concludes that the "applicable international law" was intended by its drafters to mean the relevant principles and rules to be derived from Article 38(1) of the Statute of the ICJ, with "allowance being made for the fact that Article 38 was designed to apply to interstate disputes."[129] Such "international law" could obviously be derived from the fundamental principles of international law set out in Article 38(1)(c),[130] customary international law, or "the large and rapidly growing numbers of BITs and multilateral treaties dealing with investment . . . ."[131] Of course, any such principles or rules would obviously play only an interpretative role when specific treaty standards were in dispute. In their absence, however, such rules would arguably remain relevant as substantive norms to be applied to the specific facts of the case at hand.

With Article 42(1) of the ICSID Convention, the drafters hopefully understood that allowances might need to be made for the fact that Article 38(1) was intended for application to disputes between states. In this respect, ICSID scholar Christopher Schreuer has suggested that the applicable rules of international law, such as the VCLT, may need to be "adjusted" when applied to the interpretation of a contract between a state and an individual.[132]

Schreuer is correct, but not only with respect to contracts between states and individuals. The disputes that arise under such contracts are as likely to be governed by international commercial law principles which will find their own grounding in the fundamental principles of law and international custom. It is likely that this condition is of particular relevance in the context of disputes arising out of investment protection treaties in which the right is enjoyed by an individual, but its vindication is only possible through an

---

128. Compañia del Desarrollo de Santa Elena, S.A. v. Republic of Costa Rica, Final Award, 15 ICSID REV.-FOREIGN INVEST. L.J. 169, 191 (2000); Compañia del Desarrollo de Santa Elena, S.A. v. Republic of Costa Rica, Rectification, 15 ICSID REV.-FOREIGN INVEST. L.J. 205 (2000).

129. SCHREUER, *supra* note 123, at 609–10.

130. *Id.* at 609, 615–16 (mentioning the interesting case of Klöckner v. Camaroon, Decision on Annulment, 2 ICSID REV.-FOREIGN INVEST. L.J. 121 (1985), in which a tribunal was castigated by the Annulment Panel for essentially having applied a principle of French contract law to the dispute as if it were a fundamental principle of international law, without having parsed the evidence which would have been necessary to make such a finding of law).

131. *Id.* at 610–11.

132. *Id.* at 618–19.

agreement between states. This agreement provides for the States' consent to arbitration with that individual.

Given that it is not clear that those who drafted the VCLT intended their work for application to treaties bestowing rights upon individuals, it would appear that IEL treaty interpreters must be careful not to allow themselves to adopt an approach which is too narrow or "Statist" (by implicitly acknowledging too high a degree of primacy to the role of the State in international law and politics today). In other words, their interpretations should take into account the teachings of Breton Woods and Uruguay more so than those of Westphalia. This includes being careful about using VCLT Article 31 to interpret obligations that have a particular nexus to individual rights granted, or interests protected, under that treaty. The project of identifying IEL obligations demonstrates that there are a certain set of universal principles which govern state practice for the benefit of individuals. These IEL principles can be put to use within the Article 31 paradigm, in order to ensure that the special nexus between the state and the individual is respected at all times.

Within the context of BITs and multilateral investment protection regimes such as Chapter 11 of the NAFTA and Article 26 of the Energy Charter Treaty, individuals enjoy a catalogue of rights that protect their commercial interests, as well as a direct mechanism to vindicate them. Within the WTO context, however, there is no direct right of vindication. However, it has been said that individual actors enjoy the "indirect effect" of WTO obligations. As noted in the seminal decision of the Panel in *U.S.—Section 301*:

> 7.75 Providing security and predictability to the multilateral trading system is another central object and purpose of the system which could be instrumental to achieving the broad objectives of the Preamble. Of all WTO disciplines, the DSU is one of the most important instruments to protect the security and predictability of the multilateral trading system and through it that of the marketplace and its different operators. DSU provisions must, thus, be interpreted in the light of this object and purpose and in a manner which would most effectively enhance it. In this respect we are referring not only to preambular language but also to positive law provisions in the DSU itself. Article 3.2 of the DSU provides:
>
> > The dispute settlement system of the WTO is a central element in providing security and

> predictability to the multilateral trading system. The Members recognize that it serves to preserve the rights and obligations of Members under the covered agreements . . . .
>
> 7.76 The security and predictability in question are of "the multilateral trading system." The multilateral trading system is, per force, composed not only of States but also, indeed mostly, of individual economic operators. The lack of security and predictability affects mostly these individual operators.
>
> 7.77 Trade is conducted most often and increasingly by private operators. It is through improved conditions for these private operators that Members benefit from WTO disciplines. The denial of benefits to a Member which flows from a breach is often indirect and results from the impact of the breach on the marketplace and the activities of individuals within it. Sections 301-310 themselves recognize this nexus. One of the principal triggers for U.S. action to vindicate U.S. rights under covered agreements is the impact alleged breaches have had on, and the complaint emanating from, individual economic operators.[133]

The need for an articulation of substantive principles that are specific to the field of IEL is demonstrated by the fact that IEL treaties offer the same kind of unique protection for individuals against the actions of the state, using similar, if not identical, norms. An inductive approach to understanding the evolving doctrine of the WTO *acquis* and the emerging doctrine of "international investment *acquis*" also provides adjudicators with the opportunity to learn from the teachings of their colleagues. These colleagues may have encountered a similar or analogous problem in the past.

When Schwarzenberger first unveiled his inductive approach, there was a dearth of adjudicators and a dearth of law. Today, the

---

133. WTO Panel Report: United States—Sections 301–310 of the Trade Act of 1974, WT/DS152/R39, (Dec. 22, 1999) (citation omitted). The Panel (composed of David Hawes, Terje Johannessen and Joseph Weiler) continued at paras. 7.78–.79:

> It may, thus, be convenient in the GATT/"WTO" legal order to speak not of the principle of direct effect but of the principle of indirect effect. Apart from this name-of-convenience, there is nothing novel or radical in our analysis. We have already seen that it is rooted in the language of the "WTO" itself. It also represents a GATT/"WTO" orthodoxy confirmed in a variety of ways over the years including panel and Appellate Body reports as well as the practice of Members.

reverse is true. There are many tribunals, providing too much jurisprudence to easily collect or assess, without adopting a principled approach to the articulation of its doctrines. Marceau recognizes this need to find a comprehensive approach within the context of the WTO regime, advocating recourse to VCLT Article 31(3)(c) and the principles that might be drawn from the sources of law which lay within. She did so because such an analysis would permit one to adopt an evolutionary approach to interpretation that would promote coherence.[134] The same reasoning could be extended to cover the entire field of IEL, although certain warnings must be made and hopes must not be set too high.

For example, one should not expect the WTO Appellate Body to make frequent reference to the decisions of non-WTO tribunals for guidance on most substantive areas of GATT law. GATT law is comparatively well-settled, and the Appellate Body is clearly the de facto World Trade Court. Nonetheless, should NAFTA tribunal jurisprudence in the fields of services and investment regulation continue to outstrip that of WTO panels, it would not seem too much to ask that NAFTA awards be considered by WTO panels in the adoption of an inductive approach to as-of-yet "untested" GATS obligations.[135] In so doing, the adjudicator must take care not to "do violence" to the text of the treaty in question, while also taking into account its object and purposes.[136]

One possible way to "do violence" to an IEL treaty provision is to use an inappropriate source of law for the enunciation of an IEL principle. For example, one might be tempted to rely upon the jurisprudence emanating from the European Court of Justice concerning the regulation of the European common market. The danger of doing so lies in the fact that the legal underpinnings of European Community law go far beyond the liberalization of trade and/or investment among sovereign states. It is a constitutional project which, according to Professor Joseph Weiler, has effectively renounced public international law as its "operating system." The

134. *See generally* Gabrielle Marceau, *A Call for Coherence in International Law: Praises for the Prohibition Against "Clinical Isolation" in WTO Dispute Settlement*, 33 J. WORLD TRADE 87 (1999).

135. The application of GATS Article II has been considered only in the following two panel reports: WTO Appellate Body Report: *Automotive Industry, supra* note 74; WTO Panel Report: *Bananas, supra* note 98. That is essentially the extent of the WTO's services jurisprudence.

136. Ford, *supra* note 26, at 72, citing Wolfgang Friedman, *The Uses of "General Principles" in the Development of International Law*, 57 AM. J. INT'L L. 279, 285 n.134 (1963).

architecture of the European Communities has undergone a metamorphosis, which has forever changed the legal discourse that existed between and among member states.[137] Accordingly, legal concepts emanating from this type of discourse must be treated with tremendous care by the international lawyer who is attempting to identify a few substantive principles applicable within the context of IEL.

IV. NAFTA ARTICLE 1105

With this caveat in place, we can consider some of the practical implications of employing an inductive approach in the NAFTA context. Perhaps the most obvious candidates for application of IEL principles are NAFTA Articles 1102 and 1103, which provide for national treatment and MFN treatment respectively. The national treatment and MFN treatment standards have a long history in IEL treaty law and in GATT, WTO, and mixed-claims tribunal jurisprudence. Obviously, there are lessons to be drawn from these sources. It is not uncommon to find a NAFTA tribunal considering and applying the teachings of the WTO Appellate Body in this context.[138] However, this Article will tackle a potentially more difficult subject: the interpretation of NAFTA Article 1105. This provision requires federal, state, and local governments to provide "treatment in accordance with international law, including fair and equitable treatment and full protection and security" to all qualifying foreign investments.[139]

Article 1105 has probably been the most controversial NAFTA provision in practice, having been considered by five tribunals, with three of them having found that a breach of Article 1105 had occurred. The reaction of NAFTA government officials to these "losses" was to issue an interpretative statement designed to curtail the future application of Article 1105. The impact of this unheralded action was negligible, although this assessment is based

---

137. J.H.H. Weiler, *The Transformation of Europe*, 100 YALE L.J. 2403, 2407 (1991).

138. *See, e.g.*, Pope & Talbot, Inc. v. Canada, Final Merits Award, paras. 43–63 (Apr. 10, 2001), (NAFTA/UNCITRAL), *available at* http://www.naftaclaims.com.

139. NAFTA Article 1105 clarifies that most NAFTA obligations apply to all levels of government. Investments "qualify" for protection under Article 1105 if they conform to the broad definition of "investment" contained within Article 1139 and are made by a qualifying "investor" (i.e. a national of one of the other two NAFTA countries that owns or controls the investment). *See* NAFTA, *supra* note 1, art. 1105, 32 I.L.M. at 639.

upon only three final awards.[140]

What kind of treatment does Article 1105 require, and how can its interpretation be aided by recourse to the IEL principles derived from an inductive approach? The first part of this question is relatively easy to answer. The second part requires more explanation. Article 1105 establishes that the NAFTA Parties owe a "minimum standard of treatment" to foreign investors who choose to invest in their territories. The adjective "minimum" does not mean that the standard itself is low, i.e., an easy test to meet. Instead, the standard is something below which no government conduct can fall without triggering a successful claim for compensation.

Working in the wake of the NAFTA governments' imposition of their binding interpretation of Article 1105, the NAFTA tribunals have concluded that this treaty-based standard is required of all States as a matter of customary international law.[141] The significance of memorializing the minimum standard in NAFTA Article 1105 lies in the fact that, before NAFTA was signed, Mexico had arguably never agreed to binding international arbitration concerning its potential liability for breaching this standard in virtually any investment context.

What remains to be determined, however, is how this minimum standard will be interpreted in future cases. It should first be noted that the project of applying Article 1105 in any given case may be highly contextual. Accordingly, it may be some time before a sufficient amount of jurisprudence has developed to cover the gamut of situations for which the obligation may be relevant. To be sure, "minimum standard" provisions exist in many of the over 2,500 investment protection treaties that are now in force throughout the world.[142] Any tribunal awards provided under virtually any of these treaties are likely to be of some persuasive value for future litigants and tribunals. But what is the role, if any, for the jurisprudence of the

---

140. *See* Todd Weiler, *NAFTA Chapter 11 Jurisprudence: Coming Along Nicely*, 9 SW. J.L. & TRADE AM. 245 (2003).

141. *See, e.g.*, Pope & Talbot, Inc. v. Canada, Counter Memorial, Second Phase, para. 55 (Oct. 10, 2000), (NAFTA/UNCITRAL), *available at* http://www.naftaclaims.com; *see also* Mondev International Ltd. v. United States, Final Award, paras. 39–42 (Oct. 11, 2002), (NAFTA/ICSID), *available at* http://www.naftaclaims.com.

142. Of course, the wording of all of these provisions is not exactly homogenous. Some minimum standard provisions impose an obligation to accord "fair and equitable treatment" in addition to whatever treatment is required under international law, while others (such as NAFTA Article 1105) subsume the "fair and equitable treatment" obligation within that treatment which is required under international law. Others include "fair and equitable treatment" with no reference to international law at all, while others combine these variations with national treatment and MFN treatment standards.

WTO, as well as other sources of international law? At most, NAFTA tribunals state that recourse can be had to any relevant source of international law, including state practice and doctrine, to understand the content of the minimum standard.[143] They are right, but their approach is unrefined. A more systematic approach is necessary and could be provided through the use of the inductive method.

Employing the inductive approach permits us to take advantage of the most salient principles of an investment dispute, while staying true to the treaty text. NAFTA Article 1105 provides that governments must treat investments "in accordance with international law, including fair and equitable treatment and full protection and security." Other minimum standard provisions are more explicit, such as those found in Canada's Foreign Investment Protection Treaty model, which requires "treatment in accordance with the principles of international law."[144] Others do not mention "international law" at all.[145] Regardless of the minor differences found among these various provisions, it would be elementary to conclude that the best way to explain the meaning of the terms "fair and equitable treatment," as they are informed by international law is to rely on the most relevant principles that could be drawn from "international law"—i.e., customary international law, treaty law, and the general principles of international law. The inductive approach provides the ideal methodology through which to provide such interpretative principles.

There are a number of IEL principles that may prove useful for the interpretation of minimum standards provisions such as NAFTA Article 1105. However, this Article is not a suitable place to describe the character and potential application of all of these principles. Rather, only broad outlines can be provided here. It is important to stress, however, the manner in which this process of identifying principles should be conducted. The process begins by relying on the primary and secondary sources of public international

143. ADF Group, Inc. v. United States, Final Award, paras. 39, 89, (NAFTA/ICSID), (Jan. 9, 2003), *available at* http://www.naftaclaims.com.

144. *See, e.g.*, Agreement between the Government of Canada and the Government of Costa Rica for the Promotion and Protection of Investments, Mar. 18, 1998, Cost Rica-Can., art. 2.2(a), *available at* http://www.dfait-maeci.gc.ca/tna-nac/documents/FIPA/COSTARICA-E.PDF.

145. For a comprehensive collection of provisions, *see* UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT—INTERNATIONAL INVESTMENT INSTRUMENTS: A COMPENDIUM, UNCTAD/DTCI/30, U.N. Sales No. E.96.II.A.10 (1996); UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT—FAIR AND EQUITABLE TREATMENT, UNCTAD/ITE/IIT/11, U.N. Sales No. E.99.II.D.15 (1999).

law, which are often found in the writings of the most highly regarded scholars and jurists. After one identifies the nascent elements of each IEL principle in the generally accepted rules of customary international law and in the fundamental principles of law, one moves to considering how to better specify or limit them.

In other words, one tests these potential principles against the mettle of individual IEL cases and in contemplation of the existing mass of international economic law conventions and soft law. During this latter step of the process, one must conduct the test impartially. It may be that the principle is not borne out in the IEL context, which involves the interests of individual actors as much as it involves the interests of States. The stronger principle is the one that has successfully passed the most difficult tests.

Again, this Article is not the place to fully test these IEL principles. Instead, it will propose three substantive IEL principles that are appropriate for the interpretation of an investment treaty provision, which typically requires a State to act in no less than a "fair and equitable manner" in its regulatory activities. These principles are good faith, due process, and transparency.[146]

A. Transparency

The principle of transparency has been addressed once by the WTO Appellate Body and once by a NAFTA Chapter 11 tribunal. Elements of this principle can also be found in numerous IEL treaty provisions.[147] In *U.S.—Underwear*, the Appellate Body described how the principle of transparency finds expression in GATT Article X:2.[148] Schwarzenberger cautions us, however, not to rush too quickly to the enunciation of a new principle, based merely on a

146. This list is by no means exclusive. For example, one could argue that a principle exists that requires compensation to be paid in cases of detrimental reliance by an investor upon the representations of a government official or agent. Such a principle could be based upon a stream of mixed-claim jurisprudence extending up to the *Metalclad* award, where the investor detrimentally relied on assurances from federal officials concerning the apparently arbitrary demands of a local town council. The principle could also be drawn from a comparative analysis of detrimental reliance laws among the world's legal systems and perhaps a study of the rules of equity, as received into international law. *See* Metalclad Corp. v. United Mexican States (U.S. v. Mex.), 5 ICSID (W. Bank) Reports 209, 226 (2001).

147. SCHWARZENBERGER, *supra* note 10, at 95 (noting that if a principle is explicitly included in a treaty [even if only for declaratory purposes] it may become "more precisely defined. Instead of being a mere abstraction from legal rules, it may itself become a binding rule of wide scope from which other subordinate rules may be legitimately derived. . . .").

148. WTO Appellate Body Report: United States—Restriction on Imports of Cotton and Man-made Fibre Underwear, WT/DS24/AB/R, 19–20 (Feb. 10, 1997).

grouping of similar treaty provisions:

> It is also possible, and, for systematic purposes, helpful, to group together treaty clauses of a similar character under the headings of optional principles and standards. What is not permissible is to derive from such abstractions new rules which are read into the treaty either by way of questionable analogies or as being inherent for systematic or teaching purposes. If such conclusions can be drawn from the interpretation of the intention of the parties to the treaty, this is legitimate, although not necessarily subjective, judicial or quasi-judicial activity. If however, such 'rules' are merely logical deductions from concepts which a number of treaties have in common, this form of law-finding is a notorious example of legal conceptualism (Begriffsjurisprudenz) and amounts to a form of surreptitious law-making.[149]

Fortunately, the Appellate Body carefully noted that the principle of transparency is also related to the fundamental international law principle of "due process."[150] One could also note how the principle of transparency implicitly resides in the jurisprudence of mixed-claim tribunals. For example, in one case, a tribunal awarded damages against a state for imposing a measure which was so lacking in transparency that it effectively deprived a foreign investor of the opportunity to legally protect its investment.[151] Recall that the purpose of enunciating IEL principles is not to create new substantive obligations, but only to assist in the interpretation of existing obligations.

The *Metalclad* case provides an interesting, and wholly justifiable, example of how the transparency principle may be relevant in the investment context. The principle of transparency accordingly appears ripe for further review. Whether its appearance in numerous treaty provisions and the jurisprudence of international tribunals—combined with its relationship to general principles of law such as due process—will be sufficient to establish its status as a relevant IEL principle is a task to be assigned to a future paper.

---

149. SCHWARZENBERGER, *supra* note 10, at 90.

150. WTO Appellate Body Report: United States—Import Prohibition of Certain Shrimp and Shrimp Products, WT/DS58/AB/R, paras. 182–83 (Oct. 12, 1998) [hereinafter WTO Appellate Body: *Shrimp*].

151. De Saba Case (U.S. v. Pan.), 6 R.I.A.A. 358, 362–63 (1955).

B. Due Process

The fundamental principle of due process, perhaps known more commonly in other jurisdictions as procedural justice or fairness, has a well-established place in public international law, particularly mixed-claim jurisprudence. Examples can also be found in the jurisprudence of various tribunals, including the WTO Appellate Body[152] and the provisions of virtually every IEL treaty.[153] The best examples, however, are in the "denial of justice" decisions of various mixed-claim tribunals.

Perhaps the best encapsulation of the doctrine of denial of justice is to be found in the views contained within the 1961 Harvard Draft Convention on Responsibility of States for Damage Done on Their Territory to the Person or Property of Foreigners. Article 7 of this document states:

> The denial to an alien by a tribunal or an administrative authority of a fair hearing in a proceeding involving the determination of his civil rights or obligations or of any criminal charges against him is wrongful if a decision or judgment is rendered against him or he is accorded an inadequate recovery. In determining the fairness of any hearing, it is relevant to consider whether it was held before an independent tribunal and whether the alien was denied:
>
> (a) specific information in advance of the hearing of any claim or charge against him;
>
> (b) adequate time to prepare his case;
>
> (c) full opportunity to know the substance and source of any evidence against him and to contest its validity;
>
> (d) full opportunity to have compulsory process for obtaining witnesses and evidence;
>
> (e) full opportunity to have legal representation of his own choice;

---

152. WTO Appellate Body: *Shrimp, supra* note 150, para. 183.

153. *See, e.g.*, General Agreement on Tariffs and Trade, Oct. 30, 1947, art. X, 61 Stat. A-11, 55 U.N.T.S. 187; NAFTA, *supra* note 1, art. 1804, 32 I.L.M. at 681.

(f) free or assisted legal representation on the same basis as nationals of the State concerned or on the basis recognized by the principal legal systems of the world, whichever standard is higher;

(g) the services of a competent interpreter during the proceedings if he cannot fully understand or speak the language used in the tribunal;

(h) full opportunity to communicate with a representative of the government of the State entitled to extend its diplomatic protection to him;

(i) full opportunity to have such a representative present at any judicial or administrative proceeding in accordance with the rules of procedure of the tribunal or administrative agency;

(j) disposition of his case with reasonable dispatch at all stages of the proceedings; or

(k) any other procedural right conferred by a treaty or recognized by the principal legal systems of the world.[154]

The kinds of activities that will constitute a denial of procedural justice would include an effective refusal to hear an interested party,[155] or "a continued absence of seriousness on the part of [the decision-maker]."[156] Professor Edwin Borchard, who wrote the first *Harvard Draft*, summarized the content of the prohibition against procedural denials of justice as follows:

> On the procedural side, we are perhaps in less doubt of the content of the standard, although we must still be satisfied with general principles. Fair courts, readily open to aliens, administering justice honestly, impartially, without bias or political control, seem essentials of international due process. While the details of procedure necessarily vary considerably

154. Louis B. Sohn & R.R. Baxter, *Responsibility of States for Injuries to the Economic Interests of Aliens*, 55 AM. J. INT'L. L. 545, 550 (1961).

155. *Cotesworth & Powell* (Gr. Brit. v. Colom.), *reprinted in* 2 John Bassett Moore, History and Digest of the International Arbitrations to which the United States Has Been a Party 2050, 2083 (1898).

156. Chattin v. United Mexican States (U.S. v. Mex.), 4 R.I.A.A. 282, 292 (1928).

> from country to country, certain essential elements of fair trial and objective justice are required of all systems. It is probably less difficult to apply than to define these principles, and we have in their application the aid of innumerable precedents from international practice. In spite of the legislative effort strictly to narrow the conception of denial of justice and the privilege of diplomatic interposition, few foreign countries have been willing to abandon their nationals to the arbitrariness of corrupt courts or administrative bodies.[157]

Borchard's use of the term "due process" is telling. The NAFTA expropriation provision, Article 1110, makes specific reference to "due process" in relation to the application of Article 1105.[158] Further, the term has appeared in numerous draft conventions on the protection of foreign property as well as in many bilateral investment treaties.[159] It connotes a fundamental respect for the rule of law that must be present in the decision-making processes under review. Its use in interpreting the "fair and equitable treatment" standard, particularly in terms of identifying the proper floor below which no conduct should fall, is clear.

C. *Good Faith*

In contrast to its considerable coverage in the context of the WTO, the IEL principle of good faith has yet to be fully addressed by a NAFTA tribunal.[160] Accordingly, the experiences of the WTO may provide guidance to future NAFTA and BIT tribunals interpreting

---

157. Edwin Borchard, *The "Minimum Standard" of the Treatment of Aliens*, 38 MICH. L. REV. 445, 460 (1940).

158. NAFTA, *supra* note 1, art. 1110, 32 I.L.M. at 641–42.

159. In his treatise on the subject of these draft conventions, Professor Schwarzenberger hypothesized that, with the inclusion of the term "due process of law," the drafters of such codifying instruments as the *Abs-Shawcross Convention* and the *OECD Draft Convention* were attempting to acknowledge the role of the minimum standard in consideration of the lawfulness of a taking, as such a principle embodies elements of the Rule of Law. However, he suggested that they would have done better to state more precisely what they had in mind. *See* GEORG SCHWARZENBERGER, FOREIGN INVESTMENTS AND INTERNATIONAL LAW 119, 172 (1969).

160. In his separate opinion in the *Myers* NAFTA claim, Professor Schwartz sketches out some of the investor's arguments as embodying potential breaches of Article 1105, which could include application of principles such as transparency and good faith (although he did not name the latter). *See* S.D. Myers, Inc. v. Canada, (Nov. 13, 2000), 40 I.L.M. 1408, 1484–85 (2001).

provisions such as NAFTA Article 1105. The IEL principle of good faith may be evidenced in the WTO *acquis*, the jurisprudence of the ICJ, and the teachings of the most highly qualified publicists. These devices demonstrate how customary international law doctrines and the general or "fundamental" international law principle of good faith can inform the IEL principle of good faith.

For example, it is common practice in many investment treaties, including the multilateral Energy Charter Treaty, for investors to be permitted to claim damages in cases where a commitment made by the State to the investors is not honored.[161] This obligation obviously relates to the *pacta sunt servanda* rule of customary international law. Another example is the doctrine on abuses of right. This doctrine is based upon the general international law principle of good faith. Its premise is that a State cannot exercise any right under international law, including the liberty to exercise its sovereign regulatory authority, in an arbitrary, discriminatory, or otherwise abusive manner.

As an elemental principle in the ordering of relations between states, good faith provides the glue that largely holds the international order together. Section 711 of the Restatement (Third) of the Foreign Relations Law of the United States establishes the principle of good faith in state responsibility, providing that "a state is responsible under international law for injury to a national of another state caused by an official act or omission that violates . . . a personal right that, under international law, a state is obligated to respect individuals of foreign nationality."[162] As the ICJ noted in the *Anglo-Norwegian Fisheries* case:

> The principle of good faith requires that every right be exercised honestly and loyally. Any fictious exercise of a right for the purpose of evading either a rule of law or a contractual obligation will not be tolerated. Such an exercise constitutes an abuse of the right,

161. *See, e.g.*, European Energy Charter Treaty, Dec. 17 1994, art. 10, 33 I.L.M. 360, 389–390 (1995); Investment Treaty, Jan. 11 1995, U.S.–Alb., art. II:3, *available at* http://www.state.gov/www/issues/economic/bit_abania.pdf.

162. RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW § 711 (1987). Commentary (e) to Section 711 confirms that this provision refers both to the interests of individuals and to the fact that "a juridical person of foreign nationality also enjoys some protection, for instance, against denials of procedural justice" and that "for a juridical person, such violations would normally result in economic injury and fall within clause (c)," which provides that responsibility attaches for acts that unreasonably interfere with "a right to property or other economic interests that, under international law, a state is obligated to respect for persons, natural or judicial, of foreign nationality, as provided in section 712." *Id.*

prohibited by law.[163]

In its merits award, the ICSID tribunal in *AMCO Asia v. Indonesia* has even determined that good faith is a principle upon which an investor could base its claim. The tribunal concluded that an investor should be entitled "to realize the investment, to operate it with a reasonable expectation to make profit and to have the benefit of the incentives provided by law," without suffering the arbitrary exercise of a right which would prevent such enjoyment.[164]

Bin Cheng devoted an entire chapter of his renowned treatise on the principles of international law to the manner in which the doctrine of abuse of rights arises from the principle of good faith. He summarized his view of the doctrine as follows:

> [D]iscretion must be exercised in good faith, and the law will intervene in all cases where this discretion is abused . . . . Whenever, therefore, the owner of a right enjoys a certain discretionary power, this must be exercised in good faith, which means that is must be exercised reasonably, honestly, in conformity with the spirit of the law and with due regard to the interest of others.[165]

> The exercise of a right—or a supposed right, since the right no longer exists—for the sole purpose of causing injury to another is thus prohibited. Every right is the legal protection of a legitimate interest. An alleged exercise of a right not in furtherance of such interest, but with the malicious purpose of injuring others can no longer claim protection of the law.[166]

For his part, Schwarenberger argued that since the theory of abuse of rights was so well ensconced in the principle of good faith and in the customary international law minimum standard of treatment of aliens, it was not even necessary to refer to it as a separate standard (or international tort), except for the "hard core" of the theory. He considered the hard core to include: "the arbitrary or unreasonable exercise of rights or powers within the exclusive

163. Anglo-Norwegian Fisheries Case (U.K. v. Nor.), 1951 I.C.J. 116 (Dec. 18).

164. AMCO Asia Corp. v. Indonesia, ICSID Case No. ARB/81/1, 25 I.L.M. 1439 (1986); *see also* Sapphire Int'l Petroleum Ltd. v. Nat'l Iranian Oil Co., Mar. 15, 1963, 35 I.L.R. 136, 181 (1967).

165. CHENG, *supra* note 11, at 132–34.

166. *Id.* at 122.

jurisdiction of States."[167] Schwarzenberger accordingly stated:

> Arbitrariness in any form is—or ought to be—abhorrent to *homo juridicus*. His whole professional outlook is dominated by the attitude that, in the eyes of the law, equal situations require equal remedies.[168]

As Schwarzenberger hinted, what the abuse of rights doctrine can tell us about the interpretation of the "fair and equitable treatment" standard is rather straightforward. States are not permitted to exercise their authority—whether granted by treaty or existing as part of the sovereign right to regulate the affairs of their citizens—in an abusive or discriminatory manner. The telltale sign of an "abuse of right" is a seemingly arbitrary governmental decision which causes damage to the interests of a foreign investor. If state officials can demonstrate that the decision was made in an objective and rational, reasoned manner, they will defeat any claim made under this standard. If they cannot, the arbitrary result must be remedied. One way to guard against arbitrariness and discrimination in governmental decision-making is to promote transparency. The principles work hand in glove to improve the quality of regulatory decision-making.

V. CONCLUSION

When Schwarzenberger first set out his inductive approach to international law, he briefly noted that IEL might be a good candidate for its application. Forty years later, IEL has "grown up," through a proliferation of treaty regimes, jurisprudence and a steadily increasing flow of jurisprudence. The WTO has assumed the role envisaged for the failed International Trade Organization of the postwar Havana Charter. International investment protection has matured as the essentially unenforceable friendship, commerce, and navigation treaties have gradually been replaced by an increasing web of over two thousand BITs, which contain binding investor-state arbitration clauses. When these investment obligations were contained within the multilateral framework of the NAFTA and the Energy Charter Treaty, they were extended between developed economies with heavy cross-border investment flows. The result was the evolution of meaningful self-help for investors.

---

167. GEORG SCHWARZENBERGER, INTERNATIONAL LAW AND ORDER, 89–90, 99–100 (1971).

168. *Id.* at 100.

Investment lawyers have taken advantage of enhanced electronic access to sources of international law, which were heretofore the province of an exclusive clique of scholars and practitioners. They have also taken advantage of the explosion of norm-generation and dispute settlement taking place in the WTO. The time is accordingly right to enunciate some basic principles of substantive IEL, not only because the material now exists for the inductive approach to work, but because this burgeoning body of law will benefit immensely from the structure and coherence that the approach can provide.

NAFTA Article 1105, with its potentially vague reference to "treatment in accordance with international law," is a natural choice for the application of an inductive approach. The NAFTA experience thus far may only establish that Article 1105 requires the same conduct that is required under customary international law. If so, the content of this "minimum standard" may remain elusive to most onlookers. The remedy to this potential problem is to employ an inductive approach to the wealth of IEL material emanating from the WTO and an increasing number of ad hoc investment tribunals.

In any given case, the relevant IEL principles can be employed to interpret what "fair and equitable treatment" or "treatment in accordance with international law" should mean. The resulting tribunal decision would promote coherence and consistency across treaty platforms, permitting individual economic actors greater security and predictability to conduct their activities. Given that enhanced security and predictability are common goals in most international economic agreements, only such a result would be appropriate.

INCREMENTALISM: ERODING THE IMPEDIMENTS TO A GLOBAL PUBLIC PROCUREMENT MARKET

CHRISTOPHER R. YUKINS & STEVEN L. SCHOONER*

ABSTRACT

Following decades of international negotiations and agreements, the world's multi-trillion-dollar public procurement market appears to be maturing into a free, open international market. To reach that point, nations must lower a broad array of barriers to trade in procurement. As the U.S. experience demonstrates, purchasing agencies, laboring under the constraints of domestic preferences, may effectively seek to promote free trade. At the same time, a variety of international organizations, from the World Trade Organization to Transparency International, have developed tools and instruments—including model codes and explicit nondiscrimination agreements—that ease barriers to trade in procurement. To accelerate the erosion of these barriers, this Article suggests assessing progress in four potentially overlapping steps: nondiscrimination, a political decision; harmonization, an effort to coordinate the international instruments; rationalization, an effort to enhance the efficiency of regimes launched under the international instruments; and, institutionalization, an integration of the evolving international procurement norms into the legal fabric of the nations entering the international free market in procurement.

INTRODUCTION

After centuries of isolationism, the world's public procurement markets are emerging as a progressively integrated, open market. This trend accelerates as nations agree—by treaty, agreement, and practice—to open their respective procurement markets to outside competition. Trade liberalization in this sphere remains controversial,[1] as

* Christopher R. Yukins is Associate Professor of Government Contract Law and Steven L. Schooner is Senior Associate Dean for Academic Affairs at The George Washington University Law School. © 2007 Christopher R. Yukins and Steven L. Schooner. Both co-direct the law school's Government Procurement Law Program. Earlier versions of this paper were presented at the GEORGETOWN JOURNAL OF INTERNATIONAL LAW's *Global Sourcing and the Global Lawyer* Symposium (Jan. 2007) and at the WEST-THOMSON GOVERNMENT CONTRACTS YEAR IN REVIEW CONFERENCE (Feb. 2007). The authors acknowledge the generous support of the Seymour Herman Faculty Research Fund in Government Procurement Law, and thank Frederick Lawrence for his support and insights, and Maria Aspiazu and Daniel Greenspahn for their diligent research assistance.

1. Because our focus is limited to public procurement, we do not endeavor here to catalogue the literature favoring free trade. Conversely, we remain cognizant that the free trade literature is

many states, particularly developing nations,[2] fear that opening their markets will expose domestic industries to crushing competition. Experience suggests, however, that by opening their procurement markets, nations serve their own procurement systems and domestic economies by gaining access to a richer and more diverse pool of goods and services, often at more competitive prices. Concomitantly, these states benefit as foreign markets open to their own producers. Opening an increasing number of public procurement markets may be the most important development in procurement today. Although it is an encouraging trend, the process likely will require at least a generation to mature.

As this process unfolds, individual states must identify the barriers to foreign contractor entry posed by domestic procurement rules. Public procurement law—especially the legal regimes that govern public contract formation[3]—often erects a dense, twisted web of rules, which

---

not uniformly accepted. *See, e.g.*, David Wessel & Bob Davis, *Pain From Free Trade Spurs Second Thoughts*, WALL ST. J., Mar. 28, 2007, at A1 (noting that a critique of free trade by economist, former Federal Reserve Board vice chairman, and perennial free-trade advocate, Alan S. Blinder "comes as public skepticism about allowing an unfettered flow of goods, services, people and money across borders is intensifying, including some Republicans as well as many Democrats"). Further,

> [Blinder suggests that] a new industrial revolution—communication technology that allows services to be delivered electronically from afar—will put as many as 40 million American jobs at risk of being shipped out of the country in the next decade or two [, and that's] ... "only the tip of a very big iceberg ...." Mr. Blinder's answer is not protectionism .... He wants government to do far more for displaced workers ... [and h]e thinks the U.S. education system must be revamped so it prepares workers for jobs that can't easily go overseas, and is contemplating changes to the tax code that would reward companies that produce jobs that stay in the U.S.

Id.

2. For example, an informative contrast to the prevalent Western free-trade literature can be found in the India-based Consumer Unity & Trust Society Centre for International Trade, Economics & Environment ("CUTS CITEE"). CUTS CITEE's "philosophy is 'liberalisation yes, but with safety nets.'" *See generally* CUTS Centre for International Trade, Economics & Environment, http://www.cuts-citee.org/.

3. In the United States, clear legal and pedagogical lines distinguish between the *formation* and the *performance* (or administration or management) of a government contract. Briefly, the formation process begins with acquisition planning, revolves around the government's solicitation (e.g., invitation for bids, request for proposals, or request for quotations), depends in large part upon the government's evaluation criteria (e.g., lowest price technically acceptable, best value, or proven past performance), and concludes with the selection of a contractor and award of a contract. Typical legal challenges during all phases of this process—whether alleging inequities or ambiguities in the solicitation, restrictions on competition, or award improprieties—are known as

may impede (and frequently intimidates) potential foreign entrants. As international instruments focused on public procurement emerged over the past few decades, most were intended, at least in part, to ease those artificial barriers to entry.

At a broad, conceptual level, this market-opening initiative appears to proceed in four somewhat irregular phases. First, and perhaps most controversially, states must embrace *nondiscrimination* as a policy that will, on balance, benefit those nations that adopt it. This is a highly political calculation, and it may take decades for some nations to acknowledge and accept it. Second, to facilitate market-opening, the instruments for international cooperation on procurement should be *harmonized.* This nascent process appears to be gaining momentum through various international agreements and structures. Harmonization itself reduces barriers to trade because it reduces transaction costs for vendors crossing borders. Simultaneously, harmonization eases the transition to a common procurement market, based on common instruments. Third, as states harmonize their public procurement instruments, rather than using the *lowest common denominator* (typically, corruption control) as a baseline, these instruments should be *rationalized* to ensure *optimal* procurement functions. Doing so will pay dividends through enhanced efficiency and, at a political level, will lend the rationalized instruments more legitimacy as a tool for development.[4] Fourth, the regulatory regimes shaped by the instruments should be *institutionalized,* to integrate the new rules into the fabric of

---

bid protests or disappointed offeror litigation. Contrast this with the performance phase, in which the contract, replete with standard remedy-granting clauses intended to anticipate every conceivable contingency, defines the contracting parties' responsibilities to, for example, perform a service or deliver a good in exchange for the payment of money, which fulfills the government's obligation and concludes the relationship. Contract disputes that arise during performance may involve, for example, delays, failure to comply with specifications, and modifications to, or termination of, the contract.

4. Two leading economists put the case for efficient procurement markets this way:

> Efficiency in government procurement is of importance in ensuring that the best value for money is obtained by public entities. Procurement practices also figure prominently in the way that many potential investors and civil society view a country. Ensuring transparency of the procurement process is an important determinant of efficiency insofar as it enhances the contestability of public procurement markets (by giving all qualified potential suppliers a chance to bid). If procurement procedures are opaque and discretionary, the incentive for firms to enter into a market are typically reduced. The same problem arises if it is possible for firms to obtain "preferred status" through bribery of officials and potential entrants do not know how to "play by the rules of the game."

each nation's existing procurement law.

Our aim here is not mere advocacy for open procurement markets, although we favor such a result. The case for open public markets, ultimately, is a simple one for economists, agency procurement officials, and elected officials to make. Rather, our modest goal is to describe the critical legal and practical milestones as the historically chaotic and balkanized collection of protectionist public procurement regimes[5] evolves toward a unified, open, and ultimately global market.

Accordingly, we begin, in Part I, by opining that, despite the never-ending succession of acquisition reform initiatives in the United States and abroad, the most significant development in public procurement today may be the incremental opening of an increasing number of public procurement markets across the globe. Although this nascent trend necessarily will span decades, and no doubt will proceed in fits and starts, we are heartened by what we perceive as increasing momentum. For the trend to accelerate, states must not only identify, but overcome, longstanding and often instinctively erected barriers to entry. Part II discusses the identification of individual states' procurement rules that both explicitly and implicitly serve as barriers to foreign firms' entry into those states' domestic procurement markets. Part III traces the role that certain legal and policy instruments may play in opening world procurement markets. We discuss three types of instruments that, intentionally or fortuitously, may liberalize international procurement markets: (1) model procurement codes or model statements of principle; (2) procurement guidelines imposed by central financial institutions; and (3) binding international agreements or directives that require nondiscrimination. Finally, in Part IV, we offer a rubric or four-stage process through which we expect the global procurement market to pass in order to fully achieve openness. These potentially overlapping stages include: (1) acceptance of nondiscrimination (in lieu of protectionism) as a norm; (2) harmonization of the fundamental aspects of public procurement regimes; (3) rationalization of procurement practices in the pursuit of commonly accepted

---

Simon J. Evenett & Bernard M. Hoekman, *International Cooperation and the Reform of Public Procurement Policies* 32 (World Bank Policy Research, Working Paper No. 3720, Sept. 2005), *available at* http://ssrn.com/abstract=821424.

5. Federico Trionfetti, *Discriminatory Public Procurement and International Trade*, 23 WORLD ECONOMY 57, 73 (2000), *available at* http://www.univ-paris13.fr/CEPN/1467_9701_00262.pdf ("[G]overnments exhibit consistently lower import share than the private economy. This evidence supports the hypothesis that government purchases are home biased.").

aspirations for successful procurement regimes, such as achieving value for money, efficiency, and customer satisfaction (rather than, in contrast, wealth distribution); and (4) institutionalization or the incorporation of harmonized, rationalized agreements into the legal fabric of the states that adopt these procurement practices. We optimistically conclude that liberalized procurement markets will enhance the value of money states expend procuring goods and services and, as a result, will provide better service to the constituencies those states ultimately serve.

I. THE IMPORTANCE OF OPENING THE INTERNATIONAL PROCUREMENT MARKET

There are many reasons to open the international procurement market, including, of course, the sheer size of the market and its impact upon both the public and private sectors.[6] The Organisation for Economic Cooperation and Development ("OECD") estimated that total world procurement amounted to approximately $5.5 trillion in 1998.[7] During fiscal year 2007, the United States federal procurement market alone will account for approximately $400 billion,[8] an amount that reflects continued growth on top of the roughly 75 percent increase experienced from FY2000 to FY2005.

As governments increasingly rely upon the private sector to perform governmental functions, we expect this trend of public procurement

---

6. "Government procurement ranges from eight to ten percent of the gross domestic product of major OECD countries, and this share is even larger in developing countries." Hiroshi Ohashi, *Effects of Transparency in Procurement Practices on Government Expenditure: A Case Study of Municipal Public Works*, http://www.mfj.gr.jp/lunch_seminar/documents/ohashipaper.pdf. "Government procurement . . . typically accounts for between 12 and 19% of EU Member State's [GDP]." UK Department of Trade & Industry, http://www.dti.gov.uk/europeandtrade/key-trade-issues/procurement/page23706.html; "Such purchases [of goods, works and services] by public bodies represent about 14% of the EU's total [GDP]." International Local Government Association, Public Procurement, http://international.lga.gov.uk/european_work/democracy/public Procurement/index.html.

7. *See* ORG. FOR ECON. COOPERATION AND DEV., THE SIZE OF GOVERNMENT PROCUREMENT MARKETS 25, 34 (2002) [hereinafter OECD REPORT], *available at* http://www.oecd.org/dataoecd/34/14/1845927.pdf.

8. "Each year Federal agencies spend nearly $400 billion for a range of goods and services to meet their mission needs." ACQUISITION ADVISORY PANEL, REPORT OF THE ACQUISITION ADVISORY PANEL TO THE OFFICE OF FEDERAL PROCUREMENT POLICY AND THE UNITED STATES CONGRESS 1 (Draft Final Report, Dec. 2006) [hereinafter AAP DRAFT REPORT], *available at* http://www.acquisition.gov/comp/aap/documents/DraftFinalReport.pdf. Of course, these figures exclude procurement by the fifty States, municipalities, and regional authorities.

U.S. FEDERAL PUBLIC PROCUREMENT FISCAL YEARS 2000-2005[9]

Fiscal Year	Transactions (in millions)	Dollars (in billions)	Percentage increase
2005	10.8	$382	10.2
2004	10.5	$346	13.5
2003	11.5	$305	22.1
2002	8.65	$250	6.5
2001	11.4	$234	7.3
2000	9.8	$218	–

growth to continue.[10]

By necessity, market-opening agreements typically are reciprocal. Thus, a nation's decision to open its domestic market will almost always increase that nation's firms' access to the vast international public procurement market. More robust opportunities in industrialized nations' procurement markets suggest that developing nations have more to gain from reciprocal access to procurement markets in industrialized nations.[11] The alternative—leaving a domestic market closed—may impose significant costs on the protectionist nation, both in terms of paying higher prices to less efficient domestic firms or, more often, foreclosing access to superior goods and services. Moreover, protection-

---

9. *See* Federal Procurement Data System – Next Generation, https://www.fpds.gov (click on "Trending Analysis Report for the Last 5 Years" link). For more statistical data, see also FedSpending.org, recently created by OMB Watch, at http://www.fedspending.org.

10. The recent draft report from the distinguished Acquisition Advisory Panel chronicled the government's transition, in the span of a single generation, from a purchaser of supplies to a service consumer:

> Services now comprise a greater percentage of the government's acquisition budget. Between 1990 and 1995 the government began spending more on services than goods. Currently, procurement spending on services accounts for more than 60% of total procurement dollars. In FY 2005, DOD obligated more than $141 billion on service contracts, a 72% increase since FY 1999.

AAP DRAFT REPORT, *supra* note 8, at 2-3 (footnotes omitted).

11. *See* OECD REPORT, *supra* note 7, at 23, 25 (noting that in 1998, government expenditures in OECD countries totaled $4.7 trillion versus $0.8 trillion in non-OECD nations); *see also* Bernard M. Hoekman & Petros C. Mavroidis, *The World Trade Organization's Agreement on Government Procurement* 4-5 (World Bank Policy Research, Working Paper No. 1429, Mar. 1995), *available at* http://econ.worldbank.org/external/default/main?ImgPagePK=64202990&entityID=000009265_3970311121546&menuPK=64168175&pagePK=64210502&theSitePK=544849&piPK=64210520.

ist policies ignore the realities of the global marketplace, particularly in the context of commercial items, where firms unavoidably depend upon a global supply chain. While the topic remains unsettled and controversial,[12] past studies have identified welfare losses in those countries with high barriers to procurement trade.[13] Indeed, as the U.S. experience discussed below shows, customer agencies may resist domestic preferences more aggressively than their elected leadership, as they more acutely feel the pinch of those welfare losses.

II. PROCUREMENT RULES AS (INHERENTLY UNSTABLE) BARRIERS

Procurement rules serve as explicit and implicit barriers to foreign firms' entry into domestic procurement markets. Professor Sue Arrowsmith's authoritative text, *Government Procurement in the WTO*, describes four relevant categories of procurement rules that serve as barriers to nations' procurement markets. These are: (1) measures to provide domestic industry with a competitive advantage; (2) secondary objectives of a non-economic nature; (3) illegitimate practices including corruption, nepotism, and patronage; and, (4) conventional domestic procurement rules concerned with the "commercial" aspects of procurement and efforts to achieve an efficient domestic procurement process.[14] Drawing on the U.S. experience, we employ this conceptual structure to demonstrate why fissures are emerging in these rules-based barriers.

---

12. *See, e.g.*, Hoekman & Mavroidis, *supra* note 11; SIMON J. EVENETT & BERNARD HOEKMAN, THE WTO AND GOVERNMENT PROCUREMENT (2006) (providing a very accessible review of the economic literature on discrimination in procurement); George Deltas & Simon J. Evenett, *Quantitative Estimates of the Effects of Preference Policies* (2000), *reprinted in* EVENETT & HOEKMAN, *supra*, at 302 ("price preference policies generate at best only marginal improvements in social welfare .... However, even small price preferences are found to generate substantial increases in the domestic firm's expected profits ...."); Vivek Srivastava, *India's Accession to the Government Procurement Agreement: Identifying Costs and Benefits* (2003), *reprinted in* EVENETT & HOEKMAN, *supra*, at 460.

13. *See, e.g.*, OECD REPORT, *supra* note 7, 15-17 (reviewing literature on costs of domestic preferences); SUE ARROWSMITH, GOVERNMENT PROCUREMENT IN THE WTO 8-11 (2003); *see* Robert E. Baldwin & J. David Richardson, *Government Purchasing Policies, Other NTB's, and the International Monetary Crisis* (1972), *reprinted in* EVENETT & HOEKMAN, *supra* note 12, at 235 (economic modeling to show relatively marginal impact of U.S. procurement preferences on overall trade deficit); Aaditya Mattoo, *The Government Procurement Agreement: Implications of Economic Theory* (1996), *reprinted in* EVENETT & HOEKMAN, *supra* note 12, at 276 (predicting that GPA members may be willing to forego nondiscrimination in favor of other transparency and efficiency gains as other nations join GPA).

14. *See* ARROWSMITH, *supra* note 13, at 13-19.

A. *Measures to Protect Domestic Industry: Assessing Developments Under the Berry Amendment's Specialty Metals Ban*

One common form of trade barrier is those explicit *measures to provide domestic industry with a competitive advantage over foreign competitors.* Historically, "the United States operated significant overt policies, generally embodied in legislation"—the Buy American Act[15] is the most obvious example—"whilst the policies of many of its major trading partners, including most European states, were more covert."[16] The obvious preferences (and barriers) raised by the Buy American Act have, for the most part, been overtaken by the United States' obligations under the World Trade Organization (WTO) Government Procurement Agreement, discussed below.[17]

Throughout the U.S. procurement system, however, less obvious domestic preferences continue to thrive.[18] Recently, for example, the U.S. Congress made substantial revisions to the Berry Amendment,[19] a decades-old piece of legislation which requires the U.S. Department of Defense to purchase certain items only from U.S. producers, including

15. *See generally* 48 C.F.R. § 25.100-.105 (citing 41 U.S.C. §§ 10a - 10d and Exec. Order 10582 (Dec. 17, 1954)). Title 48 of the C.F.R. is the Federal Acquisition Regulation (FAR) system, "established for the codification and publication of uniform policies and procedures for acquisition by all executive agencies. The Federal Acquisition Regulations System consists of the . . . [FAR], which is the primary document, and agency acquisition regulations that implement or supplement the FAR." 48 C.F.R. § 1.101. The current, official version of the FAR is available online through Acquisition Central, *www.acquisition.gov,* the Federal government's single-point-of-entry for the acquisition community, at http://www.acquisition.gov/far/.

16. ARROWSMITH, *supra* note 13, at 15.

17. See *infra* text accompanying notes 127-31.

18. *See* Steven L. Schooner, *Desiderata: Objectives for a System of Government Contract Law,* 11 PUB. PROC. L. REV. 103 (2002).

> [W]ealth distribution is merely a subset of the larger phenomenon of burdening the procurement process (or, for that matter, the process of governing) with efforts to promote social policies. These social policies, in addition to those that potentially distribute wealth to domestic manufacturers, essential military suppliers, and small (and small disadvantaged and women-owned) businesses, also mandate drug-free workplaces, occupational safety standards, compliance with labor laws, [and] preferences for environmentally friendly purchasing practices . . . .

Id. at 108 n.28.

19. The so-called Berry Amendment was handled as an amendment to appropriations acts for many years, until Congress passed section 832 of the National Defense Authorization Act for Fiscal Year 2002, Pub. L. 107-107, 115 Stat. 1012, 1019 (codified at 10 U.S.C. § 2533(a) (2007)).

clothing and specialty metals, the subject of recent legislation.[20]

With regard to specialty metals, the Berry Amendment poses enormous compliance challenges for the Department of Defense and its contractors.[21] Titanium and certain alloys, for example, are critical to the sophisticated electronics and weapons systems regularly procured by the U.S. military. Yet these and other specialty metals covered by the current ban are often, according to industry, difficult to access in the domestic U.S. market, and the Defense Department has scrambled to make sense of the Berry Amendment's blanket ban.[22]

1. A Troubling but Informative Anecdote

The Berry Amendment's ban on specialty metals offers an interesting case study in domestic-content requirements for several reasons. First, because it calls for domestic specialty metals in a highly mechanized military, the requirement intrudes into almost every corner and crevice of the defense complex, wherever specialty metals are used—from aircraft to weapons to computers. Unlike other domestic-content requirements that simply lend domestic products a price preference (such as the requirements of the Buy American Act), the Berry Amendment wholly bars the Defense Department from buying any item that contains foreign specialty metals absent exceptional circumstances. Second, the pervasive impact of the absolute bar against foreign specialty metals divides the U.S. specialty metals industry from the Defense Department and its major contractors.[23] Third, the debate shows how a global economy reorders the politics of domestic prefer-

20. *See* Christopher R. Yukins, Feature Comment, *Procurement Reform in the Defense Authorization Act for Fiscal Year 2007—A Creature of Compromise, Pointing the Way to Future Debates*, 48 GOV'T CONTRACTOR ¶ 367 (2006). *See generally* John W. Chierichella & David S. Gallacher, Feature Comment, *Specialty Metals and the Berry Amendment—Frankenstein's Monster and Bad Domestic Policy*, 46 GOV'T CONTRACTOR ¶ 168 (2004).

21. This is not the first time that aspects of the Berry Amendment have bedeviled the defense procurement process. *See generally* Steven L. Schooner, Feature Comment, *Buying the "Black Beret": Balancing Customer "Needs" and Socio-Economic Policies*, 43 GOV'T CONTRACTOR ¶ 158 (2001) (discussing a congressional mandate involving domestic manufacture of military uniform items).

22. *See, e.g., Air Force Failed to Follow Policy on Berry Amendment Waivers*, 2 INT'L GOV'T CONTRACTOR ¶ 79 (2005).

23. *See* Roxana Tiron, *U.S. Titanium Industry Defending its Territory*, THE HILL, Mar. 16, 2006, *available at* http://www.hillnews.com/thehill/export/TheHill/News/TheExecutive/031606_titanium.html; Roxana Tiron, *Specialty-Metals Industry Clashes with Defense Giants, Pentagon*, THE HILL, May 16, 2006, *available at* http://www.hillnews.com/thehill/export/TheHill/Business/051606_barry.html; Roxana Tiron, *Glint of Steel in Clash over Specialty Metals*, THE HILL, June 13, 2006, *available at* http://www.hillnews.com/thehill/export/TheHill/Business/061306_berry.html.

ences. Traditionally, most domestic-content requirements have left purchasing agencies uneasily allied with domestic industry. The agencies typically have been willing to bear the additional costs of domestic preferences in order to further other social or political goals. Now, as is discussed below, purchasing agencies' new decision to demand flexibility (rather than slavishly adhere to a domestic preference mandate) highlights the internal fissures that undermine traditional domestic preferences. Agencies and contractors, under pressure to utilize the collective strength of a global supply chain, cannot indefinitely abide arbitrary political demands to accommodate self-interested domestic industries.

2. A Tortured History

The Berry Amendment's absolute bar against specialty metals is so severe and disruptive that the Defense Department has shifted to a stance of cautious opposition to the ban.[24] Throughout 2006, while proposed legislation to amend the Berry Amendment remained stalled in Congress, the Defense Department issued a number of guidance documents to its agencies, and to its contractors, as they struggled to comply with the specialty metals ban.

In February 2006, the U.S. Defense Contract Management Agency (DCMA) issued guidance, updated in March, which emphasized that foreign specialty metals would *not* be accepted in items delivered to the Defense Department, but that—in very limited circumstances—items that contained "nonconforming" specialty metals could be accepted "conditionally," with a corresponding reduction in price.[25] In June 2006—after the House had passed proposed expansions to the specialty metals ban—senior leadership in the Defense Department endorsed the earlier DCMA guidance.[26] The Defense Department's statement of position reflected its continuing concern with the Berry Amendment ban. Although the Under Secretary of Defense acknowl-

---

24. *See* Office of Mgmt. & Budget, Executive Office of the President, Statement of Administration Policy: S. 2766—National Defense Authorization Act for Fiscal Year 2007, at 2 (2006), *available at* http://www.whitehouse.gov/omb/legislative/sap/109-2/s2766sap-s.pdf (indicating Bush administration support for Section 823 of the Senate defense authorization bill, which would have provided limited authority to waive domestic content requirements).

25. *See* DCMA, Interim Instruction, Noncompliance with the Preference for Specialty Metals Clause, DFARS 252.225-7014 (Feb. 2006/rev. Mar. 10, 2006), *available at* http://guidebook.dcma.mil/225/instructions.htm.

26. *See* Memorandum from U.S. Under Secretary of Defense Kenneth J. Krieg (June 1, 2006), *available at* http://guidebook.dcma.mil/225/dc06-183USD(AT&L).pdf.

edged "that certain specialty metal parts used in the performance of some defense contracts may be non-compliant with the Berry Amendment," he emphasized that "in some cases, the delay that would be caused by immediately pursuing certain remedies may seriously impact our ability to meet military needs."[27] In memoranda dated August 18, 2006 and September 21, 2006,[28] Shay Assad, the Director of Defense Procurement and Acquisition Policy, issued guidance to Defense agencies on accepting items with non-compliant specialty metals. The August 2006 memorandum acknowledged that compliance could lead to higher costs, and the September 2006 memorandum noted that contractors may be unable to trace their supply chains completely, to keep out all "foreign" specialty metals in items delivered to the Defense Department. Taken together, the 2006 guidance made clear the Defense Department's concern that the specialty metals ban was expensive and disruptive.

Indeed, in a May 2006 statement the Bush administration threatened to veto a draft defense authorization bill that would have substantially broadened the Berry Amendment's requirements if the domestic preferences were enhanced, an extraordinary threat to a then-Republican Congress, in a time of war:

> The Administration strongly opposes legislative provisions . . . that would undermine the longstanding U.S. policy—repeatedly affirmed by Congress—to open U.S. procurement markets to suppliers from allied and friendly countries that open their procurement markets to U.S. suppliers. These sections could jeopardize our military readiness when our objective should be to enhance our ability to get the best capability for the warfighter at the best value for the taxpayer. Such provisions would restrict U.S. suppliers' access to foreign markets; would decrease competition; increase costs for U.S. taxpayers; and unnecessarily add red tape to the procurement process. DoD suppliers rely on global supply chains for materials, often without knowing the country of origin. . . . These . . . sections, which would require domestic sources for all critical items, fail to

27. *Id.*

28. *See* Memorandum from Shay D. Assad, Director, Defense Procurement and Acquisition Policy to Commander, U.S. Special Operations (Aug. 18, 2006), *available at* http://www.acq.osd.mil/dpap/policy/policyvault/2006-1445-DPAP.pdf; Memorandum from Shay D. Assad, Director, Defense Procurement and Acquisition Policy to Commander, U.S. Special Operations (Sept. 21, 2006), *available at* http://www.acq.osd.mil/dpap/policy/policyvault/2006-1788-DPAP.pdf.

> recognize that it is acceptable to rely on dependable foreign sources from allied and friendly countries for many critical items. Unwillingness to rely on such dependable foreign sources would undermine future efforts to build coalitions. . . . In addition, Section 1211 would prohibit procurements from any entity that has exported or transferred certain items linked to the U.S. Munitions List to the People's Republic of China, causing irreparable damage to DoD's efforts to implement a strategy of world-wide engagement with allies and friendly nations. *If the President is presented a bill that includes such provisions, his senior advisors will recommend that he veto the bill.*[29]

As the Bush administration's message reflected, practical and political demands pushed the specialty metals ban directly into the colliding paths of domestic preferences and policy. Despite strong congressional support for the domestic specialty metals industry, the Bush administration fought hard to reduce barriers to the U.S. procurement market because of the forces aligned *against* the specialty metals preference: the need for U.S. agencies to access foreign materials; the additional costs and inefficiency that the preference forces on U.S. prime contractors and their international supply chains (costs that ultimately the United States itself must bear, in large part); and, finally, the severe impact that domestic preferences can have on U.S. foreign policy, which increasingly relies on strong international alliances. This "new triumvirate"—U.S. agencies drawing aggressively on foreign suppliers, a globalized U.S. contractor community, and potentially angry foreign allies—make the Berry Amendment's specialty metals preference inherently unstable.

The Defense Department's opposition to the specialty metals ban forced Congress to revisit the requirement. Caught between competing demands from defense suppliers, the specialty metals industry, and the Defense Department itself, Congress compromised. The John Warner National Defense Authorization Act for fiscal year 2007,[30] which President George W. Bush signed into law on October 17, 2006, contained

29. Office of Mgmt. & Budget, Executive Office of the President, Statement of Administration Policy: H.R. 5122—National Defense Authorization Act for Fiscal Year 2007, at 2 (2006) (emphasis in original), *available at* http://www.whitehouse.gov/omb/legislative/sap/109-2/hr5122sap-h.pdf.

30. John Warner National Defense Authorization Act of 2007, Pub. L. No. 109-364, 120 Stat. 2083 (2006).

several measures intended to ease the Berry Amendment's ban.[31]

Specifically, Section 842 of the act established a new specialty metals provision, which "carved out" specialty metals from the other Berry Amendment prohibitions (textiles, etc.).[32] The new statute defined specialty metals in accord with standing Defense Department rules,[33] but left open the possibility that other metals will be added in the future based on studies of critical materials by a special board created in the Department of Defense. The new statute gave the Defense Department authority to waive the specialty metals ban if insufficient domestic specialty metals are available or if contractors could reasonably explain noncompliance. The statute also exempted smaller procurements (under $100,000), purchases of electronic components of "de minimis" value, and sole-source procurements done under "unusual and compelling urgency."[34]

Most importantly from an international trade perspective, the new statute left in place the exemptions created by treaty and agreement for those specialty metals incorporated into defense items in qualifying nations. This is an anomalous and telling exception in a highly-industrialized nation,[35] for it means that the specialty metals ban does *not* impede U.S. trading partners' in exporting *completed defense items* to the United States, even if those items contain foreign specialty metals. Instead, the ban is meant to—and does—impede only transnational trade in a material, *i.e.,* specialty metals.

In passing the new statute, however, Congress opted not to treat the Berry Amendment as a blunt tool to enrich the domestic specialty metals industry—that would be difficult to sustain politically, given the disruption it causes defense production—but rather as a means of ensuring U.S. access to specialty metals in a time of war. As an extension of that "supply chain" rationale, Congress created a new board that will assess the strategic imperatives for the specialty metals ban. Congress' new emphasis on sheltering a strategic supply chain, rather than simply protecting U.S. industry, arguably set a new tone in domestic preferences, one that may shape future policy debates. Unfortunately, the legislation also left a number of questions unanswered.

On December 6, 2006, Shay Assad, Director of Defense Procurement

31. *See generally* Chierichella & Gallacher, *supra* note 20.

32. 10 U.S.C. § 2533(b) (2006).

33. *See* Defense Federal Acquisition Regulation Supplement (DFARS), 48 C.F.R. § 252.225-7014 (2007).

34. *See generally* Yukins, *supra* note 20.

35. *See, e.g.*, Chierichella & Gallacher, *supra* note 20.

and Acquisition Policy, issued guidance to implement the new legislation. This guidance, issued in the form of a class deviation[36] to existing regulations,[37] will remain in place until rescinded or supplanted by a revised regulation.[38] The new guidance resolves several ambiguities in the recent defense authorization act, though it is almost certainly not the last word on this topic.

3. Tiering: Enhanced Complexity Rather Than Optimal Policy?

The December 6, 2006 class deviation created a curious "tiering" of specialty metals compliance, which seems to borrow loosely from other domestic-content regimes. It is reminiscent of the Federal Transit Administration's "Buy American" regulations, for example, which require that all manufactured products used in federally funded projects be manufactured in the United States, and that all *components* of those manufactured products—but not necessarily all *sub*components—also be of U.S. origin.[39] The tiers would apply to contracts in six key categories of contracts: (1) aircraft, (2) missile and space systems, (3) ships, (4) tank and automotive items, (5) weapon systems, and (6) ammunition.[40] The new "tiering" prescription, taken in conjunction with the Alternate I version of a new Defense Federal Acquisition Regulation Supplement (DFARS) clause,[41] to be used in the six key

---

36. "Class deviations affect more than one contract action. When an agency knows that it will require a class deviation on a permanent basis, it should propose a FAR revision, if appropriate. Civilian agencies, other than NASA, must furnish a copy of each approved class deviation to the FAR Secretariat." FAR 1.404, 48 C.F.R. § 1.404 (2007).

37. *See* Memorandum from Shay D. Assad, Director, Defense Procurement and Acquisition Policy to Commander, U.S. Special Operations, re: DAR Tracking No. 2006-O0004 (Dec. 6, 2006), *available at* http://www.acq.osd.mil/dpap/policy/policyvault/2006-2051-DPAP.pdf.

38. *See, e.g.*, David M. Nadler, Harvey G. Sherzer & Michael C. Mateer, Feature Comment, *New Department of Defense Berry Amendment Guidance—Some Answers and More Questions*, 48 GOV'T CONTRACTOR ¶ 435 (2006).

39. *See* 49 C.F.R. § 661.5(d)(2) (2007).

40. These six categories date back at least to the early 1970s, when then-Secretary of Defense Melvin Laird focused Berry Amendment specialty metals enforcement on these categories because they encompass most of the specialty metals purchased by the Defense Department.

41. DFARS 252.225-7014, 48 C.F.R. § 252.225-7014 (deviation). As is noted further below, the controversy over specialty metals is likely to continue for some time. The Defense Department's December 2006 action was followed by Defense Department "non-availability" determinations that there were not adequate domestic sources of specialty metals for circuit cards and fasteners; those determinations are available at http://guidebook.dcma.mil/225/instructions.htm ("cancel" password). The House Armed Services Committee responded in May 2007 with a number of provisions which seemed specifically intended to constrain the use of foreign specialty metals. *See* National Defense Authorization Act for Fiscal Year 2008, H.R. 1585, 110th Cong., 1st Sess. (as

categories of contracts, mean that the Berry Amendment specialty metals ban will extend only to:

- End products, *i.e.*, supplies delivered under a line item of a contract;
- "First-tier components," defined as "first-tier parts and assemblies that are incorporated directly into the end product"; and
- "Second-tier components," in turn defined as parts and assemblies "that are incorporated directly into a first-tier component."

The Defense Department's "tiering" approach also follows the conceptual structure of the Federal Acquisition Regulation (FAR), which defines "end products" ("articles, materials, and supplies to be acquired for public use") and "components" ("an article, material, or supply incorporated directly into an end product")[42]—though the FAR definition does not seem to contemplate "second-tier" components.

The "tiering" approach adopted by the Defense Department may reflect a practical concern that haunts the Berry Amendment specialty metals requirements: the concern, for example, that a small bolt containing Russian titanium, if installed in an otherwise compliant fighter jet, could disrupt delivery of that aircraft. By applying the Berry Amendment ban only to "end products" and "first- and second-tier" components, the Defense Department's latest guidance avoids that practical concern because the small "noncompliant" bolt in our example presumably would not fall into any of those categories.

Even this simple example of the Russian titanium bolt, however, exposes how hard the Defense Department strained to accommodate dueling demands—legislative protectionism and a global supply chain. The example suggests that the compromise drawn by the Defense Department ultimately may not be sustainable. How is one to determine whether the hypothetical "noncompliant" bolt is a "first-tier" or "second-tier" component? Unlike an "end product," which one assumes would be listed in a contractual schedule of items to be delivered, assigning "tiers" to components is a hugely subjective exercise.

---

reported out of the House Armed Services Committee, May 11, 2007), at § 809 (which would "clarify" requirements relating to specialty metals), § 845 (which would "level" the competitive advantage enjoyed by certain foreign users of specialty metals), and § 846 (which would call for formal rulemaking before the DoD exempted contracts from specialty metals requirements on a class basis). The Bush administration threatened to veto the legislation if it passed with these domestic preferences in place. *See* Statement of Administration Policy, H.R. 1585—National Defense Authorization Act for Fiscal Year 2008, at 1 (May 16, 2007), *available at* http://www.whitehouse.gov/omb/legislative/sap/110-1/hr1585sap-h.pdf.

42. 48 C.F.R. § 25.003 (2007).

The examples provided with the December 2006 class deviation indicate that "tiers" do *not* correspond to levels of prime- and subcontractors; thus, per the example provided by the Defense Department, a *prime* contractor may contract for and deliver to the government a "first-tier component." The examples suggest that first- and second-tier components are instead defined *functionally*, rather than by the level of contractor (or subcontractor) supplying the item. The Defense Department guidance states that a first-tier component (a rocket motor, in the example) is incorporated directly into an end product (the rocket), and a second-tier component (a power supply for the rocket motor, in the example) is incorporated directly into a first-tier component. This "functional" approach makes a great deal of sense, for if the Defense Department had taken a "contractor-tier" approach—if, for example, materials from "third-tier" subcontractors automatically qualified as "third-tier" components (and thus fell outside the Berry Amendment ban)—prime contractors would simply fragment the supply chain into many more contractual layers in order to avoid Berry Amendment compliance costs.

On its face, this "functional" approach also seems simple to implement: it merely means identifying "end products" to be delivered under a contract, and then, like unpacking Russian *matryoshka* dolls, determining which "tier" of component may include noncompliant specialty metals. Under the Defense Department class deviation, only the first and second tiers of components will be relevant.

In fact, however, the Defense Department's "tiering" approach leaves a great deal of uncertainty. In a highly complex weapon system, it is often very difficult to determine at what "tier" a specific item falls. Is a "tier" an aircraft door or the aircraft's entire fuselage, for example? This uncertainty will generate substantial costs and inefficiencies as contractors and suppliers haggle over the metaphysics of "tiers" in order to allocate the risks and costs of Berry Amendment compliance.

At the same time, however, the uncertainty in interpretation will leave the Defense Department and its contractors significant flexibility in interpreting the Berry Amendment's specialty metals ban—flexibility that ultimately may allow for narrow interpretations of the ban. The confusion over defining "tiers" of components also means that it will be difficult to punish noncompliance as fraud, a threat which normally cows contractors into strict compliance in the U.S. system. In the end, the Defense Department's decision to inject flexibility into Berry Amendment compliance reflects the internal fissures that undermine traditional domestic preferences: agencies and contractors, under pressure to draw on a global supply chain, are resisting political

demands to accommodate domestic industries.

B. *Secondary, Non-Economic Objectives As Barriers: Assessing Accessibility Requirements in Information Technology*

The next category of rules-based barriers is secondary objectives of a non-economic nature. As Arrowsmith describes them, "[s]econdary policies (or, in United States terminology, 'collateral' policies) are those that do not relate to the main object of the procurement . . . for example, a policy of placing government contracts with disadvantaged ethnic groups to promote racial equality."[43] These "secondary" or "collateral" policies, which typically are used to identify favored contractors, or weigh in the decision to award a contract, can erect substantial barriers to entry to a procurement market. Intentionally or not, these collateral policies may discriminate in favor of domestic industry. Furthermore, when integrated into a complex procurement process, collateral policies almost invariably increase contracting officials' discretion, and thus diminish transparency and increase the threat of corruption.[44]

One intriguing example in this sphere is the collateral (or "secondary") procurement policy of requiring that government agencies generally purchase only information technology that is accessible to persons with disabilities. This requirement, now enshrined in U.S. federal procurement rules,[45] proves particularly relevant because the European Union is considering a similar accessibility requirement for

---

43. ARROWSMITH, *supra* note 13, at 15, 325-26.

44. *Id.* at 327; *see also* Schooner, *supra* note 18.

> It is axiomatic that government spending can influence behaviour and infuse growth in communities and economic sectors. Conversely, efforts to redistribute wealth through the procurement system, by their very nature, restrict competition.... [A]s various constituencies or special interest groups compete for their perceived "fair share of the pie," others are left wanting.

Schooner, *supra* note 18, at 108-9.

45. *See generally* John J. Pavlick & Rebecca Pearson, *Implementing the New 508 Accessibility Standards for the Disabled*, 36 PROCUREMENT LAW. 1 (Spring 2001); Aaron P. Silberman, *Recent Developments in Section 508 Disabled Access Requirements for IT Procurements*, 40 PROCUREMENT LAW. 19 (Spring 2005); Sheila C. Stark, Feature Comment, *The FAR Rule on EIT Accessibility Under Section 508—Nine Months Later*, 44 GOV'T CONTRACTOR ¶ 149 (2002); Christopher R. Yukins, *Making Federal Information Technology Accessible: A Case Study in Social Policy and Procurement*, 33 PUB. CONT. L.J. 667 (2004).

procurements in its member states.[46]

As in the United States, the goal of the European effort is to leverage government procurement to increase accessibility across the information technology marketplace, both inside and outside government.[47] The European "eAccessibility" initiative, like the accessibility initiative in the U.S. procurement system, is thus a typical "collateral" policy imported into the procurement system: a social goal carried out through the procurement process, but not directly related to the procurement system's core mission. Although the European initiative is several years behind the United States' effort, there is every indication that the European Union will follow much the same path, and promulgate technical standards for accessibility that European agencies will have to follow in purchasing information technology and communications equipment. The U.S. experience is therefore important in predicting the trade impact that a matching regime might have in Europe.

In principle, the U.S. accessibility requirements could have proven terribly discriminatory against foreign suppliers. Unlike the European initiative, which seeks to build on harmonized international accessibility standards,[48] the U.S. accessibility standards-writers did not simply rely on industry standards, but in many instances crafted their own specific standards under Section 508 of the Rehabilitation Act.[49] Foreign vendors thus faced a real risk that their electronics and information technology products, not developed in accordance with the unique U.S. standards under Section 508, would be excluded from the U.S.

---

46. *See* Press Release, European Commission, How Information and Communications Technologies Can Be Made More Accessible for EU Citizens: Frequently Asked Questions, EC MEMO/05/320 (Sept. 15, 2005); *Communication from the Commission to the Council, eAccessibility*, at 9-10, COM (2005) 425 final (Sept. 13, 2005), *available at* http://eur-lex.europa.eu/LexUriServ/site/en/com/2005/com2005_0425en01.pdf.

47. *See, e.g.*, *European Commission Standardisation Mandate to CEN, CENELEC and ETSI in Support of European Accessibility Requirements for Public Procurement of Products and Services in the ICT Domain*, at 2, EC Mandate M376 (Dec. 7, 2005) ("The inclusion of accessibility requirements in public procurement will constitute an incentive for manufacturers to develop and to offer accessible devices, applications and services, which in turn will benefit people with disabilities and older people but also will be to the benefit of other users."), *available at* http://europa.eu.int/information_society/policy/accessibility/deploy/pubproc/eso-m376/a_documents/m376%20en.pdf.

48. *See* European Commission, *eAccessibility*, *supra* note 46, at 10 (European Commission seeks to work with United States and other international partners "on harmonisation of eAccessibility requirements for public procurement"); European Commission, EC Mandate M376, *supra* note 47 (European standards for accessibility will look to international standards).

49. *See* 65 Fed. Reg. 80500, 80510 (Dec. 21, 2001) (codified at 36 C.F.R. pt. 1194).

procurement market.

In practice, however, the U.S. accessibility standards proved less restrictive than expected for both domestic and foreign vendors. The U.S. accessibility standards were overtaken by changes in technology and hampered by their incompatibility with emerging international standards.[50] The accessibility standards left numerous loopholes for agencies and vendors,[51] and in implementing the standards in procurement, agencies have not been aggressive in forcing accessibility.[52] Vendors, for their part, have proven reluctant to challenge agencies or competitors on accessibility through bid protests or otherwise.

The agencies' slow implementation of accessibility requirements may be due to the sheer complexity of the standards, but is also likely due, in part, to agencies' resistance to "collateral" policies that distract from the agencies' core missions.[53] For many of the same reasons that agencies resist traditional domestic preferences such as the Berry Amendment's specialty metals ban—agencies' reluctance to incur additional costs, suffer delay, or lose focus in procuring best value—agencies are likely to resist collateral (or "secondary") policies in procurement. This is not, of course, to argue that collateral policies are not important in procurement, or to suggest that they will not work, in practice, to discriminate against foreign suppliers, which are generally less familiar with how those policies are implemented in procurement systems. The point instead is that the protectionist impact of these discriminatory collateral policies—and the impulse to accommodate them in the first place—will likely be muted by agencies' stubborn reluctance to implement preferences and policies that are not, at bottom, the agencies' own.

C. *"Illegitimate Practices" as a Barrier to Entry: The Boeing-Druyun Debacle*

The third category of barriers to procurement markets stems from "illegitimate practices." This category, Arrowsmith argues, "consists of corruption, nepotism and patronage (the use of procurement to

50. *See* Wade-Hahn Chan, *Advisory Committee Faces Major Hurdles with Section 508 Revision*, FED. COMPUTER WK., Nov. 15, 2006, *available at* http://www.fcw.com/article96831-11-15-06-Web.

51. *See, e.g.*, Yukins, *supra* note 45, at 704-8.

52. *See, e.g.*, Randall Edwards, *Fed Sites Lack Accessibility*, FED. COMPUTER WK., Oct. 21, 2003, *available at* http://www.fcw.com/article81271-10-21-03-Web; William Matthews, *One Year and Counting: Section 508*, FED. COMPUTER WK., June 24, 2002, *available at* http://www.fcw.com/article77009.

53. *See* Margaret A.T. Reed, *Agencies Still on the Learning Curve*, FED. COMPUTER WK., Aug. 11, 2003, *available at* http://www.fcw.com/article80520-08-11-03-Print.

reward political supporters)." Most of these practices are patently illegal and unethical, which sets them apart from the generally legal discriminatory practices discussed above, such as traditional domestic-content requirements and "collateral" socioeconomic policies. Corruption, in contrast, is clearly illegal. Patronage, however, makes a harder case; Arrowsmith points out "in the case of patronage the line between the legitimate and the illegitimate uses of procurement may be difficult to draw and is different in different national systems."[54]

The corruption of Darleen Druyun, a senior U.S. Air Force procurement official, captured the attention of the U.S. procurement community[55] and prominently illustrated discriminatory illegitimate practices.[56] Ms. Druyun was the senior civilian procurement official in the Air Force, and had accumulated extraordinary powers over the decades she spent in its procurement system.[57] As part of a broader investigation into an Air Force procurement involving a potential lease of refueling tankers—driven, in part, by Senator John McCain's (R-AZ) concern for apparent waste in the procurement—it emerged that Ms. Druyun had negotiated her later employment with the Boeing Com-

---

54. ARROWSMITH, *supra* note 13, at 16.

55. *See, e.g.*, Jeffrey Branstetter, *Darleen Druyun: An Evolving Case Study in Corruption, Power, and Procurement*, 34 PUB. CONT. L.J. 443 (2005); *see, e.g.*, *Lockheed Martin Corp.*, Comp. Gen. B-295402, 2005 Comp. Gen. Proc. Dec. ¶ 24 (Feb. 18, 2005), *available at* http://frwebgate.access.gpo.gov/cgi-bin/useftp.cgi?IPaddress=162.140.64.21&filename=295402.pdf&directory=/diskb/wais/data/gao_comptroller_general.

56. Sadly, the Druyun scandal proved a mere harbinger for, among others, Representative Randy "Duke" Cunningham, who:

> demanded, sought, and received at least $2.4 million in illicit payments and benefits . . . including cash, checks, meals, travel, lodging, furnishings, antiques, rugs, yacht club fees, boat repairs and improvements, moving expenses, cars, and boats; . . . used his public office and took other official action to pressure and influence [DoD] personnel to award and execute government contracts in a manner that would benefit [his coconspirators] . . . because of his receipt of the above-described payments and benefits, and not because using [these firms] was in the best interest of the country[.]

Plea Agreement for Defendant Randall Harold Cunningham, *United States v. Cunningham*, Crim. No. 05cr2137-LAB (S.D. Cal. Nov. 23, 2005), *available at* http://news.findlaw.com/wp/docs/crim/uscnnghm112805plea.pdf. Even before it became clear that the sensational Cunningham allegations were true, it was apparent that a strong message regarding the importance of integrity was not emanating from the highest levels of government. *See, e.g.*, Steven L. Schooner, Viewpoint, *Procurement Proper*, 37 GOV'T EXEC. 70 (Aug. 15, 2005), http://www.govexec.com/features/0805-15/0805-15advp.htm.

57. *See, e.g.*, Leslie Wayne, *The Scandal of the Pentagon's "Dragon Lady,"* INT'L HERALD TRIB., Oct. 9, 2004, at 16.

pany at the same time she was negotiating with Boeing on the tanker procurement, in violation of 18 U.S.C. § 208. She pleaded guilty and served nine months in federal prison. Boeing ultimately paid a record fine of $615 million to resolve various allegations stemming from procurement improprieties, including its dealings with Ms. Druyun.[58]

For our purposes here, the Druyun case is interesting because she improperly and corruptly favored Boeing, a domestic supplier, over a foreign supplier, European Aeronautic Defense and Space Company (EADS).[59] But it was not discrimination against a foreign supplier that landed Ms. Druyun in prison. Rather, it was the *corruption, her personal self-dealing*, that triggered the discrimination and landed Ms. Druyun in jail. Indeed, any discriminatory favoritism Ms. Druyun afforded Boeing would have been against a backdrop of fervent domestic support for Boeing, a leading U.S. manufacturer.[60] What the Druyun case illustrates is that an anti-corruption legal regime—even one as strong and mature as that of the United States'—can attack only corruption, and can do little (if anything) to dissipate anti-foreign discrimination that can, in effect, block access to a procurement market.[61] The good news,

---

58. *See, e.g.*, Press Release, U.S. Dep't of Justice, Boeing to Pay United States Record $615 Million to Resolve Fraud Allegations (June 30, 2006), http://www.usdoj.gov/opa/pr/2006/June/06_civ_412.html; Tony Capaccio & Robert Schmidt, *Boeing to Pay Record Settlement*, S. FLA. SUN-SENTINEL, July 1, 2006, at 14B.

59. *See* Supplemental Statement of Facts, *United States v. Druyun*, Crim. No. 04-150-A, at 2-3 (E.D. Va. 2004), *available at* http://www.govexec.com/pdfs/druyunpostpleaadmission.pdf. According to this document,

> In negotiations with Boeing concerning the lease agreement for 100 Boeing KC 767A tanker aircraft, the defendant agreed to a higher price for the aircraft than she believed was appropriate. The defendant did so, in her view, as a "parting gift to Boeing" and because of her desire to ingratiate herself with Boeing, her future employer. The defendant also now acknowledges providing to Boeing during the negotiations what at the time she considered to be proprietary pricing data supplied by another aircraft manufacturer [presumably EADS].

Id.; George Cahlink, *Ex-Pentagon Procurement Executive Gets Jail Time*, GOV'T EXEC., Oct. 1, 2004, *available at* http://www.govexec.com/dailyfed/1004/100104g1.htm.

60. *See* James Wallace, *Tanker Wars: Boeing Challenged*, SEATTLE POST-INTELLIGENCER, June 1, 2006, at A1, *available at* http://seattlepi.nwsource.com/business/272243_tankers01.html.

61. European aerospace executives and trade proponents must have been troubled, for example, when Senator John McCain released a number of e-mails related to the Boeing tanker-lease deal, including this April 16, 2003 exchange. Michael W. Wynne, then-Under Secretary of Defense for Acquisition, wrote: "They [Airbus] came in a couple of weeks ago and offered to build the majority [of the tankers] here in America .... I am not sure where this will lead, but the benefits of competition may be revealing." The Secretary of the Air Force, John

however, is that an effective anti-corruption regime, such as that in the United States,[62] can help tamp down discrimination (and thus help open a domestic procurement market) by deterring corruption that would otherwise fuel the fires of discrimination; that, in turn, can yield substantial welfare benefits for the purchasing nation.[63]

D. *Restrictions Directed to Agencies' Procurement Objectives: Framework Agreements and Interagency Contracting*

The fourth category of barriers stems from measures "concerned with the 'commercial' aspects of procurement. . .and an efficient procurement process." Arrowsmith cautions that these measures, while ostensibly intended only to improve the procurement system, may, in practice, have deep discriminatory effects.[64]

In the U.S. procurement market, the best current example of this type of indirect barrier is framework contracting.[65] In the U.S. federal arena, framework agreements are known as "indefinite delivery/ indefinite quantity" (IDIQ) contracts, "government-wide acquisition contracts" (GWACs), or "Multiple Award Schedules" (MAS) contracts, depending on the agency or context in which they arise. For purposes of common understanding, however, this Article uses the more descriptive European term, "framework agreements."[66]

Roche, replied: "Mike, you must be out of your mind!!! . . . We won't be happy with your doing this!" 150 CONG. REC. S11776, S11780 (Nov. 20, 2004). This is an important reminder that, as at least one post-scandal review panel concluded, procurement rules alone are insufficient; leadership plays a critical role in implementing policy. *See generally* DEF. SCI. BD., REPORT OF THE DEFENSE SCIENCE BOARD TASK FORCE ON MANAGEMENT OVERSIGHT IN ACQUISITION ORGANIZATIONS (March 2005), *available at* http://www.acq.osd.mil/dsb/reports/2005-03-MOAO_Report_Final.pdf.

62. This is not to suggest that the current oversight regime in the United States is fully effective. Failure to invest in appropriate personnel to staff the U.S. procurement regime has led to an increasingly distressing string of scandals and failures that, we expect, will result in congressional action (and potential over-reaction) for the foreseeable future. *See generally* Steven L. Schooner, *Contractor Atrocities at Abu Ghraib: Compromised Accountability in a Streamlined, Outsourced Government*, 16 STAN. L. & POL'Y REV. 549, 550 n.3, 557-61 (2005).

63. *See, e.g.*, Simon J. Evenett & Bernard M. Hoekman, *Government Procurement: Market Access, Transparency, and Multilateral Trade Rules* 18-19 (World Bank Policy Research, Working Paper No. 3195, Jan. 2004), *available at* http://ssrn.com/abstract=342380 (analyzing theoretical economic impact of gains in transparency).

64. *See* ARROWSMITH, *supra* note 13, at 17-18.

65. This review of framework contracting draws on discussion papers presented by Christopher Yukins at The George Washington University Law School (Sept. 2005) and at the conference of the Federal Circuit Bar Association (Washington, D.C., May 2006).

66. *See, e.g.*, Sue Arrowsmith, *The Past and Future Evolution of EC Procurement Law: From Framework to Common Code*, 35 PUB. CONT. L.J. 337, 348-49, 362 (2006) (discussing regulation of

Under framework contracting, a procuring agency (often a centralized purchasing agency) generally will compete and award multiple standing contracts, or "framework" agreements. To win those contracts, vendors typically propose unit prices for specific goods or services; at the time of award, however, there is no certainty as to the actual number of items or hours that will be ordered.

As requirements arise, a customer agency—which may not be the agency that actually holds the contract, for that may be a centralized purchasing agency—will actually issue a task or delivery order against a standing contract. That order may be competed among the various holders of the standing contracts; the extent of competition varies enormously, depending on the applicable rules and agency procedures. There may be no effective competition at all (the worst-case scenario). Further, there may be little to no transparency to the order: in many cases, the requirement is never announced, the competition (if any) is held privately among the standing contract holders, and the order is issued with no public disclosure.

In theory, these types of contracts should provide more competition because framework agreements, as noted, are *presumptively* awarded to multiple suppliers at initial award, and U.S. regulations require that, after initial award, each of these multiple suppliers must be afforded a "fair opportunity" to compete for subsequent orders awarded under the framework agreements. In practice, however, too often suppliers are denied that fair opportunity to compete, even if they hold standing contracts.[67]

Agencies can avoid competition—and thus deny suppliers the "fair opportunity to compete"—by abusing certain exceptions authorized by the Federal Acquisition Regulation (FAR). Furthermore, the Government Accountability Office (GAO) has found that even if multiple-award contractors are theoretically given a fair opportunity to compete, practical considerations often make it impossible for non-incumbent contractors to respond in time to be eligible for award.[68]

---

framework agreement under new European procurement directives); Sue Arrowsmith, *Framework Purchasing and Qualification Lists under the European Procurement Directives (Parts I & II)*, 8 PUB. PROC. L. REV. 115, 161, 168 (1999).

67. *See, e.g.*, Thomas F. Burke & Stanley C. Dees, Feature Comment, *The Impact of Multiple-Award Contracts on the Underlying Values of the Federal Procurement System*, 44 GOV. CONTRACTOR ¶ 431 (Nov. 6, 2002) (citing U.S. DEP'T OF DEF., OFFICE OF INSPECTOR GEN., MULTIPLE AWARD CONTRACTS FOR SERVICES, REPORT NO. D-2001-189 (Sept. 30, 2001) [hereinafter MULTIPLE AWARD CONTRACTS]).

68. *See* U.S. GEN. ACCOUNTING OFFICE, REPORT NO. GAO/NSIAD-00-56, FEW COMPETING PROPOSALS FOR LARGE DOD INFORMATION TECHNOLOGY ORDERS 10 (Mar. 2000), *available at* http://www.gao.gov (search "Keyword or Report #" for "NSIAD-00-56").

Collusion, or at least calculation, seems to play a part in this loss of competition. A report from the Defense Department's Inspector General showed that multiple-award framework agreements had been used on at least one occasion to create an illusion of competition, when in reality the customer agency had already selected a preferred contractor or knew that two contractors had agreed not to compete against each other. The audit report revealed that two-thirds of the contracting organizations reviewed "awarded task orders on a directed-source basis because the program offices preferred to work with a specific contractor."[69]

A number of reports have suggested why agency officials collude to reduce competition under task-order contracts. Centralized purchasing agencies, which establish the framework agreements in the first instance, will feel pressure to accommodate customer agencies by allowing tasks to be awarded to those customer agencies' favored contractors. To ease award to a favored contractor—often the incumbent contractor—the contracting agency may (1) fail to notify other vendors (other framework agreement holders) of an available task, (2) provide inadequate notice, (3) fail to provide useful specifications, (4) impose biased technical requirements, (5) allow a slanted evaluation of offers, (6) inadequately assess the reasonableness of the favored vendor's proffered price,[70] or (7) ignore the many other rules meant to ensure vigorous, transparent competition.[71]

These failures in competition are compounded, and shrouded, by a lack of transparency and accountability. As an example, although traditionally all federal business opportunities over $25,000 had to be advertised,[72] neither requirements nor awards under U.S. framework agreements must be published.[73]

Indeed, even the *existence* of task-order contracts is not currently published. Although FAR Subpart 5.6 requires publication of a list of

---

69. MULTIPLE AWARD CONTRACTS, *supra* note 67, at 10.

70. *See, e.g.*, U.S. GOV'T ACCOUNTABILITY OFFICE, REPORT NO. GAO-05-229, OPPORTUNITIES TO IMPROVE PRICING OF GSA MULTIPLE AWARD SCHEDULES CONTRACTS 15-16 (Feb. 2005) (criticizing drop in effective pre-award audits); *see also* Patience Wait, *GSA Urged to Resume Post-Award Audits of Vendors*, WASH. TECH., July 29, 2005, *available at* http://www.washingtontechnology.com/news/1_1/daily_news/26666-1.html (discussing congressional criticism of failure to hold pre- and post-award audits on GSA contracts).

71. *See, e.g.*, U.S. GOV'T ACCOUNTABILITY OFFICE, *supra* note 70, at 15-16; *see also* Wait, *supra* note 70.

72. *See* FAR, 48 C.F.R. §§ 5.101, 5.203 (2007).

73. *See, e.g.*, FAR, 48 C.F.R. § 16.505(a)(1) (2007) (a "contracting officer does not synopsize orders under indefinite-delivery contracts").

interagency framework agreements, as of February 1, 2006 that list, which is to be published at www.contractdirectory.gov, had been disabled. Customer agencies instead must rely on vendors and centralized purchasing agencies to search out these contracting vehicles in an all-too-invisible marketplace that relies on relationships more than on competition, and which raises obvious dangers of corruption.[74] Nor are there effective institutional checks on this marketplace of relationships, for many orders under task-order contracts are exempt from protest.[75]

These failures in transparency and competition have prompted many calls for reform of task-order contracts,[76] and Congress and the agencies have responded with a number of incremental efforts at reform.[77] The Acquisition Advisory Panel, a blue-ribbon panel launched in 2003, recently issued a nearly 500-page draft report, much of which focused on problems (and possible solutions) regarding these types of contracts.[78] Despite these efforts, however, the core problems with task-order contracting in the United States—minimal transparency, diluted competition, and inadequate review—remain unresolved.

The framework agreements and their associated problems are not unique to the United States. As the discussion above notes, in the federal system in the United States, orders under a master framework agreement need not be publicized for competition or award. Similarly, under the recent European Union procurement directives, once a framework agreement is in place, the "mini-competitions" between multiple awardees for the follow-on contracts need not be publicized.[79] Guidance published by the U.K. Office of Government Commerce

---

74. *See* Christopher R. Yukins, *Ethics in Procurement: New Challenges After a Decade of Reform*, 38 PROCUREMENT LAW. 3 (2003).

75. *See* FAR, 48 C.F.R. § 16.505(a)(6) (2007).

76. *See, e.g.*, Steven L. Schooner, Feature Comment, *Risky Business: Managing Interagency Acquisition*, 47 GOV'T CONTRACTOR ¶ 156 (2005) (applauding the GAO for adding the management of interagency contracting to its "high risk" list and suggesting that interagency acquisition has evolved from "the poster child for the flexible, streamlined, businesslike approach of the 1990's acquisition reform movement" into the federal procurement system's "Achilles heel").

77. *See, e.g.*, 70 Fed. Reg. 43,578 (July 27, 2005) (noting that the rule would require special justification if fewer than three master agreement holders will be solicited for opportunity under the GSA schedule contracts).

78. *See* AAP DRAFT REPORT, *supra* note 8, at 3 (30-44).

79. *See, e.g.*, EUR. DEV. BANK FOR RECONSTRUCTION & DEV., PROCUREMENT POLICIES AND RULES 8 (2000), *available at* http://www.ebrd.com/about/policies/procure/ppr.pdf; *see also* EBRD—Policies, http://www.ebrd.com/about/policies/procure/index.htm ("The EBRD's Procurement Policies and Rules are based on the fundamental principles of non-discrimination, fairness and transparency. They are designed to promote efficiency and effectiveness and to minimise credit risk in the implementation of the Bank's lending and investment operations.").

indicates that, if the original agreement is publicized in the *Official Journal of the European Communities*, subsequent contracts competed under that agreement need not be advertised.[80] Unlike the U.S. system, the European directive contemplates an initial "framework agreement" and then a series of "contracts," to be issued under the framework agreement.[81]

There are subtle distinctions in terminology, but not necessarily in substance, between the U.S. and European rules systems.[82] As in the United States, requirements need only be competed among the standing awardees under the EU framework agreements.[83] Indeed, under the EU system there may be even less competition. While U.S. rules on competition contemplate affording all the master contract holders a "fair opportunity to compete" for individual orders,[84] the EU directive countenances award of an order (a "contract") without further competition among the standing framework contractors, if it is possible to make an award per the terms already "laid down in the [original] framework agreement."[85]

All of the problems presented by framework contracting—the loss of transparency and competition, and the profound incentives (and opportunities) for favoritism and corruption—raise serious potential barriers to foreign vendors. As a threshold matter, a foreign vendor

80. *See* U.K. Office of Gov't Commerce, *Framework Agreements and EC Developments* ¶ 9 (2004), *available at* http://www/ogc.gov/documents/Framework_Agreements_and_EC_Developments.doc ("It is far better, therefore, to advertise the framework itself, so that there is no need to consider the need for advertising as each call-off comes up."); *cf.* FAR, 48 C.F.R. § 16.505(b)(4) (record required only in contract file). *See generally* Sue Arrowsmith, *Framework Agreements under the UK Procurement Regulations: Denfleet v. NHS Purchasing and Supply Agency*, 14 PUB. PROC. L. REV. NA86 (2005); Arrowsmith, *Framework Purchasing, supra* note 66, at 123 (attributing an increasing use of electronic media and electronic ordering to the increased importance of framework agreements).

81. *See* Council Directive 2004/18, On the Coordination of Procedures for the Award of Public Works Contracts, Public Supply Contracts and Public Service Contracts, art. 32, 2004 O.J. (L 134) 114 [hereinafter Public Works Directive], *available at* http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:32004L0018:EN:NOT. See generally Steven L. Schooner & Christopher R. Yukins, *Emerging Policy and Practice Issues*, a paper presented at the West-Thomson Government Contracts Year in Review Conference in February, 2005, *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=663464.

82. In the United States' federal system, as noted, the initial award is for a competitive "contract," but then task and delivery *orders—not* contracts—are issued against that master contract. *See* FAR, 48 C.F.R. §§ 16.501, 16.505 (2007). Thus, there is a subtle difference in nomenclature: U.S. agencies issue "task orders" under a master contract, while European agencies will issue "contracts" under a master framework agreement.

83. *See* Public Works Directive, *supra* note 81, art. 12.

84. *See* FAR, 48 C.F.R. § 16.505(b)(1) (2007).

85. *See* Public Works Directive, *supra* note 81, art. 32, ¶ 4.

new to the market must learn of the framework agreements' importance. Because opportunities and awards under framework agreements are not publicized, however, it is difficult for any newcomer to discern their importance. Notably, even seasoned U.S. observers were surprised when the Acquisition Advisory Panel, an independent commission, reported that fully forty percent of the nearly-$400 billion U.S. procurement market are handled through interagency framework agreements.[86]

Once a foreign vendor does finally appreciate the importance of framework agreements, the vendor faces a practical problem of actually joining one. Most framework arrangements in the United States are "closed" once the initial contracts are awarded, typically for terms of up to five to ten years. An exception is the General Services Administration's Multiple Award Schedules (MAS) contracts, which are always "open": a vendor willing to submit to the three- to six-month negotiation process may always submit an offer to join the MAS contracts. There is no true "competition," in the strictest sense, to join the GSA MAS arrangement; instead, the vendor must disclose its commercial pricing, and generally must commit to keep its MAS prices at a level below its commercial prices over the term of the MAS contract, which may be extended up to twenty years (through five-year options). As a result of this "open" approach, literally thousands of vendors have joined the GSA MAS system.

The "open" system used by the GSA MAS contracts eliminates one barrier to entry for foreign vendors—the problem of arriving too late, after the standing agreements are in place—but raises other, far less obvious barriers to the naïve foreign vendor. Over decades of practice, the MAS negotiation process has evolved into an arcane and highly sophisticated art form. Because the MAS vehicle is always "open," and there is no real competition *between* vendors to join, a vendor's commercial pricing is the key benchmark for the vendor's MAS pricing. As a result, in negotiating prices under MAS contracts, vendors must struggle artfully to distinguish their commercial discounts, both before and after award. Otherwise, low commercial prices may "choke" the prices allowed under the MAS contract; at the same time, vendors must be concerned that the MAS pricing structure (in essence, a "most favored nation" pricing structure) will restrict their ability to lower their commercial prices. In sum, therefore, the arcane rules of pricing under the GSA MAS contracts raise their own, maddening barrier to foreign

86. *See* AAP DRAFT REPORT, *supra* note 8, at 3.

vendors that seek to enter the U.S. market.

Even if a foreign vendor has discovered framework contracting, has identified a viable framework arrangement to join, and has passed through the contracting process, the vendor must still survive in the brutal and shadowy world of "call-off" competitions. As noted, agencies are *not* required to publicize opportunities to be let through standing contracts. Depending on the applicable rules and circumstances, the customer agencies *may* solicit competition from those that hold standing framework agreements; in some cases, however, the agency may not. When the competition for an order is held, the agency may keep its stated criteria for award to a breezy minimum, and, because debriefings and protests often are not required, the agency's discretionary award decision may be completely immune from challenge or review. To add insult to injury, the data on the award may be spotty, and the terms used—because the standing contracts are generically crafted with little particularity—may well favor a savvy, incumbent contractor.

In both principle and practice, therefore, framework agreements pose a very real barrier to international trade.[87] More broadly, they show how pernicious these types of rules-based barriers can be: where agencies are enticed by "efficiency" (or other gains), customer agencies (and their central purchasing cohorts) may well embrace a procurement device that is, in practice, grotesquely discriminatory. The agencies will *not,* in this instance, serve as a counterweight to discrimination. Unlike other categories of barriers to procurement across borders—classic domestic-content requirements, collateral socioeconomic requirements, or illegitimate practices—here there is no institutional resistance to the barrier: the government agencies, normally natural proponents of reducing barriers, will instead *foster* the barriers in their eagerness to grasp some other institutional goal, such as efficiency. For these types of barriers, therefore, the pressure for reform—and for reducing the barriers to trade—probably must come from outside the procurement system's own institutions.

III. Instruments to Open the International Procurement Market

Having described the potential of an open international procurement market, and the obstacles to achieving it, we turn now to the various types of instruments that might be used to open that market. Public procurement policymakers might recoil at the menu we offer to

87. *Cf.* Arrowsmith, *supra* note 13, at 271-75 (discussing framework purchasing under the GPA).

the extent that none of these vehicles is a typical tool used to effectuate public procurement policy. For example, in the United States, procurement policy and practice are, *inter alia,* framed by legislation both authorizing action and appropriating money to pursue objectives, implemented by regulation, clarified and embellished upon in policy documents, interpreted through adjudicatory actions (*e.g.*, bid protests, contract disputes, and criminal indictments and prosecutions, some of which produce publicly available precedential opinions), and commented upon by scholars and practitioners in books, journal articles, and in the trade press. But experience suggests that in the United States, as in other nations, procurement policy and law tend to be grudgingly reconciled with, rather than driven by, norm-creating global procurement instruments.

For our purposes here, there are at least three basic types of instruments that may help liberalize international procurement markets:

- *Model procurement codes, or model statements of principle or best practices,* that discourage discrimination, either explicitly or by discouraging indirect barriers to trade. The United Nations Commission on International Trade Law (UNCITRAL) Model Law on Procurement of Goods, Construction and Services falls within this category. Less obvious models include the Organisation for Economic Cooperation and Development (OECD) procurement assessment tool, and the "Integrity Pacts" fostered by Transparency International.
- *Procurement guidelines imposed by central financial institutions.* Procurement guidelines issued by the World Bank or the regional development banks are examples of this category.
- *Binding international agreements or directives that require nondiscrimination,* both explicitly and implicitly by barring various recognized indirect barriers to international procurement. These include, of course, the World Trade Organization (WTO)'s Government Procurement Agreement.

We will address each of these only briefly, with due regard for the extensive literature already available regarding many of these instruments. Of course, our list is not exhaustive. In his 2005 essay, *The Global Procurement Harmonisation Initiative,*[88] Attila Kovacs canvassed many of these instruments in his effort to chart a path forward for harmoniza-

88. Attila Kovacs, *The Global Procurement Harmonisation Initiative,* 14 PUB. PROC. L. REV. 15 (2005).

tion of procurement codes worldwide. Frankly, Kovacs' vision is far more ambitious than ours. Where he aspires to a form of global uniformity, through thoroughly harmonized global procurement codes, we do not share his optimism.[89] Rather, we merely seek to identify an instrument or instruments that could be used, much like a constitution, to shape individual nations' procurement codes in a common fashion in order to open markets and reduce discrimination. In the end, Kovacs is right to press for more thorough harmonization, because dissonance between countries' procurement codes is inefficient and poses barriers to entry. Arrowsmith calls these inefficiencies "structural restrictions," which raise practical barriers to entry as foreign vendors run headlong into dense and alien procurement regimes.[90] As a practical and political matter, however, we sense that any semblance of true procurement code harmonization is at least a generation away. For now, therefore, progress will stem from instruments that impose common norms on hugely disparate procurement regimes.

A. *Model Codes and Principles*

Internationally, the most commonly recognized model procurement code is the 1994 UNCITRAL Model Law on Procurement of Goods, Construction and Services.[91] According to UNCITRAL, at least seventeen nations have modeled at least some part of their procurement

89. Our cynicism stems not only from the vagaries of global cooperation and convergence, but also from domestic experience. More than two decades have passed since the putatively uniform U.S. Federal Acquisition Regulation (FAR) system first became effective, on April 1, 1984. *See generally* JAMES F. NAGLE, A HISTORY OF GOVERNMENT CONTRACTING, Ch. 22, "The Modern Era: A Sea of Paperwork" (1992) (discussing the evolution of the uniform regulation system). Since then, Balkanization has reigned. For example, the mid-1990's witnessed a tsunami of procurement reforms intended to make the procurement system less bureaucratic and more businesslike. Wide-reaching reform statutes, such as the Federal Acquisition Streamlining Act of 1994, Pub. L. No. 103-355, 108 Stat. 3243, the Federal Acquisition Reform Act of 1996 (FARA), Pub. L. No. 104-106, Division D, §§ 4001-4402, 110 Stat. 642, and the Information Technology Management Reform Act of 1995 (ITMRA), Pub. L. No. 104-106, Division E, §§ 5001-5703, 110 Stat. 679 (1996) (FARA and ITMRA are now jointly known as the Clinger-Cohen Act), were implemented by new and revised regulations, dramatically altering the Federal procurement landscape. And the calls for reform continue unabated.

90. *See* ARROWSMITH, *supra* note 13, at 18.

91. UNCITRAL, UNCITRAL MODEL LAW ON PROCUREMENT OF GOODS, CONSTRUCTION AND SERVICES WITH GUIDE TO ENACTMENT (1994), *available at* http://www.uncitral.org/uncitral/en/uncitral_texts/procurement_infrastructure/1994Model.html. Christopher Yukins serves as an expert to the current initiative to revise and update the UNCITRAL model law.

codes on its model law.[92] The UNCITRAL model law, currently being updated,[93] is regularly cited as a template for reform.[94]

The UNCITRAL model law is not necessarily a tool for opening international procurement markets, as it contemplates domestic preferences.[95] But because it offers a comprehensive set of rules to frame an efficient procurement process, the UNCITRAL model is an important tool for harmonizing nations' procurement codes.[96] Harmonization is, itself, a significant step forward in opening markets because consistency between procurement regimes reduces costs for vendors that seek to compete across borders, and for nations trying to improve their own procurement systems.

There are other interesting models for procurement emerging internationally. The first is an initiative coordinated by the OECD to foster better practices in procurement, as part of the OECD's broader effort to encourage development and sound governance. The OECD is made up of industrialized donor nations, and the assessment tools it is creating are intended, at least in part, to ensure that developing nations use development funds in a sound, transparent manner.[97] The OECD *Methodology for Assessment of National Procurement Systems*[98] is not directed primarily to opening procurement markets: the OECD methodology only discourages (and does *not* bar) discrimination,[99] and the purpose of the tool is to help developing nations build capacity for

---

92. *See* UNCITRAL, Status: 1994—Model Law on Procurement of Goods, Construction and Services, http://www.uncitral.org/uncitral/en/uncitral_texts/procurement_infrastructure/1994Model_status.html (citing Albania, Azerbaijan, Croatia, Estonia, Gambia, Kazakhstan, Kenya, Kyrgyzstan, Malawi, Mauritius, Mongolia, Poland, Moldova, Romania, Slovakia, Tanzania, Uganda, and Uzbekistan).

93. *See, e.g.*, Sandra M. Rocks & Kate A. Sawyer, *International Commercial Law: 2005 Developments*, 61 BUS. LAW. 1633, 1633-34 (2006); Christopher Yukins, Don Wallace, Jr., Jason Matechak & Jeffrey Marburg-Goodman, *International Legal Development in Review: 2005 Corporate—International Procurement*, 40 INT'L LAW. 337, 337-43 (2006).

94. *See, e.g.*, Sue Arrowsmith, *Public Procurement: An Appraisal of the UNCITRAL Model Law as a Global Standard*, 53 INT'L & COMP. L.Q. 17, 20-22 (2004) (noting other national procurement regimes that have looked to UNCITRAL model law).

95. *See* UNCITRAL MODEL LAW, *supra* note 91, art. 8(1) & Guide to Enactment ¶ 25.

96. *See, e.g.*, John Linarelli, *The WTO Agreement on Government Procurement and the UNCITRAL Model Procurement Law*, 1 ASIAN J. WTO & INT'L HEALTH L. & POL'Y 317 (2006).

97. *See* OECD, New Common Benchmarking and Assessment Tool for Public Procurement Systems (Version 4), http://www.oecd.org/document/40/0,2340,en_2649_19101395_37130152_1_1_1_1,00.html.

98. *See* OECD, METHODOLOGY FOR ASSESSMENT OF NATIONAL PROCUREMENT SYSTEMS (2006), *available at* http://www.oecd.org/dataoecd/1/36/37130136.pdf.

99. *See id.* at 11-12.

development,[100] not necessarily to open markets.

Another interesting model for harmonization is the "Integrity Pacts" being sponsored by Transparency International, a leading international organization battling corruption.[101] Transparency International's Integrity Pacts include agreements to be entered into by the purchasing agency and all bidders. Per those agreements, none of the parties is to engage in bribery or collude with competitors during formation or administration of the subject contract, and a monitoring system is to be put in place to ensure compliance.[102] These Integrity Pacts, however, are focused primarily on ensuring integrity, are limited to specific projects or procurements rather than state-wide regimes, and are not likely to serve as ready instruments to open international markets.

B. *Procurement Guidelines of Development Banks*

Another source of guidance and potential liberalization for procurement regimes worldwide derives from the guidelines from the World Bank and the regional development banks,[103] to which borrower nations generally must conform in order to qualify for financing.[104]

---

100. *See id.* at 2.

101. *See* Transparency International, http://www.transparency.org (last visited Apr. 5, 2007).

102. *See* Transparency International, Integrity Pacts, http://www.transparency.org/global_priorities/public_contracting/integrity_pacts (last visited Apr. 5, 2007).

103. *See* African Development Bank, http://www.afdb.org (last visited Apr. 5, 2007); Asian Development Bank, Procurement Guidelines, http://www.adb.org/Documents/Guidelines/Procurement (last visited Apr. 5, 2007); Eur. Dev. Bank for Reconstruction & Dev., Procurement Policies and Rules, *supra* note 79; Inter-American Development Bank, Procurement Procedures, http://www.iadb.org/exr/english/BUSINESS_OPP/bus_opp_procurem_procedurs.htm (last visited Apr. 5, 2007); North American Development Bank, http://www.nadbank.org (last visited Apr. 5, 2007).

104. *See, e.g.*, World Bank, Information for Borrowers, http://www.worldbank.org (follow "Projects & Operations" hyperlink; then follow "Procurement / Tender" hyperlink; then follow "Information for Borrowers" hyperlink) (last visited Apr. 5, 2007).

> When the World Bank provides financing to its member countries for investment projects, each project is governed by a legal agreement between the World Bank and the government agency who receives the funds. One of the key obligations in the 'loan agreement' is that governments abide by the Bank's procurement policies as detailed in the *Guidelines: Procurement under IBRD Loans and IDA Credits* and the *Guidelines: Selection and Employment of Consultants by World Bank Borrowers.*

Id. See also Juan Rovira, *Trade Agreements, Intellectual Property, and the Role of the World Bank in Improving Access to Medicines in Developing Countries*, 4 YALE J. HEALTH POL'Y L. & ETHICS 401 (2004)

Development banks routinely impose minimum procurement rules to ensure transparency, competition, and integrity in the projects they fund.

The World Bank's guidelines, for example, help open procurement markets by requiring that vendors from all nations be allowed an opportunity to provide goods and services,[105] though the guidelines also allow for certain domestic preferences for goods from borrower nations.[106] Moreover, the World Bank's procurement guidelines apply, by their terms, only to the contracts supported with World Bank funding.[107] Because they simultaneously stipulate open markets but allow for some measure of domestic protectionism to help economies recover, the procurement guidelines promulgated by the World Bank and the other banks, while an important means of opening international procurement markets, are not likely to bring about worldwide reform. The purpose of the various banks' guidelines is simply to ensure that the banks' funds are well spent—not to force open the procurement process of reluctant borrower nations.[108] The development banks' guidelines are not, therefore, necessarily the shortest path to an international open market in procurement.

C. *Treaties and Directives: International and Regional*

As neither model codes nor the procurement guidelines of international development banks will likely bring about open international

---

(providing a list of procurement methods permitted under the World Bank's procurement guidelines); David A. Levy, *BOT and Public Procurement: A Conceptual Framework*, 7 IND. INT'L & COMP. L. REV. 95 (1996) (arguing that the World Bank's procurement guidelines have contradictory tenets that undermine its stated preference for open procurement markets); J.M. Migai Akech, *Development Partners and Governance of Public Procurement in Kenya: Enhancing Democracy in the Administration of Aid*, 37 N.Y.U. J. INT'L L. & POL. 829 (2005) (arguing that the World Bank's tying of the aid given to developing countries to the requirement of compliance with its international procurement guidelines is both inefficient and works against the efforts of recipient nations to gain a foothold in international trade); Alejandro Posadas, *Combating Corruption Under International Law*, 10 DUKE J. COMP. & INT'L L. 345, 400 (2000) (describing the World Bank's procurement guidelines as its major vehicle used to combat corruption).

105. *See*, WORLD BANK, GUIDELINES: PROCUREMENT UNDER IBRD LOANS AND IDA CREDITS ¶ 1.6 (revised Oct. 1, 2006), *available at* http://siteresources.worldbank.org/INTPROCUREMENT/Resources/ProcGuid-10-06-ev1.doc.

106. *Id.* ¶ 2.55.

107. *Id.* ¶ 1.5.

108. *See, e.g.*, EBRD—Policies, *supra* note 79 ("The EBRD's Procurement Policies and Rules are based on the fundamental principles of non-discrimination, fairness and transparency. They are designed to promote efficiency and effectiveness and to minimise credit risk in the implementation of the Bank's lending and investment operations.").

public procurement markets, we look now to treaties and similar international instruments directed specifically to opening regional or international spheres of free trade in procurement to affect this desired outcome.

The central example of this type of agreement is the World Trade Organization's Agreement on Government Procurement (GPA).[109] The GPA is a plurilateral agreement that binds only member nations.[110] Per Article III of the agreement, the two basic principles at the core of the GPA are *non-discrimination* (no discrimination amongst covered foreign suppliers, goods or services) and *national treatment* (foreign suppliers, goods and services are to receive treatment no less favorable than that accorded locals).[111] The substantive provisions of the GPA—those that prescribe procurement rules to root out discrimination rather than those that describe the agencies, goods and services covered—were recently revised, and the proposed text of the revised GPA was published in December 2006.[112]

---

109. Although the agreement's technical name in the WTO is the "Agreement on Government Procurement," in the United States, the GPA is commonly referred to as the "Government Procurement Agreement," *see, e.g.*, FAR, 48 C.F.R. 25.400(a)(1), and for consistency's sake we will use the common acronym "GPA"—also used by the WTO—here. For a comparative discussion of the GPA and other initiatives in international agreements on procurement trade, see Simon J. Evenett, *Is There a Case for New Multilateral Rules on Transparency in Government Procurement?* (2003), *reprinted in* EVENETT & HOEKMAN, *supra* note 12, at 147. For histories of the GPA and its predecessor agreements, see Robert D. Anderson, *Policy and Legal Frameworks for Open Procurement Markets: The Role of the WTO* (paper for presentation at the West/Thomson Government Contracts Year in Review Conference, Washington, D.C., Feb. 2007) (copy on file with authors); Annet Blank & Gabrielle Marceau, *The History of the Government Procurement Negotiations Since 1945* (1996), *reprinted in* EVENETT & HOEKMAN, *supra* note 12, at 3; ARROWSMITH, *supra* note 13, at 25-47; Gerard De Graaf & Matthew King, *Towards a More Global Government Procurement Market: The Expansion of the GATT Government Procurement Agreement in the Context of the Uruguay Round*, 29 INT'L LAW. 435 (1995); Michael T. Janik, *A U.S. Perspective on the GATT Agreement on Government Procurement*, 20 GEO. WASH. J. INT'L L. & ECON. 491 (1987).

110. These currently include Canada, the European Communities (including its 25 member States: Austria, Belgium, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxemburg, Malta, Netherlands, Poland, Portugal, Slovak Republic, Slovenia, Spain, Sweden, and the United Kingdom), Hong Kong China, Iceland, Israel, Japan, Korea, Liechtenstein, Netherlands with respect to Aruba, Norway, Singapore, Switzerland, and the United States.

111. *See, e.g.*, Hoekman & Mavroidis, *supra* note 11, at 4-5. Here, we use the term "nondiscrimination" more broadly, to describe a general policy of not discriminating against foreign suppliers in procurement.

112. *See, e.g.*, *Greater Clarity is Focus of Updated WTO GPA*, 3 INT'L GOV. CONTRACTOR ¶ 102 (Dec. 2006). For a discussion of proposed areas of reform in the GPA, see Sue Arrowsmith, *Reviewing the GPA: the Role and Development of the Plurilateral Agreement after Doha*, 5 J. INT'L ECON. L. 761 (2002).

In parallel with the GPA, the United States and other states have entered into bilateral and multilateral free trade agreements (FTAs) which include commitments to open procurement markets.[113] While these types of bilateral and multilateral agreements typically provide for nondiscrimination and may spur broader liberalization,[114] the agreements, by their terms, are limited in scope and cannot create a truly international open procurement market.

Another model of a market-opening international accord is the European procurement directives; indeed, many aspects of the GPA originally came from earlier European directives.[115] As Arrowsmith noted, the European directives, like the WTO's Agreement on Government Procurement, offer a "skeletal" set of requirements for member states' procurement systems; these minimum requirements are designed to eliminate barriers between the European member states' procurement markets. Over time, the European directives have become more prescriptive. Given additional force by interpretive rulings from the European Court of Justice, the European directives have evolved into something much closer to a common code for the European member states.[116] This evolution toward a common, harmonized code has been driven, in important part, by a continuing desire in the European central institutions to eliminate discriminatory procurement rules that impede trade between member states.[117]

Another example of a regional directive is that of the Common Market for Eastern and Southern Africa (COMESA). With support from the African Development Bank, COMESA has been developing its

---

113. *See, e.g.,* Jean Heilman Grier, *Recent Developments in International Trade Agreements Covering Government Procurement,* 35 PUB. CONT. L.J. 385 (2006) (discussing FTAs in place or under negotiation); Robert C. Taylor & Lisa M. Bolton, *Overview of Canadian Government Procurement Law,* 42 PROCUREMENT LAW. 14 (Fall 2006) (discussing role of North America Free Trade Agreement (NAFTA) in Canadian procurement regime); Laura Eyester, *NAFTA and the Barriers to Federal Procurement Opportunities in the United States,* 31 PUB. CONT. L.J. 695 (2002); Donald P. Arnavas & Nick Seddon, *The U.S.-Australia Free Trade Agreement—Focus on Government Procurement,* 3 INT'L GOV. CONTRACTOR ¶ 58 (July 2006); Tsai-yu Lin, *Regional Procurement Arrangements in East Asia: Some Reflections for the WTO Rules,* 1 ASIAN J. WTO & INT'L HEALTH L. & POL'Y 343, 357-59 (2006) (discussing interplay between East Asian free trade arrangements and GPA); Locknie Hsu, *Government Procurement: A View from Asia,* 1 ASIAN J. WTO & INT'L HEALTH L. & POL'Y 379 (2006) (reviewing regional agreements).

114. *See* Tsai-yu Lin, *supra* note 113, at 356-60.

115. *See* De Graaf & King, *supra* note 109, at 437. *See generally* Arrowsmith, *Evolution, supra* note 66, at 340; Jean-Jacques Verdeaux, *Public Procurement in the European Union and in the United States: a Comparative Study,* 32 PUB. CONT. L.J. 713 (2003).

116. *See* Arrowsmith, *Evolution, supra* note 66, at 350-54.

117. *See id.* at 339.

own procurement directives to facilitate procurement in and among its member states.[118] While that effort remains in process, it illustrates both promise and risk: it shows the hoped-for benefit of harmonized procurement schemes outside the highly industrialized world, but it also raises a risk of a balkanized international patchwork of regional procurement regions. We will return, below, to the question of harmonization.

IV. Achieving a Global Procurement Market: Four Steps

Having reviewed the barriers to international procurement, and the instruments available to reduce them, we turn now to four critical steps needed for the global procurement market to fully achieve openness. While it might prove convenient for this process to proceed in an orderly, linear fashion, it is more likely that passage through the four stages will be irregular, overlapping, disorderly, and perhaps even chaotic. Nonetheless, we sense that all four steps are necessary for a global procurement regime to enjoy credibility at home and abroad, to provide customer satisfaction, and to produce value for money in an efficient and consistent manner.

The first step, logically, is the political decision to embrace value-based outcomes, reject domestic preferences, and ultimately accept nondiscrimination as a norm, or as a universally accepted procurement "best practice". Of course, such a decision must overcome deep native protectionism. The second step is harmonization, because uniformity (in vocabulary and practice) generates efficiencies not only for buyers but for sellers. To be clear, as pragmatists, we neither expect nor

---

118. *See generally* Press Release, COMESA, Public Procurement Rules and Regulations Harmonised (June 4, 2004), http://www.comesa.int/trade/issues/procurement/MS-Office-Document.2004-06-04.5502/view; COMESA, Public Procurement Information System, http://simba.comesa.int:90/cpis/index.php?sz=1024&lang=english (last visited Apr. 5, 2007); COMESA, Report of the First Stakeholders Forum for the COMESA Public Procurement Reform Project (Dec. 2002), *available at* http://simba.comesa.int:90/cpis/uploads/reports/Report%20of%20First%20Stakeholders%20Forum.doc (describing scope and purpose of project to develop COMESA directives); Stephen Karangizi, COMESA, Regional Procurement Reform Initiative (Dec. 2002), http://www.wto.org/english/tratop_e/gproc_e/wkshop_tanz_jan03/karangizi1_e.doc (describing projected steps in development of the COMESA procurement directives and institutional structure); Press Release, EVD, Afrika: Multinational/COMESA—Proposal for an ADF Grant of UA 5,660,000 to Finance the Enhancing Procurement Reforms and Capacity Project (July 20, 2006), http://www.evd.nl (describing COMESA project and next steps); Press Release, African Development Bank, COMESA—US$ 8 Million Grant in Support of Public Procurement (Aug. 14, 2006), http://www.afdb.org (announcing a grant to continue COMESA initiative).

advocate for standardization or harmonization of entire procurement codes. Rather, we anticipate continuing harmonization of central agreements—such as the WTO's Agreement on Government Procurement—which in turn shape individual nations' procurement codes. The third step is rationalization, the process of ensuring that the instruments being relied upon by individual states to open markets do, in fact, produce a legislative and regulatory template for procurement procedures which are fundamentally sound (*e.g.*, reflect best practices) and which produce efficient, value-based results. The final step we envision is institutionalization, the process of transitioning harmonized, rationalized agreements from empty rhetoric (or toothless legal regimes) into properly-implemented policies and practices that become integrated into the fabric of the states that join those agreements.

We recognize that, to some extent, each of the four stages could serve to reinforce another. For example, we assume that, if a state affirmatively embraces harmonization, we expect that rationalization and institutionalization might (but need not necessarily) naturally follow. At the same time, we concede that, for a number of reasons, the process might implode during any of the four stages.

A. *Intermezzo: Of Political Will and Stakeholders*

Any discussion of political decision-making must begin with, and in large part depends upon, an understanding of, or at least familiarity with, the various affected interest groups or stakeholders. We have long perceived that this fundamental issue—identifying and understanding the interests and priorities of the various stakeholders in public procurement—is a critical yet under-explored piece of the public procurement policy puzzle. Unfortunately, this topic is beyond the scope of this article. Nonetheless, we pause here to catalogue some of the major players, because it is axiomatic that the political decision-making process will be influenced, nay, skewed, as constituencies exert effort to further their own interests.

From the perspective of contract law, it seems logical to begin by identifying the interested parties; there are *buyers*—here, governments, agencies, ministries, or purchasing officials—and *sellers*—contractors, vendors, or suppliers, publicly traded or closely held, whether for profit (which represents the lion's share) or not for profit. Within the seller or contractor community, we tend to distinguish truly *commercial firms* from those primarily *non-commercial* firms that sell exclusively to, and thus entirely depend upon, the government; and further, particularly

for this purpose, *domestic* from *foreign* firms.[119] On the buyer side, the government's interest may vary as we focus upon the interests of the *end user* (e.g., the pilot of a military aircraft, a judge working in a federal court house), the *source of funds* (whether the *head of agency*, tasked with achieving specific missions or mandates, or the legislative appropriator) seeking to allocate scarce resources among unlimited demands for government services, or various *accountability organizations* (such as audit or oversight instrumentalities tasked with protecting the public fisc).[120] The nature of public procurement requires inclusion of the *public* or *citizens* (individually or collectively), as *taxpayers* (whose funds are being spent) or as *consumers* (or recipients of government services), in the roster of relevant parties.

Further, particularly in an open, democratic society, *special interests* play a key role as they compete for their "piece of the procurement pie." In the United States, a short list of these interests might include small businesses, women-owned businesses, minority-owned firms, service-disabled veteran-owned firms, commercial firms, domestic producers, labor unions, firms located in areas of high unemployment, and environmentally-friendly procurement advocates.[121] Finally, for our

---

119. Experience suggests further subdivision to the extent that, for some purposes, the distinction between domestic and foreign firms may depend upon, for example, ownership or location of the corporate headquarters or, in other circumstances, where the work is performed. *See generally* 48 C.F.R. § 25.003 (2007) ("'Domestic end product' means—(1) An unmanufactured end product mined or produced in the United States; or (2) An end product manufactured in the United States, if the cost of its components mined, produced, or manufactured in the United States exceeds 50 percent of the cost of all its components. . . .").

120. A simple anecdote offers a window into the range of competing interests. A legislator responsible for defense appropriations must make difficult decisions relating to, for example, air superiority; the legislator must balance the number of aircraft to buy and the amount of resources to be invested in maximizing a given aircraft's speed, agility, range, or ability to carry armaments. A legislator might reasonably conclude that a greater number of less potent aircraft would increase the likelihood of mission success (and taxpayers, as a whole, may or may not agree). Contrast this with a customer satisfaction model focused upon the government's end user, the fighter pilot (or wing commander) who would typically (for obvious reasons) express a strong preference for the maximum amount of speed, agility, range, and ability to carry armaments without regard for price. Of course, these considerations could become increasingly hypothetical as the military increases its reliance upon U.A.V.'s or unmanned aerial vehicles. *See, e.g.*, Charles Duhigg, *The Pilotless Plane That Only Looks Like Child's Play*, N.Y. TIMES, Apr. 15, 2007, at BU1 ("For years, . . . U.A.V.'s, . . . were pariahs within the military industry, [which . . .] saw them as threats to the status quo . . . . 'For a long time, the only thing most generals could agree on was that they didn't want any unmanned vehicles,' says Senator John W. Warner, the Virginia Republican who is a member of the Senate Armed Services Committee. 'Now everyone wants as many as they can get.'").

121. See, e.g., the discussion of wealth distribution in Schooner, *supra* note 18.

purposes, this discussion could not be complete without recognition of the facilitators of transparency, the *media* outlets (print, electronic, audio, visual, etc.) that not only educate the public (taxpayers and vendors alike) but perform a valuable third-party oversight role in the procurement process.

B. *Nondiscrimination*

The first and most political step is to embrace nondiscrimination by deciding to open a state's domestic procurement market to international competition. Practically speaking, there is no way in a modern, globalized economy to seal off any domestic procurement system completely; any modern government relies, to some extent, on foreign vendors for goods or services.[122] The decision is one of degree, then, but the experience of most nations—including the United States—is that opening a domestic procurement market can be politically wrenching and difficult, with considerations that carry well beyond the procurement rules themselves.[123]

As the discussion of the U.S. experience above reflected, market opening can be driven by unexpected proponents in the agencies themselves. Agency personnel—the customers affected by market barriers—may push to reduce domestic preferences because of the difficulty of compliance,[124] because of annoyed indifference to a collateral social goal that is impeding trade,[125] or simply because trade-impeding corruption will be prosecuted and destroyed as matter of course.

Some benefits weighing in favor of an open domestic procurement market were discussed above. But, for less obvious reasons, joining a liberalizing international regime may prove very useful for regimes with a procurement system riddled with inefficient standards and

---

122. *Cf.* Manickam Supperamaniam, *Asian Perspective on Government Procurement Matters*, 1 ASIAN J. WTO & INT'L HEALTH L. & POL'Y 291, 292-93 (2006) (Malaysia requires that local sources be used, unless requirement cannot be filled by local sources).

123. *See, e.g.*, ARROWSMITH, *supra* note 13, at 11-12 (reviewing political constraints on achieving free trade); De Graaf & King, *supra* note 109, at 442-43 (describing respective negotiation objectives of EU and United States in entering into 1994 GPA); Margaret Liang, *Government Procurement at the GATT/WTO: 25 Years of Plurilateral Framework*, 1 ASIAN J. WTO & INT'L HEALTH L. & POL'Y 277, 282-84 (2006) (reviewing costs and benefits to developing nations); Bernard Hoekman, *Using International Institutions to Improve Public Procurement*, 13 WORLD BANK RES. OBSERVER 249 (1998), *available at* http://www.worldbank.org/research/journals/wbro/obsaug98/pdf/article6.pdf (reviewing economics literature regarding costs and benefits of nondiscrimination).

124. *See* Berry Amendment discussion, *supra* Part II.A.

125. *See* Accessibility Requirements discussion, *supra* Part II.B.

requirements. Opening and subjecting domestic markets to international standards for sound procurement may incidentally clear away those inefficient domestic procurement practices.[126]

The costs of opening procurement markets are usually highly specific to individual nations because those nations are typically using protectionist procurement policies to shelter strategic domestic industries. What is common across the globe, however, is that the nondiscrimination decision to open a domestic procurement market can typically be highly centralized and made by a few key decisionmakers. That is not always true, of course; the debate over whether to discriminate against foreign specialty metals has drawn in many hundreds of stakeholders across the U.S. procurement market. In principle, however, nondiscrimination can be tightly controlled by a political elite, unlike harmonization, rationalization, and institutionalization, discussed below.

C. *Harmonization*

The next step is to harmonize international instruments for opening markets.[127] Harmonization need not be overly specific, but requires a common set of carefully defined "bounding" rules or a "constitution," such as the GPA or the EU Directives.

Harmonization may seem, to some, a radical idea. If the goal of these instruments is simply to open markets which are at very different stages of development, one might argue that harmonizing the instruments—aligning the WTO GPA and the COMESA procurement directives, for

---

126. *See* Victor Mosoti, *The WTO Agreement on Government Procurement: A Necessary Evil in the Legal Strategy for Development in the Poor World?*, 25 U. PA. J. INT'L ECON. L. 593 (2004). Mosoti notes:

> What is distressing, however, is that some of the poorer countries' decision not to sign the WTO GPA seems guided by priorities that are defeated by other factors inherent in these countries, and have nothing to do with a careful and honest assessment of what the nations really stand to gain or lose by signing. In offering the explanation that they would like to shield their domestic suppliers from external competition for government tenders, and nurture various strategic sectors, these countries are deliberately missing the point. They are being bled to ruination by terribly warped procurement laws and policies.

Id. at 596.

127. *See, e.g.*, Arrowsmith, *supra* note 94, at 23-24 (discussing need for harmonization); Sue Arrowsmith, *Transparency in Government Procurement* (2003), *reprinted in* EVENETT & HOEKMAN, *supra* note 12, at 126, 137 (discussing lack of transparency in rules as an independent barrier to foreign vendors).

example—is beside the point. Harmonization is essential, though, if progress is to continue in opening world procurement markets.[128] At the broadest level, harmonization will help to transfer lessons learned between different systems which are now relying on different integrative instruments. At the same time, and through the same process, harmonization will help to highlight the nagging problems buried in those instruments; this will be the first step towards "rationalization," discussed below.

If, as seems likely, harmonization centers on the WTO Government Procurement Agreement, harmonization will afford additional benefits. Integrating strands of many international procurement instruments through a revised GPA will help to win over those who fear that the GPA is merely a hegemonic instrument for opening markets, and not a tool for improving procurement systems in the developing world.

Realistically, harmonization (as suggested above) is likely to occur through the WTO Government Procurement Agreement, in part for purely practical reasons: the United States' federal procurement market is by far the largest national procurement market in the world, and under U.S. law, the GPA in essence creates a "walled garden" excluding those *outside* the GPA. Under U.S. law, generally only GPA members and those nations with bilateral arrangements with the United States may trade freely into the U.S. procurement market. Thus, under the Trade Agreements Act,[129] as implemented by the Federal Acquisition Regulation,[130] U.S. government contracting personnel may (subject to certain exceptions) purchase goods and services *only* from nations that are members of the GPA or have joined the United States in regional or bilateral arrangements, such as the North American Free Trade Agreement (NAFTA). This legal "walled garden" which generally affords non-discrimination only to those nations *inside* the GPA (or inside other, typically bilateral, U.S. agreements) is explicitly designed to encourage other nations to join agreements with the United States to open their procurement markets.[131]

---

128. *Cf.* 19 U.S.C. § 2514(a) (President is to press for harmonization to encourage broader opportunities in international procurement trade).

129. *See generally* 19 U.S.C. §§ 2511-2518. *See also* 19 U.S.C. § 2511(a), (b); 19 U.S.C. § 2512.

130. *See* FAR, 48 C.F.R. § 25.403(c) (2007).

131. *See* 19 U.S.C. § 2512; Angela B. Styles, Robert K. Huffman & Lara Covington, *GSA Trade Agreements Certification: an Ambush for Commercial Providers*, 41 PROCUREMENT LAW. 1 (2006) (discussing serious potential fraud liability for vendors that provide goods from non-GPA nations); John A. Howell, *The Trade Agreements Act of 1979 Versus the Buy American Act: The Irresistible Force Meets the Immovable Object*, 35 PUB. CONT. L.J. 495 (2006); Thomas C. Lowinger, *Discrimination*

In order to access the U.S. procurement market developing nations will either need to join a bilateral free trade agreement with the United States (which is growing increasingly difficult, because the President will likely soon lose his "fast-track" negotiation authority), or—more likely—to join the GPA. The opportunity offered by the huge U.S. procurement market thus makes it more likely that developing nations will, over time, be drawn to the GPA; on balance, therefore, harmonization in public procurement is more likely to progress under the GPA.

Unlike nondiscrimination, which is typically a political decision made to further carefully calculated political and economic goals, harmonization is a more technical endeavor, as experts work to harmonize different regimes' procurement rules. Harmonization is more technically complex, however, if the goal is not just to harmonize nondiscrimination agreements, but also to create a technically advanced set of procurement rules—if, in other words, harmonization is to evolve naturally into rationalization, the logical next step in this process. If that broader harmonization is to succeed, the harmonization process should be fully transparent, and there must be robust communication between the various organizations developing international standards for procurement.

D. *Rationalization*

Rationalization involves improving international instruments to maximize efficiency in procurement systems. It can enhance domestic welfare and facilitate international trade, but poses a challenge to the GPA and other market-opening instruments. If the goal is only to harmonize international commitments not to discriminate, that can be done in a few paragraphs; harmonization is relatively simple, and no real rationalization is needed, because the states joining the instrument will be agreeing only to foreswear discrimination.

If the goal is broader, though, to agree to reduce irrational barriers to efficient procurement, "rationalization" becomes much more complicated and difficult. It means reopening the international instruments to reduce explicit and hidden barriers to international procurement—and, in the process, to improve the efficiency of procurement

---

in Government Procurement of Foreign Goods in the U.S. and Western Europe (1976), *reprinted in* EVENETT & HOEKMAN, *supra* note 12, at 319, 326 (earlier study suggests that GPA and Trade Agreements Act, which came later, had important impact on U.S. procurement in neutralizing discrimination under the Buy American Act, for 1976 study suggested "that the 'Buy American' policy has had a significant impact in curtailing U.S. government procurement of imports").

systems in each of the signatory states. This is a very sophisticated, technical undertaking requiring extensive data on the member nations' existing procurement regimes, on how advanced those procurement systems are, and on the procurement strategies that those member nations should (and should not) rely upon.[132] Drawing a common regulatory thread among the member states—setting a lowest common denominator for fair procurement by international agreement—is difficult,[133] but not impossible.

An example illustrates the promise and perils of rationalization. As noted above, "framework" agreements have emerged as a critical issue in U.S. and European procurement systems. Framework agreements offer enormous promise by allowing agencies (often centralized procurement agencies) to establish standing contracts for commodity goods and services that reduce the time, expense and frustrations normally part of government procurement. Yet absent careful regulation, framework agreements can erode nondiscrimination commitments by quietly destroying the competition and transparency that are vital to a truly open procurement regime. In the United States, framework agreements have swallowed up billions of dollars in largely noncompetitive, nontransparent procurement, creating an invisible "gap" in the U.S. commitment to open its procurement market to its

132. For example, less developed procurement regimes, in an effort to minimize corruption, maximize competition, and increase transparency, tend to favor publicly disclosed bids or tenders with low price determining contractor success. More advanced regimes tend to employ "alternative means of competitive procurement that are better suited to the production of . . . complex goods and services—competitive negotiation techniques—[that] are more susceptible to subjectivity, bias, favouritism, and corruption." *See generally* Joshua I. Schwartz, *Learning From the United States' Procurement Law Experience: On "Law Transfer" And Its Limitations*, 11 PUB. PROC. L. REV. 115, 119 (2002). Schwartz suggests that:

> [T]he progression . . . from tendering systems in which the primary criterion for award of a contract among the field of competitors is the lowest price, to a best value system in which a much more extensive list of criteria is assessed to evaluate the quality of the goods or services offered, is one that developing procurement systems may be well advised to retrace, rather than race to the (temporary) end-state of best value procurement.

Id. at 121.

133. While corruption control is a common and entirely reasonable metric upon which to judge a procurement regime, Schwartz recognizes "that rigidly controlled procurement often fails to allow procurement officers to achieve good results for the government, especially in a dynamic environment." *Id.* at 120. Moreover, procurement reform always entails a balancing act. *See also* Schooner, *supra* note 18.

trading partners.

A simple international nondiscrimination agreement would not need to address framework agreements; indeed, even the recently revised GPA does not do so. That begs the question, however, of how to resolve framework agreements' potentially corrosive effect on international trade and member nations' own procurement systems. Rationalization of the GPA (or any other international instrument) would require assessing framework agreements' benefits and risks, and setting benchmarks for acceptable standards. By doing so, rationalization would enhance the GPA *and* the procurement systems of its member nations, improving both international trade and domestic efficiency. The GPA would gain legitimacy in the eyes of nonmember nations as a result, no longer viewed as merely as a wedge to open their domestic procurement markets to international vendors, but as a reliable tool for enhancing their own procurement regimes.

E. *Institutionalization*

The last step in opening public procurement markets, after harmonization and rationalization, is what we call here "institutionalization." As international procurement instruments expand their reach and address more complex barriers to trade, the key challenge will be to "institutionalize" the commitments those instruments make by working them into the fabric of member nations' procurement regimes.[134] There are a number of tools to "institutionalize," from training procurement officials and private firms in commonly accepted practices from open, competitive procurement regimes, to building states' institutional capacity to oversee and manage procurement. One of the readiest tools to ensure "institutionalization" would be a remedial means for competitors—prospective contractors—to enforce states' commitments.[135] The United States' experience in this regard shows the value of an effective remedies system in "institutionalization," and the shortcomings in the current treaty structure.

In the United States, concerned vendors may quite easily challenge the terms of a solicitation or award as discriminatory or illegal. There

134. *See, e.g.*, UNCITRAL MODEL LAW, *supra* note 91, at Guide to Enactment ¶¶ 36-40 (noting suggested steps for implementing UNCITRAL model law).

135. *See generally* Daniel I. Gordon, *Constructing a Bid Protest Process: the Choices that Every Procurement Challenge System Must Make*, 35 PUB. CONT. L. J. 427 (2006); Harvey Gordon, Shane Rimmer & Sue Arrowsmith, *The Economic Impact of the European Union Regime on Public Procurement: Lessons for the WTO* (1998), *reprinted in* EVENETT & HOEKMAN, *supra* note 12, at 431, 453 (arguing for effective remedies regime for enforcement).

are at least three established fora for such challenges, which are known as "bid protests" in the United States: the Government Accountability Office (which hears more than a thousand such challenges each year), the U.S. Court of Federal Claims (which hears far fewer), and the contracting agencies themselves (which generally do not publish statistics on agency-level protests).[136] A vendor may bring a bid protest in any of these fora, and can generally rely on a prompt and objective review of the vendor's concerns with appropriate remedies. Over many decades, the U.S. bid protest system has evolved into an effective means of ensuring competition, transparency, integrity, and accountability in the federal procurement system.[137] By affording a ready enforcement mechanism to vendors when the law is not followed, this mature bid protest system thus "institutionalizes" the procurement rules into the daily workings of the procurement system.

Current international instruments do not necessarily afford vendors (or other stakeholders) the same ready means of protest. The GPA, for example, requires that member states incorporate its requirements into their national laws and establish a forum to hear protests regarding violations of national law ("national challenge procedures"), but does *not* require that vendors be allowed to protest violations of the GPA.[138] Thus, if a member state violates the GPA and there is no corresponding violation of domestic law, the injured vendor's only recourse under the GPA is to complain to the vendor's government, which in turn may seek relief from the discriminating government.[139] The U.S. Commerce Department describes this process on its website by suggesting that government officials can help injured vendors understand their rights under the GPA, ask foreign officials to review the matter, or invoke the WTO dispute settlement process as a last

136. We view this election of forum as a historical oddity, and do not, as a matter of policy, suggest that it is efficient or optimal. Indeed, one of us has criticized the current regime at length. Steven L. Schooner, *The Future: Scrutinizing the Empirical Case for the Court of Federal Claims*, 71 GEO. WASH. L. REV. 714, 755-56, 768-70 (2003); Steven L. Schooner, Feature Comment, *Watching The Sunset: Anticipating GAO's Study Of Concurrent Bid Protest Jurisdiction in the COFC and the District Courts*, 42 GOV'T CONTRACTOR ¶ 108 (2000).

137. Indeed, we view this as a crucial form of third-party oversight of the procurement process. Steven L. Schooner, *Fear of Oversight: the Fundamental Failure of Businesslike Government*, 50 AM. U. L. REV. 627, 691-93 (2001).

138. *See* ARROWSMITH, *supra* note 13, at 386 (noting that if a member state has failed to incorporate a GPA requirement into domestic law, the injured vendor may in effect have no recourse through "national challenge" procedures based on national law).

139. *Id.* at 358-84 (discussing the process under the WTO Dispute Settlement Mechanism).

resort.[140]

As the Commerce Department's explanation suggests, instead of bringing a direct protest, the vendor must ask its home government to intervene with the offending government, and then, if that fails, to invoke the dispute process under the WTO.[141] It is extremely unlikely, however, that a system this unwieldy will truly institutionalize the GPA. Indeed, in its decade of existence, there have been only three matters brought under the current Government Procurement Agreement,[142] two of which (the consolidated matters relating to United States procurement) ended before decision, when the issue, a Massachusetts boycott against Myanmar, was addressed by the U.S. Supreme Court.[143]

Notably, possibly the most publicized event in the GPA's nondiscrimination regime—the United States' December 2003 announcement[144]

---

140. *See* U.S. Dep't of Commerce, Trade Compliance Ctr., Exporter's Guide to WTO Agreement on Government Procurement, http://tcc.export.gov/Trade_Agreements/Exporters_Guides/List_All_Guides/exp_005325.asp.

141. *See generally* Christopher F. Corr & Kristina Zissis, *Convergence and Opportunity: the WTO Government Procurement Agreement and U.S. Procurement Reform*, 18 N.Y.L SCH. J. INT'L & COMP. L. 303 (1999) (discussing vendors' practical difficulty in using cumbersome WTO process).

142. *See* Panel Report, *Korea—Measures Affecting Government Procurement*, WT/DS163/R (May 1, 2000), http://docsonline.wto.org (search "Document Symbol" for "WT/DS163/R); Request for Consultations by the European Communities, *United States—Measure Affecting Government Procurement*, WT/DS88/1 (June 26, 1997), http://docsonline.wto.org (search "Document Symbol" for "WT/DS88/1"); Request for Consultations by Japan, *United States—Measure Affecting Government Procurement*, WT/DS95/1 (July 21, 1997), http://docsonline.wto.org (search "Document Symbol" for "WT/DS95/1").

143. *See Crosby v. National Foreign Trade Council*, 530 U.S. 363 (2000) (declaring Massachusetts' procurement boycott unconstitutional because of preemption by federal law); ARROWSMITH, *supra* note 13, at 327-28 (discussing procedural history); Mitsuo Matsushita, *Major WTO Dispute Cases Concerning Government Procurement*, 1 ASIAN J. WTO & INT'L HEALTH L. & POL'Y 299, 300 (2006); *see also* WTO, Disputes Gateway, http://www.wto.org/english/tratop_e/dispu_e/find_dispu_cases_e.htm (database of WTO disputes).

144. See Paul Wolfowitz, Deputy Secretary of Defense, Determination and Findings (Dec. 5, 2003), stating, *inter alia*, that "essential security interests of the United States" necessitated that competition for a projected $18.6 billion in contracts to "upgrade and rebuild [Iraq's] electrical sector, public works and water, military courts and borders, building, housing and health, transportation, communications, and oil infrastructure" be limited to firms from the U.S., Iraq, and "coalition partners and force contributing nations." This action was noteworthy, not only because no nation formally challenged it, but also because, as a matter of U.S. law, Deputy Secretary Wolfowitz may have lacked the authority to execute it. See generally 10 U.S.C. § 2304(c)(7), as implemented by 48 C.F.R. § 6.302-7 (2007), indicating that: "*Limitations*. . . . A written determination to use this authority shall be made . . . by . . . The Secretary of Defense . . . or . . . [t]he head of any other executive agency. This authority may not be delegated." See also 48 C.F.R. § 206.302-7, "*Limitations*. For the defense agencies, the written determination to use this authority must be made by the Secretary of Defense." (Emphasis in the original.)

that it would not open prime contracts for Iraqi reconstruction to prime contractors from nations, including GPA member nations, that did not join the coalition that invaded Iraq—was apparently never raised in a WTO proceeding.[145] Political concerns may overwhelm even serious violations of the GPA, and the enforcement mechanism currently in place holds little guarantee of "institutionalizing" the GPA's rules; member states are, for most practical purposes, on their honor to bring their procurement systems into compliance with the GPA. As the international procurement system matures, therefore, and as the GPA's rules become a more central part of states' procurement regimes, it may prove vitally important to expand vendors' ability to bring "challenges" directly under the GPA.

V. Conclusion: A Global Public Procurement Regime?

The barriers that normally impede world procurement trade—classic domestic preferences, distorting and inefficient collateral social policies, corruption, self-serving agency "efficiencies" in procurement, and structural barriers to entry—are slowly eroding in the face of numerous international instruments, including various forms of agreements and guidance that are helping the world procurement market integrate. Although many nations continue to resist liberalization in procurement, a pattern of steps (a plan of action, really, to effect nondiscrimination) is beginning to emerge. To accept nondiscrimination as a norm—the fundamental predicate to a global procurement market—and to permit procurement regimes to operate more smoothly, the instruments used for guiding liberalization should be harmonized, with an eye to rationalizing those instruments to improve efficiency. Unlike the political decision to liberalize, which may be driven by a political elite, harmonization and rationalization require a much broader effort. The effort, in principle, should engage and coordinate the many technical, legal, and trade experts responsible for improving the instruments. Once harmonized and rationalized, the guiding instrument(s) should be institutionalized, through training, capacity building, and, where appropriate, challenge mechanisms. Such institutionalization involves an even broader orbit of technical, legal, and

145. *See, e.g.*, Christian Pitschas, *World Trade Organisation/United States: Award of Prime Contracts for Infrastructure Reconstruction in Iraq—an Assessment under the WTO Agreement on Government Procurement*, 13 PUB. PROC. L. REV. NA85 (2004); Owen Bonheimer, *The Duty to Prevent Waste of Iraqi Assets During Reconstruction: Taming Temptation Through ICJ Jurisdiction*, 34 PUB. CONT. L.J. 673, 692 (2005).

procurement personnel, as a procurement system at large is recast for an open market. The cycle of improvement can then turn full circle as challenges and other reviews disclose faults in the system that can be improved—both to assure international vendors of the procurement system's integrity and, equally importantly, to ensure that the system evolves towards efficient procedures that will produce optimal outcomes. Thus, opening procurement markets should, at least in principle, both enhance the value of goods and services bought, and strengthen the liberalizing procurement systems themselves.

CLA-000057

Defendant: Republic of Finland (represented by: A. Guimaraes-Purokoski, Agent)

Re:

Failure to fulfil obligations under Article 8(1), (2)(b) and 3(c) of Directive 2002/21/EC of the European Parliament and of the Council of 7 March 2002 on a common regulatory framework for electronic communications networks and services (OJ 2002 L 108, p. 33) and under Article 8(1) and (4) of Directive 2002/19/EC of the European Parliament and of the Council of 7 March 2002 on access to, and interconnection of, electronic communications networks and associated facilities ('Access' Directive) (OJ 2002 L 108, p. 7)

Operative part of the judgment

The Court:

1. *Dismisses the action;*

2. *Orders the Commission of the European Communities and the Republic of France to bear their own costs.*

---

[1] OJ C 294, 2.12.2006.

Judgment of the Court (First Chamber) of 24 January 2008 (reference for a preliminary ruling from the Simvoulio tis Epikratias, Greece) — Emm. G. Lianakis AE, Sima Anonymi Techniki Etairia Meleton kai Epivlepseon, Nikolaos Vlachopoulos v Dimos Alexandroupolis, Planitiki AE, Aikaterini Georgoula, Dimitrios Vasios, N. Loukatos kai Synergates AE Meleton, Eratosthenis Meletitiki AE, A. Pantazis — Pan. Kyriopoulos kai syn/tes OS Filon OE, Nikolaos Sideris

(Case C-532/06) [1]

(Directive 92/50/EEC — Public service contracts — Carrying out of a project in respect of the cadastre, town plan and implementing measure for a residential area — Criteria which may be accepted as 'criteria for qualitative selection' or 'award criteria' — Economically most advantageous tender — Compliance with the award criteria set out in the contract documents or contract notice — Subsequent determination of weighting factors and sub-criteria in respect of the award criteria referred to in the contract documents or contract notice — Principle of equal treatment of economic operators and obligation of transparency)

(2008/C 64/15)

Language of the case: Greek

Referring court

Simvoulio tis Epikratias

Parties to the main proceedings

Applicants: Emm. G. Lianakis AE, Sima Anonymi Techniki Etairia Meleton kai Epivlepseon, Nikolaos Vlachopoulos

Defendants: Dimos Alexandroupolis, Planitiki AE, Aikaterini Georgoula, Dimitrios Vasios, N. Loukatos kai Synergates AE Meleton, Eratosthenis Meletitiki AE, A. Pantazis — Pan. Kyriopoulos kai syn/tes OS Filon OE, Nikolaos Sideris

Re:

Reference for a preliminary ruling — Simvoulio tis Epikratias — Interpretation of Article 36 of Council Directive 92/50/EEC of 18 June 1992 relating to the coordination of procedures for the award of public service contracts (OJ 1992 L 209, p. 1) — Criteria for awarding contract — Subsequent fixing of the specific weighting for each criterion when the award procedure was already under way

Operative part of the judgment

Read in the light of the principle of equal treatment of economic operators and the ensuing obligation of transparency, Article 36(2) of Council Directive 92/50/EEC of 18 June 1992 relating to the coordination of procedures for the award of public service contracts, as amended by European Parliament and Council Directive 97/52/EC of 13 October 1997, precludes the contracting authority in a tendering procedure from stipulating at a later date the weighting factors and sub-criteria to be applied to the award criteria referred to in the contract documents or contract notice.

---

[1] OJ C 56, 10.3.2007.

Judgment of the Court (First Chamber) of 17 January 2008 (reference for a preliminary ruling from the Cour de cassation (France)) — Paul Chevassus-Marche v Groupe Danone, Société Kro beer brands SA (BKSA), Société Evian eaux minérales d'Evian SA (SAEME)

(Case C-19/07) [1]

(Approximation of laws — Directive 86/653/EEC — Self-employed commercial agents — Right of an agent entrusted with a specific geographical area to a commission — Transactions concluded without any action on the part of the principal)

(2008/C 64/16)

Language of the case: French

Referring court

Cour de cassation

Parties to the main proceedings

Applicant: Paul Chevassus-Marche

CLA-000058

JUDGMENT OF THE COURT (Fifth Chamber)
25 April 1996 *

In Case C-87/94,

Commission of the European Communities, represented by Hendrik van Lier, Legal Adviser, acting as Agent, with an address for service in Luxembourg at the office of Carlos Gómez de la Cruz, of its Legal Service, Wagner Centre, Kirchberg,

applicant,

v

Kingdom of Belgium, represented by Jan Devadder, Director at the Ministry of Foreign Affairs, Foreign Trade and Cooperation for Development, acting as Agent, and by Michel Waelbroeck and Denis Waelbroeck, of the Brussels Bar, with an address for service in Luxembourg at the Belgian Embassy, 4 Rue des Girondins,

defendant,

APPLICATION for a declaration that, by taking into account, in the procedure for the award of a public contract by the Société Régionale Wallonne du Transport, amendments made to one of the tenders after the opening of those tenders, by admitting to the procedure for the award of the contract a tenderer who did not meet the selection criteria laid down in the contract documents and by accepting a tender which did not meet the criteria for the award of the contract laid down in the contract documents, the Kingdom of Belgium has failed to fulfil its obligations under Council Directive 90/531/EEC of 17 September 1990 on the procurement

* Language of the case: French.

procedures of entities operating in the water, energy, transport and telecommunications sectors (OJ 1990 L 297, p. 1) and to comply with the principle of equal treatment, which underlies all the rules on procedures for the award of public contracts,

THE COURT (Fifth Chamber),

composed of: D. A. O. Edward (Rapporteur), President of the Chamber, J. C. Moitinho de Almeida, C. Gulmann, P. Jann and L. Sevón, Judges,

Advocate General: C. O. Lenz,
Registrar: H. A. Rühl, Principal Administrator,

having regard to the Report for the Hearing,

after hearing oral argument from the parties at the hearing on 13 July 1995,

after hearing the Opinion of the Advocate General at the sitting on 12 September 1995,

gives the following

Judgment

1 By application lodged at the Court Registry on 11 March 1994, the Commission of the European Communities brought an action under Article 169 of the EC Treaty for a declaration that, by taking into account, in the procedure for the award of a public contract by the Société Régionale Wallonne du Transport (SRWT), amendments made to one of the tenders after the opening of those tenders, by admitting

to the procedure for the award of the contract a tenderer who did not meet the selection criteria laid down in the contract documents and by accepting a tender which did not meet the criteria for the award of the contract laid down in the contract documents, the Kingdom of Belgium has failed to fulfil its obligations under Council Directive 90/531/EEC of 17 September 1990 on the procurement procedures of entities operating in the water, energy, transport and telecommunications sectors (OJ 1990 L 297, p. 1, hereinafter 'the Directive') and to comply with the principle of equal treatment, which underlies all the rules on procedures for the award of public contracts.

The Directive

2 The 32nd and 33rd recitals in the preamble to the Directive state that the rules to be applied by the entities concerned should establish a framework for sound commercial practice and leave a maximum of flexibility and that, as a counterpart for such flexibility and in the interest of mutual confidence, a minimum level of transparency must be ensured.

3 Article 2 of the Directive mentions, as one of the contracting entities to which the Directive applies, public undertakings operating a network providing a public bus service. Under the second subparagraph of Article 2(2)(c) such a network exists where the service is provided under operating conditions laid down by a competent authority of a Member State, such as conditions on the routes to be served, the capacity to be made available or the frequency of the service.

4 Article 4(1) provides that, when awarding supply contracts, the contracting entities are to apply procedures which are adapted to the provisions of the Directive.

5 Article 4(2) states that contracting entities are to ensure that there is no discrimination between different suppliers or contractors.

6 Article 27(2) provides that where the contract is to be awarded to the most economically advantageous tender '... contracting entities shall state in the contract documents or in the tender notice all the criteria they intend to apply to the award, where possible in descending order of importance'.

7 Finally, Article 27(3) states:

'Where the criterion for the award of the contract is that of the most economically advantageous tender, contracting entities may take account of variants which are submitted by a tenderer and meet the minimum specifications required by the contracting entities. Contracting entities shall state in the contract documents the minimum specifications to be respected by the variants and any specific requirements for their presentation. Where variants are not permitted, they shall so indicate in the contract documents.'

8 A joint statement by the Council and the Commission concerning Article 15 of the Directive (OJ 1990 L 297, p. 48) provides:

'*The Council and the Commission* state that in open and restricted procedures all negotiation with candidates or tenderers on fundamental aspects of contracts, variations in which are likely to distort competition, and in particular on prices, shall be ruled out; however, discussions with candidates or tenderers may be held but only for the purpose of clarifying or supplementing the content of their tenders or the requirements of the contracting entities and provided this does not involve discrimination.'

The facts

9 By a tender notice published in the supplement to the *Official Journal of the European Communities* of 22 April 1993 (OJ 1993 S 78, p. 76), the SRWT, which is based in Namur (Belgium), issued an invitation to tender for the award, under an open procedure, of a public contract for the supply of 307 standard vehicles. That contract, for an estimated sum of over BFR 2 000 000 000 (excluding VAT) and divided into eight lots, was to be performed over a period of three years.

10 The contract documents consisted of the *Cahier des Charges Type No 1* (hereinafter 'the general conditions') and the *Cahier Spécial des Charges No 545* (hereinafter 'the special conditions'), which amended the general conditions in certain respects.

11 Point 20.2 of the special conditions provided that the contract was to be awarded to the most economically advantageous tender. That tender would be selected on the basis of an evaluation of the tenders by reference to the award criteria under headings which are set out in point 59 of the Advocate General's Opinion. An evaluation was to be made, in particular, of the basic price of the bus, increased by the price of variants taken into account and then adjusted in accordance with the advantages and disadvantages resulting from the application of ten technical assessment criteria (hereinafter 'the technical criteria').

12 The SRWT expressly requested potential tenderers to propose certain variants concerning the financial structure of the contract, such as staggered payment terms, lease or hire of the vehicles.

13 As regards the technical criteria, the special conditions laid down, under each heading, a formula enabling the SRWT to allocate for certain features of the buses

offered a notional bonus or penalty in 'francs fictifs', the amount of which depended on the variables of the formula and was to be added to or deducted from the basic price.

14 After sending the contract documents to the interested parties, the SRWT issued three notices of amendment, dated 30 April, 5 May and 28 May 1993, rectifying and clarifying the contract documents in certain respects. In the second notice the SRWT clarified certain aspects of the contract documents relating to the minimum number of seated places, the desired total number of places, the maximum height of the floor and the formula for calculating one of the notional penalties. Each notice stated that tenderers had to indicate clearly in their tenders that they had received the notices of amendment and that they had taken them into account.

15 By 7 June 1993, the date fixed by the tender notice for both the receipt and the public opening of tenders, the following five companies had submitted tenders: EMI (Aubange), Van Hool (Koningshooikt), Mercedes-Belgium (Brussels), Berkhof (Roeselaere) and Jonckheere (Roeselaere).

16 The SRWT examined those tenders during June and July 1993. A memorandum dated 24 August 1993, drawn up for the meeting of the *conseil d'administration* on 2 September 1993, recommended the award of Lot No 1 to Jonckheere and Lots Nos 2 to 6 to Van Hool.

17 In the meantime, on 3, 23 and 24 August 1993 EMI had sent to the contracting entity three 'supplementary' notes commenting on certain points of its initial tenders, in particular fuel consumption, the frequency of engine and gearbox replacements, and certain aspects of the technical quality of the material offered.

18 After examining those three notes, the technical department of the contracting entity drew up a memorandum on 31 August 1993 stating that EMI's supplementary notes contained changes to its initial tenders and could not therefore be taken into account. The proposals for the award of contracts in the memorandum drawn up for the meeting on 2 September 1993 should therefore still stand.

19 At the meeting on 2 September 1993 the *conseil d'administration* took the view that it had insufficient information to adopt a final decision. In particular it was unsure whether it could take EMI's three supplementary notes into account and decided to ask for a legal opinion on that question from the Walloon Minister of Transport.

20 By letter of 14 September 1993 the Walloon Minister of Transport replied that, as regards most of the points mentioned, no legal problem would be raised by taking into account EMI's three supplementary notes. He therefore suggested that the file be re-examined in the light of his observations.

21 On 28 September 1993 the SRWT requested EMI to confirm the fuel consumption figures indicated in its supplementary note of 24 August 1993 and also the frequency of the engine and gear box replacements referred to in the supplementary note of 23 August 1993. By letter of 29 September 1993 EMI confirmed that the information it had supplied was correct.

22 Following that confirmation, the SRWT undertook a fresh comparison of the tenders, taking into account the content of the three supplementary notes. A memorandum prepared for the meeting of the *conseil d'administation* on 6 October 1993 proposed awarding Lot No 1 to Jonckheere and Lots Nos 2 to 6 to EMI.

23 At its meeting on 6 October 1993 the *conseil d'administration* decided, first, to adopt those proposals and thus award Lot No 1 to Jonckheere and Lots Nos 2 to 6 to EMI and, secondly, to postpone until 1996 an order for 30 vehicles.

24 On the same day, Van Hool applied to the Belgian Conseil d'État for an order suspending the operation of that decision under the emergency procedure. That application was dismissed by judgment of 17 November 1993.

25 On 30 November 1993 the Commission, with which Van Hool had lodged a complaint, gave the Kingdom of Belgium formal notice to submit its observations pursuant to Article 169 of the Treaty. By letter of 15 December 1993 the Belgian Government stated that the allegation that it had failed to fulfil its obligations was unfounded. The Commission was not satisfied by that reply and delivered a reasoned opinion to the Belgian Government, requesting it to intervene with the competent authorities to suspend the legal effects of the contract concluded between the SRWT and EMI. In its reply to that opinion, the Belgian Government claimed that the Commission had not proved any failure to fulfil obligations.

26 On 11 March 1994 the Commission brought the present action and applied for interim measures to suspend both SRWT's decision to award the contract and the measures implementing that decision. That application was dismissed by order of 22 April 1994.

27 By letter of 9 June 1995 the Commission abandoned its second plea, which alleged that the Kingdom of Belgium had accepted tenders from EMI which did not meet the selection criteria laid down in the special conditions.

28 The application, as so amended, seeks a declaration that the Kingdom of Belgium has failed to fulfil its obligations under the Directive and to comply with the principle of equal treatment of tenderers which underlies all the rules on procedures for the award of public contracts, in that, in the procedure for the award of a public contract by the SRWT,

— it took into account amendments made to one of the tenders after the opening of tenders, and

— it accepted a tender which did not meet the criteria for the award of the contract laid down in the contract documents.

29 Before examining those heads of complaint it is necessary to consider the Belgian Government's claim that the Directive does not apply in the present case.

The applicability of Community law

30 It is not disputed that the SRWT is a public undertaking operating a network providing a public bus service within the meaning of Article 2 of the Directive and that it therefore had to comply with the rules of the Directive, in conformity with Article 4, when it awarded the contract for the supply of the eight lots of buses at the origin of this action.

31 However, since all the tenderers are Belgian companies, the Belgian Government claims that the case concerned a purely internal situation to which Community law did not apply.

32 That argument cannot be accepted.

33 The obligation imposed on contracting entities by Article 4(1) of the Directive is not subject to any condition concerning the nationality or seat of tenderers. Moreover, as the Advocate General has pointed out in point 24 of his Opinion, it is always possible that undertakings established in other Member States may be concerned directly or indirectly by the award of a contract. The procedure laid down by the Directive must therefore be observed irrespective of the nationality or seat of the tenderers.

34 In the course of the procedure the Belgian Government also claimed that the contracting entity was not obliged to award the contract through an open procedure. It could have chosen a negotiated procedure and its conduct would have been in conformity with such a procedure.

35 Suffice it to state that, although under Article 15(1) of the Directive contracting entities obliged to apply the procedures in the Directive do indeed have a degree of choice regarding the procedure to be applied to a contract, once they have issued an invitation to tender under one particular procedure, they are required to observe the rules applicable to it, until the contract has been finally awarded.

The heads of complaint

36 The Commission considers that, by taking into account information submitted to it in EMI's three supplementary notes concerning, in particular, fuel consumption, the frequency of engine and gear box replacements, and certain aspects of the

technical quality of the material offered, EMI breached the principle of the equal treatment of tenderers.

37 As regards fuel consumption, the Commission complains that, when evaluating the tenders, the Kingdom of Belgium took into account the new consumption indicated by EMI to the SRWT after the opening of the tenders, which had been changed from the figure in its initial tenders.

38 As regards the frequency of engine and gear box replacements, the Commission complains that the Kingdom of Belgium took into account information supplied by EMI after the opening of tenders, which amended its initial tenders and also failed to comply with the prescriptive requirements of the contract documents.

39 As regards the technical quality of the material offered, the Commission considers that, when evaluating EMI's tenders, the SRWT wrongly took into account matters not included amongst the award criteria.

Fuel consumption

40 Point 20.2.2.1 of the special conditions provides:

'20.2.2.1 Fuel consumption

When comparing tenders, a notional advantage equivalent to the value of 6 000 litres of diesel for a standard bus (official price at the date of the opening of tenders) will be awarded for each whole litre per 100 km difference between the fuel consumption guaranteed in the tender (including tolerance) under the test cycle laid down in Annex 10 to these contract documents and the fuel consumption of the vehicle with the highest consumption.'

41 Under the conditions laid down in that annex, the test was to be performed with a vehicle loaded with a weight corresponding to the minimum number of passengers.

42 In its original tenders, EMI indicated a fuel consumption of 54 litres per 100 km in respect of Lots Nos 2 to 6. However, in Note No 1 (hereinafter 'Note 1') annexed to its tenders EMI claimed that, since consumption of 54 litres per 100 km had been obtained in tests on a vehicle which had not been run in and was not particularly well-tuned, the consumption which would be recorded with a vehicle which was both run in and optimally tuned could be reduced by 5 to 8% in relation to the consumption indicated in its tenders.

43 EMI also confirmed in its initial tenders that it had received the three notices of amendment and that it had taken them into account.

44 The SRWT carried out a first evaluation of the tenders on the basis of the fuel consumption indicated by EMI in its initial tenders, namely 54 litres per 100 km. Since it had the highest fuel consumption of all the tenders submitted for those lots, that consumption was, according to the method of calculation stipulated in the special conditions, to be used as the basis for evaluating the notional advantages of the other tenders. It is clear from Annexes 5 and 6 to the memorandum drawn up for the meeting of 2 September 1993 that in the course of that evaluation EMI's tenders were not accorded any notional advantage in respect of fuel consumption, whereas all the other tenderers were accorded such advantages, calculated by reference to the consumption indicated by EMI.

45 In its first supplementary note of 3 August 1993, EMI informed the SRWT of its interpretation of the purport of notice of amendment No 2. EMI claimed that, as a consequence of that notice, the total number of places stipulated in the special conditions as an absolute contractual requirement had been waived. That waiver affected the calculation of fuel consumption, since the equal treatment of tenderers logically required that the calculation be made on the basis of maximum authorized weight. It concluded that, for its data to be compared with those of the other tenderers, it was necessary to take into account the consumption indicated in its initial tenders, reduced by 8%.

46 Thereafter, in its supplementary note of 24 August 1993, EMI informed the SRWT, after referring to the contents of Note 1, that it had carried out further tests, this time under optimal conditions, and that these had shown a fuel consumption for its tenders relating to Lots Nos 2 to 6 of 45 litres per 100 km, representing a reduction of 16.7% on the consumption of 54 litres per 100 km. EMI requested the SRWT to take that new consumption into account when evaluating its tenders.

47 The Belgian Government has confirmed that SRWT did take that new consumption into account when awarding the contract to EMI.

48 Since EMI's new fuel consumption was no longer the highest, the SRWT re-evaluated the notional advantages awarded to all the tenderers. Annexes 1 and 2 to the memorandum drafted for the meeting of 6 October 1993 show that in the second evaluation the notional advantages of tenderers other than EMI were reduced in relation to those awarded on the first evaluation, so that Jonckheere no longer had any notional advantages, whereas EMI's tenders were awarded an advantage.

49 The Commission considers that SRWT breached the principle of the equal treatment of tenderers by taking into account, when allocating the contract, the data

supplied by EMI in its supplementary note of 24 August 1993 which amended, after the opening of tenders, the consumption initially indicated by EMI.

50 The Belgian Government submits, first, that the principle of equality of treatment actually required EMI's correction of its fuel consumption to be taken into account in the award of the contract, since the other tenderers had indicated already optimized results in their initial tenders. Secondly, it points out that fuel consumption is objective and verifiable; the amendment was therefore not a matter of choice, nor was it made after negotiations with the contracting entity. Finally, the change had no effect on the technical characteristics of the vehicle or its engine and EMI's initial tenders were not therefore amended.

51 It is to be noted at the outset that in Case C-243/89 *Commission* v *Denmark* [1993] ECR I-3353 (the 'Storebaelt case'), at paragraph 33, the Court held that the duty to observe the principle of equal treatment of tenderers lies at the heart of Council Directive 71/305/EEC of 26 July 1971 concerning the coordination of procedures for the award of public works contracts (OJ, English Special Edition 1971 (II), p. 682).

52 As is shown by Article 4(2) the position is the same in the case of the Directive in question here.

53 Furthermore, the 33rd recital in the preamble shows that the Directive aims to ensure a minimum level of transparency in the award of the contracts to which it applies.

54 The procedure for comparing tenders therefore had to comply at every stage with both the principle of the equal treatment of tenderers and the principle of transparency so as to afford equality of opportunity to all tenderers when formulating their tenders.

55 When, as in the present case, a contracting entity opts for an open procedure, such equality of opportunity is ensured by the requirement under Article 16(1)(a) of the Directive for the contracting entity to act in accordance with Annex XII A of the Directive. It must therefore both set a final date for receipt of tenders, so that all tenderers have the same period after publication of the tender notice within which to prepare their tenders, and set the date, hour and place of opening tenders, which also reinforces the transparency of the procedure, since the terms of all the tenders submitted are revealed at the same time.

56 When a contracting entity takes into account an amendment to the initial tenders of only one tenderer, it is clear that that tenderer enjoys an advantage over his competitors, which breaches the principle of the equal treatment of tenderers and impairs the transparency of the procedure.

57 In the present case it is not disputed that, first, the reduction in fuel consumption indicated by EMI in its supplementary note of 24 August 1993 considerably exceeded the limit of 8% referred to by EMI in Note 1 annexed to its initial tenders and, secondly, that in its final comparison of the tenders the SRWT took into account that last figure of consumption.

58 Without it even being necessary to decide whether the SRWT could have taken into account the new consumption indicated by EMI in its supplementary note of 3 August 1993, which was within the 8% limit stipulated in its tender, the fact that that limit was exceeded shows that the new consumption of 45 litres per 100 km constituted an amendment of EMI's initial tenders. Indeed, in its supplementary notes EMI referred to points in the notices of amendment, which it claimed to

have taken into account in its initial tender, and did not explain why its new tests could not have been carried out before the final date for receipt of tenders. It follows that the consumption of 45 litres per 100 km should not on any view have been taken into account.

59 Moreover, the taking into account of those figures placed the other tenderers at a disadvantage by changing the amount of notional advantages resulting from the first comparison of tenders, thus affecting their ranking.

60 It must therefore be held that, by taking into account information on fuel consumption submitted by EMI in its supplementary note of 24 August 1993 and, therefore, after the opening of tenders, the Kingdom of Belgium failed to fulfil its obligations under the Directive.

The frequency of engine and gear box replacements

61 Point 20.2.2.2 of the special conditions provides:

'20.2.2.2 Assembly and dismantling times, price of spare parts

The tenderer shall set out the prices of spare parts and the assembly and dismantling times of the items listed in Annex 23.

In conformity with the table in Annex 23, a notional penalty will be applied automatically to all tenders to take account of maintenance costs.'

62 According to the table in Annex 23 a notional penalty was to be imposed in regard to the maintenance costs of only 45 components of the bus. For each component mentioned, that penalty was calculated by reference to a formula in which the variables were the number of identical items of that component in the bus, the dismantling time, the assembly time, the price and the foreseeable number of replacements of the component.

63 However, for the purposes of calculating the notional penalty, Annex 23 of the special conditions asked tenderers to indicate figures for only the first three variables. As regards the foreseeable number of replacements, Annex 23 set out, on the basis of SRWT's experience, a fixed number for each component, the figures for engine and gear box replacement being two and three respectively. Potential tenderers were therefore not asked to state the foreseeable number of replacements for those two components.

64 In conformity with the terms of Annex 23, EMI did not, when completing the table provided, indicate any proposal regarding the foreseeable number of replacements for the components mentioned. However, in its supplementary note of 23 August 1993 it stressed to the SRWT that provision should be made for only one engine and 1.25 gear boxes when using its buses and that the figures fixed by the SRWT in Annex 23 should not, therefore, be applied to its tenders.

65 The Belgian Government accepts that, when the SRWT calculated the notional penalty for EMI's tenders, the SRWT used those new figures instead of the figures appearing in the table in Annex 23, whereas when calculating the notional penalties for all other tenders it applied the latter figures.

66 The Commission considers that such conduct infringes the principle of equal treatment of tenderers in two respects. First, by taking the figures in question into account when awarding the contract, the SRWT allowed one of the tenderers to amend the terms of its initial tenders after they had been opened. Secondly, since those new figures did not comply with the prescriptive requirements of the table in Annex 23, the SRWT awarded the contract to a tenderer in disregard of the award criteria it had itself laid down in the special conditions.

67 As regards the first of those complaints, the Commission considers that if, following the observations submitted by EMI, the SRWT believed that, in the light of the tenders lodged, the prescriptive requirements it had laid down were wrong, it could have amended them by offering the other tenderers the same opportunity to depart from them. However, since it gave such an opportunity only to EMI, it breached the principle of equal treatment of tenderers.

68 The Belgian Government considers that EMI did not amend its initial tenders, since the material offered remained precisely the same. All the other tenderers could also have informed the SRWT that the performance of their buses exceeded the requirements of Annex 23. It concludes that, if the SRWT could not take the figures in question into account, it would be precluded from taking into consideration the advantages of vehicles of more recent design.

69 It should be recalled that Annex 23 of the special conditions did not ask tenderers to indicate the frequency of spare part replacements for their buses. On the contrary, the SRWT had fixed a figure for that element in respect of each component in the table. Moreover, in point 20.2.2.2 of the special conditions the SRWT had stated that a notional penalty would be applied to all tenders 'in accordance with the table in Annex 23'. The figures in that table must therefore be considered to be prescriptive requirements of the special conditions.

70 The Court held in the *Storebaelt* case, at paragraph 37, that when a contracting entity had laid down prescriptive requirements in the contract documents, observance of the principle of equal treatment of tenderers required that all the tenders must comply with them so as to ensure objective comparison of the tenders.

71 Accordingly, the requirements of Annex 23 continued to be applicable to all the tenders and those tenders had to comply with them. It must therefore be held that EMI was not entitled to 'amend' the terms of its initial tenders regarding those requirements and that the SRWT was not entitled to calculate EMI's notional penalties by reference to its new figures, which did not correspond to the prescriptive requirements of the special conditions.

72 The fact that EMI's new figures were taken into account necessarily gave it a real advantage when the tenders were compared. According to Annex 23, the figure relating to the frequency of spare part replacements acts, for the purposes of calculating the notional penalty, as a multiplier of the other figures provided by the tenderers relating to costs. As regards EMI's notional penalty, the SRWT used a figure for the number of replacements which was lower than that laid down in Annex 23 and, therefore, lower than those used in the calculation for the other tenders. The notional penalty for the maintenance of the components in question in EMI's buses was therefore obtained by using a lower multiplier.

73 Since the SRWT permitted only EMI to disregard the requirements in question, it is not necessary to decide whether the Commission is correct in considering that the SRWT could after opening the tenders have altered the prescriptive requirements fixed by the contract documents, giving all tenderers the same opportunity to disregard those requirements.

74 It must therefore be held with regard to this part of the complaint that, by awarding the contract to EMI on the basis of figures which did not correspond to the prescriptive requirements of Annex 23 of the special conditions for calculating its

notional penalty for maintenance costs for engine and gear box replacement, the SRWT infringed the award criteria laid down in the special conditions and also the principle of equal treatment of tenderers. The Kingdom of Belgium therefore failed to fulfil the obligations which the directive imposes on it in that regard.

The technical quality of the material offered

75 In its supplementary note of 3 August 1993 EMI claimed that 'the day-to-day running' of the buses it offered 'enables significant savings' to be made by the operator. EMI drew up two lists of features of the bus which enabled those savings to be made (hereinafter 'the cost-saving features').

76 The first list, entitled 'Quantifiable features', concerned the cantilever seats offered, a mechanism for demisting the side windows, and a special modular assembly system. EMI indicated, for each of those features, the financial advantage which would result during the lifetime of each bus, namely BFR 480 000, BFR 240 000 and BFR 100 000 respectively.

77 The second list, entitled 'Non-quantifiable features', included eight features which contributed to 'cost-savings', although EMI did not evaluate them in its initial tenders or in its supplementary note of 3 August 1993.

78 The Commission contends that the SRWT took those cost-saving features into account when deciding to award the contract to EMI, although they did not appear in the award criteria listed in the tender notice or in the contract documents. Under Article 27(2) of the Directive, which applies in the present case, only the criteria stated in the tender notice or in the contract documents should have

been taken into account by the SRWT when awarding the contract. Furthermore, the SRWT took account of those features solely when assessing EMI's tenders, while for the other tenders it applied strictly the award criteria set out in point 20.2 of the special conditions. That conduct breached, once again, the principle of equal treatment.

79 In the memorandum drawn up for the meeting of 6 October 1993 SRWT's management referred to all those cost-saving features when recommending the award of Lots Nos 2 to 6 to EMI. It stated, in the reasons for its recommendation in respect of Lot No 2, that the cost-saving features had 'a not inconsiderable financial impact', so that they were 'likely to have a favourable influence on the vehicle's operating costs, to an extent greatly exceeding the financial difference resulting solely from the valuation criteria adopted'.

80 According to the file, as regards Lots Nos 4, 5 and 6, the comparison of tenders solely on the basis of the award criteria laid down in point 20.2 of the special conditions had led to one of Van Hool's tenders being placed first, whereas one of EMI's tenders, even taking into account the figures supplied by it in its supplementary notes regarding fuel consumption and engine and gear box replacements, was placed second. The differences between the best tenders of Van Hool and the second-placed tenders of EMI amounted to BFR 294 799, BFR 471 513 and BFR 185 897 respectively for the three lots. However, after the cost-saving features had been taken into account, that initial ranking was reversed, so that, despite those differences, an EMI tender replaced the Van Hool tender as the tender recommended for those lots.

81 The Belgian Government has formally accepted that all the cost-saving features were taken into account in the decision to award the contract and that this had a decisive influence on the choice of EMI as supplier for Lots Nos 2 to 6.

82 The Belgian Government observes that point 20.2.1 of the special conditions expressly permitted the SRWT to take account of any suggestions, such as the cost-saving features. Moreover, Article 27(3) of the Directive also authorized the SRWT to take account of such suggestions, provided that they met the minimum specifications required.

83 It adds that the cost-saving features, which were in conformity with the minimum specifications in the contract documents, were not evaluated when the tenders were compared, but were taken into account as un-quantified comfort and quality features, leading to the conclusion that, taken as a whole, EMI's offer was economically the most advantageous. Furthermore, both the tender notice and the special conditions referred to the technical qualities of the material offered as being a criterion of award. It concludes that the SRWT was therefore entitled to take account of the cost-saving features at issue.

84 The Commission accepts that tenderers have the right to submit variants and that those variants may be taken into account by a contracting entity, provided, however, that the principle of equal treatment is observed. It contends that it was not observed in the present case, since the derogation from the criteria laid down in the special conditions resulted in an advantage being granted only to EMI.

85 The Court finds that the cost-saving features were not amongst the award criteria adopted by the SRWT for the award of the contract.

86 Admittedly the headings for the award criteria set out in point 20.2 of the special conditions could be interpreted — if no regard is had to the subsequent definitions — as having a wide scope (see, for example, in point 20.2.2.4 of the special conditions, the heading for the seven technical criteria, namely 'the technical qualities of the material offered'), so that, as the Belgian Government submits, all the characteristics relating to the technical qualities of the material offered would be relevant when comparing the tenders.

87 However, the SRWT itself defined all the technical criteria using a precise formula set out under each heading (see paragraph 13 of this judgment). Accordingly, the scope of the technical criteria, whatever the wording of the headings, was restricted by the formulas used by the SRWT to define them.

88 The requirement under Article 27(2) of the Directive for the contracting entities to state 'in the contract documents or in the tender notice all the criteria they intend to apply to the award, where possible in descending order of importance' is intended precisely to inform potential tenderers of the features to be taken into account in identifying the economically most advantageous offer. All the tenderers are thus aware of the award criteria to be satisfied by their tenders and the relative importance of those criteria. Moreover, that requirement ensures the observance of the principles of equal treatment of tenderers and of transparency.

89 Furthermore, although Article 27(3) of the Directive does indeed enable contracting entities to take account of variants, that provision must be interpreted in the light both of the principles underlying the Directive and of Article 27(2). Accordingly, in order to ensure that a contract is awarded on the basis of criteria known to all the tenderers before the preparation of their tender, a contracting entity can take account of variants as award criteria only in so far as it expressly mentioned them as such in the contract documents or in the tender notice.

90 As regards the Belgian Government's submissions concerning the taking into account of 'suggestions', suffice it to note that Article 27(3) of the Directive recognizes only the taking into account of variants, not suggestions. Moreover, the Directive makes no reference to them as award criteria and, consequently, such suggestions cannot be taken into account by a contracting entity when awarding the contract either.

91 In the present case it is sufficient to find that the principles of equal treatment of tenderers and of transparency of the procedure have not been observed and it is not therefore necessary to decide whether the rule laid down in Article 27(2) of the Directive precludes a contracting entity from changing its award criteria during the course of the procedure, provided that it observes those principles.

92 It is clear that, for Lots Nos 4, 5 and 6, the SRWT applied, in the case of EMI alone, the cost-saving features suggested by EMI to offset the financial differences, amounting to BFR 294 799, BFR 471 513 and BFR 185 897, between the tenders of Van Hool in first place and those of EMI placed second. Even if, as the Belgian Government submits, the SRWT did not allocate a precise value to the cost-saving features, EMI provided it with a list of 'Quantifiable features' (see paragraph 76 of this judgment), the total amount of which for each lot (BFR 820 000) more than sufficed to offset those differences.

93 On the other hand, as regards Lots Nos 2 and 3, it is evident from the memorandum drawn up for the meeting of 6 October 1993 that the tenders of EMI at issue were in first place even before the SRWT had taken the cost-saving features into account. The SRWT could not therefore have attached decisive importance to the cost-saving features relating to those lots, since EMI's tenders were already regarded as the most economically advantageous. This part of the complaint has not therefore been established.

94 It must be concluded that, by taking into account, in its comparison of tenders for Lots Nos 4, 5 and 6, the cost-saving features suggested by EMI without having referred to them in the contract documents or in the tender notice, by using them to offset the financial differences between the tenders in first place and those of EMI placed second and by accepting some of EMI's tenders as a result of taking those features into account, the Kingdom of Belgium failed to fulfil its obligations under the Directive.

95 Accordingly, the Court finds that

— by taking into account information on fuel consumption submitted by EMI in its supplementary note of 24 August 1993 and, therefore, after the opening of tenders,

— by awarding the contract to EMI on the basis of figures which did not correspond to the prescriptive requirements of Annex 23 of the special conditions for calculating the notional penalty of EMI for maintenance costs in respect of engine and gear box replacement,

— by taking into account, when comparing the tenders for Lots Nos 4, 5 and 6, the cost-saving features suggested by EMI without having referred to them in the contract documents or in the tender notice, by using them to offset the financial differences between the tenders in first place and those of EMI placed second, and by accepting some of EMI's tenders as a result of taking those features into account,

the Kingdom of Belgium has failed to fulfil its obligations under the Directive.

Costs

96 Under Article 69(2) of the Rules of Procedure, the unsuccessful party is to be ordered to pay the costs if they have been applied for in the successful party's pleadings. Since the Kingdom of Belgium has been unsuccessful and the Commission has applied for costs, the former must be ordered to pay the costs.

On those grounds,

THE COURT (Fifth Chamber)

hereby:

1. **Declares that, by taking into account, in the procedure for the award of a public contract by the Société Régionale Wallonne du Transport, information on fuel consumption submitted by EMI in its supplementary note of 24 August 1993 and, therefore, after the opening of tenders, by awarding the contract to EMI on the basis of figures which did not correspond to the prescriptive requirements of Annex 23 of the special conditions for calculating the notional penalty of EMI for maintenance costs in respect of engine and gear box replacement, by taking into account, when comparing the tenders for Lots Nos 4, 5 and 6, the cost-saving features suggested by EMI without having referred to them in the contract documents or in the tender notice, by using them to offset the financial differences between the tenders in first place and those of EMI placed second, and by accepting some of EMI's tenders as a result of taking those features into account, the Kingdom of Belgium has failed to fulfil its obligations under Council Directive 90/531/EEC of 17 September 1990 on the procurement procedures of entities operating in the water, energy, transport and telecommunications sectors;**

2. **Orders the Kingdom of Belgium to pay the costs.**

Edward Moitinho de Almeida Gulmann

Jann Sevón

Delivered in open court in Luxembourg on 25 April 1996.

R. Grass — D. A. O. Edward

Registrar — President of the Fifth Chamber

REVIEW OF EUROPEAN ADMINISTRATIVE LAW; VOL. 0, NR. 1, P. 51-61, EUROPA LAW PUBLISHING © 2007
CLA-000059

Dimensions of Transparency: The Building Blocks for a New Legal Principle?

Prof. Dr. Sacha Prechal & Dr. Madeleine de Leeuw

Professor of European law and lecturer/researcher in European law, Utrecht University, Europa Instituut, The Netherlands

Abstract

This short article explores a number less well-known aspects of the principle of transparency in so far as it emerges in the relationship between public authorities and individuals . The debate about transparency was, until know, strongly focused on transparency in the sense of openness of government and access to EU documents. The phenomenon is, however, much broader, cutting across various fields and levels of EU. Are we facing a process of a new legal principle coming into being?

1 Introduction

Ever since the 1990s transparency has gained considerable attention in the EU context. The most familiar and also the most developed dimension of transparency is openness in the decision-making process, and in particular access to documents. There are, indeed, other elements included in transparency, such as the clarity of procedures, clear drafting, the publication and notification of legislation/decisions and the duty to give reasons.

These elements manifest themselves on different levels. On the political – or perhaps constitutional – level they are often linked to the fundamental notions of democracy, legitimacy and accountability. There is, however, the more concrete level of administration and, arguably, transparency also plays a role between private individuals. As examples we could mention the extensive transparency and information obligations in EU financial markets regulation or, in a completely different area, the directive 'on an employer's obligation to inform employees of the conditions applicable to the contract or employment relationship.'[1] We are not going to address this dimension as we will confine ourselves to the relationships between public authorities and individuals (which may indeed be undertakings). To this, one may also add another distinction: the EU level and the level of the Member States. As

* The present short article is directly based on a more extensive study which is going to be published, in 2008, as a contribution to U. Bernitz, C. Cardner and J. Nergelius (eds.), *General Principles of Community Law in the Process of Development*, Kluwer Law International.

1 Directive 91/533, OJ 1991 L 288/32.

we will show, EU law-inspired transparency is increasingly relevant on both levels.

The various elements of transparency are relatively open-ended and have to be honed down in the context of the more specific areas of application in order to produce some concrete results. Clarity of legislative texts, for instance, is something which is different from the clarity of an individual decision. Nevertheless, the question should be asked whether these elements do not constitute separate building blocks of an overarching principle of transparency. To some extent one may compare this with the right of defence, a general principle of Community law, which in fact is also 'built up' from a number of sub-principles, such as the right to be informed, the right to be heard, the right not to incriminate oneself, the right to legal assistance and legal privilege.[2]

An interesting phenomenon in this respect is that there is a considerable overlap of the various elements of transparency or the – often loosely used – notion of transparency itself with other principles. In many respects transparency or its elements seem rather to support other general principles of law, instead of having a self-standing meaning. We will illustrate this interplay with a number of examples. On the basis of this brief discussion, we will reflect on the question whether transparency is emerging as a new general principle of EU law.

2 Transparency and the Principle of Sound Administration

Transparency in the sense of access to a person's file, which may be considered as an individual manifestation of access to documents in general, is explicitly recognised in Article 41(2) of the Charter of Fundamental Rights as a part of the right to good administration. Although access to a file is often linked to the right of defence, in the Charter it was included under the broader heading of good administration.

The *Natural health* case[3] illustrates another aspect of transparency, namely the need to have clear procedures. At the same time it also provides a fine example of how the principle guides the interpretation of legislation, aiming, *inter alia*, at the avoidance of an outright conflict. This case concerned, as far as is relevant, the legality of a procedure, provided under Directive 2002/46[4], to be followed when a decision has to be taken as to whether certain vitamins and minerals in food supplements may be placed

[2] Cf. Jans a.o. *Europeanisation of Public Law*, Europa Law Publishing, Groningen 2007, at p. 191-193.

[3] Joined Cases C-154/04 and C-155/04 *Natural Health* [2005] ECR I-6451.

[4] Directive 2002/46 (approximation of the laws of the Member States relating to food supplements), OJ 2002 L 183/51.

on the market, i.e. included in a so-called 'positive list'. AG Geelhoed was of the opinion that the 'procedure, in so far as it may exist and in so far as it may deserve this title, has the transparency of a black box: no provision is made for parties to be heard, no time-limits apply in respect of decision-making; nor, indeed, is there any certainty that a final decision will be taken.'[5] In his view, since the Directive lacked appropriate and transparent procedures for its application, it infringed the principle of proportionality and was, therefore, invalid.[6] The ECJ did not agree with this and found that the procedure was indeed legal. However, it did point out that '[I]t would, no doubt, have been desirable ... for the directive to have included provisions which in themselves ensured that that stage [*the critical stage of the procedure, including the consultation of the European Food Safety Authority (EFSA) – SP/ MdL*] be completed transparently and within a reasonable time.'[7] The lack of such provisions had to be compensated by the Commission. By virtue of the implementing powers conferred on it by Directive 2002/46, it had to adopt, in accordance with the principle of sound administration, the measures necessary to ensure that the consultation stage with the EFSA is carried out transparently and within a reasonable time.

In the area of state aid, it follows from the legislation and the case law that decisions must be taken without delay and must be addressed to the Member States concerned in the interest of transparency and legal certainty.[8] Therefore, a failure to notify the Commission's decision to the Member State concerned can in certain circumstances justify the annulment of an act of a Community institution.[9] However, in some cases the obligations of the Commission may extend further: according to the CFI, the Commission may be bound in accordance with its duty of 'sound administration' or 'sound administration and transparency' to inform the complainant of its decisions or its consequences.[10]

3 Transparency and the Principle of Legal Certainty

The marriage between legal certainty and transparency entails at least two different aspects. For a part it coincides with the requirements of the clarity and unambiguous nature of legal texts. In this respect,

[5] Point 85 of the Opinion.

[6] Proportionality played a role in the sense that objectives of the Directive could have been achieved by less restrictive solutions than the approach taken by the Community legislature.

[7] Para. 81 of the judgment.

[8] Preamble 21 to Council Regulation 659/1999 (detailed rules for the application of Article 93 of the EC Treaty), OJ 1999 L 83/1.

[9] Case C-398/00 *Spain* v. *Commission* [2002] ECR I-5643, para. 33.

[10] See Case T-82/96 *ARAP* v. *Commission* [1999] ECR II-1889 and Case T-277/94 *AITEC* v. *Commission* [1996] ECR II-351.

together with the requirement of publication, it strongly supports the cognizability of the law. For another part, in so far as it militates in favour of policy rules and perhaps even their codification in binding acts, at a certain moment it helps to make policy action predictable in the case of broad discretionary powers. Here it serves as one of the safeguards against discretion ending up as arbitrariness.

According to well-established Luxembourg case law, Community legislation must be certain and its application must be foreseeable by individuals. It is here, in particular, that the principle of legal certainty requires every measure of the institutions having legal effects to be clear and precise and brought to the notice of the person concerned. The latter must be able to know the extent of the obligations which it imposes on him/her.[11] Although the required clarity, precision and notification or publication undoubtedly also pertain to transparency, as a rule they are treated as a matter of legal certainty. However, since more recent times, transparency seems to 'sneak in' discretely, either in the judgments or at least is the opinions of Advocates General.

In case C-110/03, *Belgium* v. *Commission*,[12] the Belgian government sought the annulment of (group) Regulation 2204/2002.[13] It argued that the fifth recital in the preamble to Regulation 994/98 (the enabling regulation) requires exemption regulations to increase transparency and legal certainty, but that Regulation 2204/2002 on aid to employment is completely lacking in clarity in terms of both context and content. The AG first noted that the preamble or introductory recitals are not binding, and therefore any failure to take the principle of transparency and legal certainty into account cannot lead to the annulment of the Regulation. However, according to the AG, "both the principle of transparency and legal certainty must be respected by the legislature as sources of Community law, and a failure to do so would, under article 230 EC constitute an infringement, irrespective of whether they are referred to in the preamble to Regulation 994/98".[14] The AG subsequently analyzed whether the Regulation lacks transparency in the sense of "the quality of being clear, obvious and understandable without doubt or ambiguity".[15] In the end he was satisfied that there was no breach.

The ECJ did not refer to the principle of transparency as it found that the Belgian argument as to the Regulation's lack of clarity in reality concerned a breach of the general principle of legal certainty. From the case it can be deduced that the ECJ may, at most, consider transparency only as an element of the principle of legal certainty.

---

11 Cf. *inter alia* T-115/94 *Opel Austria* [1997] ECR II-2739, and long before this case e.g. Case 70/83 *Kloppenburg* [1984] ECR 1075.

12 [2005] ECR I-2801.

13 Commission Regulation 2204/2002 (on the application of Articles 87 and 88 of the EC Treaty to State aid for employment), OJ 2002 L 337/3.

14 Point 36.

15 Point 44

However, in Case *C-149/96*[16] the Court took a slightly different position. Portugal argued, in this case, that the principle of transparency had been breached "because the contested decision approves Memoranda of Understanding which [were] not adequately structured and [were] drafted in obscure terms which prevent a normal reader from immediately grasping all their implications, in particular as regards their retroactive application".[17] The ECJ dismissed this argument, however, not because Portugal could not rely on the principle of transparency, but because it found the decision to be clear in every relevant aspect.

Similarly, in the case law on the proper implementation of directives, which is, as is well known, strongly influenced by the principle of legal certainty, transparency sometimes features as a separate requirement. Thus, for instance, according to Case *C-417/99*, provisions of directives must be implemented in national law "with precision, clarity and transparency required in order to comply fully with the requirement of legal certainty".[18] Or the provisions must be "... capable of creating a situation which is sufficiently precise, clear and transparent to enable individuals to ascertain their rights and obligations".[19] This case law also illustrates how transparency may also permeate the law at the national level.

As to the second aspect, the area of state aid and competition provides some good examples. In this field the Commission attaches – as it has done since the mid-1990s – great importance to the transparency and predictability of its policy. This has resulted in the adoption and publication by the Commission of numerous soft-law instruments such as notices, communications, frameworks, guidelines, and codes, but also legislation on the application of the rules in those sectors by the Commission.

For example, in the field of state aid the Commission has adopted guidelines concerning aid to employment.[20] The guidelines explained that their objective is to clarify the interpretation of Articles 92 and 93 (now articles 87 and 88) of the Treaty with regard to State aid in the field of employment in order to ensure *greater transparency* of notification decisions under Article 93 of the Treaty. In case *C-310/99* the ECJ explained that such guidelines, setting out the approach that the Commission proposes to follow, help to ensure that it acts in a manner which is transparent, foreseeable and consistent with legal certainty.[21]

---

[16] Case C-149/96 *Portugal* v. *Council* [1999] ECR I-8395.

[17] Para. 55.

[18] Case C-417/99 *Commission* v. *Spain* [2001] ECR I-6015, para. 40.

[19] Case C-177/04 *Commission* v. *France* [2006] ECR I-2461, para 48.

[20] OJ 1995 C 334/4. These guidelines have ceased to exist from the date of the entry into force of Commission Regulation 2204/2002 of 12 December 2002 on the application of articles 87 and 88 of the EC Treaty to state aid to employment, OJ 2002 L 337/3.

[21] Case C-310/99 *Italian Republic* v. *Commission*[2002] ECR I-2289.

Another illustration is the guidelines on the method of setting fines imposed pursuant to article 15(2) of Regulation 17/62 and article 65(5) ECSC in competition cases.[22] For many years the Commission has been criticised for the opaque manner in which it calculated fines in competition cases.[23] Before the adoption of the guidelines, undertakings were required to commence court proceedings to know the method for calculating fines imposed upon them. However, this lack of transparency did not, in the opinion of the ECJ, amount to a violation of the obligation to provide reasoned decisions.[24] It follows from the preamble to the guidelines that they were adopted with a view to ensuring the *transparency and impartiality* of the Commission's decisions in that area (recital 1). According to the ECJ, the guidelines also ensure legal certainty on the part of the undertakings themselves.[25] By making the criteria for the setting of fines public, the Commission shall impose similar fines on undertakings which violate competition rules in similar circumstances.

In other – more general – terms, by clearly setting out in what way the Commission shall exercise its discretionary powers, it makes this exercise visible, clear and understandable, i.e. transparent. In this way, it becomes possible to foresee the behaviour of the institution and to achieve legal certainty. The fact that many rules regarding the Commission's discretionary exercise of powers in the area of state aid and competition are laid down in soft-law instruments, such as guidelines, does not mean that the Commission can deviate there from whenever it pleases. The Court has ruled that the Commission, by adopting and publishing rules of conduct designed to produce external effects, has imposed a limit on the exercise of its discretion and cannot depart from those rules under pain of being found, where appropriate, to be in breach of the general principles of law, such as equal treatment or the protection of legitimate expectations.[26] By setting out in detail the procedural rules, it is prevented that the Commission acts in a

---

[22] OJ 1998 C 9/3. The guidelines have now been replaced by new ones adopted pursuant Regulation 1/2003. Guidelines on the method of setting fines imposed pursuant to Article 23(2)(a) of Regulation No. 1/2003, OJ 2006 C 210/3.

[23] See in particular Case T-148/89 *Tréfilunion* v. *Commission* [1995] ECR II-1063.

[24] See C-248/98 *P NV Koninklijke KNP BT* v. *Commission* [2000] ECR I-9641.

[25] See, for example, Case C-167/04 P *JCB Service* v. *Commission* [2006] ECR I-8935. The link between transparency, foreseeability and legal certainty has also been made by the ECJ in respect of the guidelines published by the Commission setting out the amount of lump-sum or penalty payments which it intends to propose to the Court that they should be calculated in the light of Article 228(2) EC. See C-177/04 *Commission* v. *French Republic* [2006] ECR I-2461.

[26] See Joined cases C-189/02 P, C-202/02 P, C-205/02 P to C-208/02 P and C-213/02 P *Dansk Rørindustri A/S and Others* v. *Commission* [2005] ECR I-5425, par. 211. This case concerned the Guidelines on setting fines.

partial and non-objective manner. Therefore, we submit that transparency here functions as a mechanism to prevent arbitrary behaviour on the part of the institution in question.

4 Transparency and the Principle of Equal Treatment

Most clearly elaborated seems to be the relationship between transparency and non-discrimination, in particular where is aims to safeguard objectivity and non-discrimination in public procurement[27] and comparable – in particular public concessions – procedures.

The first contours of transparency in public procurement can be found in the judgment in Case C-87/94 *Commission* v. *Belgium*, in which the Court held, on the basis of the text of Directive 90/531, that the procedure for comparing tenderers had to comply at every stage with both the principle of the equal treatment of tenderers and the principle of transparency. The relationship between equality of treatment and transparency was elaborated in more detail in a number of cases, first in public procurement cases – on the national[28] and EU level[29] – but soon also in relation to concessions, which are outside the scope of the public procurement directives[30] or in cases which are below the thresholds of the procurement directives.[31] This 'spillover' from procurement to concessions was possible precisely because the link established between equal treatment or non-discrimination and transparency. As the ECJ pointed out, the principle of equal treatment underlies both the EC public procurement rules and the free movement rules of the internal market which govern, *inter alia*, the award of concessions.[32]

The relationship between equal treatment and transparency is not entirely clear. In some cases the principle of equal treatment and non-

[27] I.e. the four procurement directives are Directive 93/36 (supplies), OJ 1993 L 199/1, Directive 93/37 (works), OJ 1993 L 199/54, Directive 92/50 (services), OJ 1992 L 209/1 and Directive 93/38 (utility sectors), OJ 1993 L 199/84. These have been recently replaced by Directive 2004/18 (procedures for the award of public works contracts, public supply contracts and public service contracts), OJ 2004 L 134/114 and Directive 2004/17 (procurement procedures of entities operating in the water, energy, transport and postal services sectors), OJ 2004 L 134/1.

[28] See, for instance, Case C-275/98 *Unitron* [1999] ECR I-8291 and Case C-470/99 *Universale Bau* [2002] ECR I-11617.

[29] Cf. Joined Cases T-191/96 and T-106/97 *Succhi de fruttta* [1999] ECR II-3181 and Case T-183/00 *Strabag Benelux NV* [2003] ECR II-135.

[30] Cf. Case C-324/98 *Telaustria* [2000] ECR I-10745 and Case C-231/03 *Coname* [2005] ECR I-7287.

[31] Case C-6/05 *Medipac*, judgment of 14 June 2007, nyr. in ECR.

[32] Cf. for instance Case C-470/99 *Universale-Bau* [2002] ECR I-1617, Case C-231/03 *Coname* [2005] ECR I-7287 and Case C-458/03 *Parking Brixen* [2005] ECR I-8612.

discrimination is said to imply an obligation of transparency.[33] The judgment in *Coname* clarifies that non-compliance with transparency requirements amounts to a violation of the rule against discrimination.[34] In *Succhi di Frutta* the principle of transparency is referred to as the 'corollary' of the principle of equal treatment between tenderers.[35] However, there are also cases which may suggest that transparency and equal treatment are to be considered as two separate principles which exist alongside each other.[36] In any case, while, on the one hand, there is a very close link between the principle of equal treatment and transparency, on the other transparency also has, in certain respects, a more specific meaning of its own. It requires, *inter alia*, the clear and unambiguous drafting of the conditions for and the rules on the award procedure. The selection and award criteria must be formulated in such a way as to allow all reasonably well-informed and normally diligent tenderers to interpret them in the same way.[37] The adjudicating authority must interpret the selection and award criteria in the same way throughout the entire procedure and must apply them objectively and uniformly to all tenderers.[38] The substantive and procedural conditions concerning participation in a contract, including criteria for selecting candidates and those for awarding the contract must be clearly defined in advance and made known to the persons concerned.[39] In principle, no new criteria or specifications may subsequently be taken into account.[40] There should be at least a certain a degree of publicity or advertising in order to enable the market in question to be opened up to competition.[41]

---

[33] Cf. for instance Case C-19/00 *SIAC* [2001] ECR I-7725 and Case C-410/04 *ANAV* [2006] ECR I-3303.

[34] Case C-231/03 *Coname* [2005] ECR I-7287.

[35] Case C-496/99 P *Succhi di frutta* [2004] ECR I-3801; or principle transparency flows from principle of equal treatment: cf. C-340/02 *Commission* v. *France* [2004] ECR I-9845.

[36] For instance Case C-458/03 *Parking Brixen* [2005] ECR I-8612, para. 50 or Case C-448/01 *Wienstrom* [2003] ECR I-14527, para. 58.

[37] Case C-19/00 *SIAC* [2001] ECR I-7725 and Case C-448/01 *Wienstrom* [2003] ECR I-14527.

[38] Cf. Case C-19/00 *SIAC* [2001] ECR I-7725 and Case C-448/01 *Wienstrom* [2003] ECR I-14527. Case C-6/05 *Medipac*, judgment of 14 June 2007, nyr. in ECR goes in the same direction.

[39] For instance Case C-470/99 *Universale-Bau* [2002] ECR I-1617 and Joined Cases C-226/04 and C-228/04 *La Cascina* [2006] ECR I-1347.

[40] Cf. Case C-6/05 *Medipac*, judgment of 14 June 2007, nyr. in ECR (unless, for instance, the health and safety of patients is at stake, as was arguably the case in Medipac. Then, however, the appropirate procedures, where present, have to be followed).

[41] A question under discussion for some time now is how to flesh out the 'sufficient degree of publicity' since it can hardly be the purpose of this case law to oblige all contract awards to be publicly announced. For a disussion of this question see, for instance, the Opinion of AG Sharpston, of 18 January 2007, in Case C-195/04 *Commission* v. *Finland* and the Opinion of AG Stix-Hackl, of 14 Septemebr 2006, in case C-532/03 *Commission* v. *Ireland*. Cf. also the

The principle of equal treatment is said to imply an obligation of transparency for mainly two reasons. The first is the *creation* of equality of opportunity, thus to place all potential bidders on an equal footing. According to the ECJ transparency affords all interested parties equality of opportunity in formulating the terms of the applications for and participation in the tenders. The absence of any transparency may amount to indirect discrimination on the ground of nationality which is prohibited by the Treaty, in particular under Articles 43 and 39.[42]

The second reason is to facilitate the control of compliance with the principle of equal treatment. The ECJ stresses in its case law that transparency enables the contracting or concession-granting authorities to ensure that the principles of equal treatment and non-discrimination are complied with,[43] and the impartiality of procurement procedures are to be reviewed.[44] In other terms, as we understand it, such control must be possible *during* the award procedure and *ex post*. Without transparency, it is not very feasible for both the tenderers and the authorities to verify whether the principle of equal treatment has been complied with.[45]

The fact that transparency must make it possible to review whether the principle of non-discrimination has been observed illustrates, in our view, that transparency precedes non-discrimination and in this sense it can be separated from equal treatment. Another indication to consider transparency as a principle independent from equality and non-discrimination is that it is also 'intended to preclude any risk of favouritism or arbitrariness on the part of the contracting authority.'[46] In brief, in some respects transparency seems to extend beyond what non-discrimination requires. The – partly – independent nature of transparency also seems to be underlined in recent public procurement legislation. In two directives from 2004, transparency

Commission's Interpretative [*and not entirely unambiguous- SP/MdL*] Communication on the Community law applicable to contract awards not or not fully subject to the provisions of the Public Procurement Directives, OJ 2006 C 179/2.

[42] Case C-231/03 *Coname* [2005] ECR I-7287, para. 17 and 18.

[43] Case C-458/03 *Parking Brixen* [2005] ECR I-8612, para. 49 and Case C-324/98 *Telaustria* [2000] ECR I-10745, para. 61.

[44] Case C-458/03 *Parking Brixen* [2005] ECR I-8612, para. 49 and Case C-324/98 *Telaustria* [2000] ECR I-10745, para. 62.

[45] Some cases may suggest that what is at stake is mainly control by the authorities. However, also tenderers have some interest in control. Indeed, such a broader interpretation seems to be the correct one. Cf. Case C-26/03 *Stadt Halle* [2005] ECR I-1, para. 39: "The obligation of transparency, to which the contracting authority is subject in order to make it possible to verify that the Community rules have been complied with (*HI*, paragraph 45), should be noted in this respect."

[46] Case C-496/99 P *Succhi di frutta* [2004] ECR I-3801, para. 111 and Case C-6/05 *Medipack*, judgment of 14 June 2007, nyr. in ECR, para. 53.

has been codified alongside the requirements of equal treatment and non-discrimination.[47]

An interesting aspect of the close link between transparency and the principles of equal treatment and non-discrimination is the potential to spread out to other areas of the law, beyond public procurement and concession contracts. Since equality of treatment and non-discrimination underpin the fundamental Treaty freedoms, it is not difficult to imagine that equal treatment may serve as a vehicle for extending the scope of transparency requirements. After all, the transparency requirements apply to concessions exactly because these are governed by the Treaty provisions on the free movement of services and establishment. The effects may and do, however, reach further, in particular where other aspects of market access are at issue.

In EU legislation, the coupling of transparency and non-discrimination can be found, for instance, in directives concerning liberalization of network sectors, such as Article 7(3) of Directive 2002/20 (authorisation of electronic communications networks and services),[48] Article 6 of Directive 2003/54 (common rules for the internal market in electricity),[49] Articles 9 and 11 of Directive 2002/21 (common regulatory framework for electronic communications networks and services – the Framework Directive)[50] or Article 9 Directive 97/67 (internal market for Community postal services).[51]

Another example of the codification of transparency in relation to market access in a more general fashion can be found in the Services Directive.[52] In so far as this Directive allows for authorisation schemes, justified by overriding reasons relating to public interest (Article 9), the latter must 'be based on criteria which preclude the competent authorities from exercising their power of assessment in an arbitrary manner.' (Article 10) According to Section 2 of Article 10, these criteria shall, *inter alia*, be '(a) non-discriminatory; ... (d) clear and unambiguous; ... (f) made public in advance; (g) transparent and accessible.'[53] Interesting in the Service Directive is also Article 12, which deals with a limited number of authorisations being available due to the scarcity of natural resources or technical capacity. The Member States are bound to apply a selection procedure to potential candidates which

[47] Directive 2004/18 (procedures for the award of public works contracts, public supply contracts and public service contracts), OJ 2004 L 134/114, Article 2 and Directive 2004/17 (procurement procedures of entities operating in the water, energy, transport and postal services sectors), OJ 2004 L 134/1, Article 10.

[48] OJ 2002 L 108/21.

[49] OJ 2003 L 176/37.

[50] OJ 2002 L 108/33.

[51] OJ 1998 L 15/14.

[52] Directive 2006/123 (services in the internal market), OJ 2006 L 376/36.

[53] Indeed, one may here wonder what meaning is left for transparency itself where it features alongside the requirements of clarity and unambiguity, accessibility and being made public in advance.

'provides full guarantees of impartiality and transparency, including, in particular, adequate publicity about the launch, conduct and completion of the procedure.' Article 13(1) provides that authorization procedures and formalities shall be 'clear, made public in advance and be such as to provide the applicants with a guarantee that their application will be dealt with objectively and impartially.'

5 Some Conclusions

Until now, only transparency in the sense of 'access to documents' has been generally considered as a serious nominee for being accepted as a general principle of Community law.[54] However, our brief exploration illustrates that transparency as a legal principle 'in gestation' may cover a much broader area of the law. In many respects it may be too early to recognize transparency as a self-standing principle of law. The various elements need to be crystallized in more detail and have to gain – partly in that same process – more autonomy.

To an extent it is possible to identify a number of recurring core elements of transparency, despite the different 'colouring in' depending on the context: clear language, physical access to information and, closely linked to that, publication or notification, the predictability of public authorities' actions/behaviour, and consistency in the interpretation and application of the law. This may sometimes require the drafting of policy rules which curtail the use of the discretionary powers of the authority concerned. However, the very concrete meaning of the various elements are still very much in a process of taking shape, either in case law or in legislation. The still uncertain content of transparency may also explain why transparency is often linked to other well-established principles of law. The coupling of transparency with another principle also depends on the area or context in which transparency is invoked.

The moulding process which is discretely going on is particularly confusing in the sense that transparency emerges on so many levels. Sometimes it appears next to other legal principles or, occasionally, instead of an established principle. In other situations it is presented as an element of a principle of law, for instance, alongside clarity and precision when legal certainty is at stake. Yet, in other cases any reference to transparency is lacking. Again in other cases it is suggested that transparency includes clarity and precision.

In any case, transparency seems to overlap – partially or completely – with certain elements in other legal principles. How must we asses this? In part, transparency here builds upon existing legal values, such as legal

[54] P. Craig and G. de Búrca, *EU Law: Text, Cases and Materials*, Fourth Edition, Oxford University Press, Oxford 2007, p. 567, referring to K. Lenaerts.

certainty and equality of treatment. At the same time it further elaborates these values. However, as it also leads to a new amalgamation of these elements, it provides a new – integrated – perspective and, potentially, new dynamics.

CLA-000060

CASE No. ARB(AF)/97/1

INTERNATIONAL CENTRE FOR
SETTLEMENT OF INVESTMENT DISPUTES
(ADDITIONAL FACILITY)

B E T W E E N:

METALCLAD CORPORATION
Claimant

and

THE UNITED MEXICAN STATES
Respondent

A W A R D

Before the Arbitral Tribunal constituted under Chapter Eleven of the North American Free Trade Agreement, and comprised of:

Professor Sir Elihu Lauterpacht, QC, CBE
President
Mr Benjamin R. Civiletti
Mr José Luis Siqueiros

Date of dispatch to the parties: August 30, 2000

TABLE OF CONTENTS

		Paragraph
I.	INTRODUCTION	1
II.	THE PARTIES	2–5
	A. The Claimant	2–4
	B. The Respondent	5
III.	OTHER ENTITIES	6
IV.	PROCEDURAL HISTORY	7–27
V.	FACTS AND ALLEGATIONS	28–69
	A. The Facilities at Issue	28–29
	B. Metalclad's Purchase of the Site and Its Landfill Permits	30–36
	C. Construction of the Hazardous Waste Landfill	37–44
	D. Metalclad is Prevented from Operating the Landfill	45–69
VI.	APPLICABLE LAW	70–71
VII.	THE TRIBUNAL'S DECISION	72–112
	A. Responsibility for the conduct of state and local governments	73
	B. NAFTA, Article 1105: fair and equitable treatment	74–101
	C. NAFTA, Article 1110: Expropriation	102–112

VIII. QUANTIFICATION OF DAMAGES OR COMPENSATION 113–129

A. Basic elements of Valuation 113–125
B. “Bundling” 126
C. Remediation 127
D. Interest 128
E. Recipient 129

IX. COSTS 130

X. AWARD 131

I. INTRODUCTION

1. This dispute arises out of the activities of the Claimant, Metalclad Corporation (hereinafter "Metalclad"), in the Mexican Municipality of Guadalcazar (hereinafter "Guadalcazar"), located in the Mexican State of San Luis Potosi (hereinafter "SLP"). Metalclad alleges that Respondent, the United Mexican States (hereinafter "Mexico"), through its local governments of SLP and Guadalcazar, interfered with its development and operation of a hazardous waste landfill. Metalclad claims that this interference is a violation of the Chapter Eleven investment provisions of the North American Free Trade Agreement (hereinafter "NAFTA"). In particular, Metalclad alleges violations of (i) NAFTA, Article 1105, which requires each Party to NAFTA to "accord to investments of investors of another Party treatment in accordance with international law, including fair and equitable treatment and full protection and security"; and (ii) NAFTA, Article 1110, which provides that "no Party to NAFTA may directly or indirectly nationalize or expropriate an investment of an investor of another Party in its territory or take a measure tantamount to nationalization or expropriation of such an investment ('expropriation'), except: (a) for a public purpose; (b) on a non-discriminatory basis; (c) in accordance with due process of law and Article 1105(1); and (d) on payment of compensation in accordance with paragraphs 2 through 6". Mexico denies these allegations.

II. THE PARTIES

A. The Claimant

2. Metalclad is an enterprise of the United States of America, incorporated under the laws of Delaware. Eco-Metalclad Corporation (hereinafter "ECO") is an enterprise of the United States of America, incorporated under the laws of Utah. ECO is wholly-owned by Metalclad, and owns 100% of the shares in Ecosistemas Nacionales, S.A. de C.V. (hereinafter "ECONSA"), a Mexican corporation. In 1993, ECONSA

purchased the Mexican company Confinamiento Tecnico de Residuos Industriales, S.A. de C.V. (hereinafter "COTERIN") with a view to the acquisition, development and operation of the latter's hazardous waste transfer station and landfill in the valley of La Pedrera, located in Guadalcazar. COTERIN is the owner of record of the landfill property as well as the permits and licenses which are at the base of this dispute.

3. COTERIN is the "enterprise" on behalf of which Metalclad has, as an "investor of a Party", submitted a claim to arbitration under NAFTA, Article 1117.

4. In these proceedings, Metalclad has been represented by:

Clyde C. Pearce, Esq.
Law Offices of Clyde C. Pearce
1418 South Main Street
Suite 201
Salinas, California 93908
USA.

B. The Respondent

5. The Respondent is the Government of the United Mexican States. It has been represented by:

Lic. Hugo Perezcano Diaz
Consultor Juridico
Subsecretaria de Negociaciones Comerciales Internacionales
Direccion General de Consultoria Juridica de Negociaciones
Secretaria de Comercio y Fomento Industrial
Alfonso Reyes No.30, Piso 17
Colonia Condesa
Mexico, Distrito Federal, C.P. 06149
Mexico.

III. OTHER ENTITIES

6. The Town Council of Guadalcazar, SLP, is the municipal government of Guadalcazar, the site of the landfill project. While neither Guadal-

cazar nor SLP are named as Respondents, Metalclad alleges that Guadalcazar and SLP took some of the actions claimed to constitute unfair treatment and expropriation violative of NAFTA.

IV. PROCEDURAL HISTORY

7. On October 2, 1996, Metalclad delivered to Mexico a Notice of Intent to Submit a Claim to Arbitration in accordance with NAFTA, Article 1119, thereby instituting proceedings on behalf of its wholly owned enterprise, COTERIN, for purposes of standing under NAFTA, Article 1117. On December 30, 1996, Metalclad delivered to Mexico a written consent and waiver in compliance with NAFTA, Article 1121(2)(a) and (b).

8. On January 2, 1997, and pursuant to the NAFTA, Article 1120, Metalclad filed its Notice of Claim with the International Centre for Settlement of Investment Disputes (hereinafter "ICSID"),[1] and requested the Secretary-General of ICSID to approve and register its application and to permit access to the ICSID Additional Facility.

9. On January 13, 1997, the Secretary-General of ICSID informed the parties that the requirements of Article 4(2) of the ICSID Additional Facility Rules had been fulfilled and that Metalclad's application for access to the Additional Facility was approved. The Secretary-General of ICSID issued a Certificate of Registration of the Notice of Claim on that same day.

10. On May 19, 1997, the Tribunal was constituted. The Secretary-General of ICSID informed the parties that the Tribunal was "deemed to have been constituted and the proceedings to have begun" on May 19, 1997, and that Mr. Alejandro A. Escobar, ICSID, would serve as Secretary to the Tribunal. All subsequent written communications between the Tribunal and the parties were made through the ICSID Secretariat.

---

[1] Under NAFTA, Article 1120(1)(b), a disputing investor may submit its claim to arbitration under the Additional Facility Rules of ICSID provided that either the disputing Party whose measure is alleged to be a breach referred to in Article 1117 (in this case, Mexico) or the Party of the investor (in this case, the United States of America), but not both, is a party to the ICSID Convention. The United States of America is a party to the ICSID Convention; Mexico is not. Hence the Additional Facility Rules of ICSID appropriately govern the administration of these proceedings.

11. The first session of the Tribunal was held, with the parties' agreement, in Washington, D.C. on July 15, 1997. In accordance with Article 21 of the ICSID Arbitration (Additional Facility) Rules (hereinafter "the Rules"), the Tribunal then determined that the place of arbitration would be Vancouver, British Columbia, Canada. The parties accepted that determination by the Tribunal.

12. Numerous requests for production of documents were exchanged by the parties, some of which were allowed, and some of which were disallowed, particularly those that came later in the proceedings. Through instructions given by its President,[2] the Tribunal issued a ruling on April 27, 1999, relating to Mexico's April 14, 1999 Request for Production of Documents. The President of the Tribunal indicated that he could not, at that stage of the case, decide the extent to which the requested documents and materials might be relevant to the case, but ordered Metalclad to produce the documents at issue and noted that Metalclad might seek an award of costs related to the production should the requests be adjudged unreasonable or improper. No such finding has been made.

13. On September 10, 1997, pursuant to NAFTA, Article 1134 providing for interim measures of protection and Article 28 of the Rules providing for Procedural Orders, Mexico filed a Request for a Confidentiality Order seeking a formal order that the proceedings be confidential. Metalclad filed its response on October 9, 1997. On October 27, 1997, the Tribunal issued a determination, which in its material part reads as follows:

> "There remains nonetheless a question as to whether there exists any general principle of confidentiality that would operate to prohibit public discussion of the arbitration proceedings by either party. Neither the NAFTA nor the ICSID (Additional Facility) Rules contain any express restriction on the freedom of the parties in this respect. Though it is frequently said that one of the reasons for recourse to arbitration is to avoid publicity, unless the agreement between the parties incorporates such a limitation,

[2] At the first session of the Tribunal, of July 15, 1997, the parties agreed that the President of the Tribunal should have the power to determine procedural matters.

> each of them is still free to speak publicly of the arbitration. It may be observed that no such limitation is written into such major arbitral texts as the UNCITRAL Rules or the draft Articles on Arbitration adopted by the International Law Commission. Indeed, as has been pointed out by the Claimant in its comments, under United States security laws, the Claimant, as a public company traded on a public stock exchange in the United States, is under a positive duty to provide certain information about its activities to its shareholders, especially regarding its involvement in a process the outcome of which could perhaps significantly affect its share value.
>
> "The above having been said, it still appears to the Arbitral Tribunal that it would be of advantage to the orderly unfolding of the arbitral process and conducive to the maintenance of working relations between the Parties if during the proceedings they were both to limit public discussion of the case to a minimum, subject only to any externally imposed obligation of disclosure by which either of them may be legally bound".

14. On October 14, 1997, Metalclad filed its Memorial. On December 17, 1997, Mexico filed a Request for an Extension of Time for the filing of its Counter-memorial. Metalclad filed an Opposition to the requested extension, Mexico filed a Reply and Metalclad filed a Rejoinder. On January 7, 1998, the Tribunal granted Mexico's request for an extension and ordered that Mexico's Counter-Memorial be filed February 17, 1998.

15. On February 17, 1998, Mexico filed its Counter-Memorial without objection. Certain exhibits of Mexico's Counter-Memorial were filed May 22, 1998, and Mexico's translations of certain exhibits were filed with the Claimant on July 17, 1998 and with the Secretariat on July 20, 1998.

16. On February 20, 1998, Metalclad filed a Motion for Sanctions regarding Mexico's "untimely" filing of its Counter-Memorial. Metalclad objected to Mexico's failure to submit translations of all pertinent documents with the Counter-Memorial on the date due and set by previous

Order of the Arbitral Tribunal. Mexico filed an Opposition to the Motion for Sanctions, to which Metalclad filed a Reply and Rejoinder, to which Mexico filed an additional Opposition. On March 31, 1998, the Tribunal denied Metalclad's Motion for Sanctions and stated that non-acceptance of the Counter-Memorial and/or the exclusion of certain documents from consideration would be excessive under the circumstances. The Tribunal further stated that it had been "unable to identify significant, if any, harm suffered by the Claimant by reason of the delay in the filing of the translations".

17. On April 6, 1998, Metalclad filed a Request to Submit a Reply to Mexico's Counter-Memorial, to which Mexico filed an Opposition. On April 20, 1998, the Tribunal granted Metalclad's Request to Submit a Reply, and ordered Metalclad to file the same by June 30, 1998. In its Order, the Tribunal noted that the date for Mexico's Rejoinder would be set after the Tribunal had considered the Reply.

18. On June 22, 1998, Metalclad filed a Motion for Additional Time to File its Reply, to which Mexico filed a Response. On June 29, 1998, the Tribunal granted Metalclad's Motion for Additional Time and ordered the Reply to be filed August 6, 1998. On July 28, 1998, the Tribunal granted the Claimant's request for a further extension of the time period for filing its Reply until August 21, 1998.

19. On August 21, 1998, Metalclad filed its Reply without objection. Transcriptions of portions of the American Appraisal Associate's ("AAA") Expert Report were filed September 3, 1998. Translations of the Reply were filed September 22, 1998 and translations of the AAA Expert Report were filed September 28, 1998.

20. On October 5, 1998, Mexico filed Observations regarding Metalclad's Reply. Metalclad filed a Reply to the Observations, to which Mexico filed a Reply. On November 13, 1998, the Tribunal denied Mexico's requests for exclusion of certain information submitted with the Reply and for the award of costs at that point in time. The Tribunal ordered Mexico to file its Rejoinder by March 19, 1999.

21. On February 22, 1999, Mexico filed a Request for an Extension of Time for the Filing of its Rejoinder. On March 4, 1999, the Tribunal granted Mexico's Request for an Extension of Time and ordered Mexico to

file the Rejoinder by April 19, 1999. In the same Order, the Tribunal set the pre-hearing conference for the marshalling of the evidence for July 6, 1999 in Washington, D.C. The Tribunal also ordered the parties' witness lists to be filed by June 11, 1999, together with an outline of each witness's testimony and an estimate of time for each party's presentation of its case and for the examination of witnesses. The Tribunal further set the hearing on the merits for August 30, 1999.

22. On March 11, 1999, Mexico filed a Request for Production of Documents. Metalclad filed a Response to Mexico's Request, to which Mexico filed a Reply. On April 14, 1999, Mexico then filed a request for an extension of one month in the time for filing its Rejoinder. On April 16, 1999, the Tribunal granted in part Mexico's Request for an Extension and ordered that the Rejoinder be filed by May 3, 1999. The Tribunal further extended the time for the parties to submit their marshalling of the evidence briefs to June 18, 1999. On May 3, 1999, Mexico filed its Rejoinder.

23. During the written phase of the pleadings, statements from the following persons were submitted by the Parties: **by Metalclad** – American Appraisal Associates, Augustina Armijo Bautista, Kevin C. Brennan, Gustavo Carvajal Isunza, Francisco Castillo Ayala, Centro JURICI, Ramon Chavez Quirarte, Anthony Dabbene, Daniel de la Torre, Jorge de la Torre, Lee A. Deets, William E. Gordon, Javier Guerra Cisneros, Bruce H. Haglund, Jaime E. Herrera, Ambassador James R. Jones, Grant S. Kesler, Ariel Miranda Nieto, Paul Mitchener, T. Daniel Neveau, Herbert L. Oakes Jr., Sandra Ray-Baucom, David Robinson, Sergio Reyes Lujan, Humberto C. Rodarte Ramon, Mario Salgado de la Sancha, Leland E. Sweetser, Anthony Talamantez, Mike Tuckett, Roy Zanatta; **by Mexico** – Luis Manuel Abella Armella, Sergio Aleman Gonzalez, Rene Altamirano Perez, Salomon Avila Perez, Antonio Azuela de la Cueva, Fernando Bejarano, Alan Borner, John C. Butler III, Julia Carabias Lillo, Juan Carrera Mendoza, José Ramón Cossío Díaz, Pablo Cruz Llañez, Kevin Dages, Jaime de la Cruz Nogueda, Jose Mario de la Garza Mendizabal, Carlos de Silva, Fernando Diaz-Barriga Martinez, Hector Raul Garcia Leos, Jorge Adolfo Hermosillo Silva, Francisco Enrique Hernandez Sanchez, Sergio Lopez Ayllon, Joel Milan, Pedro Medellin Milan, Hermilo Mendez Aguilar, Angelina Nunez, Santiago Oñate Laborde, Rogelio Orta Campos, Jose Antonio Ortega Rivero, Praxedis Palomo Tovar, Officials of PRODIN, Leonel Ramos Torres, Ronald E. Robertson, Aurelio Romo Navarro, Juan

Antonio Romo, Horacio Sanchez Unzueta, Leonel Serrato Sanchez, Ulises Schmill Ordonez, Marcia Williams, Ramiro Zaragoza Garcia, Mark Zmijewski.

24. As permitted by NAFTA, Article 1128, Canada made a written submission to the Tribunal on July 28, 1999. Although Canada does not have any specific commercial interest in the dispute in this case, the submission addressed the interpretation of NAFTA, Article 1110 relating to expropriation and compensation. Specifically, Canada rejected Metalclad's suggestion that NAFTA, Article 1110 is a codification of the United States' position on the rules of international law regarding expropriation and compensation.

25. With the agreement of the parties, a hearing was held in Washington, D.C. from August 30, 1999 through September 9, 1999, at which both parties appeared and presented witnesses. The Tribunal directed that only those portions of the written submissions that were disputed were to be introduced at the hearing. Witnesses called by Metalclad for cross-examination were Julia Carabias Lillo, Horacio Sanchez Unzuetta, Pedro Medellin Milan, Leonel Ramos Torres, Marcia Williams and John Butler III; witnesses called for cross-examination by Mexico were Grant S. Kesler, Gustavo Carvajal Isunza, Anthony Dabbene, Lee A. Deets and Daniel T. Neveau.

26. The Tribunal posed questions to the parties, which were addressed by the parties in their post-hearing briefs submitted on November 9, 1999. Full verbatim transcripts were made of the hearing and distributed to the parties.

27. As permitted by NAFTA, Article 1128, the United States made a written submission to the Tribunal on November 9, 1999. Although the United States does not have any specific commercial interest in the dispute in this case, the submission set forth the United States' position that the actions of local governments, including municipalities, are subject to NAFTA standards. The United States also submitted that the NAFTA, Article 1110, term "tantamount to expropriation" addressed both measures that directly expropriate and measures tantamount to expropriation that thereby indirectly expropriate investments. The United States rejected the suggestion that the term "tantamount to expropriation" was intended to

create a new category of expropriation not previously recognized in customary international law.

V. FACTS AND ALLEGATIONS

A. The Facilities at Issue

28. In 1990 the federal government of Mexico authorized COTERIN to construct and operate a transfer station for hazardous waste in La Pedrera, a valley located in Guadalcazar in SLP. The site has an area of 814 hectares and lies 100 kilometers northeast of the capital city of SLP, separated from it by the Sierra Guadalcazar mountain range, 70 kilometers from the city of Guadalcazar. Approximately 800 people live within ten kilometers of the site.

29. On January 23, 1993, the National Ecological Institute (hereinafter "INE"), an independent sub-agency of the federal Secretariat of the Mexican Environment, National Resources and Fishing (hereinafter "SEMARNAP"), granted COTERIN a federal permit to construct a hazardous waste landfill in La Pedrera (hereinafter "the landfill").

B. Metalclad's Purchase of the Site and its Landfill Permits

30. Three months after the issuance of the federal construction permit, on April 23, 1993, Metalclad entered into a 6-month option agreement to purchase COTERIN together with its permits, in order to build the hazardous waste landfill.

31. Shortly thereafter, on May 11, 1993, the government of SLP granted COTERIN a state land use permit to construct the landfill. The permit was issued subject to the condition that the project adapt to the specifications and technical requirements indicated by the corresponding authorities, and accompanied by the General Statement that the license did not prejudge the rights or ownership of the applicant and did not authorize works, constructions or the functioning of business or activities.

32. One month later, on June 11, 1993, Metalclad met with the Governor of SLP to discuss the project. Metalclad asserts that at this meeting it obtained the Governor's support for the project. In fact, the

Governor acknowledged at the hearing that a reasonable person might expect that the Governor would support the project if studies confirmed the site as suitable or feasible and if the environmental impact was consistent with Mexican standards.

33. Metalclad further asserts that it was told by the President of the INE and the General Director of the Mexican Secretariat of Urban Development and Ecology (hereinafter "SEDUE")[3] that all necessary permits for the landfill had been issued with the exception of the federal permit for operation of the landfill. A witness statement submitted by the President of the INE suggests that a hazardous waste landfill could be built if all permits required by the corresponding federal and state laws have been acquired.

34. Metalclad also asserts that the General Director of SEDUE told Metalclad that the responsibility for obtaining project support in the state and local community lay with the federal government.

35. On August 10, 1993, the INE granted COTERIN the federal permit for operation of the landfill. On September 10, 1993, Metalclad exercised its option and purchased COTERIN, the landfill site and the associated permits.

36. Metalclad asserts it would not have exercised its COTERIN purchase option but for the apparent approval and support of the project by federal and state officials.

C. Construction of the Hazardous Waste Landfill

37. Metalclad asserts that shortly after its purchase of COTERIN, the Governor of SLP embarked on a public campaign to denounce and prevent the operation of the landfill.

38. Metalclad further asserts, however, that in April 1994, after months of negotiation, Metalclad believed it had secured SLP's agreement to support the project. Consequently, in May 1994, after receiving an eighteen-month extension of the previously issued federal construction

[3] SEDUE is the predecessor organization to SEMARNAP.

permit from the INE, Metalclad began construction of the landfill. Mexico denies that SLP's agreement or support had ever been obtained.

39. Metalclad further maintains that construction continued openly and without interruption through October 1994. Federal officials and state representatives inspected the construction site during this period, and Metalclad provided federal and state officials with written status reports of its progress.

40. On October 26, 1994, when the Municipality ordered the cessation of all building activities due to the absence of a municipal construction permit, construction was abruptly terminated.

41. Metalclad asserts it was once again told by federal officials that it had all the authority necessary to construct and operate the landfill; that federal officials said it should apply for the municipal construction permit to facilitate an amicable relationship with the Municipality; that federal officials assured it that the Municipality would issue the permit as a matter of course; and that the Municipality lacked any basis for denying the construction permit. Mexico denies that any federal officials represented that a municipal permit was not required, and affirmatively states that a permit was required and that Metalclad knew, or should have known, that the permit was required.

42. On November 15, 1994, Metalclad resumed construction and submitted an application for a municipal construction permit.

43. On January 31, 1995, the INE granted Metalclad an additional federal construction permit to construct the final disposition cell for hazardous waste and other complementary structures such as the landfill's administration building and laboratory.

44. In February 1995, the Autonomous University of SLP (hereinafter "UASLP") issued a study confirming earlier findings that, although the landfill site raised some concerns, with proper engineering it was geographically suitable for a hazardous waste landfill. In March 1995, the Mexican Federal Attorney's Office for the Protection of the Environment (hereinafter "PROFEPA"), an independent sub-agency of SEMARNAP, conducted an audit of the site and also concluded that, with proper engi-

neering and operation, the landfill site was geographically suitable for a hazardous waste landfill.

D. Metalclad is Prevented from Operating the Landfill

45. Metalclad completed construction of the landfill in March 1995. On March 10, 1995, Metalclad held an "open house," or "inauguration," of the landfill which was attended by a number of dignitaries from the United States and from Mexico's federal, state and local governments.

46. Demonstrators impeded the "inauguration," blocked the entry and exit of buses carrying guests and workers, and employed tactics of intimidation against Metalclad. Metalclad asserts that the demonstration was organized at least in part by the Mexican state and local governments, and that state troopers assisted in blocking traffic into and out of the site. Metalclad was thenceforth effectively prevented from opening the landfill.

47. After months of negotiation, on November 25, 1995, Metalclad and Mexico, through two of SEMARNAP's independent sub-agencies (the INE and PROFEPA), entered into an agreement that provided for and allowed the operation of the landfill (hereinafter "the *Convenio*").

48. The *Convenio* stated that an environmental audit of the site was carried out from December, 1994 through March, 1995; that the purpose of the audit was to check the project's compliance with the laws and regulations; to check the project's plans for prevention of and attention to emergencies; and to study the project's existing conditions, control proceedings, maintenance, operation, personnel training and mechanisms to respond to environmental emergencies. The *Convenio* also stated that, as the audit detected certain deficiencies, Metalclad was required to submit an action plan to correct them; that Metalclad did indeed submit an action plan including a corresponding site remediation plan; and that Metalclad agreed to carry out the work and activities set forth in the action plan, including those in the corresponding plan of remediation. These plans required that remediation and commercial operation should take place simultaneously within the first three years of the landfill's operation. The *Convenio* provided for a five-year term of operation for the landfill, renewable by the INE and PROFEPA. In addition to requiring remediation, the *Convenio* stated that Metalclad would designate 34 hectares of its property as a buffer zone for the conservation of endemic species. The

Convenio also required PROFEPA to create a Technical-Scientific Committee to monitor the remediation and required that representatives of the INE, the National Autonomous University of Mexico and the UASLP be invited to participate in that Committee. A Citizen Supervision Committee was to be created. Metalclad was to contribute two new pesos per ton of waste toward social works in Guadalcazar and give a 10% discount for the treatment and final disposition of hazardous waste generated in SLP. Metalclad would also provide one day per week of free medical advice for the inhabitants of Guadalcazar through Metalclad's qualified medical personnel, employ manual labor from within Guadalcazar, and give preference to the inhabitants of Guadalcazar for technical training. Metalclad would also consult with government authorities on matters of remediation and hazardous waste, and provide two courses per year on the management of hazardous waste to personnel of the public, federal, state and municipal sectors, as well as social and private sectors.

49. Metalclad asserts that SLP was invited to participate in the process of negotiating the *Convenio*, but that SLP declined. The Governor of SLP denounced the *Convenio* shortly after it was publicly announced.

50. On December 5, 1995, thirteen months after Metalclad's application for the municipal construction permit was filed, the application was denied. In doing this, the Municipality recalled its decision to deny a construction permit to COTERIN in October 1991 and January 1992 and noted the "impropriety" of Metalclad's construction of the landfill prior to receiving a municipal construction permit.

51. There is no indication that the Municipality gave any consideration to the construction of the landfill and the efforts at operation during the thirteen months during which the application was pending.

52. Metalclad has pointed out that there was no evidence of inadequacy of performance by Metalclad of any legal obligation, nor any showing that Metalclad violated the terms of any federal or state permit; that there was no evidence that the Municipality gave any consideration to the recently completed environmental reports indicating that the site was in fact suitable for a hazardous waste landfill; that there was no evidence that the site, as constructed, failed to meet any specific construction requirements; that there was no evidence that the Municipality ever required or issued a municipal construction permit for any other construction project

in Guadalcazar; and that there was no evidence that there was an established administrative process with respect to municipal construction permits in the Municipality of Guadalcazar.

53. Mexico asserts that Metalclad was aware through due diligence that a municipal permit might be necessary on the basis of the case of COTERIN (1991, 1992), and other past precedents for various projects in SLP.

54. Metalclad was not notified of the Town Council meeting where the permit application was discussed and rejected, nor was Metalclad given any opportunity to participate in that process. Metalclad's request for reconsideration of the denial of the permit was rejected.

55. In December 1995, shortly following the Municipality's rejection of Metalclad's permit application, the Municipality filed an administrative complaint with SEMARNAP challenging the *Convenio*. SEMARNAP denied the Municipality's complaint.

56. On January 31, 1996, the Municipality filed an *amparo* proceeding in the Mexican courts challenging SEMARNAP's dismissal of its *Convenio* complaint. An injunction was issued and Metalclad was barred from conducting any hazardous waste landfill operations. The *amparo* was finally dismissed, and the injunction lifted, in May 1999.

57. On February 8, 1996, the INE granted Metalclad an additional permit authorizing the expansion of the landfill capacity from 36,000 tons per year to 360,000 tons per year.

58. From May 1996 through December 1996, Metalclad and the State of SLP attempted to resolve their issues with respect to the operation of the landfill. These efforts failed and, on January 2, 1997, Metalclad initiated the present arbitral proceedings against the Government of Mexico under Chapter Eleven of the NAFTA.

59. On September 23, 1997, three days before the expiry of his term, the Governor issued an Ecological Decree declaring a Natural Area for the protection of rare cactus. The Natural Area encompasses the area of the landfill. Metalclad relies in part on this Ecological Decree as an additional element in its claim of expropriation, maintaining that the Decree effectively and permanently precluded the operation of the landfill.

60. Metalclad also alleges, on the basis of reports by the Mexican media, that the Governor of SLP stated, that the Ecological Decree "definitely cancelled any possibility that exists of opening the industrial waste landfill of La Pedrera".

61. Metalclad also asserts that a high level SLP official, with respect to the Ecological Decree and as reported by Mexican media, "expressed confidence in closing in this way, all possibility for the United States firm Metalclad to operate its landfill in this zone, independently of the future outcome of its claim before the Arbitral Tribunals of the NAFTA treaty".

62. The landfill remains dormant. Metalclad has not sold or transferred any portion of it.

63. Mexico denies each of these media accounts as they relate to the Ecological Decree.

64. Mexico also maintains that consideration of the Ecological Decree is outside the jurisdiction of the Tribunal because the Decree was enacted after the filing of the Notice of Intent of Arbitration. More particularly, Mexico argues that NAFTA, Article 1119, entitled "Notice of Intent to Submit a Claim", precludes claims for breaches that have not yet occurred, relying on the language in that Article which states that:

> "The disputing investor shall deliver to the disputing Party written notice of its intention to submit a claim to arbitration at least 90 days before a claim is submitted, which notice shall specify:
>
> . . .
>
> (b) The provisions of [the NAFTA] alleged to have been breached and any other relevant provisions.
>
> (c) The issues and factual basis for the claim."

Mexico further invokes NAFTA, Article 1120 which requires that six months elapse between the events giving rise to a claim and the submission of the claim. On the basis of these two Articles, Mexico argues that a claimant must ensure its claim is ripe at the time it is filed. At the same time, Mexico does not exclude the possibility that amendments to a claim

may be made. Rather, Mexico initially asserted that in order to ensure fairness and clarity, amendment of a claim or the presentation of an ancillary claim within Article 48 of the Additional Facility Rules should be the subject of a formal application and the required amendment should be stated clearly. Later, Mexico adjusted its position in its post-hearing brief in which it argues that Section B of Chapter Eleven does not contemplate the amendment of ripened claims to include post-claim events. Mexico contends that Section B of Chapter Eleven modifies the Additional Facility Rules as regards the amendment of claims and the filing of ancillary claims, making Article 48 of the Additional Facility Rules inapplicable.

65. Metalclad's position is that Mexico's analysis of Articles 1119 and 1120 is artificial, and that the six month rule merely sets forth an initial rule for claim eligibility designed to foster exhaustion of pre-arbitral methods of dispute resolution. In support of its position, Metalclad invokes NAFTA, Article 1118, which provides that disputing parties should first attempt to settle a claim through consultation or negotiation. Metalclad further adduces policy reasons in support of its right to base its claim on acts occurring after submission of its Notice of Claim. First, Metalclad argues that policies related to the administration of justice support its position. In particular, it argues that an inability to rely on post-Notice of Claim acts would deprive parties of redress concerning a period during which a State might be most inclined to disregard its treaty obligations. Second, Metalclad argues that requiring a claimant to forego or defer the airing of subsequent, related, breaches would be inconsistent with NAFTA's stated aim of creating effective procedures for the resolution of its disputes. Such an interpretation, Metalclad suggests, would create serious inefficiencies by requiring the claimant to bring related actions *seriatim* and that those actions would be subject to *res judicata* principles to a Claimant's detriment. Metalclad also argues that injustice would result because claimants will choose, for financial and other reasons, not to start a fresh NAFTA action and tribunals would be unable to consider acts of bad faith occurring during the arbitration. Third, Metalclad maintains that its view is consistent with the ICSID Arbitral Tribunal's broad jurisdiction. Metalclad points out that the texts mentioned in NAFTA, Article 1120, allow for amendment of claims and cites Article 48 of the Rules as allowing for incidental or additional claims provided that such claims are within the scope of the arbitration agreement of the parties. Metalclad concludes that the policies underlying NAFTA, Articles 1119 and 1120, are fulfilled once

the appropriate periods have passed prior to submission of the claim and that the Respondent is not prejudiced by the amendments, provided that they are made no later than the Claimant's Reply and that the Respondent is permitted a Rejoinder.

66. The Tribunal accepts Mexico's contention that a case may not be initiated on the basis of an anticipated breach. However, the Tribunal cannot accept Mexico's interpretation and application of the time limits set out in the NAFTA. Metalclad properly submitted its claim under the Additional Facility Rules as provided under NAFTA, Article 1120. Article 1120(2) provides that the arbitration rules under which the claim is submitted shall govern the arbitration except to the extent modified by Section B of Chapter Eleven. Article 48(1) of the Rules clearly states that a party may present an incidental or additional claim provided that the ancillary claim is within the scope of the arbitration agreement of the parties.

67. The Tribunal does not agree with Mexico's post-hearing position that Section B of Chapter Eleven modifies Article 48 of the Rules. The Tribunal believes it was not the intent of the drafters of NAFTA, Articles 1119 and 1120, to limit the jurisdiction of a Tribunal under Chapter Eleven in this way. Rather, the Tribunal prefers Mexico's position, as stated in its Rejoinder, that construes NAFTA Chapter Eleven, Section B, and Article 48 of the Rules as permitting amendments to previously submitted claims and consideration of facts and events occurring subsequent to the submission of a Notice of Claim, particularly where the facts and events arise out of and/or are directly related to the original claim. A contrary holding would require a claimant to file multiple subsequent and related actions and would lead to inefficiency and inequity.

68. The Tribunal agrees with Mexico that the process regarding amendments to claims must be one that ensures fairness and clarity. Article 48(2) of the Rules ensures such fairness by requiring that any ancillary claim be presented not later than the Claimant's Reply. In this matter, Metalclad presented information relating to the Ecological Decree and its intent to rely on the Ecological Decree as early as its Memorial. Mexico subsequently filed its Counter-Memorial and Rejoinder. The Ecological Decree directly relates to the property and investment at issue, and Mexico has had ample notice and opportunity to address issues relating to that Decree.

69. The Tribunal thus finds that, although the Ecological Decree was issued subsequent to Metalclad's submission of its claim, issues relating to it were presented by Metalclad in a timely manner and consistently with the principles of fairness and clarity. Mexico has had ample opportunity to respond and has suffered no prejudice. The Tribunal therefore holds that consideration of the Ecological Decree is within its jurisdiction but, as will be seen, does not attach to it controlling importance.

VI. APPLICABLE LAW

70. A Tribunal established pursuant to NAFTA Chapter Eleven, Section B must decide the issues in dispute in accordance with NAFTA and applicable rules of international law. (*NAFTA Article 1131*(*1*)). In addition, NAFTA Article 102(2) provides that the Agreement must be interpreted and applied in the light of its stated objectives and in accordance with applicable rules of international law. These objectives specifically include transparency and the substantial increase in investment opportunities in the territories of the Parties. (*NAFTA Article 102*(*1*)(*c*)). The Vienna Convention on the Law of Treaties, Article 31(1) provides that a treaty is to be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of the treaty's object and purpose. The context for the purpose of the interpretation of a treaty shall comprise, in addition to the text, including its preamble and annexes, any agreement relating to the treaty which was made between all the parties in connection with the conclusion of the treaty. (*Id., Article 31(2)(a)).* There shall also be taken into account, together with the context, any relevant rules of international law applicable in the relations between the parties. (*Id., Article 31(3)).* Every treaty in force is binding upon the parties to it and must be performed by them in good faith. (*Id., Article 26).* A State party to a treaty may not invoke the provisions of its internal law as justification for its failure to perform the treaty. (*Id., Article 27).*

71. The Parties to NAFTA specifically agreed to "ENSURE a predictable commercial framework for business planning and investment". (*NAFTA Preamble, para. 6 (emphasis in original))*. NAFTA further requires that "[e]ach Party shall ensure that its laws, regulations, procedures, and administrative rulings of general application respecting any matter covered by this Agreement are promptly published or otherwise made available in

such a manner as to enable interested persons and Parties to become acquainted with them". *Id. Article 1802.1.*

VII. THE TRIBUNAL'S DECISION

72. Metalclad contends that Mexico, through its local governments of SLP and Guadalcazar, interfered with and precluded its operation of the landfill. Metalclad alleges that this interference is a violation of Articles 1105 and 1110 of Chapter Eleven of the investment provisions of NAFTA.

A. Responsibility for the conduct of state and local governments.

73. A threshold question is whether Mexico is internationally responsible for the acts of SLP and Guadalcazar. The issue was largely disposed of by Mexico in paragraph 233 of its post-hearing submission, which stated that "[Mexico] did not plead that the acts of the Municipality were not covered by NAFTA. [Mexico] was, and remains, prepared to proceed on the assumption that the normal rule of state responsibility applies; that is, that the Respondent can be internationally responsible for the acts of state organs at all three levels of government". Parties to that Agreement must "ensure that all necessary measures are taken in order to give effect to the provisions of the Agreement, including their observance, except as otherwise provided in this Agreement, by state and provincial governments". (*NAFTA Article 105*). A reference to a state or province includes local governments of that state or province. (*NAFTA Article 201(2)*). The exemptions from the requirements of Articles 1105 and 1110 laid down in Article 1108(1) do not extend to states or local governments. This approach accords fully with the established position in customary international law. This has been clearly stated in Article 10 of the draft articles on state responsibility adopted by the International Law Commission of the United Nations in 1975 which, though currently still under consideration, may nonetheless be regarded as an accurate restatement of the present law: "The conduct of an organ of a State, of a territorial government entity or of an entity empowered to exercise elements of the Governmental authority, such organ having acted in that capacity, shall be considered as an act of the State under international law even if, in the particular case, the organ exceeded its competence according to internal law or contravened instructions concerning its activity". (*Yearbook of the International Law Commission*, 1975, vol. ii, p.61).

B. NAFTA Article 1105: Fair and equitable Treatment

74. NAFTA Article 1105(1) provides that "each Party shall accord to investments of investors of another Party treatment in accordance with international law, including fair and equitable treatment and full protection and security". For the reasons set out below, the Tribunal finds that Metalclad's investment was not accorded fair and equitable treatment in accordance with international law, and that Mexico has violated NAFTA Article 1105(1).

75. An underlying objective of NAFTA is to promote and increase cross-border investment opportunities and ensure the successful implementation of investment initiatives. (*NAFTA Article 102(1)*).

76. Prominent in the statement of principles and rules that introduces the Agreement is the reference to "transparency" (*NAFTA Article 102(1)*). The Tribunal understands this to include the idea that all relevant legal requirements for the purpose of initiating, completing and successfully operating investments made, or intended to be made, under the Agreement should be capable of being readily known to all affected investors of another Party. There should be no room for doubt or uncertainty on such matters. Once the authorities of the central government of any Party (whose international responsibility in such matters has been identified in the preceding section) become aware of any scope for misunderstanding or confusion in this connection, it is their duty to ensure that the correct position is promptly determined and clearly stated so that investors can proceed with all appropriate expedition in the confident belief that they are acting in accordance with all relevant laws.

77. Metalclad acquired COTERIN for the sole purpose of developing and operating a hazardous waste landfill in the valley of La Pedrera, in Guadalcazar, SLP.

78. The Government of Mexico issued federal construction and operating permits for the landfill prior to Metalclad's purchase of COTERIN, and the Government of SLP likewise issued a state operating permit which implied its political support for the landfill project.

79. A central point in this case has been whether, in addition to the above-mentioned permits, a municipal permit for the construction of a hazardous waste landfill was required.

80. When Metalclad inquired, prior to its purchase of COTERIN, as to the necessity for municipal permits, federal officials assured it that it had all that was needed to undertake the landfill project. Indeed, following Metalclad's acquisition of COTERIN, the federal government extended the federal construction permit for eighteen months.

81. As presented and confirmed by Metalclad's expert on Mexican law, the authority of the municipality extends only to the administration of the construction permit, ". . .to grant licenses and permits for constructions and to participate in the creation and administration of ecological reserve zones . . .". (*Mexican Const. Art. 115, Fraction V*). However, Mexico's experts on constitutional law expressed a different view.

82. Mexico's General Ecology Law of 1988 (hereinafter "LGEEPA") expressly grants to the Federation the power to authorize construction and operation of hazardous waste landfills. Article 5 of the LGEEPA provides that the powers of the Federation extend to:

> V. [t]he regulation and control of activities considered to be highly hazardous, and of the generation, handling and final disposal of hazardous materials and wastes for the environments of ecosystems, as well as for the preservation of natural resources, in accordance with [the] Law, other applicable ordinances and their regulatory provisions.

83. LGEEPA also limits the environmental powers of the municipality to issues relating to non-hazardous waste. Specifically, Article 8 of the LGEEPA grants municipalities the power in accordance with the provisions of the law and local laws to apply:

> [l]egal provisions in matters of prevention and control of the effects on the environment caused by generation, transportation, storage, handling treatment and final disposal of solid industrial wastes which are not considered to be hazardous in accordance with the provisions of Article 137 of [the 1988] law. (Emphasis supplied).

84. The same law also limits state environmental powers to those not expressly attributed to the federal government. *Id., Article 7.*

85. Metalclad was led to believe, and did believe, that the federal and state permits allowed for the construction and operation of the landfill. Metalclad argues that in all hazardous waste matters, the Municipality has no authority. However, Mexico argues that constitutionally and lawfully the Municipality has the authority to issue construction permits.

86. Even if Mexico is correct that a municipal construction permit was required, the evidence also shows that, as to hazardous waste evaluations and assessments, the federal authority's jurisdiction was controlling and the authority of the municipality only extended to appropriate construction considerations. Consequently, the denial of the permit by the Municipality by reference to environmental impact considerations in the case of what was basically a hazardous waste disposal landfill, was improper, as was the municipality's denial of the permit for any reason other than those related to the physical construction or defects in the site.

87. Relying on the representations of the federal government, Metalclad started constructing the landfill, and did this openly and continuously, and with the full knowledge of the federal, state, and municipal governments, until the municipal "Stop Work Order" on October 26, 1994. The basis of this order was said to have been Metalclad's failure to obtain a municipal construction permit.

88. In addition, Metalclad asserted that federal officials told it that if it submitted an application for a municipal construction permit, the Municipality would have no legal basis for denying the permit and that it would be issued as a matter of course. The absence of a clear rule as to the requirement or not of a municipal construction permit, as well as the absence of any established practice or procedure as to the manner of handling applications for a municipal construction permit, amounts to a failure on the part of Mexico to ensure the transparency required by NAFTA.

89. Metalclad was entitled to rely on the representations of federal officials and to believe that it was entitled to continue its construction of the landfill. In following the advice of these officials, and filing the municipal permit application on November 15, 1994, Metalclad was merely acting prudently and in the full expectation that the permit would be granted.

90. On December 5, 1995, thirteen months after the submission of Metalclad's application – during which time Metalclad continued its open and obvious investment activity – the Municipality denied Metalclad's application for a construction permit. The denial was issued well after construction was virtually complete and immediately following the announcement of the *Convenio* providing for the operation of the landfill.

91. Moreover, the permit was denied at a meeting of the Municipal Town Council of which Metalclad received no notice, to which it received no invitation, and at which it was given no opportunity to appear.

92. The Town Council denied the permit for reasons which included, but may not have been limited to, the opposition of the local population, the fact that construction had already begun when the application was submitted, the denial of the permit to COTERIN in December 1991 and January 1992, and the ecological concerns regarding the environmental effect and impact on the site and surrounding communities. None of the reasons included a reference to any problems associated with the physical construction of the landfill or to any physical defects therein.

93. The Tribunal therefore finds that the construction permit was denied without any consideration of, or specific reference to, construction aspects or flaws of the physical facility.

94. Moreover, the Tribunal cannot disregard the fact that immediately after the Municipality's denial of the permit it filed an administrative complaint with SEMARNAP challenging the *Convenio.* The Tribunal infers from this that the Municipality lacked confidence in its right to deny permission for the landfill solely on the basis of the absence of a municipal construction permit.

95. SEMARNAP dismissed the challenge for lack of standing, which the Municipality promptly challenged by filing an *amparo* action. An injunction was issued, and the landfill was barred from operation through 1999.

96. In 1997 SLP re-entered the scene and issued an Ecological Decree in 1997 which effectively and permanently prevented the use by Metalclad of its investment.

97. The actions of the Municipality following its denial of the municipal construction permit, coupled with the procedural and substantive deficiencies of the denial, support the Tribunal's finding, for the reasons stated above, that the Municipality's insistence upon and denial of the construction permit in this instance was improper.[4]

98. This conclusion is not affected by NAFTA Article 1114, which permits a Party to ensure that investment activity is undertaken in a manner sensitive to environmental concerns. The conclusion of the *Convenio* and the issuance of the federal permits show clearly that Mexico was satisfied that this project was consistent with, and sensitive to, its environmental concerns.

99. Mexico failed to ensure a transparent and predictable framework for Metalclad's business planning and investment. The totality of these circumstances demonstrates a lack of orderly process and timely disposition in relation to an investor of a Party acting in the expectation that it would be treated fairly and justly in accordance with the NAFTA.

100. Moreover, the acts of the State and the Municipality – and therefore the acts of Mexico – fail to comply with or adhere to the requirements of NAFTA, Article 1105(1) that each Party accord to investments of investors of another Party treatment in accordance with international law, including fair and equitable treatment. This is so particularly in light of the governing principle that internal law (such as the Municipality's stated permit requirements) does not justify failure to perform a treaty. (*Vienna Convention on the Law of Treaties, Arts. 26, 27*).

101. The Tribunal therefore holds that Metalclad was not treated fairly or equitably under the NAFTA and succeeds on its claim under Article 1105.

[4] The question of turning to NAFTA before exhausting local remedies was examined by the parties. However, Mexico does not insist that local remedies must be exhausted. Mexico's position is correct in light of NAFTA Article 1121(2)(b) which provides that a disputing investor may submit a claim under NAFTA Article 1117 if both the investor and the enterprise waive their rights to initiate or continue before any administrative tribunal or court under the law of any Party any proceedings with respect to the measure of the disputing Party that is alleged to be a breach referred to in NAFTA Article 1117.

C. NAFTA, Article 1110: Expropriation

102. NAFTA Article 1110 provides that "[n]o party shall directly or indirectly . . . expropriate an investment . . . or take a measure tantamount to . . . expropriation . . . except: (a) for a public purpose; (b) on a non-discriminatory basis; (c) in accordance with due process of law and Article 1105(1); and (d) on payment of compensation . . . ." "A measure" is defined in Article 201(1) as including "any law, regulation, procedure, requirement or practice".

103. Thus, expropriation under NAFTA includes not only open, deliberate and acknowledged takings of property, such as outright seizure or formal or obligatory transfer of title in favour of the host State, but also covert or incidental interference with the use of property 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 even if not necessarily to the obvious benefit of the host State.

104. By permitting or tolerating the conduct of Guadalcazar in relation to Metalclad which the Tribunal has already held amounts to unfair and inequitable treatment breaching Article 1105 and by thus participating or acquiescing in the denial to Metalclad of the right to operate the landfill, notwithstanding the fact that the project was fully approved and endorsed by the federal government, Mexico must be held to have taken a measure tantamount to expropriation in violation of NAFTA Article 1110(1).

105. The Tribunal holds that the exclusive authority for siting and permitting a hazardous waste landfill resides with the Mexican federal government. This finding is consistent with the testimony of the Secretary of SEMARNAP and, as stated above, is consistent with the express language of the LGEEPA.

106. As determined earlier (see above, para 92), the Municipality denied the local construction permit in part because of the Municipality's perception of the adverse environmental effects of the hazardous waste landfill and the geological unsuitability of the landfill site. In so doing, the Municipality acted outside its authority. As stated above, the Municipality's denial of the construction permit without any basis in the proposed physical construction or any defect in the site, and extended by its subsequent administrative and judicial actions regarding the *Convenio*,

effectively and unlawfully prevented the Claimant's operation of the landfill.

107. These measures, taken together with the representations of the Mexican federal government, on which Metalclad relied, and the absence of a timely, orderly or substantive basis for the denial by the Municipality of the local construction permit, amount to an indirect expropriation.

108. The present case resembles in a number of pertinent respects that of *Biloune, et al. v. Ghana Investment Centre, et al.,* 95 I.L.R.183, 207-10 (1993) (Judge Schwebel, President; Wallace and Leigh, Arbitrators). In that case, a private investor was renovating and expanding a resort restaurant in Ghana. As with Metalclad, the investor, basing itself on the representations of a government affiliated entity, began construction before applying for a building permit. As with Metalclad, a stop work order was issued after a substantial amount of work had been completed. The order was based on the absence of a building permit. An application was submitted, but although it was not expressly denied, a permit was never issued. The Tribunal found that an indirect expropriation had taken place because the totality of the circumstances had the effect of causing the irreparable cessation of work on the project. The Tribunal paid particular regard to the investor's justified reliance on the government's representations regarding the permit, the fact that government authorities knew of the construction for more than one year before issuing the stop work order, the fact that permits had not been required for other projects and the fact that no procedure was in place for dealing with building permit applications. Although the decision in *Biloune* does not bind this Tribunal, it is a persuasive authority and the Tribunal is in agreement with its analysis and its conclusion.

109. Although not strictly necessary for its conclusion, the Tribunal also identifies as a further ground for a finding of expropriation the Ecological Decree issued by the Governor of SLP on September 20, 1997. This Decree covers an area of 188,758 hectares within the "Real de Guadalcazar" that includes the landfill site, and created therein an ecological preserve. This Decree had the effect of barring forever the operation of the landfill.

110. The Tribunal is not persuaded by Mexico's representation to the contrary. The Ninth Article, for instance, forbids any work inconsistent

with the Ecological Decree's management program. The management program is defined by the Fifth Article as one of diagnosing the ecological problems of the cacti reserve and of ensuring its ecological preservation. In addition, the Fourteenth Article of the Decree forbids any conduct that might involve the discharge of polluting agents on the reserve soil, subsoil, running water or water deposits and prohibits the undertaking of any potentially polluting activities. The Fifteenth Article of the Ecological Decree also forbids any activity requiring permits or licenses unless such activity is related to the exploration, extraction or utilization of natural resources.

111. The Tribunal need not decide or consider the motivation or intent of the adoption of the Ecological Decree. Indeed, a finding of expropriation on the basis of the Ecological Decree is not essential to the Tribunal's finding of a violation of NAFTA Article 1110. However, the Tribunal considers that the implementation of the Ecological Decree would, in and of itself, constitute an act tantamount to expropriation.

112. In conclusion, the Tribunal holds that Mexico has indirectly expropriated Metalclad's investment without providing compensation to Metalclad for the expropriation. Mexico has violated Article 1110 of the NAFTA.

VIII. QUANTIFICATION OF DAMAGES OR COMPENSATION

A. Basic Elements of Valuation

113. In this instance, the damages arising under NAFTA, Article 1105 and the compensation due under NAFTA, Article 1110 would be the same since both situations involve the complete frustration of the operation of the landfill and negate the possibility of any meaningful return on Metalclad's investment. In other words, Metalclad has completely lost its investment.

114. Metalclad has proposed two alternative methods for calculating damages: the first is to use a discounted cash flow analysis of future profits to establish the fair market value of the investment (approximately $90 million); the second is to value Metalclad's actual investment in the landfill (approximately $20–25 million).

115. Metalclad also seeks an additional $20–25 million for the negative impact the circumstances are alleged to have had on its other business operations. The Tribunal disallows this additional claim because a variety of factors, not necessarily related to the La Pedrera development, have affected Metalclad's share price. The causal relationship between Mexico's actions and the reduction in value of Metalclad's other business operations are too remote and uncertain to support this claim. This element of damage is, therefore, left aside.

116. Mexico asserts that a discounted cash flow analysis is inappropriate where the expropriated entity is not a going concern. Mexico offers an alternative calculation of fair market value based on COTERIN's "market capitalization". Mexico's "market capitalization" calculations show a loss to Metalclad of $13-15 million.

117. Mexico also suggests a direct investment value approach to damages. Mexico estimates Metalclad's direct investment value, or loss, to be approximately $3-4 million.

118. NAFTA, Article 1135(1)(a), provides for the award of monetary damages and applicable interest where a Party is found to have violated a Chapter Eleven provision. With respect to expropriation, NAFTA, Article 1110(2), specifically requires compensation to be equivalent to the fair market value of the expropriated investment immediately before the expropriation took place. This paragraph further states that "the valuation criteria shall include going concern value, asset value including declared tax value of tangible property, and other criteria, as appropriate, to determine fair market value".

119. Normally, the fair market value of a going concern which has a history of profitable operation may be based on an estimate of future profits subject to a discounted cash flow analysis. *Benvenuti and Bonfant Srl v. The Government of the People's Republic of Congo*, 1 ICSID Reports 330; 21 I.L.M. 758; *AGIP SPA v. The Government of the People's Republic of Congo*, 1 ICSID Reports 306; 21 I.L.M. 737.

120. However, where the enterprise has not operated for a sufficiently long time to establish a performance record or where it has failed to make a profit, future profits cannot be used to determine going concern or fair

market value. In *Sola Tiles, Inc. v. Iran (1987)* (14 Iran-U.S.C.T.R. 224, 240-42; 83 I.L.R. 460, 480-81), the Iran-U.S. Claims Tribunal pointed to the importance in relation to a company's value of "its business reputation and the relationship it has established with its suppliers and customers". Similarly, in *Asian Agricultural Products v. Sri Lanka* (4 ICSID Reports 246 (1990) at 292), another ICSID Tribunal observed, in dealing with the comparable problem of the assessment of the value of good will, that its ascertainment "requires the prior presence on the market for at least two or three years, which is the minimum period needed in order to establish continuing business connections".

121. The Tribunal agrees with Mexico that a discounted cash flow analysis is inappropriate in the present case because the landfill was never operative and any award based on future profits would be wholly speculative.

122. Rather, the Tribunal agrees with the parties that fair market value is best arrived at in this case by reference to Metalclad's actual investment in the project. Thus, in *Phelps Dodge Corp. v. Iran* (10 Iran-U.S. C.T.R. 121 (1986)), the Iran-U.S. Claims Tribunal concluded that the value of the expropriated property was the value of claimant's investment in that property. In reaching this conclusion, the Tribunal considered that the property's future profits were so dependent on as yet unobtained preferential treatment from the government that any prediction of them would be entirely speculative. (*Id. at 132-33*). Similarly, in the *Biloune* case (see above), the Tribunal concluded that the value of the expropriated property was the value of the claimant's investment in that property. While the Tribunal recognized the validity of the principle that lost profits should be considered in the valuation of expropriated property, the Tribunal did not award lost profits because the claimants could not provide any realistic estimate of them. In that case, as in the present one, the expropriation occurred when the project was not yet in operation and had yet to generate revenue. (*Biloune,* 95 I.L.R. at 228-229). The award to Metalclad of the cost of its investment in the landfill is consistent with the principles set forth in *Chorzow Factory (Claim for Indemnity) (Merits), Germany v. Poland, P.C.I.J. Series A., No. 17 (1928) at p.47,* namely, that where the state has acted contrary to its obligations, any award to the claimant should, as far as is possible, wipe out all the consequences of the illegal act and reestablish the situation which would in all probability have existed if that act had not been committed (the *status quo ante).*

123. Metalclad asserts that it invested $20,474,528.00 in the landfill project, basing its value on its United States Federal Income Tax Returns and Auditors' Workpapers of Capitalized Costs for the Landfill reflected in a table marked Schedule A and produced by Metalclad as response 7(a)A in the course of document discovery. The calculations include landfill costs Metalclad claims to have incurred from 1991 through 1996 for expenses categorized as the COTERIN acquisition, personnel, insurance, travel and living, telephone, accounting and legal, consulting, interest, office, property, plant and equipment, including $328,167.00 for "other".

124. Mexico challenges the correctness of these calculations on several grounds, of which one is the lack of supporting documentation for each expense item claimed. However, the Tribunal finds that the tax filings of Metalclad, together with the independent audit documents supporting those tax filings, are to be accorded substantial evidential weight and that difficulties in verifying expense items due to incomplete files do not necessarily render the expenses claimed fundamentally erroneous. *See Biloune,* 95 I.L.R. at 223-24.

125. The Tribunal agrees, however, with Mexico's position that costs incurred prior to the year in which Metalclad purchased COTERIN are too far removed from the investment for which damages are claimed. The Tribunal will reduce the Award by the amount of the costs claimed for 1991 and 1992.

B. "Bundling"

126. Some of the subsequent costs claimed by Metalclad involve what has been termed "bundling". "Bundling" is an accounting concept where the expenses related to different projects are aggregated and allocated to another project. Metalclad has claimed as costs related to the development at La Pedrera earlier costs incurred on certain other sites in Mexico. While not taking any decision in principle regarding the concept of bundling as it may be applicable to other situations (for example in the oil industry where the costs in relation to a "dry hole" may in part be allocated to the cost of exploring for and developing a successful well), the Tribunal does not consider it appropriate to apply the concept in the present case. The Tribunal has reduced accordingly the sum payable by the Government of Mexico.

C. Remediation

127. The question remains of the future status of the landfill site, legal title to which at present rests with COTERIN. Clearly, COTERIN's substantive interest in the property will come to an end when it receives payment under this award. COTERIN must, therefore, relinquish as from that moment all claim, title and interest in the site. The fact that the site may require remediation has been borne in mind by the Tribunal and allowance has been made for this in the calculation of the sum payable by the Government of Mexico.

D. Interest

128. The question arises whether any interest is payable on the amount of the compensation. In providing in Article 1135(1) that a Tribunal may award "monetary damages and any applicable interest", NAFTA clearly contemplates the inclusion of interest in an award. On the basis of a review of the authorities, the tribunal in *Asian Agricultural Products v. Sri Lanka* (4 *ICSID Reports* 245) held that "interest becomes an integral part of the compensation itself, and should run consequently from the date when the State's international responsibility became engaged" (*ibid.* p.294, para. 114). The Tribunal sees no reason to depart from this view. As has been shown above, Mexico's international responsibility is founded upon an accumulation of a number of factors. In the circumstances, the Tribunal considers that of the various possible dates at which it might be possible to fix the engagement of Mexico's responsibility, it is reasonable to select the date on which the Municipality of Guadalcazar wrongly denied Metalclad's application for a construction permit. The Tribunal therefore concludes that interest should be awarded from that date until the date 45 days from that on which this Award is made. So as to restore the Claimant to a reasonable approximation of the position in which it would have been if the wrongful act had not taken place, interest has been calculated at 6% p.a., compounded annually.

E. Recipient

129. As required by NAFTA, Article 1135(2)(b), the award of monetary damages and interest shall be payable to the enterprise. As required by NAFTA, Article 1135(2)(c), the award is made without prejudice to any right that any person may have in the relief under applicable domestic law.

IX. COSTS

130. Both parties seek an award of costs and fees. However, the Tribunal finds that it is equitable in this matter for each party to bear its own costs and fees, as well as half the advance payments made to ICSID.

X. AWARD

131. For the reasons stated above, the Tribunal hereby decides that, reflecting the amount of Metalclad's investment in the project, less the disallowance of expenses claimed for 1991 and 1992, less the amount claimed by way of bundling of certain expenses, and less the estimated amount allowed for remediation, plus interest at the rate of 6% compounded annually, the Respondent shall, within 45 days from the date on which this Award is rendered, pay to Metalclad the amount of $16,685,000.00. Following such period, interest shall accrue on the unpaid award or any unpaid part thereof at the rate of 6% compounded monthly.

Made as at Vancouver, British Columbia, Canada, in English and Spanish.

Professor Sir Elihu Lauterpacht, CBE, QC
Date: [August 25, 2000]

Mr Benjamin R. Civiletti
Date: [August 22, 2000]

Mr José Luis Siqueiros
Date: [August 21, 2000]

International Centre for Settlement of Investment Disputes

TECNICAS MEDIOAMBIENTALES TECMED S.A.

v.

THE UNITED MEXICAN STATES

CASE No. ARB (AF)/00/2

AWARD

President: **Dr. Horacio A. GRIGERA NAON**

Co-arbitrators: **Prof. José Carlos FERNANDEZ ROZAS**
Mr. Carlos BERNAL VEREA

Secretary to the Tribunal: **Ms. Gabriela ALVAREZ AVILA**

Date of dispatch to the parties: May 29, 2003

TABLE OF CONTENTS

Para.

A. **Introduction**……………………………………………………………..… 1-3

B. **Procedural History**……………………………………………………….. 4-34

C. **Summary of Facts and Allegations**…..……………………..………… 35-51

D. **Preliminary Matters**………………………………………………………. 52-92

I. Jurisdiction of the Arbitral Tribunal……………………………………. 53-71

II. Timely submission by Claimant of its claims against Respondent……………………………………………… 72-74

III. Scope of the Purchase Transaction……………………………………… 75-92

E. **The Merits of the Dispute**…………………………………………………. 93-201

I. Expropriation…………………………………………………………… 95-151

II. Fair and Equitable Treatment…………………………………………… 152-174

III. Full Protection and Security and other Guarantees under the Agreement………………………………………………………………. 175-181

F. **Compensation. Restitution in Kind**……………………………………….. 182-200

G. **Decision**…………………………………………………………………… 201

THE TRIBUNAL

Constituted as indicated above,

Having conducted its deliberations,

Issues the following award:

A. Introduction

1. The Claimant, Técnicas Medioambientales, TECMED S.A., is a commercial company organized under Spanish law, domiciled in Madrid, Spain. It is represented in this arbitration proceeding by:

Mr. Juan Carlos Calvo Corbella
Técnicas Medioambientales TECMED S.A.
Albasanz 16 – 1a planta
28037 Madrid, Spain

Ms. Mercedes Fernández
Mr. Juan Ignacio Tena García
Jones, Day, Reavis & Pogue abogados
Velázquez 51 – 4a planta
28001 Madrid, Spain

2. The Respondent is the Government of the United Mexican States, represented in this arbitration proceeding by:

Mr. Hugo Perezcano Díaz
Consultor Jurídico
Dirección General de Consultoría Jurídica
de Negociaciones Comerciales
Subsecretaría de Negociaciones Comerciales Internacionales
Secretaría de Economía
Alfonso Reyes No. 30, piso 17
Colonia Condesa
Mexico, D.F., C.P. 06179, Mexico

3. This Award decides on the merits of the dispute between the parties in accordance with Article 53 of the Arbitration Additional Facility Rules (Arbitration Rules) of the International Centre for Settlement of Investment Disputes.

B. Procedural History

4. On July 28, 2000, the Claimant filed with the Secretariat of the International Centre for Settlement of Investment Disputes ("ICSID") an application for approval of access to the Additional Facility and a request for arbitration against the Respondent in accordance with the Additional Facility Rules for the Administration of Proceedings by the Secretariat of the International Centre for Settlement of Investment Disputes (hereinafter referred to as the "Rules") and under the provisions of the Agreement on the Reciprocal Promotion and Protection of Investments signed by the Kingdom of Spain and the United Mexican States (hereinafter referred to as the "Agreement"). The Agreement entered into force for both countries on December 18, 1996. The Claimant is the parent company in Spain of TECMED, TECNICAS MEDIOAMBIENTALES DE MEXICO, S.A. de C:V. ("Tecmed"), a company incorporated under Mexican law, and holds over 99% of the shares of such company. Additionally, Tecmed holds over 99% of the shares of CYTRAR, S.A. DE C.V. ("Cytrar"), a company incorporated under Mexican law through which the investment giving rise to the disputes leading to these arbitration proceedings was made.

5. On August 28, 2000, the Acting Secretary-General of ICSID, pursuant to Article 4 of the Rules, notified the Claimant that access to the Additional Facility Rules had been approved with respect to this case and that the notice of institution of arbitration proceedings had been registered; he then sent the certificate of registration to the parties and forwarded copies of the notice of institution of arbitration proceedings to the Respondent.

6. On October 2, 2000, the Claimant notified the Centre of the appointment of Professor José Carlos Fernández Rosas as arbitrator and of its consent for the Parties to appoint as arbitrator a person of the same nationality of the Party making the proposal.

7. On November 7, 2000, the Respondent notified the Centre of the appointment of Mr. Guillermo Aguilar Alvarez as arbitrator and nominated Mr. Albert Jan van den Berg as President of the Arbitral Tribunal.

8. On November 29, 2000, the Claimant objected to the nomination of Mr. van den Berg and proposed instead that the Parties request their designated arbitrators to appoint the President of the Arbitral Tribunal, which was accepted by the Respondent.

9. On January 30, 2001, the ICSID Secretariat informed that Mr. Fernández Rosas and Mr. Aguilar Alvarez had appointed Dr. Horacio A. Grigera Naón as President of the Arbitral Tribunal. On February 2, 2001, the Claimant confirmed its agreement to this appointment and, in its communication dated February 22, 2001, the Respondent notified the Centre of its agreement to the President's appointment.

10. On March 13, 2001, the Centre's Acting Secretary-General informed the parties that, as from that date, the Arbitral Tribunal was deemed to have been constituted and the proceedings to have begun.

11. The first session of the Arbitral Tribunal with the parties was held in Paris, France on May 7, 2001. During the course of the session, procedural rules applicable to these

proceedings were established and the schedule for the submission of memorials by the Parties was fixed, among other things.

12. On September 4, 2001, the Claimant filed its memorial.

13. On November 16, 2001, the Respondent made certain observations regarding opinions alleged to have been given by Mr. Aguilar Alvarez in another arbitration proceeding which, in the Respondent's view, also involved legal matters to be debated in this arbitration proceeding.

14. On November 16, 2001, Lic. Aguilar Alvarez submitted his resignation as arbitrator in these proceedings, upon which, in a letter of the same date, the ICSID Secretariat served notice of the suspension of the proceedings until the vacancy created by Mr. Aguilar Alvarez's resignation was filled.

15. On November 20, 2001, the Arbitral Tribunal accepted the resignation of Mr. Aguilar Alvarez.

16. On December 14, 2001, the Respondent served notice of the appointment of Mr. Carlos Bernal Verea in replacement of Mr. Guillermo Aguilar Alvarez.

17. On December 17, 2001, the ICSID Secretariat informed that Mr. Carlos Bernal Verea had accepted his appointment by the Respondent to serve as arbitrator in these proceedings and as from such date deemed the Arbitral Tribunal to have been reconstituted and the arbitration proceedings to have resumed.

18. On January 22, 2002, the Arbitral Tribunal issued a procedural order deciding certain procedural matters raised by the Parties and extended the deadline for the submission of the Respondent's counter-memorial until February 4, 2002.

19. Following a new request by the Respondent in its written communication of January 31, 2002, on February 1, 2002, the Arbitral Tribunal extended the deadline for the submission of the Respondent's counter-memorial until February 11, 2002.

20. The Respondent's counter-memorial was received on February 11, 2002. On February 19, 2002, the Respondent enclosed a list of the facts alleged in the memorial that were recognized by the Respondent in its counter-memorial and those that were not.

21. On March 7, 2002, the Arbitral Tribunal issued Procedural Order No. 1, fixing the week of May 20, 2002 for the Evidentiary Hearing to be held in Washington, D.C., USA, dispensing with the submission of a reply and rejoinder by the Parties, establishing guidelines for holding the hearing and setting June 28, 2002 as the deadline for the Parties to submit their closing statements after the hearing.

22. Following new requests and exchanges between the Parties in the notes of the Respondent and Claimant dated March 13 and 21, 2002, respectively, the Arbitral Tribunal issued its Procedural Order No. 2, which —in addition to specifying certain additional

matters in relation to the hearing scheduled for the week of May 20 – provided that, at the end of the hearing on May 24, 2003, the Parties could address the Arbitral Tribunal orally, and extended the deadline for the submission of closing statements until July 15, 2002.

23. On April 29, 2002, the Secretariat of ICSID notified the Parties of the agenda issued by the Arbitral Tribunal for the conduct of the hearing.

24. The hearing was held in Washington, D.C., at the seat of ICSID. It began in the morning of May 20, 2002, and ended on May 24, 2002, after the Parties addressed the Arbitral Tribunal orally.

25. A stenographic transcript of the hearing was made, which lists the following persons as having been present at the hearing:

Members of the Arbitral Tribunal

1. Dr. Horacio A. Grigera Naón, President

2. Prof. José Carlos Fernández Rozas

3. Mr. Carlos Bernal Verea

Secretary of the Arbitral Tribunal

4. Ms. Gabriela Alvarez Avila

Técnicas Medioambientales TECMED S.A.

5. Mr. Juan Carlos Calvo Corbella

6. Ms. Mercedes Fernández

7. Mr. José Daniel Fernández

The United Mexican States

8. Mr. Hugo Perezcano Díaz

9. Mr. Luis Alberto González García

10. Ms. Alejandra Treviño Solís

11. Mr. Sergio Ampudia

12. Mr. Carlos García

13. Mr. Rolando García

14. Cameron Mowatt, Esq.

15. Stephen Becker, Esq.

16. Sanjay Mullick, Esq.

17. Ms. Jacqueline Paniagua

18. Lars Christianson, Engineer

19 Ms. Ruth Benkley

20. Francisco Maytorena Fontes, Engineer

21. Christopher Thomas, Esq.

26. The hearing was held in accordance with the agenda fixed by the Arbitral Tribunal and within the time limit set for the Parties in Procedural Order No. 2 for the examination of witnesses and experts.

27. The following witnesses and experts were heard at the hearing after the opening statements made by the Claimant and the Respondent, respectively.

Offered by the Claimant

José Luis Calderón Bartheneuf

Javier Polanco Gómez Lavin

Enrique Diez Canedo Ruiz

José María Zapatero Vaquero

Jesús M. Pérez de Vega

Luis R. Vera Morales

José Visoso Lomelín

Offered by the Respondent

Alfonso Camacho Gómez

Cristina Cortinas de Nava

Jorge Sánchez Gómez

Lars Christianson

28. During the course of the hearing, the Arbitral Tribunal decided to agree to the inclusion of documents introduced by either the Respondent or the Claimant during the hearing. It further decided —after dismissing the Respondent's objections in this regard— to agree to the inclusion of certain documents submitted in support of the statement made by Mr. Jesús M. Pérez de Vega as an expert proposed by the Claimant; nevertheless, it gave the Respondent an opportunity to examine such documents and exercise its right to question the expert once the inclusion of such documents had been decided. However, the Respondent declined to exercise such right.

29. At the end of the hearing, the Arbitral Tribunal heard the oral presentations made by the Parties, each of which was allowed 90 minutes.

30. On August 1, 2002, the Claimant and the Respondent submitted their respective closing statements.

31. In a note dated July 31, 2002, the Respondent had explained the reasons why it was annexing to its closing statement a "Declaration of Lars Christianson, Engineer", accompanied by exhibits.

32. In a note dated August 2, 2002, the Claimant objected to the inclusion of such declaration and exhibits.

33. In its procedural order of August 12, 2002, the Arbitral Tribunal decided to agree to the inclusion of such statement and exhibits, not as part of the evidence offered and produced, but as part of the Respondent's closing statement.

34. By note dated April 9, 2003, the Secretariat of ICSID notified the Parties that the Arbitral Tribunal had declared the proceedings closed in accordance with Article 45 of the Rules.

C. Summary of Facts and Allegations presented by the Parties

35. The Claimant's claims are related to an investment in land, buildings and other assets in connection with a public auction called by Promotora Inmobiliaria del Ayuntamiento de Hermosillo (hereinafter referred to as "Promotora"), a decentralized municipal agency of the Municipality of Hermosillo, located in the State of Sonora, Mexico. The purpose of the auction was the sale of real property, buildings and facilities and other assets relating to "Cytrar", a controlled landfill of hazardous industrial waste. Tecmed was the awardee, pursuant to a decision adopted by the Management Board of Promotora on February 16, 1996. Later on, the holder of Tecmed´s rights and obligations under the tender came to be Cytrar, a company organized by Tecmed for such purpose and to run the landfill operations.

36. The landfill was built in 1988 on land purchased by the Government of the State of Sonora, in the locality of Las Víboras, within the jurisdiction of the Municipality of Hermosillo, State of Sonora. The landfill had a renewable license to operate for a five-year term as from December 7, 1988, issued by the Ministry of Urban Development and Ecology (SEDUE) of the Federal Government of Mexico to Parques Industriales de Sonora, a decentralized agency of the Government of the State of Sonora. During this period, the landfill operator was not this agency but another entity, Parque Industrial de Hermosillo, another public agency of the State of Sonora. Ownership of the landfill was then transferred to a decentralized agency of the Municipality of Hermosillo, Confinamiento Controlado Parque Industrial de Hermosillo O.P.D.; in this new phase, it had a new authorization to operate for an indefinite period of time. Such authorization had been granted on May 4, 1994, by the Hazardous Materials, Waste and Activities Division of the National Ecology Institute of Mexico (hereinafter referred to as INE), an agency of the Federal Government of the United Mexican States within the Ministry of the Environment, Natural Resources and Fisheries (SEMARNAP), which cancelled the previous authorization, granted on December 7, 1988. INE —both within the framework of SEDUE as well as of its successor SEMARNAP— is in charge of Mexico's national policy on ecology and environmental protection, and is also the regulatory body on environmental issues.

37. Upon the liquidation and dissolution of the above-mentioned decentralized agency, ordered by the Governor of the State of Sonora on July 6, 1995, in mid-1995, the assets of the landfill became the property of the Government of the State of Sonora. Subsequently, on November 27, 1995, through a donation agreement entered into between that Government and the Municipality of Hermosillo, the property was transferred to Promotora.

38. In a letter dated April 16, 1996, confirmed by letters of June 5, August 26 and September 5, 1996, Tecmed made a request to INE for the operating license of the landfill —then in the name of Confinamiento Controlado Parque Industrial de Hermosillo O.P.D.— to be issued in the name of Cytrar. The Municipality of Hermosillo supported this request in its note to INE dated March 28, 1996, requesting INE to provide all possible assistance in connection with the name change procedure in the operating license in favor of Tecmed or of the company organized by it. In an official letter of September 24, 1996, INE notified

Cytrar, in connection with the application to change the name of the entity from Promotora to Cytrar, that Cytrar had been registered with INE. The official letter was then returned by Cytrar to INE as requested by INE after having been issued, and replaced by another one of the same date to which the authorization relating to the landfill was attached, dated November 11, 1996, stating the new name of the entity. Such authorization could be extended every year at the applicant's request 30 days prior to expiration. It was so extended for an additional year, until November 19, 1998.

39. The arbitration claim seeks damages, including compensation for damage to reputation, and interests in connection with damage alleged to have accrued as of November 25, 1998, on which date INE rejected the application for renewal of the authorization to operate the landfill, expiring on November 19, 1998, pursuant to an INE resolution on the same date, whereby INE further requested Cytrar to submit a program for the closure of the landfill. Subsidiarily, the Claimant has requested restitution in kind through the granting of permits to the Claimant enabling it to operate the Las Víboras landfill until the end of its useful life, in addition to compensation for damages.

40. The Claimant further argues that the successive permits granted by INE to Cytrar in connection with the operation of the landfill constitute a violation of the conditions on which the Claimant made its investment because (i) such permits, both as regards their duration as well as the conditions to which they were subject, were different from the permit given for operation of the landfill at the time the investment was made; and (ii) the price paid by Cytrar included the acquisition of intangible assets which involved the transfer to Cytrar of existing permits to operate the landfill and under which such landfill was being operated at the time of making the investment, and not the ones ultimately granted to it. The Claimant argues that such a violation of conditions also involves a violation of, among other provisions, Articles 2 and 3(1) of the Agreement and a violation of Mexican law. However, the Claimant states that it is not seeking in these arbitration proceedings a pronouncement or declaration regarding the lawfulness or unlawfulness, legality or illegality of acts or omissions attributable to the Respondent in connection with permits or authorizations relating to the operation of the Las Víboras landfill prior to the INE resolution of November 19, 1998, which terminated Cytrar's authorization to operate the landfill, considered in isolation, although it highlights the significance of such acts or omissions as preparatory acts for subsequent conduct attributable to the Respondent which, according to the Claimant, is in violation of the Agreement or facilitated such conduct.

41. The Claimant argues that the refusal to renew the landfill's operating permit, contained in the INE resolution of November 25, 1998, constitutes an expropriation of its investment, without any compensation or justification thereof, and further constitutes a violation of Articles 3(1), 3(2), 4(1), 4(5), 5(1), 5(2) and 5(3) of the Agreement, as well as a violation of Mexican law. According to the Claimant, such refusal would frustrate its justified expectation of the continuity and duration of the investment made and would impair recovery of the invested amounts and the expected rate of return.

42. The Claimant alleges that the conditions of the tender and the invitation to tender, the award or sale of the landfill or of the assets relating thereto and the investment made by the Claimant were substantially modified after the investment was made for reasons

attributable to acts or omissions of Mexican municipal, state and federal authorities. The Claimant claims that such modifications, with detrimental effects for its investment and which allegedly led to the denial by the Federal Government of an extension to operate the landfill, are, to a large extent, due to political circumstances essentially associated to the change of administration in the Municipality of Hermosillo, in which the landfill is physically situated, rather than to legal considerations. Specifically, the Claimant attributes such changes to the result of the election held in Mexico in July 1997, one of the consequences of which was the taking of office of a new Mayor of the Municipality of Hermosillo and similar changes in other municipal governments in the State of Sonora. According to the Claimant's allegations, the new authorities of Hermosillo encouraged a movement of citizens against the landfill, which sought the withdrawal or non-renewal of the landfill's operating permit and its closedown, and which also led to confrontation with the community, even leading to blocking access to the landfill. The authorities of the State of Sonora, where the Municipality of Hermosillo is located, are alleged to have expressly supported the position adopted by the Municipality.

43. The Claimant argues that the Federal Government yielded to the combined pressure of the municipal authorities of Hermosillo and of the State of Sonora along with the community movement opposed to the landfill, which, according to the Claimant, led to the INE Resolution of November 25, 1998, referred to above. This Resolution denied Cytrar authorization to operate the landfill and ordered its closedown. The Claimant argues that INE's refusal to extend the authorization to operate the landfill is an arbitrary act which violates the Agreement, international law and Mexican law. It further denies any misconduct or violation on its part of the terms under which the landfill permit was granted and which could justify a refusal to extend the authorization. The Claimant alleges that certain breaches of the conditions of the permit that expired on November 19, 1998, which was subsequently not extended by INE, did not warrant such an extreme decision. The Claimant points out that such breaches had been the subject matter of an investigation conducted by the Federal Environmental Protection Attorney's Office ("PROFEPA"), which, like INE, is an agency within the purview of SEMARNAP, but with powers, among other things, to monitor compliance with federal environmental rules and to impose sanctions, which may include a revocation of the operating license. It also stresses that PROFEPA had not found violations of such an extent that they might endanger the environment or the health of the population or which justified more stringent sanctions than the fines eventually imposed on Cytrar by PROFEPA as a result of its investigations.

44. The Claimant stresses the commitment of Cytrar, with the support of Tecmed, as from July 3, 1998, to relocate the hazardous waste landfill operation to another site on the basis of agreements reached with federal, state and municipal authorities as of such date, and denies the allegation that the fact that such relocation had not yet taken place at the time the extension of Cytrar's permit was refused could be validly argued among the grounds referred to by INE in its resolution of November 1998 denying the extension. The Claimant points out that Cytrar, with the support of Tecmed, subsequently added to its commitment to relocate the landfill another commitment to pay the costs and economic consequences involved in such relocation, and further denies that the delay or failure to relocate was attributable to it. The Claimant insists that the only condition to which Cytrar subjected its relocation commitment was that, pending such relocation, operation by Cytrar of the Las

Víboras landfill and the relevant operating permit should continue, and that such condition is a part of the relocation agreement entered into with the federal, state and municipal authorities of the Respondent. At any rate, the Respondent argues that Cytrar unsuccessfully applied to INE for a limited extension of its permit to operate the Las Víboras landfill (five months as from November 19, 1998), in order to come to an agreement, within such term, on the identification of the site to which the landfill operation would be relocated and to carry out the relocation.

45. According to the Claimant, the expropriation act and other violations of the Agreement which it deems to have suffered, have caused the Claimant to sustain a complete loss of the profits and income from the economic and commercial operation of the Las Víboras landfill as an on going business. Therefore the damage sustained includes the impossibility of recovering the cost incurred in the acquisition of assets for the landfill, its adaptation and preparation and, more generally, the investments relating to or required for this kind of industrial activity, including, but not limited to, constructions relating to the landfill; lost profits and business opportunities; the impossibility of performing contracts entered into with entities producing industrial waste, thus leading to termination of such contracts and to possible claims relating thereto; and the injury caused to the Claimant and to its subsidiaries in Mexico due to the adverse effect on its image in that country, with the consequent negative impact on the Claimant's capacity to expand and develop its activities in Mexico.

46. The Respondent, after pointing out that it does not consider that the powers of INE to deny the landfill's operating permit are regulated but discretionary, denies that such denial was a result of an arbitrary exercise of such discretionary powers. The Respondent claims that denial of the permit is a control measure in a highly regulated sector and which is very closely linked to public interests. Accordingly, the Respondent holds that such denial seeks to discourage certain types of conduct, but is not intended to penalize. The Respondent stresses that the matters debated in these arbitration proceedings are to be solved in a manner consistent with the provisions of the Agreement and of international law.

47. The Respondent denies that the subject matter of the tender and subsequent award to Tecmed was a landfill, understood as a group or pool of tangible and intangible assets including licenses or permits to operate a controlled landfill of hazardous waste. The Respondent argues that the assets tendered and sold by Promotora solely include certain facilities, land, infrastructure and equipment, but no permits, authorizations or licenses. With regard to the documents signed by Promotora, Tecmed and Cytrar in connection with the public auction of the assets relating to the landfill, the Respondent further argues that (i) the obligation or responsibility to obtain permits, licenses or authorizations to operate the landfill was vested in Cytrar; (ii) Promotora did not attempt to obtain or provide such permits, licenses and authorizations for the benefit of or in the name of Cytrar, of the Claimant or of Tecmed, nor did it guarantee that they would be obtained; (iii) Promotora's only commitment in this regard was to ensure that Cytrar could operate the landfill under the existing permits, authorizations or licenses, which remained vested in Confinamiento Parque Industrial de Hermosillo O.P.D. until Cytrar obtained its own permits, authorizations or licenses; (iv) it was always clear to Cytrar that it would require its own licenses, authorizations or permits in order to operate the landfill; and (v) neither Cytrar nor

Tecmed contacted the competent federal authorities for information regarding the possibility of transferring existing authorizations or permits. The Respondent denies the claim that the amount of $ 24,047,988.26 (Mexican Pesos) was paid as price for the permits or authorizations to operate the landfill, or that Promotora's related invoice reflects the reality of the tender and of the subsequent sales transaction.

48. The Respondent challenges the Arbitral Tribunal's jurisdiction to decide in connection with conduct attributable or attributed to the Respondent which occurred before the entry into force of the Agreement, or that any interpretation thereof —particularly Article 2(2), which extends the application of the Agreement to investments made prior to its entry into force— could lead to a different conclusion. Likewise, based on Title II.5 of the Appendix to the Agreement, the Respondent rejects the Arbitral Tribunal's jurisdiction over acts or omissions attributed or attributable to the Respondent which were or could have been known to the Claimant, together with the resulting damages, prior to a fixed 3-year period, calculated as from the commencement date of this arbitration pursuant to the Agreement. The Respondent further denies that the conduct allegedly in violation of the Agreement attributed to the Respondent caused any damage to the Claimant, so the Claimant's claims would not fulfill the requirements of Title II.4 of the Appendix to the Agreement.

49. The Respondent claims that the granting and conditions of the license of November 11, 1996, were within the statutory powers of INE, and that such conditions were similar to the ones governing other permits granted by INE at the time. The Respondent stresses the negative attitude of the community towards the landfill due to its location and to the negative and highly critical view taken by the community with regard to the way Cytrar performed its task of transporting and confining the hazardous toxic waste originating in the former lead recycling and recovery plant of Alco Pacífico de México, S.A. de C.V. (hereinafter referred to as "Alco Pacífico"), located in Tijuana, Baja California, which would highlight the importance of demanding strict compliance with the new operating permit granted by INE to Cytrar on November 19, 1997.

50. The Respondent alleges that the municipal, state and federal authorities, as well as the security forces and courts of law addressed by Cytrar, acted diligently and in a manner consistent with the Respondent's obligations under the Agreement to offer protection to Cytrar, to its personnel and to the Claimant's investment relating to the landfill, in view of the different forms of social pressure exercised by groups or individuals opposed to the landfill, as well as to finding solutions to the problems resulting from such social pressure. The Respondent further denies that any acts or omissions on the part of such groups or individuals or any liability arising out of such acts or omissions are attributable to the Respondent under the Agreement or under international law. The Respondent underscores the distinct duties performed by PROFEPA and INE, and points out that only INE is competent to decide whether or not to renew an expired permit, based on an assessment of different elements and circumstances exclusively pertaining to INE. The Respondent therefore argues that it is irrelevant that PROFEPA did not revoke Cytrar's permit relating to the Landfill or that it did not close it down due to considerations taken into account by INE in order to decide not to extend the authorization, or that PROFEPA did not find that such matters were significant enough to justify more serious sanctions other than a fine.

However, the Respondent highlights the growing number of violations committed by PROFEPA in Cytrar's operation of the landfill.

51. The Respondent ultimately concludes that there is no conduct on the part of municipal, state or federal authorities of the United Mexican States in connection with Cytrar, Tecmed, the Claimant, the landfill or the Claimant's investments which constitutes a violation of the Agreement pursuant to its provisions or to the provisions of Mexican or international law. It specifically denies that refusing to give a new permit to Cytrar to operate the landfill is in the nature of an expropriation or that there has been a violation of Article 5 of the Agreement. The Respondent also denies that the Claimant suffered discrimination or that it was denied national treatment in violation of Article 4 of the Agreement. The Respondent denies having violated Article 2(1) of the Agreement regarding promotion or admission of investments or having committed any violation of Article 3 of the Agreement. Finally, the Respondent challenges the calculation basis for the compensation sought by the Claimant, which it considers absolutely inappropriate and inordinate.

D. Preliminary Matters

52. The Arbitral Tribunal will first examine the issues which, due to their nature or connection with its jurisdiction to decide this case or due to their close connection with other matters relating to the decisions that the Tribunal must make on the merits of the disputes between the Parties, need to be decided previously. Such matters are (i) the Respondent's challenges to the Arbitral Tribunal's jurisdiction; (ii) the Respondent's challenges to the timely submission by the Claimant of some of its claims; and (iii) the price and scope of the acquisition by Cytrar and Tecmed of assets relating to the Las Víboras landfill.

I. Jurisdiction of the Arbitral Tribunal

53. The Claimant argues,[1] based on Article 2(2) of the Agreement, that the Agreement applies retroactively to the Respondent's conduct prior to the effective date of the Agreement. Such provision stipulates that the Agreement "…shall also apply to investments made prior to its entry into force by the investors of a Contracting Party". According to the Claimant, under this provision, the Agreement covers all conduct or events relating to the investment giving rise to the disputes of this arbitration which took place before December 18, 1996, the entry into force of the Agreement pursuant to Article 12 thereof. Article 12 provides that the Agreement will enter into force on the date of mutual notification between the Contracting Parties of compliance with constitutional requirements for the entry into force of international agreements. Title X of the Appendix to the Agreement shows that this took place on December 18, 1996. The Claimant also alleges, based on Article 18 of the United Nations Vienna Convention of 1969 on the Law of Treaties (hereinafter referred to as the "Vienna Convention"),[2] that the Respondent was

[1] Memorial, p. 84, note 109.
[2] United Nations Conference on the Law of Treaties, First and Second Sessions, Official Records-Documents of the Conference, A/CONF.39/11/Add.2, or 1155 U.N.T.S. 331.

bound, even before entry into force of the Agreement, to "…refrain from acts which would defeat the object matter and purpose…" of the Agreement.[3]

54. The Respondent, in turn,[4] contends that this Arbitral Tribunal has no jurisdiction *ratione temporis* to consider the application of the Agreement to the Respondent's conduct prior to December 18, 1996. The Respondent alleges that any other interpretation would be inconsistent with the principle of non-retroactive application of treaties embodied in Article 28 of the Vienna Convention and with a basic rule of international law. In other words, the Respondent does not recognize the Arbitral Tribunal's jurisdiction to decide in connection with matters or conduct taking place prior to such date.[5]

55. The Arbitral Tribunal does not deem it appropriate to establish the meaning, in abstract or general terms, of "retroactive application" of a legal provision, an expression that does not appear to meet generally accepted criteria.[6] Therefore, in this regard, in addition to following the claims of the Parties as indicated below, the Tribunal will follow the text of the Agreement itself and the rules governing the interpretation of treaties.[7]

56. Based on the standards that have just been defined, consideration of whether the Agreement is to be applied retroactively must first be determined in light of the claims of the Parties. The mandate of an arbitration tribunal is subject to limitations, among them those arising out of disputed issues specifically referred to it by the Parties in their claims. An arbitral tribunal cannot decide more or less than is necessary to settle the disputes referred to it. There is no doubt that the Parties have opposing views as to whether the Agreement applies retroactively or not, and they have extensively argued this point[8] —all the more reason to examine this matter in light of the express requests and arguments of the Parties.

57. The Respondent's conduct prior to December 18, 1996, complained about by the Claimant, essentially consisted of (a) failure to transfer to Cytrar the permit already existing for the operation of the landfill or failure to grant to Cytrar a permit equal or equivalent to such permit, particularly as regards its indefinite duration;[9] and (b) INE's alleged

[3] In 109, p. 85 of its memorial, the Claimant misquotes Article 28 of the Vienna Convention, when in fact the correct reference, based on the text and content of such note, should have been to Article 18 of the Convention.

[4] Counter-memorial, pp. 116-120; 414 *et seq*.

[5] The text and case quoted on page 117, 418 of the counter-memorial and note 327, clearly evidence that the Respondent challenges the jurisdiction of the Arbitral Tribunal to the extent stated above.

[6] See Decision on Jurisdiction in *Tradex Hellas S.A. v. Republic of Albania*, December 24, 1996, ICSID case No.Arb/94/2, http:www.worldbank.org/icsid/cases/tradex_decision.pdf, p. 186, "there does not seem to be a common terminology as to what is "retroactive" application, and also the solutions found in substantive and procedural national and international law in this regard seem to make it very difficult, if at all possible, to agree on a common denominator as to where "retroactive" application is permissible and where not".

[7] Award in *Mondev International Ltd. v. United States of America*, October 11, 2002, ICSID case No. ARB(AF)/99/2, p. 14, 43: www.nafta.law.org.

[8] Counter-memorial, pp. 116-120, 414 *et seq*. Claimant's closing statement, pp. 93-97. Respondent's closing statement, pp. 4-6; 13 *et seq*.

[9] These events took place as follows: the first one on September 24, 1996 (note from INE to Cytrar informing that "it had been duly registered"), document A42, and the second one some time later, upon INE replacing the note by a new one on even date and with a substantially identical text, except that the new note evidences

ambiguous conduct, in that it first included Cytrar in an INE register in terms that could be deemed to be a transfer to Cytrar of the existing unlimited permit, subsequently revoking it by replacing it with another one, limited in its initial duration (a year) and the subsequent renewal of which was subject to approval by INE.[10].

58. In its memorial, the Claimant states as follows with regard to the conduct of INE with respect to the exchange or replacement of operating permits for the landfill:

However, this fact, although serious when we know what happened subsequently, did not cause immediate prejudice to the claimant which, after all, was still entitled to operate the Landfill acquired.[11]

Nevertheless, the Claimant highlights the following in this regard:

…the unwarranted change in the conditions of operation and as a result of a new and different permit being issued, unrelated to the plans and guarantees existing as of the time of the investment, is truly a discriminatory measure without any legal foundation, expressly prohibited by Article III of the ARPPI (Agreement on the Reciprocal Promotion and Protection of Investments).[12]

And a little later:

It should not be understood that the conversion of an authorization for an unlimited period of time into a temporary one legitimized or enabled the subsequent resolution contrary to renewal. That resolution of INE, challenged in this arbitration, is illegal and unlawful just like a revocation of the license on the same grounds. It is, however, beyond doubt that the precariousness (due to the short duration) and provisional nature of an authorization for such a limited time are greater than in the case of an authorization for an unlimited period of time.[13]

In connection with the same point, the Claimant explains the following:

However, CYTRAR, S.A. de C.V. and TECMED had an authorization covering the operation of the landfill and were not in a position to make complaints that could “displease” the competent officials. Still, in spite of undeniable differences between an authorization for an unlimited duration and a temporary one, the one granted in 1996 was a legitimate and sufficient title, operation of the landfill continued uninterruptedly and relations between the personnel of the companies and the representatives of the Administration were cordial and fluid. Everyone’s intent was that the landfill should operate and be managed appropriately and that it should last. At the time, at least for the Claimant, it was unthinkable that it would be unlawfully deprived of its lawfully obtained authorization only two years later.[14]

---

the granting of a new permit and notifies it to Cytrar (this permit, for a year and renewable, was dated November 11, 1996) as an annex, documents A43 and A44, Memorial, pp. 40-45; 107-109. Claimant’s closing statement, pp. 30-38.

[10] Claimant’s closing statement, pp. 110-115.

[11] Memorial, p. 42.

[12] Memorial, p. 108.

[13] Memorial, p. 109.

[14] Memorial, pp. 44-45. This was later reaffirmed by the Claimant when referring to the authorization granted by INE for the operation of the landfill by Cytrar, of November 19, 1997: “At any rate, we shall reiterate what has already been stated regarding the sufficiency of both authorizations to make operation of the landfill lawful and the practical considerations that caused CYTRAR S.A. de C.V. and TECMED to refrain from expressly protesting such changes in the conditions. The landfill continued to be operational; its duration potential, which depended on its useful life, had not been altered; and the competent authorities had expressed

Referring to INE's refusal to renew the authorization granted on November 19, 1997, the Claimant states that:

This is precisely the violation challenged in this arbitration —an Official Letter of the National Ecology Institute which deprived Cytrar, S.A. de C.V. of the asset that was the basis of its exclusive activity. A definitive and fundamental act accompanied by a number of proximate, previous and subsequent acts which completed the multiple violation of the ARPPI and which are claimed against in this arbitration.[15]

The Claimant further states:

However, the necessary accuracy with which the facts have been dealt in this memorial shows how the respondent's breach did not materialize in a single act, but was gradually prepared, implemented and strengthened until it was finally consummated in the act of refusing renewal.

It was certainly the refusal that caused damage and definitively prevented this company from obtaining a legitimate return on its investment. The preceding acts, particularly the ones leading to adverse modifications of the terms of the authorization, are in the nature of acts prior to that decisive breach which caused the damage for which compensation is requested. But the truth is that, although there is a difference between the operation of a landfill under a temporary authorization and under a license for an unlimited duration, in both cases there exists a title to undertake and lawfully continue operations, and the day-to-day activities are not curtailed by such time limitations.[16]

In connection with the refusal to renew the authorization of November 19, 1997, the Claimant further points out the following:

Therein lies the respondent's essential breach, which has caused the damage for which compensation is requested in this arbitration.[17]

Referring to the fair and equitable treatment under international law guaranteed by Article 4(1) of the Agreement, the Claimant claims that it encompasses the duty to act transparently and respecting the legitimate trust generated in the investor. In this regard, the Claimant states the following:

In sum, the legitimate trust generated in TECMED inducing it to make the investment was violated and seriously trampled upon. First, as a result of the change in the landfill's operating conditions and, subsequently and definitively, through the measure that led to its immediate standstill.

If Mexican law were to protect and permit the conversion of unlimited permits into annual ones, which we deny, the least that could be said is that such legislation is completely lacking in transparency, since none of its provisions specifies that licenses are limited in duration.[18]

The Claimant also argues that the replacement of the existing unlimited duration license, which in the past was given to state investors (municipal investors or investors from the

---

no reservations with regard to the landfill or operation thereof, nor had they expressed any intention that might affect the extent or duration of such operation": Memorial, pp. 47-48.

[15] Memorial, p. 53.

[16] Memorial, p. 103-104.

[17] Memorial, p. 112.

[18] Memorial, p. 122.

State of Sonora) by a limited duration license when it was granted to Cytrar constituted a violation of the fair and equitable treatment guarantee set forth in Article 4(5) of the Agreement.[19]

Finally, the Claimant summarizes its claims as follows:

> A declaration is sought from the Arbitral Tribunal regarding the breach committed by the United Mexican States as a result of the actions and decisions stated in this memorial, both as regards the breach itself and in connection with acts in preparation of such breach…[20]

After listing the main breaches of the Agreement alleged by the Claimant against the Respondent, which include "the substantial change in the conditions governing the operation of the landfill…" as a result of the replacement of the authorization existing at the time of making the investment and "…particularly due to the conversion of an unlimited duration permit into an annual or annually renewable one",[21] the Claimant summarizes its claims as follows:

> Such acts prepare and constitute an express, serious and blatant breach of the duty to protect foreign investments, declared in Article II of the ARPPI and of the duty to offer fair and equitable treatment to foreign investors, pursuant to Article IV of the Agreement; non-renewal is a measure having equivalent effects to the type of expropriation provided for in Article V of the ARPPI, carried out for political reasons and interests contrary to the public interest and without appropriate compensation.[22]

59. In its closing statement, the Claimant gives additional details of its requests and claims. Regarding the replacement of the unlimited duration license to operate the Landfill by a one-year license, and in view of the Respondent's statement that the Claimant's claims also seek to hold the Respondent liable for such replacement, the Claimant states as follows:

> This is absolutely false. Suffice it to look at the request for relief in the claim, which contains the Claimant's claims, to understand that the only declaration of breach sought from the Arbitral Tribunal relates to the refusal to renew the license for the operation of the CYTRAR Landfill.
>
> Certainly, the Claimant has provided an account, and informed the Tribunal, of other facts occurring prior to November 25, 1998, because they are relevant and clearly illustrate the attitude and conduct of the Mexican authorities, but the Claimant has not requested a declaration of breach or liability in respect of only one of them.[23]

The Claimant then adds:

> In sum, we hold that the act in connection with which an award is requested in this arbitration is the refusal to renew the permit with respect to the Landfill of Cytrar, aside from the fact that the Tribunal needs to know and assess the meaning of previous acts and measures of the Mexican authorities.

---

[19] Memorial, p. 127.
[20] Memorial, p. 139.
[21] Memorial, p. 139.
[22] Memorial, pp. 139-140.
[23] Claimant's closing statement, p. 93.

This claim is fully and expressly supported by the provisions on retroactivity contained in the ARPPI between Spain and Mexico, and does not need to rely on any other conventions.[24]

The Claimant further states that:

We stress that the only violation of the ARPPI requested to be penalized by the Tribunal is the decision not to renew the license, which caused the damage sustained by TECMED […] However, this does not prevent, but rather determines, that the Arbitral Tribunal should examine and assess the preceding and even subsequent acts of the Mexican authorities.[25]

60. The Arbitral Tribunal sees a certain fluctuation in the Claimant's position as to whether the Respondent's conduct prior to December 18, 1996, can be taken into account in order to determine whether the Respondent has violated the Agreement. In any case, the Arbitral Tribunal concludes that the Claimant does not include in its claims submitted to this Tribunal acts or omissions of the Respondent prior to such date which, considered *in isolation*, could be deemed to be in violation of the Agreement prior to such date.

61. A more difficult issue is whether such acts or omissions, combined with acts or conduct of the Respondent after December 18, 1996, constitute a violation of the Agreement after that date.

62. The Claimant's considerations, particularly detailed in its memorial and transcribed in paragraph 58 above, show that the Claimant, in order to determine whether there has been a violation of the Agreement, holds that the investment and the Respondent's conduct are to be considered as a process and not as an unrelated sequence of isolated events. This position of the Claimant would have two consequences. The first one is that the Respondent, prior to December 18, 1996, and through the conduct of different agencies or entities in the state structure, gradually but increasingly appears to have weakened the rights and legal position of the Claimant as an investor. Such conduct would appear to have continued after the entry into force of the Agreement, and would have resulted in the refusal to extend the authorization on November 25, 1998, which would have caused the concrete damage suffered by the Claimant as a result of such conduct. The common thread weaving together each act or omission into a single conduct attributable to the Respondent is not a subjective element or intent, but a converging action towards the same result, i.e. depriving the investor of its investment, thereby violating the Agreement. The second consequence is that, before getting to know the final result of such conduct, this conduct could not be fully recognized as a violation or detriment for the purpose of a claim under the Agreement,[26] all the more so if, at the time a substantial part of such conduct occurred, the provisions of the Agreement could not be relied upon before an international arbitration tribunal because the Agreement was not yet in force.

---

[24] Claimant's closing statement, p. 97.

[25] Claimant´s closing statement, p. 98.

[26] Whether it be conduct that continues in time, or a complex act whose constituting elements are in a time period with different durations, it is only by observation as a whole or as a unit that it is possible to see to what extent a violation of a treaty or of international law rises or to what extent damage is caused: J. Crawford, *The International Law Commission's Articles on State Responsibility* (Cambridge University Press, 2002), pp. 136-137; 143.

63. Clearly, the basic principle in international law is that unless there is a different interpretation of the treaty or unless otherwise established in its provisions, such provisions are not binding in connection with an act or event which took place or a situation that ceased to exist before the date of its entry into force.[27] The burden of proving the existence of any exception to the principle of non-retroactive application established therein naturally lies with the party making the claim.

64. Although the Agreement applies to investments existing as of the date of its entry into force —which suggests as a logical conclusion that the situations surrounding investments existing at the time do not escape its provisions—, the way the provisions on which the Claimant relies are drafted suggests that application thereof is forward-looking. Thus, for example,[28] Article 3(1) of the Agreement:

Each Contracting Party *shall offer* full protection and security…[…] and *shall not hinder*[29] […] the management, maintenance, development, use, enjoyment, expansion, sale or, as the case may be, the liquidation of such investments.

The same can be said about Article 3(2) of the Agreement:

Each Contracting Party, within the framework of its own legislation, *shall grant*[30] any authorizations needed in connection with the investments…

Or about Article 4(1) and (2) with regard to fair and equitable treatment:

Each Contracting Party *shall guarantee*[31] fair and equitable treatment in its territory pursuant to international law for investments made by investors from another Contracting Party […]. Such treatment *shall not be* less favorable than that afforded in similar circumstances by each Contracting Party to investments made in its territory by investors from a third party state.

The same is found in Article 4(5) in connection with national treatment:

…each Contracting party *shall offer*[32] to investors from the other Contracting Party treatment no less favorable than that afforded to its own investors.

Or in Article 5(1) in connection with nationalization or expropriation:

Nationalization, expropriation or any other measure of similar effects […] *which may be adopted*[33] by the authorities of a Contracting Party against investments in its territory made by investors from the other Contracting Party…

---

[27] Vienna Convention, Article 28. Award in *Mondev International Ltd. v. United States of America* (ICSID Case No. ARB(AF)/99/2), 68, p. 22, www.naftalaw.org. I. Sinclair, The Vienna Convention on the Law of Treaties, 2nd Edition (Manchester University Press, 1984), p. 85.
[28] Italics in the quotations transcribed in paragraph 64 inserted by the Arbitral Tribunal.
[29] Emphasis added by the Arbitral Tribunal.
[30] Emphasis added by the Arbitral Tribunal.
[31] Emphasis added by the Arbitral Tribunal.
[32] Emphasis added by the Arbitral Tribunal.
[33] Emphasis added by the Arbitral Tribunal.

65. The continuous use of the future tense, which connotes the undertaking of an obligation linked to a time period, rules out any interpretation to the effect that the provisions of the Agreement, even in relation to investments existing as of the time of its entry into force, apply retroactively.[34]

66. However, it should not necessarily follow from this that events or conduct prior to the entry into force of the Agreement are not relevant for the purpose of determining whether the Respondent violated the Agreement through conduct which took place or reached its consummation point *after* its entry into force. For this purpose, it will still be necessary to identify conduct —acts or omissions— of the Respondent after the entry into force of the Agreement constituting a violation thereof.

…events or conduct prior to the entry into force of an obligation for the respondent State may be relevant in determining whether the State has subsequently committed a breach of the obligation. But it must still be possible to point to conduct of the State after that date which is itself a breach.[35]

In broader terms, Article 28 of the Vienna Convention reads as follows on this matter:

If, however, an act or fact or situation which took place or arose prior to the entry into force of a treaty continues to occur or exist after the treaty has come into force, it will be caught by the provisions of the treaty.(United Nations Conference on The Law of Treaties, First and Second Sessions, Official Records (Documents of the Conference, Draft Articles on the Law of Treaties with Commentaries, as adopted by the International Law Commission at its Eighteenth Session), pag. 32, (3) (United Nations publication, Sales No.:E.70V.5, A/CONF.39/11/Add.2))

67. In view of the above precedents and of the Claimant's specific requests, the Arbitral Tribunal will not consider any possible violations of the Agreement prior to its entry into force on December 18, 1996, as a result of isolated acts or omissions that took place previously or of conduct by the Respondent considered in whole as an isolated unit and that went by before such date. In order to reach such conclusion, a relevant fact is that Cytrar, Tecmed and the Claimant did not choose to make any claim in connection with conduct occurring prior to December 18, 1996, not even through a note addressed to the relevant Mexican authorities stating their objections to the measures or resolutions adopted,[36] although they were not under any violence or pressure at the time preventing them from doing so.

---

[34] Decision on Jurisdiction in *Tradex Hellas S.A. v. Republic of Albania*, December 24, 1996, ICSID case No.Arb/94/2, p. 191, http:www.worldbank.org/icsid/cases/tradex_decision.pdf.

[35] Award in *Mondev International Ltd. v. United States of America* (ICSID Case No. ARB(AF)/99/2), 70, p. 23, www.naftalaw.org.

[36] For instance, the Claimant chose not to make any claim in connection with the replacement of its operating permits in order not to damage its relationship with the Mexican authorities: see transcript of the Claimant's statements in paragraph 58. As pointed out by the arbitral tribunal in the case Kuwait and the American Independent Oil Company (Aminoil), 21 I.L.M. p. 976 et seq. (1982), 44, p. 1008: "In truth, the Company made a choice; disagreeable as certain demands might be, it considered that it was better to accede to them because it was still possible to live with them. The whole conduct of the Company shows that the pressure it was under was not of a kind to inhibit its freedom of choice. The absence of protest during the years following […], confirms the non-existence, or else the abandonment, of this ground of complaint." See also I. Brownlie, *Principles of International Law* (5th Ed., Oxford University Press, 1998), p. 642-644.

68. On the other hand, conduct, acts or omissions of the Respondent which, though they happened before the entry into force, may be considered a constituting part, concurrent factor or aggravating or mitigating element of conduct or acts or omissions of the Respondent which took place after such date do fall within the scope of this Arbitral Tribunal's jurisdiction. This is so, provided such conduct or acts, upon consummation or completion of their consummation after the entry into force of the Agreement constitute a breach of the Agreement, and particularly if the conduct, acts or omissions prior to December 18, 1996, could not reasonably have been fully assessed by the Claimant in their significance and effects when they took place, either because as the Agreement was not in force they could not be considered within the framework of a possible claim under its provisions or because it was not possible to assess them within the general context of conduct attributable to the Respondent in connection with the investment, the key point of which led to violations of the Agreement following its entry into force.

69. The Arbitral Tribunal is aware that the Claimant, relying on the decision in the case *Emilio Agustín Mafezzini v. Kingdom of Spain,*[37] refers in its closing statement to the most favored nation treatment provided for in Article 8(1) of the Agreement in order to enable retroactive application in view of the more favorable treatment in connection with that matter which would be afforded to an Austrian investor under the bilateral treaty on investment protection between the United Mexican States and Austria of June 29, 1998. The Arbitral Tribunal will not examine the provisions of such Treaty in detail in light of such principle, because it deems that matters relating to the application over time of the Agreement, which involve more the time dimension of application of its substantive provisions rather than matters of procedure or jurisdiction, due to their significance and importance, go to the core of matters that must be deemed to be specifically negotiated by the Contracting Parties. These are determining factors for their acceptance of the Agreement, as they are directly linked to the identification of the substantive protection regime applicable to the foreign investor and, particularly, to the general (national or international) legal context within which such regime operates, as well as to the access of the foreign investor to the substantive provisions of such regime. Their application cannot therefore be impaired by the principle contained in the most favored nation clause.[38]

70. In assessing the Respondent's conduct, for the purpose of and with the scope provided for in paragraph 68 above, the Arbitral Tribunal shall take into account the principle of good faith, both as the general expression of a principle of international law embodied in Article 26 of the Vienna Convention and in its particular manifestation embodied in Article 18 of such Convention[39] with respect to the Respondent's conduct between June 23, 1995

---

[37] ICSID Case No. ARB/97/7, decision on jurisdiction of January 25, 1999, http://www.worldbank.org/icsid/cases/awards.htm.

[38] *Ibid*., *Maffezini case*, Decision on jurisdiction, p. 25-26, 62-63.

[39] Regarding the importance of the principle of good faith within the framework of the law of treaties, including the period between signing and ratification, see R. Kolb, *La bonne foi en droit international public*, Presses Universitaires de France, 179-207 (2000). Article 18 of the Vienna Convention arises out of a general rule of international law based on good faith, which it expresses; it is therefore independent, and does not constitute an exception to the principle of non-retroactive application of treaties: I. Sinclair, *The Vienna Convention on the Law of Treaties*, p. 99, Manchester University Press (2nd Edition, 1984).

—the date on which the Agreement was signed by the Contracting Parties— and the date of its entry into force mentioned above,[40] in that such Article provides that:

A State shall refrain from acts that defeat[41] the object and purpose of a treaty when:

a) it has signed the treaty or has exchanged instruments constituting the treaty subject to ratification, acceptance or approval, until it shall have made its intention clear not to become a party to the treaty…

71. Writings of publicists point out that Article 18 of the Vienna Convention does not only refer to the intentional acts of States but also to conduct which falls within its provisions,[42] which need not be intentional or manifestly damaging or fraudulent to go against the principle of good faith, but merely negligent or in disregard of the provisions of a treaty or of its underlying principles, or contradictory or unreasonable in light of such provisions or principles. It should be noted that the principle inspiring such article has been applied in order to settle, through international arbitration, disputes between States and individuals which, in order to be decided, required a pronouncement on obligations of the former vis-à-vis the latter based on the law of treaties. The Mixed Greek-Turkish Arbitral Tribunal, in the case *A.A. Megalidis v. Turkey,*[43] stated:

qu´il est de principe que déjà avec la signature d´un Traité et avant sa mise en vigueur, il existe pour les parties contractantes une obligation de ne rien faire qui puisse nuire au Traité en diminuant la portée de ses clauses.

Qu´il est intéressant de faire observer que ce principe –lequel en somme n´est qu'une manifestation de la bonne foi qui est la base de toute loi et de toute convention- a reçu un certain nombre d´applications…[44]

II. Timely submission by the Claimant of its Claims against the Respondent

72. In Chapter III of its counter-memorial, in a general section entitled "C. Objections regarding Jurisdiction", the Respondent introduces defenses based on the Claimant's claims allegedly not satisfying the requirements of Title II(4) and Title II(5) of the Appendix to the Agreement, for which reason this Arbitral Tribunal would be prevented from dealing with such claims.

Title II(4) of the Appendix to the Agreement provides the following:

An investor from a Contracting Party may, either on its own behalf or representing a company owned by it or under its direct or indirect control, refer to arbitration a claim on the grounds that the other Contracting Party

[40] See comment at the International Law Commission (United Nations Conference on the Law of Treaties, Official Records, Documents of the Conference, United Nations Publication A/CONF.39/11/Add.2), p. 22.
[41] It should be noted that the English version of this provision uses the expression *"defeat the object"*, which is not strictly equivalent to the notion of "frustrate" in English or "frustrar" in Spanish.
[42] A. Remiro Brotóns, *Derecho Internacional Público*. 2 Derecho de los Tratados (Tecnos, Madrid, 1987), p. 246.
[43] Annual Digest of Public International Law Cases (1927-1928) [A. Mc Nair & H. Lauterpacht Editors], Vol. 4 (1931), 272, p. 395.
[44] Lord McNair, *The Law of Treaties* (Clarendon Press, Oxford, 1961), p. 202.

has violated an obligation under this Agreement, as long as the investor or its investment have suffered a loss or damage by reason or as a consequence of the breach.

Title II(5) of the Appendix to the Agreement provides the following:

The investor may not submit a claim under this Agreement if more than three years have elapsed since the date on which the investor had or should have had notice of the alleged violation, as well as of the loss or damage sustained.

73. In the opinion of the Arbitral Tribunal, the defenses filed by the Respondent, relying on Title II(4) and (5) of the Appendix to the Agreement, do not relate to the jurisdiction of the Arbitral Tribunal but rather to (non)compliance with certain requirements of the Agreement governing the admissibility of the foreign investor's claims. The Arbitral Tribunal notes that to the extent such defenses have been filed with respect to claims referring to conduct or acts or omissions of the Respondent which are excluded from the Arbitral Tribunal's jurisdiction or from the substantive scope of application of the Agreement pursuant to the decision contained in paragraphs 67 and 68 of this award, any determination as to whether such claims fulfill the requirements of Title II(4) and (5) of the Appendix to the Agreement would be superfluous.

74. When it comes to the Claimant's claims falling within the scope of this arbitration and of the provisions of the Agreement, the Arbitral Tribunal will decide if the admissibility requirements set forth in Title II(4) and (5) of the Appendix to the Agreement have been complied with or not with respect to the acts on which such claims are based, together with the remaining considerations or matters to be taken into account by the Arbitral Tribunal in deciding on the merits of the allegations of the Parties in this award. If the acts under review are deemed by the Arbitral Tribunal to be a part of more general, and not merely isolated conduct, the Arbitral Tribunal reserves the power to consider that the time when it will assess whether such acts have caused losses or damage for the purposes of Title II(4) of the Appendix to the Agreement, or whether they were deemed by the Claimant to be a breach of the Agreement or damaging within the three-year term provided for in Title II(5), will not be earlier than the point of consummation of the conduct encompassing and giving an overarching sense to such acts. In any case, and within the general framework of considerations already made when deciding whether the provisions of the Agreement are to be applied retroactively or not, the Arbitral Tribunal is of the view that Title II(4) and (5) of the Appendix to the Agreement contains requirements relating to the substantive admissibility of claims by the foreign investor, i.e. its access to the substantive protection regime contemplated under the Agreement. Consequently, such requirements are necessarily a part of the essential core of negotiations of the Contracting Parties; it should therefore be presumed that they would not have entered into the Agreement in the absence of such provisions. Such provisions, in the opinion of the Arbitral Tribunal, therefore fall outside the scope of the most favored nation clause contained in Article 8(1) of the Agreement.

III. The Scope of the Purchase Transaction

75. The Claimant alleges, mainly on the basis of documents signed with Promotora in the process of award and transfer of the assets under which it operated the landfill of hazardous waste physically located in Las Víboras, Municipality of Hermosillo, State of Sonora, that what the Claimant acquired through that process was actually a pool of personal and real property and intangibles, the latter consisting of permits issued by municipal and federal authorities of the Respondent which enabled and empowered the Claimant to operate the Las Víboras site as a hazardous waste landfill. According to the Claimant, out of the total price of $34,047,988.26 (Mexican Pesos) paid to Promotora for the acquisition of the assets relating to the landfill, the most substantial part, $24,047,988.26 (Mexican Pesos), was paid by the Claimant in kind —by closing down an existing landfill for urban waste and constructing and advising in respect of the operation of a new landfill for the same purpose— in exchange for the permits and authorizations to operate the Las Víboras site as a landfill for hazardous waste.[45] Both the landfill that was closed down as well as the new one currently in operation are located in land owned by the Municipality of Hermosillo, under the jurisdiction of that Municipality and this location is other than the site for landfill of hazardous waste at Las Víboras, acquired by the Claimant as a result of the public bidding.[46]

76. The Respondent, on the other hand, argues that Promotora only tendered and sold to the Claimant a pool of personal and real property "relating to the Industrial Park" of the city of Hermosillo, which did not include permits or licenses to operate the landfill.[47] According to the Respondent, the public bidding and award of assets relating to the landfill at the Las Víboras site to Tecmed and Cytrar also included acquisition by another company of the Tecmed group of a concession for a landfill —a municipal dump also situated in the Municipality of Hermosillo—, for which Cytrar allegedly paid the above-mentioned amount of $ 24,047,988.26 (Mexican Pesos). The Respondent specifically argues the following:

Tecmed (Mexico) acquired two things in the tender of February 1996. A pool of personal and real property relating to the landfill of hazardous waste, which consisted of a piece of land, existing constructions and machinery and equipment clearly described in the supporting documents of the transaction. It paid 10 million pesos in cash for them, as reflected in the financial statements submitted in these proceedings.

Secondly, it acquired the concession of a landfill, the municipal dump, for which it offered 24 million pesos, a concession which it still holds and continues to operate. What Dr. Calvo Corbella said a moment ago is true, not in respect of Cytrar but in respect of the company [sic], as confirmed by engineer Polanco, who attended the Tecmed (Mexico) tender. This was also confirmed by engineer Diez-Canedo, in reply to a question I expressly made when I asked him if, in addition to the amount of ten million pesos, he had offered a non-monetary contribution consisting of the construction and comprising the general facilities and the first phase of operations. Engineer Díaz Canedo answered that that was true.[48]

[45] Memorial, pp. 20-40. Claimant's closing statement, pp. 10-30.
[46] Declaration of Javier Polanco Gómez Lavin, Hearing of May 20-24, 2002; transcription of May 20, 2002, pp. 31 overleaf/33.
[47] Counter-memorial, pp. 24-31; Nº 90 *et seq.*
[48] Oral statement by the Claimant at the Hearing of May 20, 2002, transcript of May 24, 2002, pp. 27-28.

In sum, the Respondent not only holds that that amount, or contribution in kind valued at such amount, was not paid or made in exchange for intangible assets (the permits, authorizations or licenses to which Claimant refers), but also that it was not even a part of the price paid for assets relating to the landfill in Las Víboras. According to the Respondent, such amount or contribution was paid or made in exchange for the concession to operate the urban waste landfill of Hermosillo.

77. Based on the allegations of the Parties and of the facts presented before this Arbitral Tribunal, it is to be concluded that the award, the public bidding and sales transaction of assets relating to the Las Víboras landfill and the rights and obligations for each of the parties to such transaction and resulting therefrom were embodied in different instruments requiring joint consideration in order to determine the scope of the operation and its effects.

78. The award by Promotora of assets relating to the Las Víboras landfill to Tecmed as a result of the tender of such assets by Promotora was followed by the signing of a "promise to sell" contract dated February 20, 1996, entered into between Promotora and Tecmed, the fourth clause of which provides that at the time of executing the notarial deed of conveyance, the assets conveyed would include copies of permits, licenses and authorizations relating to the assets specified in the agreement.[49] In item or representation No. IIII of such instrument, it is stated that the Board of Directors of Promotora unanimously approved the following proposal:

> Price offer for the purchase of Cytrar, alternative number two, consisting of 10 million pesos plus a non-monetary contribution to the Municipality of Hermosillo in the form of a project for the construction of and advice in connection with the operation of the new landfill in accordance with the attached project which comprises the general facilities and their first phase of operation, including the closedown of the current landfill, services valued at $ 24,155,185.00 (Mexican Pesos). Total offer: $34,155,185 (Mexican Pesos).

The second clause of the document stipulates that part of the price - $ 10,000,000 (Mexican Pesos)- would be paid in cash, part upon signing the promise to sell and part upon signing the notarized deed of conveyance of the tendered real property, with the balance, amounting to $24,155,185.00 (Mexican Pesos), to be paid in kind, by providing the service of closing down the existing landfill and constructing and providing advice in connection with the operation of a new one as mentioned above and referred to in item or representation number III of the "promise to sell" contract. As regards payment in kind of that part of the price, the second clause of the promise to sell expressly states as follows:

> The difference relates to the cost of constructing a new landfill and closing down the existing one, in accordance with the approved proposal, which would be at the time of completing the construction of the new landfill to the satisfaction of Promotora Inmobiliaria of the Municipality of Hermosillo based on the construction project submitted by the buyer, upon which time the reservation of ownership would end; in the case of sale of the personal property located in the "landfill", it will be billed by seller to buyer upon formalization of the final transaction, such formalities being the responsibility of Promotora Inmobiliaria of the Municipality of Hermosillo.

In turn, the fifth clause of the "promise to sell" contract provides the following:

[49] Document A23.

The parties specify that as from now the use to be given to the hazardous waste landfill shall be precisely that, failing which the property will revert back to the seller, in which case the buyer shall automatically forfeit any advances or payments made, unless the buyer "Tecmed, Técnicas Medioambientales de México S.A. de C.V." fails to obtain the government permits and licenses required for lawful operation, in which case it may change the mode of operation by using the existing original license for operation of the landfill by "Tecmed, Técnicas Medioambientales de México S.A. de C.V.".

79. In addition to the above, on the same date, Promotora, Tecmed and Cytrar entered into an agreement "to determine the method and terms of payment of the consideration arising out of the 'promise to sell' contract with reservation of ownership, dated February 20, 1996".[50] Under such agreement, the total price to be paid by Cytrar amounted to $ 24,047,988.26 (Mexican Pesos), broken down as follows: $6,277,409.50 (Mexican Pesos) for land and constructions; $237,034.00 (Mexican Pesos) for machinery and equipment; $24,047,988.26 (Mexican Pesos) for intangibles. The agreement sets forth that Promotora shall issue an invoice covering the intangibles and that Cytrar shall issue invoices for the part of the price payable through the construction of the new landfill and closedown of the Hermosillo municipal dump, such invoices to be issued upon completion of the works. Clauses three and four of the agreement specifically provide the following:

Third: Promotora Inmobiliaria of the Municipality of Hermosillo OPD further undertakes to issue an invoice for the intangibles upon full compliance by Cytrar S.A. de C.V. of the obligation set forth in clause two of the above-mentioned agreement of February 20, 1996. The invoice value will be $24,047,988.26 (Mexican Pesos) plus $ 3,607,198.24 (Mexican Pesos) VAT, totaling $ 27,655,186.50 (Mexican Pesos).

Fourth: Cytrar S.A. de C.V. agrees to the terms of the preceding clauses and in turn undertakes to issue invoices for the part it will pay with the construction and delivery of the new landfill of the Municipality of Hermosillo and the closedown of the current municipal dump. Such invoices will be issued upon formal delivery of the works.

80. Finally, pursuant to the award conditions, through a notarial deed of March 27, 1996,[51] Cytrar acquired from Promotora the real property, constructions and personal property relating to the landfill. Item or representation number 1 of the deed specifies that the seller (Promotora). "..tendered various assets held by it, in particular the 'hazardous waste landfill situated at the Las Víboras' site in the Hermosillo Industrial Park." In item or representation II of such deed, reference is made to the meeting of the Board of Directors of Promotora, which unanimously approved the proposal submitted by Tecmed on the following terms:

"Price Offer for Acquisition of Cytrar", alternative number two, consisting of $10,000,000 (ten million pesos), plus a non-monetary contribution to the Municipality of Hermosillo, approval recorded in minutes, stating that it was unanimous, and including the closedown of the current landfill, the project and the construction of the first phase of the new landfill, pursuant to the resolutions approving performance, issued by the Board of Directors…"

The requirements for approval by the Board of Directors of Promotora include, as point c) of item or representation II the following:

---

[50] Document A24.

[51] Document A25.

Identifying the responsibility of each party and the timing for obtaining operating licenses.

The second clause of the deed states a cash amount of $ 10,000,000 (Mexican Pesos) as the price, which is broken down into different amounts paid for the constructions already existing, personal property and land. Such clause also provides that:

… regardless of the price fixed, the PURCHASER undertakes to perform non-monetary obligations consisting of the project and construction of the first phase of the new landfill and closedown of the existing one, to the satisfaction of "Promotora Inmobiliaria of the Municipality of Hermosillo", in accordance with the approved proposal.

The fourth clause of the deed provides that the reservation of ownership subject to which the sale is made will be lifted

…upon completion of the construction works for the new landfill and the closing down of the existing one, to the entire satisfaction of "Promotora Inmobiliaria of the Municipality of Hermosillo", in accordance with the approved proposal.

Clause 5a) of the deed provides that the transferee (Cytrar) must undertake to perform its obligations under the public bidding in full, including the following obligations:

Specification that the acquired assets will be used solely as a landfill for hazardous waste, failing which they shall revert back to Promotora Inmobiliaria of the Municipality of Hermosillo, and any payments made will be forfeited, if the buyer "Cytrar" S.A. de C.V. should fail to obtain the government permits and licenses required for lawful operation; in such case, the mode of operation may be changed by using the existing original license for operation of the landfill by "Cytrar" S.A. de C.V.

Clause 5d) also provides that:

The steps required to be taken in order to obtain the government permits and licenses necessary for operation of the hazardous waste landfill shall be the sole responsibility of the transferee, Promotora Inmobiliaria of the Municipality of Hermosillo hereby being released from any liability with regard to the official authorizations required to be requested from the Municipality of Hermosillo. Promotora Inmobiliaria will lend its support to secure approval.

81. In a rectifying notarial deed of December 16, 1996,[52] Promotora and Cytrar corrected the amount of the part of the price relating to the acquisition of the real property as described in the original deed of conveyance of March 27, 1996, which was thus rectified and fixed at $ 6,132,530 (Mexican Pesos), but the prices for the other items were not rectified. The deed also specified that real property and intangibles would be invoiced separately as follows:

As specified in the agreement signed between the parties on March 20, 1996, which fixes the terms and conditions under which the transaction will be settled, an involuntary error led to a mistaken and insufficient breakdown of values and calculation of Value Added Tax, AS THE TECHNICAL DESCRIPTION[53] of such assets WAS NOT TAKEN INTO ACCOUNT, i.e. the necessary topographic survey and description of

[52] Document A26.
[53] Emphasis in the original.

constructions and intangibles, since it was agreed that personal property and intangibles would be invoiced separately.

82. In a service contract of March 28, 1996,[54] between Promotora and Cytrar, in consideration of Cytrar's provision of "environmental advice services to the Municipality of Hermosillo" (clause 6), Promotora undertook, among other things (clause 2 d), to:

Keep in force any federal, state and municipal licenses and other permits required for operation of the landfill.

83. After the contribution in kind provided for as part of the purchase price of the assets relating to the landfill having been made, and apparently pursuant to the procedure set forth in the second clause of the "promise to buy" contract of February 20, 1996, the third and fourth clauses of the agreement regarding the method and terms of payment on the same date and the rectifying notarially-recorded deed of December 16, 1996, Promotora issued on July 24, 1997, Invoice No. 304 to Cytrar[55] for the amount of $24,047,988.26 (Mexican Pesos) plus the applicable value added tax (VAT). The invoice comprises:

An authorization granted by the National Ecology Institute for the operation of a controlled landfill, through the collection, transport, treatment, temporary storage, and disposal of hazardous waste; the authorization also includes an authorization for soil use on the part of the Municipality of Hermosillo.

84. The different provisions laid down above and included in several documents signed by Promotora and Tecmed or Cytrar to record their mutual rights and obligations in connection with the sale and operation of the Las Víboras landfill show that performance of the works and services that were the responsibility of Cytrar relating to the landfill of urban waste, valued at $ 24,047,988.26 (Mexican Pesos), was a payment in kind that was part of the consideration to be furnished by Cytrar for the award and sale to it of different assets for Cytrar to operate the hazardous waste landfill at Las Víboras; in other words, it was part of the price for which the assets of the Las Víboras landfill were awarded and sold to Tecmed and ultimately to Cytrar. So much so that the reservation of ownership to which such sale was subject would only terminate when such consideration had been furnished in full.[56] The audited financial statements of Cytrar as of December 31, 1997 enclosed with the expert witness report of American Appraisal[57] offered by the Claimant, particularly note 6, leads to the same conclusion; no evidence to the contrary has been provided based on the accounting books of Promotora or on statements of its management that took part in the sale of assets relating to the hazardous waste landfill of Las Víboras, nor evidence of any judicial challenges, for fiscal or any other reasons, with respect to the part of the sales price paid in kind, or the value or amount thereof, or the public tender offer proposed by Tecmed on the basis of such price, or its division into a cash component and a component in kind, nor denying that such payment in kind is all part of the price payable for assets relating to the Las Víboras landfill. The expert witness proposed by the Respondent does not state otherwise in his reports, when he says that "The urban waste landfill was an operation arising out of the payment in kind to be made by Tecmed for the acquisition of Cytrar".[58]

[54] Document A33.
[55] Document A31
[56] Deed of purchase and sale of March 27, 1996, fourth clause (Document A25).
[57] Document A117.
[58] Report by Fausto García y Asociados, p. 26.

85. It is the view of the Arbitral Tribunal that the minutes of the board meeting of Promotora of March 15, 1996,[59] which reflect Promotora's decision to approve the offer made by Tecmed, clearly establish, in accordance with alternative 2 of the Tecmed acquisition offer,[60] that the contribution in kind, valued at $ 24,155,185.00 (Mexican Pesos), which was to take place through the performance of different works and services relating to the municipal dump of Hermosillo for urban waste, was part of the price paid for the assets of the Las Víboras landfill, concerned with hazardous waste, as can be read on the second page of the minutes:

> In item two, RODOLFO SALAZAR PLATT (an engineer) reads out the resolution adopted at the preceding meeting which reads (verbatim): After these reviews, the Board declares the following proposal to be unanimously approved: "Price offer for the acquisition of CYTRAR, alternative 2 (two), consisting of $10,000,000.00 (TEN MILLION MEXICAN PESOS) and a non-monetary contribution to the Municipality of Hermosillo in the form of a construction project and provision of advice to the operation of the new landfill in accordance with the enclosed project, which comprises the general installations and the first phase of operation. It includes the closing of the current landfill, work valued at $24,155,185.00 (Mexican Pesos) [….] Total value of offer is $34,155,185.00 (Mexican Pesos) [….], the opinion of the full Board being that it is the most convenient offer from the economic and technical point of view and that it is beneficial for all the community of Hermosillo.

86. There is no doubt that payment of the sales price was to be made by the purchaser of the tendered assets,[61] regardless of the individual or corporation holding or being the beneficiary of the concession for the operation of the Hermosillo urban waste landfill, and that such obligation was vested in Cytrar.[62] The approval of the tender by Promotora's management board already contemplated the acquisition by Cytrar of the Las Víboras landfill assets awarded to Tecmed, and further that Cytrar should become "..a joint and several obligee with respect to the rights and obligations acquired by the successful awardee…",[63] without excluding from such obligations the ones relating to the furnishing of the consideration in kind, referred to above. The declaration of Mr. Javier Polanco Gómez Lavín —which has not been challenged or refuted in this regard by any other evidence produced in this arbitration— confirms the above.[64]

87. Having been concluded that the consideration in kind to be furnished by the purchaser of the assets relating to the hazardous waste landfill of Las Víboras in connection with the urban waste landfill of the Municipality of Hermosillo is part of the purchase price of such assets, it remains to be determined to what extent all or part of such consideration is allocable to the acquisition of the intangible assets referred to by the Claimant.

88. A rational and logical interpretation of the documentation presented by the Parties shows that what Promotora, on the one hand, and Tecmed and Cytrar, on the other, had in

---

[59] Document A21.

[60] Document A17

[61] Page 5, notarial deed of conveyance, document A25.

[62] Second clause of the "promise-to-buy" contract (document A23); third clause of the Agreement (document A24).

[63] Document A21, p. 4

[64] Declaration of Javier Polanco Gómez Lavín, transcript of the Hearing for the Production of Evidence of May 20-24, 2002, section on May 20, 2002, pp. 31-33.

mind when entering into the agreement (from the standpoint of the latter, also when contemplating an investment in Mexico and in the Las Víboras landfill), was not simply the transfer of certain personal and real property but also to create the means for Cytrar to be able to operate the Las Víboras site as a hazardous waste landfill —i.e. to accomplish a public use purpose fully consistent with the activity that this landfill had been serving since its beginning in 1988— and to continue the same activity. Such were necessarily the legitimate expectations of Cytrar and of the Claimant, not only because the site and facilities being acquired as well as the commitments in terms of use and operation undertaken upon doing so, were to serve the normal purpose of operations of Tecmed and Cytrar, but also because the documentation of the tender whereby Tecmed was awarded the landfill assets, and the subsequent documentation signed with Promotora, highlighted that this was the only possible use for the assets being acquired, to such an extent that they would revert to Promotora if Cytrar failed to use them for the exclusive public use purpose for which such assets had been earmarked long before. This was, certainly, the expectation of Promotora and of the Municipality of Hermosillo, which controlled it, as they were both certainly interested in ensuring that the assets of the Las Víboras landfill continued being allocated to the hazardous waste landfill in view of their having been set aside for the protection of the environment and public health, as evidenced by the conditions of the tender of the assets of the landfill[65] and the terms and conditions of the documents whereby the sale was executed.[66] For example, paragraph eleven of the tender specifications required (and this requirement was fulfilled) that the notarial deed of conveyance include a clause whereby the purchaser agreed to include as an advisor, appointed by the Municipality of Hermosillo, with a voice but no vote, on an "indefinite and irrevocable" basis, in addition to ensuring that the landfill would be operated in accordance with the highest national and international standards. The Respondent points out[67] that this clause evidences

> the interest and powers of the Municipality, as a government agency formed by representatives elected by the people, by and for the purpose of supervising the proper operation of the landfill in accordance with the highest applicable national and international standards.

The appointment of the advisor was thus directly linked to the Municipality's interest in ensuring that the assets purchased should be treated as a unit for landfill of hazardous waste pursuant to the legal provisions, which was obviously not possible without the permits authorizing the operation.

89. Promotora could not, in good faith, impose such a drastic requirement or such a harsh sanction on Cytrar as the reversion to Promotora of the assets relating to the Las Víboras landfill if Cytrar was not authorized to use them in accordance with the agreed use, without assuming that access to the permits and licenses for the operation of the Las Víboras landfill in a manner consistent with their historical use was a fundamental part of the operation and of the expectations of Cytrar, Tecmed and, ultimately, the Claimant, and without assuming certain commitments to vest Cytrar with minimum rights that would prevent an outcome as adverse to such expectations and interests as the reversion of assets

[65] Document A16, paragraph 6.
[66] Document A25, notarial deed of March 27, 1996, fifth clause.
[67] Counter-memorial, pp. 24-25, 95.

and at the same time the loss of amounts paid in cash or consideration furnished until then as payment of the price. Neither could INE ignore that the real property and tangible personal property relating to the Las Víboras landfill —and the investment relating to the Las Víboras landfill— would be devoid of economic value if Cytrar did not obtain the permits, licenses or authorizations required for operation. The note of the Municipality of Hermosillo addressed to INE on March 28, 1996,[68] whereby the Municipality "most respectfully" requests the Institute

> to provide to TECMED Técnicas Medioambientales de México, S.A. de C.V., or to the company organized by it to operate the landfill, all necessary assistance to comply with the formalities for changing the name appearing in the operating license, which is currently Confinamiento Controlado Parque Industrial de Hermosillo[69]

not only confirms the above, but also evidences that no doubts were being cast as to the fact that the change of the license holder's name was considered to be the lawful, normal and logical procedure in order to ensure that Cytrar could operate the Las Víboras site in accordance with the purpose mandated to it under the tender, sale and transfer documents.

90. However, Promotora did not guarantee to Cytrar or to Tecmed that Cytrar would obtain from INE the outcome certainly desired by Cytrar and apparently –at least at that time- by Promotora and by the Municipality of Hermosillo, i.e. that Cytrar would secure an authorization to operate a hazardous waste landfill at Las Víboras, or, if granted, that such authorization would conform to certain expected requirements such as its duration. Promotora did not guarantee to Cytrar either that the transfer to the latter's name of the license given to Confinamiento Controlado Parque Industrial de Hermosillo O.P.D. would definitely take place. This does not, however, mean that Promotora was not willing to maintain the existing permits and licenses and their potential use by Cytrar in the event that that authorization or transfer did not materialize, as evidenced in clause 5 (a) of the contract of sale of March 27, 1996, between Promotora and Cytrar, mentioned above. Nor does it mean that Cytrar, through the transaction entered into with Promotora, only acquired real property and tangible personal property considered as such in isolation, i.e. unrelated to their historical and structural use and to the functional and economic dimension intimately associated to such use. As stated by Tecmed in its offer when it made it conditional to obtaining the authorizations for the use of such assets as a hazardous waste landfill,[70] neither Tecmed nor Cytrar would have acquired the assets without access to the authorizations and permits that would enable them to use them for a hazardous waste landfill. Accordingly, pursuant to clause five of the promise to sell contract signed with Tecmed on February 20, 1996, and clause 5 a) of the notarially recorded deed executed by Promotora, Tecmed and Cytrar on March 27, 1996 (transcribed above), Promotora consented to the potential use, in the case of the first document, by Tecmed, and in the second case, by Cytrar, of the existing licenses, authorizations or permits (mainly the authorization granted by INE on May 4, 1994, to Confinamiento Controlado Parque Industrial de Hermosillo O.P.D.) in the event of the failure of – as applicable – Cytrar or Tecmed to obtain the permits, licenses or authorizations required for the operation of the

[68] Document A41.
[69] Emphasis in the original.
[70] Document A17.

landfill. Under clause 2 d) of the service contract of March 28, 1996, Promotora also undertook to keep current the existing licenses and authorizations, including the federal ones, for the operation of the Las Víboras landfill until Cytrar could do so on its own. These provisions show beyond any doubt that access by Cytrar to the licenses, authorizations or permits enabling it to operate the landfill was a central part of the tender and acquisition of assets relating to the Las Víboras landfill and of the expectations of Tecmed and Cytrar when the decision was made to invest in the landfill.

91. The documentation produced evidences that such licenses, authorizations and permits, and the right to use them for the operation of the Las Víboras landfill were vested in Promotora as a result of the winding-up of Confinamiento Controlado.[71] Accordingly, and also in view of the precedent of such landfill having already been operated by an entity other than that authorized,[72] it is also inferred that Promotora could allow the operation of the Las Víboras landfill by third parties under such authorizations, licenses or permits (to the extent such third parties adapted their operation to the framework allowed thereunder), as well as the transfer to third parties of the real property and tangible personal property of the Las Víboras landfill. This is a logical conclusion not only from a functional point of view, because the personal and real property of such landfill cannot be put to use for the benefit of the public or to the advantage of the community in accordance with or pursuant to the function on the basis and in furtherance of which they are technically structured and organized as an autonomous unit, without the required authorizations, licenses or permits, but also from an economic or business point of view, as the value of the real property and tangible personal property of the landfill —which, in practical terms, have been invalidated for any use other than the landfill of hazardous waste— depends on the existence or subsistence of such authorizations, licenses and permits. Consequently, from the perspective of Promotora, the price of those assets is, at the time of sale, enhanced by the possibility of use under such authorizations or permits. It should therefore be concluded that the consideration in kind valued at $ 24,155,185.00 (Mexican Pesos) was paid as a lump sum in consideration of, on the one hand, Promotora's undertakings relating to the maintenance of the licenses, permits and authorizations and of their being made available to Cytrar for the operation, as a hazardous waste landfill, of the Las Víboras site and other assets allocated to it in the event of Cytrar not obtaining new authorizations or licenses,[73] or the transfer to Cytrar of existing ones; and on the other hand, in recognition of the higher value of the real property and tangible personal property acquired in anticipation of the expectation to use them under such authorizations, permits and licenses and, consequently, as part of the purchase price of such personal and real property, as such value was not just

[71] Administrative record of the winding-up of Confinamiento Controlado Parque Industrial de Hermosillo O.P.D. of August 31, 1995, Point IV, Annex No. 15 (Document A13); donation contract between the Government of the State of Sonora and Promotora, evidencing transfer to Promotora of the personal property listed in the record, which in Point IV, Annex 15, includes a list of permits for operation of the Las Víboras landfill, including the authorization granted by INE on May 4, 1994 (Document A14, introductory paragraphs III and IV; third clause).

[72] See paragraph 36 of this award.

[73] Regardless of the way in which this commitment on the part of Promotora should be complied with, even if compliance was as suggested by the Respondent: Cytrar being hired by Promotora –the latter, as holder of the authorizations, licenses and permits for the operation of the Las Víboras landfill- for Cytrar to operate it under them ("Admissions and Denials", pleading filed by the Respondent, p. 25).

their inherent value but also the value resulting from the possibility of being functionally applied to the storage and management of hazardous waste within the framework of a legally authorized landfill operation. From this perspective, payment of a higher price is justified by the expectation of Tecmed and Cytrar —highlighted by the expert witness appointed by the Respondent— at the time of the tender and sale of the assets relating to the Las Víboras landfill and of their acquisition by such companies, to use it "with an "unlimited duration" license".[74] It has also been established that the part in kind of the purchase price for the landfill was fully paid by its purchaser, Cytrar.

92. Upon replacement of the first official letter of INE dated September 24, 1996, by a subsequent new letter of the same date, but accompanied by an INE authorization, different not only in terms of its duration and in other respects, but which also revoked the existing authorization that had been issued to Confinamiento Controlado Parque Industrial de Hermosillo OPD under which the landfill had operated since May 4, 1994, an important change in the existing situation took place, because Promotora could no longer make such authorization available to Cytrar, nor would Cytrar probably be able to hold Promotora responsible because presumably, under both the "promise-to-buy" contract of February 20, 1996 and the notarial deed of March 27, 1996, Cytrar could only demand the performance of Promotora's obligation to make the 1994 license available if Cytrar had failed to obtain a license "required for the lawful operation of the landfill". Although of limited duration, the license of November 11, 1996, obtained by Cytrar from INE enabled the legal operation of the landfill and therefore did not give Cytrar rights against Promotora under the deed. In any event, this Arbitral Tribunal is not called to decide on these issues.

E. The Merits of the Dispute

93. The Claimant alleges that the Respondent's conduct violates the following provisions of the Agreement:

1) Article 2(1) on the promotion and admission of investments;

2) Article 3 on protection of investments;

3) Article 4(1) on fair and equitable treatment;

4) Article 4(2) on the most favorable treatment;

5) Article 4(5) on national treatment; and

6) Article 5 on nationalization and expropriation.

94. The Arbitral Tribunal deems it appropriate to consider and resolve upon the issues referred to above in the following order:

[74] Report of Fausto García y Asociados, p. 48.

1) The obligation to refrain from expropriating or nationalizing in violation of the Agreement;

2) The obligation to assure fair and equitable treatment in accordance with international law; and

3) The obligation to grant full security and protection to investments under international law, and the other violations to the Agreement alleged by the Claimant.

I. Expropriation

95. The Claimant alleges that, when the INE did not renew the permit to operate the Las Víboras Landfill (the «Landfill») through its resolution dated November 25, 1998 (hereinafter the «Resolution»), it expropriated the Claimant's investment and that such expropriation has caused damage to the Claimant. The Claimant relates the expropriation —which according to the Claimant is the exclusive cause of the damage— to the prior actions of a number of organizations and entities at the federal, state and municipal levels, and also states that those actions are attributable to the Respondent and that they are adverse to the Claimant's rights under the Agreement and to the protection awarded to its investment thereunder. The Claimant further alleges that those actions objectively facilitated or prepared the subsequent expropriatory action carried out by INE.

96. The Claimant alleges that the Agreement protects foreign investors and their investments from direct and indirect expropriation; i.e. not only expropriation aimed at real or tangible personal property whereby the owner thereof is deprived of interests over such property, but also actions consisting of measures tantamount to an expropriation with respect to such property and also to intangible property. The Claimant states that, as the resolution deprived Cytrar of its rights to use and enjoy the real and personal property forming the Landfill in accordance with its sole intended purpose, the Resolution put an end to the operation of the Landfill as an on going business exclusively engaged in the landfill of hazardous waste, an activity that is only feasible under a permit, the renewal of which was denied. Therefore, Cytrar alleges that it was deprived of the benefits and economic use of its investment. The Claimant highlights that without such permit the personal and real property had no individual or aggregate market value and that the existence of the Landfill as an on going business, as well as its value as such, were completely destroyed due to such Resolution which, in addition, ordered the closing of the Landfill.[75]

97. The Respondent alleges that INE had the discretionary powers required to grant and deny permits, and that such issues, except in special cases, are exclusively governed by domestic and not international law. On the other hand, the Respondent states that there was no progressive taking of the rights related to the permit to operate the Las Víboras landfill by means of a legislative change that could have destroyed the *status quo,* and that the Resolution was neither arbitrary nor discriminatory. It also states that the Resolution was a regulatory measure issued in compliance with the State's police power within the highly regulated and extremely sensitive framework of environmental protection and public

[75] Memorial, p. 53.

health. In those circumstances, the Respondent alleges that the Resolution is a legitimate action of the State that does not amount to an expropriation under international law.[76]

98. The Claimant affirms that the Resolution is arbitrary because the reasons invoked therein to deny the renewal of the permit that had been granted on November 19, 1997 (the «Permit»), under which the Claimant had operated the Landfill over the last year, are not proportional to the decision not to renew the Permit.

99. The Resolution[77] refuses renewal of the Permit on the following grounds: (i) the Landfill was only authorized to receive waste from agrochemicals or pesticides or containers and materials contaminated with such elements; (ii) PROFEPA's delegates in Sonora had informed, in the official communication dated November 11, 1998,[78] that the waste confined far exceeded the landfill limits established for one of the Landfill's active cells, cell No. 2; (iii) the Landfill temporarily stored hazardous waste destined for a place outside the Landfill, acting as a «transfer center», an activity for which the Landfill did not have the required authorization; Cytrar was requested on October 16, 1997 to file reports in connection with this activity, but to date the relevant authorization had not been issued; and (iv) liquid and biological-infectious waste was received at the Landfill, an activity that was prohibited and that amounted to a breach of the obligation to notify in advance any change or modification in the scope of the Permit, and to unauthorized storage at the Landfill of liquid and biological-infectious waste. The Resolution also textually provides as follows:

Furthermore, CYTRAR S.A. de C.V. agreed with the different levels of the Federal, State and Municipal Government and communicated to the public the relocation of the landfill.

100. The Claimant challenges those statements because, among other things, the excess of the authorized landfill levels of cell no. 2 was the subject matter of an investigation and an audit by PROFEPA, as a result of which a fine was imposed on Cytrar by means of an official communication dated December 16, 1999.[79] That fine was a minor penalty, substantially smaller than the maximum fine established by law. The Claimant also highlights that the official communication issued by PROFEPA to impose the fine stated that the infringement did not have a «significant effect on public health or generate an ecological imbalance».[80] The Claimant also stated that in another similar official communication issued by PROFEPA,[81] in which a fine was imposed on Cytrar for a number of infringements —including acting as a temporary storage of hazardous waste to be sent to other companies and operating as a transfer center, circumstances that were invoked by INE in the Resolution that denied the renewal of the Permit—[82], PROFEPA expressly stated that

[76] Counter-memorial, pp.160-162, 550 *et seq*. Respondent's closing statement, pp. 24-25, 56 *et seq*.
[77] Document A59.
[78] Document A62.
[79] Official communication No. PFPA-DS-UJ-2625/99 issued by Profepa, December 16, 1999; document A61.
[80] PROFEPA's official communication already cited, document A61, p. 16.
[81] Official communication No. PFPA-DS-UJ-1105/99 dated May 25, 1999. Document A63.
[82] PROFEPA's official communication already cited, page 55, paragraph (ah). Document A63.

… the infringements committed by the company involved are not sufficient to immediately cancel, suspend or revoke the permit for carrying out hazardous material and/or waste management activities, nor do they have an impact on public health or generate an ecological imbalance.[83]

101. The Claimant also states that, through the notes dated June 25[84] and July 15[85] 1998, Cytrar had already requested from INE the permit to expand cell No. 2 of the Landfill and build another cell. INE replied to this request on October 23, 1998,[86] stating, among other things, that the expansion request would be resolved together with the decision on renewal of the Permit. The Claimant claims that this decision adversely affected it because INE partly used the same reasons for which it already knew that the authorization to expand cell No. 2 would be denied (the same reasons used by PROFEPA to impose a fine on Cytrar by means of an official communication dated December 16, 1999, mentioned above), but deferred its decision to be able to use those reasons as the grounds for the Resolution under which INE refused to renew the Permit.[87]

102. The Claimant also states that in the letter dated September 5, 1996,[88] upon requesting «the change of name», Tecmed had reported to INE, among other things, that the processes carried out at the Landfill included the collection of waste in a specialized means of transportation, the preparation, packaging and labelling of waste for its subsequent transportation and the «temporary storage of waste (oil and solvents)» and that INE made no objection or reservation. Tecmed also reported that the operation of the transfer center and temporary storage of biological-infectious waste at the Landfill was not carried out by Cytrar, but by an affiliate, Técnicas Medioambientales Winco S.A. de CV,[89] which was authorized to engage in those activities at that site under a permit granted by INE for that purpose,[90] circumstances that could not be ignored by INE upon issuing the Resolution.

103. The Respondent highlights that Cytrar had not met the requirements to allow INE to evaluate an authorization to expand cell No. 2, since Cytrar had not submitted the related plans. The Respondent also states that as Cytrar had not submitted these plans and, regardless of such a breach, had commenced the cell's expansion activities, Cytrar had not complied with one of the Permit's conditions. The Respondent states that on October 23, 1998, INE requested additional information from Cytrar to decide on the expansion of cell No. 2 and on the construction of cell No. 3, and requested that Cytrar present the engineering project and the related drawings.[91] The Claimant complied with such requirement on November 4, 1998.[92]

104. The Respondent also refers to a number of circumstances related to the Landfill and its operation. The Claimant also refers to such circumstances, and substantial evidence has

[83] PROFEPA's official communication already cited, paragraph A, page 50. Document A63.
[84] Document A49
[85] Document A50
[86] Official Communication No. D00.800/005262, document A51.
[87] Memorial, pp.58-59.
[88] Document A39.
[89] Claimant's closing statement, p. 65 *et seq*.
[90] Memorial, p. 62.
[91] Counter-memorial, p. 78, 282; document D142.
[92] Counter-memorial, p. 79, 287; document D146.

been produced in that regard. Such circumstances underlie the Resolution or had a significant effect thereon, although not all such circumstances have been mentioned in the text of the Resolution.

105. According to the Respondent, those circumstances are:[93]

1) the site of the Landfill did not comply with applicable Mexican regulations in terms of its location and characteristics;

2) in 1998, Cytrar had committed a number of irregularities while operating the Landfill, mainly related to the transportation of waste from Alco Pacífico, and such irregularities triggered strong community pressure against the Landfill;

3) Mexican authorities, mainly from the Municipality of Hermosillo, expressed their doubts as to the Landfill's operations;

4) there was the risk that community pressure might increase if operation of the Landfill continued; and

5) Since 1997 Cytrar had reportedly been aware that community pressure suggested that the operation of the Landfill was not feasible due to its location, and that is why it agreed to relocate it at its own cost.

106. The opposing community groups claimed that the Landfill was only 8 km from the urban center of Hermosillo, and that such proximity breached the regulations that required a distance of at least 25 km from any settlement of more than 10,000 residents. Legally, however, such circumstance could not be invoked against Cytrar because the Landfill had been located and authorized to operate at such site before the adoption of such regulations, which are not retroactive. Reportedly, in deciding to refuse to renew the Permit, INE took into account the fact that the location of the site did not comply with the regulations as well as the resulting community pressure.[94]

107. The Parties agree that community opposition to the Landfill was due not to the manner in which Cytrar operated it, but to the transportation to the Landfill of contaminated and abandoned soil from the Alco Pacífico plant located in the state of Baja California, Mexico. Owing to a series of events that are not relevant at this point, Cytrar was in charge of the collection, transportation and landfill of Alco Pacifico's hazardous waste and contaminated soil pursuant to an agreement dated November 19, 1996, executed between PROFEPA, Los Angeles County, USA, Fomento de Ingeniería S.A. de C.V. (Fomín) and Cytrar.[95] Fomín was entrusted with the supervision of the transportation and discharge services that Cytrar had to provide under such agreement, in compliance with the contract and the applicable legal provisions, and had to report its findings to PROFEPA. The shipments of toxic materials and soil destined for the Landfill began under an initial transport permit

[93] Counter-memorial, pp. 88-89, 315.
[94] Memorial, pp. 72-74; Counter-memorial, p. 89, 315-316.
[95] Document D64

issued by INE[96] in early 1997.[97] In view of the claims of the community, PROFEPA conducted inspections of the trucks in October 1997, which essentially determined that there were open hazardous material packaging bags. PROFEPA therefore adopted urgent measures for Cytrar to rectify the situation, which were complied with by Cytrar. There were similar situations in November 1997, and, at the time, in addition to adopting urgent measures affecting Cytrar, PROFEPA applied a fine to Cytrar.[98] In April 1998, PROFEPA found some irregularities in the discharge of Alco Pacífico's waste and levied a fine on Cytrar, stating that «there are circumstances that pose or may pose a risk to the environment or to health». A similar situation was found in May 1998 in connection with the transportation and discharge of waste from the company Siderúrgica de California, which also gave rise to the issuance of urgent measures by PROFEPA, which were also complied with by Cytrar.[99]

108. The community's opposition to the Landfill, in its public manifestations, was widespread and aggressive, as evidenced by several events at different times. In November 1997, the association *Alianza Cívica de Hermosillo* (Hermosillo's Alliance for Civic Affairs) publicly denounced Cytrar's "actions and omissions" particularly in connection with waste transportation from Alco Pacífico, and requested that Cytrar's permit to operate the Landfill be cancelled and the extension thereof be denied.[100] Also in November[101] "...around 200 people organized a demonstration, marching to the landfill and closing it down symbolically… ", and then, a meeting was held with federal, state, and municipal public officials including the President of INE, the Deputy Director of the PROFEPA Environmental Audit Bureau, the Minister of SEMARNAP and representatives of the community organizations. In December 1997, the association *Academia Sonorense de Derechos Humanos* (Sonora Human Rights Academy) filed a criminal complaint against Cytrar for the commission of acts that could be defined as "environmental crimes".[102] In January 1998, the same association " ...filed a challenge... " against the Municipality of Hermosillo for the permit granted by that Municipality in 1994 to operate the Landfill.[103] In late January 1998 "...members of the community and of the different community organizations ...." organized a blockade of the Landfill which lasted until March 7, 1998, when the police intervened under orders of the Attorney's General Office. After the police intervention, the community organizations that questioned such measures organized a sit-in at Hermosillo's Town Hall[104] that lasted 192 days. By late March 1998, the same opposition groups issued a communication condemning the actions of the authorities that had put an end to the blockade of the Landfill.[105] In April 1998, a group of demonstrators attempted to block access to the Landfill but the police thwarted this action.[106] In

[96] Official Communication D00-800/000269 dated January 23, 1997; document D65.
[97] Counter-memorial, pp. 43-44, 161 *et. seq*.; particularly 166.
[98] Counter-memorial, pp. 48-52, 180 *et. seq*.
[99] Counter-memorial, pp. 67-70, 240 *et. seq*.
[100] Counter-memorial, pp. 51-52, 191 *et. seq*.
[101] Article published in Hermosillo newspaper *El Imparcial* on November 23, 1997. Document D88.
[102] Counter-memorial, p. 55, 203
[103] Counter-memorial, p. 56, 207
[104] Counter-memorial, pp. 57-59, 210 *et. seq.*
[105] Counter-memorial, p. 63, 232
[106] Counter-memorial, p. 66, 237

September 1998, a certain *Asociación de Organismos No Gubernamentales en Lucha contra el CYTRAR* (Association of NGOs Against CYTRAR) filed a claim before the State Commission of Human Rights against the authorities of the State of Sonora and the Municipality of Hermosillo for having intervened to put an end to the 192-day sit-in organized at the Town Hall[107]. In October 1998, a "family demonstration for the defense of health and dignity" and against "the landfill and the authorities' position in that regard" was organized and a public communication contrary to the Landfill was issued.[108] According to the news media, about 400 people participated in the demonstration.[109] In November 1998, community organizations submitted a petition to the local office of SEMARNAP so that expressions of such associations and individual citizens be considered upon evaluating the renewal of the Permit. During that period —as evidenced by the "Press Dossier (I)" included in the documents offered by the Claimant—[110] these developments were covered by the local press and Hermosillo's radio and television.

109. The authorities of the Municipality of Hermosillo were the direct target of "community pressure". The Municipality was one of INE's interlocutors at the time of consideration of the Permit's renewal. In view of the pressure that questioned the Municipality's grant of the permit to use the land where the Landfill was operated, the Municipality rendered an opinion on March 31, 1998, which explained that at the time of granting such permit the current legal provisions were not applicable and that those provisions came into force subsequently, establishing a minimum distance between landfills and urban centers which the Landfill did not comply with. However, the Municipality expressed its agreement with the community about the need to relocate Cytrar's hazardous waste landfill operation to a different site and its support to conduct an audit of operations to determine whether the Landfill's operation entailed any risks. That same day, the Health Commission of the Municipality rendered an opinion confirming that, although Cytrar's operation at the Las Víboras site met the legal requirements for functioning and there were no "legal, ethical or logical arguments" to seek the closing of the Landfill, all necessary efforts should be made to relocate Cytrar's operations. After this, several other decisions to the same effect were issued by the Municipality, additionally highlighting that only the federal Mexican authorities were competent in " ...events relating to toxic waste".[111] INE also consulted with the Municipality on November 18, 1998 about Cytrar's requests to, among other things, expand cell No. 2 and build another one. The Municipality did not agree to the construction of a third cell, but accepted expansion subject to:[112]

> ....a detailed and legal relocation commitment agreed upon between the three levels of Government and the company

[107] Counter-memorial, pp. 74-75, 265 *et. seq*.
[108] Counter-memorial, p. 79, 285
[109] Article published in Hermosillo newspaper *El Imparcial* on October 26, 1998. Press dossier (I), annex A70.
[110] Under annex A70
[111] Counter-memorial, pp. 63-65, 233 *et. seq*.
[112] Counter-memorial, pp. 86-97, 311 *et. seq.*; note of the Mayor of the Municipality of Hermosillo to INE's President dated November 18, 1998, document D157.

and provided that:

...a commission with representatives from each party be formed; and that, prior to that, an audit of operations be conducted and the final close down of the landfill be carried out; and that it would have to be made clear that that would be the last authorization for the current site.

The consultation with the Municipality and with the authorities of the State of Sonora and its results have been summarized as follows in the declaration of Dra. Cristina Cortinas de Nava,[113] who was at the time INE's General Director for Hazardous Materials, Waste and Activities and issued the Resolution, during the Hearing held from May 20 to May 24, 2002:

.... the gentleman is right to point out that I consulted with the municipal authority and with the state authority before making my decision about the company's application for an authorization to expand its capacity while relocation was pending[…]. Let me inform you that the reply that I obtained from the authorities was "let them fill in the cell, that's all right. But don't let them build anything else because we have waited too long for their relocation to allow them to have more space at the site they are at".

110. The relocation of Cytrar's operations as a response to community pressure was therefore also one of the factors taken into account by INE, and mentioned incidentally in the Resolution, upon deciding whether to renew the Permit. By late 1997, owing to the community pressure against the Landfill, Cytrar and the Municipality of Hermosillo started negotiations about the relocation, which, indeed, entailed the final close down of the hazardous waste landfill operation at the Las Víboras site, and that was undoubtedly the aim pursued by the community groups and the authorities of the Municipality. The relocation and the final close down of the Landfill, as it has been seen, were also the express claims of the Municipality of Hermosillo, apparently in response to the complaints about the Landfill and Cytrar's operation described above. The Claimant underscores that, as from the commencement of the negotiations, it did not object to the relocation but accepted it on the condition that a new site be identified before closing the operation at Las Víboras, and that the continuity of the operation at the new site and premises be guaranteed with the necessary permits.[114] On March 16, 1998, in a notice published by the local press, Cytrar ratified, among other things, its agreement to relocate its operation.[115] On July 3, 1998, at a meeting called by the Governor of the State of Sonora and attended by the Minister of SEMARNAP, Ms. Julia Carabias Lillo and the authorities of the Municipality of Hermosillo, Cytrar was informed of a joint declaration issued by the federal, state and municipal authorities stating that although the inspections conducted did not provide "...evidence of any risk to health and the ecosystems..." arising out of the Landfill, the relocation was necessary to "secure environmental safety in view of the rapid urban growth of Hermosillo, provide a response to the concerns that had been expressed and guarantee, in the long term, the environmental infrastructure to handle and dispose of industrial waste".[116]

The declaration also states that:

---

[113] Hearing held from May 20 to May 24, 2002, transcript of the session of May 21, 2002, p. 82 overleaf.
[114] Memorial, pp. 77-78
[115] Counter-memorial, p. 61, 228; document D111
[116] Document A92; Memorial, pp. 78-79

…As a consequence, the present landfill operated by CYTRAR shall cease to operate as soon as the new premises are ready to start operations…

111. Later, IMADES (Sonora's Environmental and Sustainable Development Institute), a government entity, focused on the search for a new site in the State of Sonora on the basis of a broader and more ambitious landfill proposal as to the scope, activities and functions related to the landfill of hazardous waste, or CIMARI (integral center for the management of industrial waste).[117] By October 1998, IMADES had "... shortlisted three possible areas...". After visiting the sites, together with Cytrar, INE considered that, with the approval of Cytrar, "carrying out the applicable studies" in a site located in the Municipality of Benjamín Hill[118] would be feasible.

112. When INE considered the renewal of the Permit, the relocation had not taken place and, reportedly, the final relocation site had not been identified, i.e. a site which had tested positive to all feasibility studies for the purpose for which it would be used, and a site qualified to be authorized as hazardous waste landfill. On November 9, 1998, a few days before issuance of the Resolution, Cytrar sent a note to the Governor of the State of Sonora —following the procedure stated by INE through the official communication of October 23, 1998, sent by Dr. Cristina Cortinas Nava—[119] ratifying its relocation commitment, stating also that it would relocate to any site indicated to it. In this note Cytrar also expressed that it would assume all costs related to the acquisition of the land, constructions and transfer of the landfill's waste to the new site, all the above without resigning to its position that the Permit should remain in full force and effect until the relocation had effectively taken place.[120] Similar commitments were reaffirmed by Tecmed in the notes dated November 12, 1998, to Julia Carabias Lillo, head of SEMARNAP,[121] and November 17, 1998, to Dr. Cristina Cortinas Nava, INE's General Director of Hazardous Materials, Waste and Activities.[122] This last note was also sent by Cytrar to Sonora's governor and to the mayor of the Municipality of Hermosillo by means of communications where Cytrar highlighted its relocation commitment included in point 7 of the original note.[123] After issuance of the Resolution that denied the renewal of the Permit, there were a number of discussions and actions, which involved Tecmed, intended to carry out the relocation. These discussions and actions extended to January 2000 but have currently ceased.[124]

113. The Agreement does not define the term "expropriation", nor does it establish the measures, actions or behaviors that would be equivalent to an expropriation or that would

[117] Counter-memorial, p. 67, 239.
[118] Counter-memorial, p. 75, 270
[119] Document A51. This official communication makes reference to the relocation agreement and makes a proposal to Cytrar so that it "…contact the authorities of the State and Municipal Government to define the steps to be followed as to the landfill relocation."
[120] Document A89. Counter-memorial, pp. 84-85, 303 *et seq*. Memorial, pp. 80-81.
[121] Document A 90.
[122] Document A55.
[123] Document A 54.
[124] Counter-memorial, p. 96, 337.

have similar characteristics. Although formally an expropriation means a forcible taking by the Government of tangible or intangible property owned by private persons by means of administrative or legislative action to that effect, the term also covers a number of situations defined as *de facto* expropriation, where such actions or laws transfer assets to third parties different from the expropriating State or where such laws or actions deprive persons of their ownership over such assets, without allocating such assets to third parties or to the Government.[125]

114. Generally, it is understood that the term "…equivalent to expropriation…" or "tantamount to expropriation" included in the Agreement and in other international treaties related to the protection of foreign investors refers to the so-called "indirect expropriation" or "creeping expropriation", as well as to the above-mentioned *de facto* expropriation.[126] Although these forms of expropriation do not have a clear or unequivocal definition, it is generally understood that they materialize through actions or conduct, which do not explicitly express the purpose of depriving one of rights or assets, but actually have that effect. This type of expropriation does not necessarily take place gradually or stealthily — the term "creeping" refers only to a type of indirect expropriation—and may be carried out through a single action, through a series of actions in a short period of time or through simultaneous actions. Therefore, a difference should be made between creeping expropriation and *de facto* expropriation,[127] although they are usually included within the broader concept of "indirect expropriation" and although both expropriation methods may take place by means of a broad number of actions that have to be examined on a case-by-case basis to conclude if one of such expropriation methods has taken place.[128]

115. To establish whether the Resolution is a measure equivalent to an expropriation under the terms of section 5(1) of the Agreement, it must be first determined if the Claimant, due to the Resolution**,** was radically deprived of the economical use and enjoyment of its investments, as if the rights related thereto —such as the income or benefits related to the Landfill or to its exploitation— had ceased to exist. In other words, if due to the actions of the Respondent, the assets involved have lost their value or economic use for their holder and the extent of the loss.[129] This determination is important because it is one of the main elements to distinguish, from the point of view of an international tribunal, between a regulatory measure, which is an ordinary expression of the exercise of the state's police power that entails a decrease in assets or rights, and a *de facto* expropriation that deprives

[125] Award dated August 30, 2000, in ICSID case No. ARB(AF)/97/1 *Metalclad v. United Mexican States*, 16 Mealey's International Arbitration Report (2000), pp. A-1 *et seq*.; p. A-13 (p. 33 of the award, 103): «Thus, expropriation [...] includes not only open, deliberate and acknowledged takings of property, such as outright seizure or formal or obligatory transfer of title in favor of the host State, but also covert or incidental interference with the use of property 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 even if not necessarily to the obvious benefit of the host State. »

[126] G. Sacerdoti, Bilateral Treaties and Multilateral Instruments on Investment Protection, 269 Recueil des cours, Académie de droit international de La Haye, 255, 385-386 (1997).

[127] *Ibid*. p. 383.

[128] R. Dolzer & M.Stevens, Bilateral Investment Treaties, pp. 99-100 (1995).

[129] Partial award in the case *Pope Talbot Inc v. Government of Canada*, 102-104, pp. 36-38, www.naftalaw.org; and II Restatement of the Law (Third) Restatement of the Foreign Relations Law of the United States, § 712, pp. 200-201; notes 6-7, pp. 211-212 (1987).

those assets and rights of any real substance. Upon determining the degree to which the investor is deprived of its goods or rights, whether such deprivation should be compensated and whether it amounts or not to a *de facto* expropriation is also determined. Thus, the effects of the actions or behavior under analysis are not irrelevant to determine whether the action or behavior is an expropriation. Section 5(1) of the Agreement confirms the above, as it covers expropriations, nationalizations or

...any other measure with similar characteristics or *effects*...[130]

The following has been stated in that respect:

In determining whether a taking constitutes an «indirect expropriation», it is particularly important to examine the effect that such taking may have had on the investor's rights. Where the effect is similar to what might have occurred under an outright expropriation, the investor could in all likelihood be covered under most BIT provisions.[131]

116. In addition to the provisions of the Agreement, the Arbitral Tribunal has to resolve any dispute submitted to it by applying international law provisions (Title VI.1 of the Appendix to the Agreement), for which purpose the Arbitral Tribunal understands that disputes are to be resolved by resorting to the sources described in Article 38 of the Statute of the International Court of Justice[132] considered, also in the case of customary international law, not as frozen in time, but in their evolution.[133] Therefore, it is understood that the measures adopted by a State, whether regulatory or not, are an indirect *de facto* expropriation if they are irreversible and permanent and if the assets or rights subject to such measure have been affected in such a way that "…any form of exploitation thereof…" has disappeared; i.e. the economic value of the use, enjoyment or disposition of the assets or rights affected by the administrative action or decision have been neutralized or destroyed.[134] Under international law, the owner is also deprived of property where the use or enjoyment of benefits related thereto is exacted or interfered with to a similar extent, even where legal ownership over the assets in question is not affected, and so long as the deprivation is not temporary. The government's intention is less important than the effects of the measures on the owner of the assets or on the benefits arising from such assets affected by the measures; and the form of the deprivation measure is less important than its actual effects.[135] To determine whether such an expropriation has taken place, the Arbitral Tribunal should not

[130] Emphasis added by the Arbitral Tribunal.
[131] R. Dolzer & M. Stevens, Bilateral Investment Treaties, p. 100 (1995).
[132] I. Brownlie, Principles of International Law (5th Edition, 1998) p.3: «These provisions […] represent the previous practice of arbitral tribunals, and Article 38 is generally regarded as a complete statement of the sources of international law ».
[133] *Mondev International Ltd v. United States of America* award, October 11, 2002, ICSID case No. ARB(AF)/99/2, p. 40, 116
[134] European Court of Human Rights, *In the case of Matos e Silva, Lda., and Others v. Portugal,* judgment of September 16, 1996, 85, p. 18, http://hudoc.echr.coe.int
[135] See Iran-USA Claims Tribunal, *Tippetts, Abbet,McCarthy, Stratton v.TAMS/Affa Consulting Engineers of Iran et al.,* decision of June 29, 1984; 6 Iran-United States Rep., p. 219 *et seq*.; p. 225 (1984-II); of the same Tribunal, *Phelps Dodge Corp. et al.v.Iran*, 10 Iran-U.S.Cl. Trib. Rep. p. 121 *et seq*..; esp. 22, p.130 (1986-I).

.... restrict itself to evaluating whether a formal dispossession or expropriation took place, but should look beyond mere appearances and establish the real situation behind the situation that was denounced.[136]

117. The Resolution meets the characteristics mentioned above: undoubtedly it has provided for the non-renewal of the Permit and the closing of the Landfill permanently and irrevocably, not only due to the imperative, affirmative and irrevocable terms under which the INE's decision included in the Resolution is formulated, which constitutes an action — and not a mere omission— attributable to the Respondent, with negative effects on the Claimant's investment and its rights to obtain the benefits arising therefrom, but also because after the non-renewal of the Permit, the Mexican regulations issued by INE become fully applicable. Such regulations prevent the use of the site where the Landfill is located to confine hazardous waste due to the proximity to the urban center of Hermosillo. Since it has been proved in this case that one of the essential causes for which the renewal of the Permit was denied was its proximity and the community pressure related thereto, there is no doubt that in the future the Landfill may not be used for the activity for which it has been used in the past and that Cytrar's economic and commercial operations in the Landfill after such denial have been fully and irrevocably destroyed, just as the benefits and profits expected or projected by the Claimant as a result of the operation of the Landfill. Moreover, the Landfill could not be used for a different purpose since hazardous waste has accumulated and been confined there for ten years. Undoubtedly, this reason would rule out any possible sale of the premises in the real estate market. Finally, the destruction of the economic value of the site should be assessed from the investor's point of view at the time it made such an investment. In consideration of the activities carried out, of its corporate purpose and of the terms and conditions under which assets related to the Landfill were acquired from Promotora, the Claimant, through Tecmed and Cytrar, invested in such assets only to engage in hazardous waste landfill activities and to profit from such activities. When the Resolution put an end to such operations and activities at the Las Víboras site, the economic or commercial value directly or indirectly associated with those operations and activities and with the assets earmarked for such operations and activities was irremediably destroyed. The above conclusions are not jeopardized by the fact that the Resolution has not prevented Cytrar from continuing operating the Landfill until completion of the authorized installed capacity existing as of the Resolution's date. Such limited, temporary and partial continuation of operation of the Landfill does not modify the definitive and detrimental effects of the Resolution with respect to the long-term investment made in the Landfill. As far as the effects of such Resolution are concerned, the decision can be treated as an expropriation under Article 5(1) of the Agreement.

118. However, the Arbitral Tribunal deems it appropriate to examine, in light of Article 5(1) of the Agreement, whether the Resolution, due to its characteristics and considering not only its effects, is an expropriatory decision.

119. The principle that the State's exercise of its sovereign powers within the framework of its police power may cause economic damage to those subject to its powers as administrator without entitling them to any compensation whatsoever is undisputable. Another undisputed issue is that within the framework or from the viewpoint of the

[136] Interamerican Court of Human Rights, *Ivcher Bronstein Case (Baruch Ivcher Bronstein vs. Peru),* judgment of February 6, 2001, 124, p. 56; www.corteidh.or.cr.

domestic laws of the State, it is only in accordance with domestic laws and before the courts of the State that the determination of whether the exercise of such power is legitimate may take place. And such determination includes that of the limits which, if infringed, would give rise to the obligation to compensate an owner for the violation of its property rights.

120. However, the perspective of this Arbitral Tribunal is different. Its function is to examine whether the Resolution violates the Agreement in light of its provisions and of international law. The Arbitral Tribunal will not review the grounds or motives of the Resolution in order to determine whether it could be or was legally issued. However, it must consider such matters to determine if the Agreement was violated. That the actions of the Respondent are legitimate or lawful or in compliance with the law from the standpoint of the Respondent's domestic laws does not mean that they conform to the Agreement or to international law:[137]

An Act of State must be characterized as internationally wrongful if it constitutes a breach of an international obligation, even if the act does not contravene the State's internal law – even if under that law, the State was actually bound to act that way.[138]

121. After reading Article 5(1) of the Agreement and interpreting its terms according to the ordinary meaning to be given to them (Article 31(1) of the Vienna Convention), we find no principle stating that regulatory administrative actions are *per se* excluded from the scope of the Agreement, even if they are beneficial to society as a whole —such as environmental protection—, particularly if the negative economic impact of such actions on the financial position of the investor is sufficient to neutralize in full the value, or economic or commercial use of its investment without receiving any compensation whatsoever. It has been stated that:

Expropriatory environmental measures – no matter how laudable and beneficial to society as a whole – are, in this respect, similar to any other expropriatory measures that a state may take in order to implement its policies: where property is expropriated, even for environmental purposes, whether domestic or international, the state's obligation to pay compensation remains.[139]

122. After establishing that regulatory actions and measures will not be initially excluded from the definition of expropriatory acts, in addition to the negative financial impact of such actions or measures, the Arbitral Tribunal will consider, in order to determine if they are to be characterized as expropriatory, whether such actions or measures 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.[140] Although the analysis starts at the due deference owing to

---

[137] International Court of Justice, *Elettronica Sicula s.p.a.(ELSI)(United States v. Italy)* case, judgment dated July 20, 1989, ICJ Reports, 1989, 73. ICSID Case No.ARB(AF)/99/1, *Marvin Feldman v. Mexico*, award of December 16, 2002, p.26, 78, www.naftalaw.org.

[138] J. Crawford, The International Law Commission's Articles on State Responsibility, p. 84 (Cambridge University Press, 2002).

[139] Award: *Compañía del Desarrollo de Santa Elena, S.A. v. Republic of Costa Rica,* ICSID case No. ARB/96/1, 15 ICSID Review-Foreign Investment Law Journal, 72, p.192 (2000).

[140] European Court of Human Rights, *In the case of Matos e Silva, Lda., and Others v. Portugal,* judgment of September 16, 1996, 92, p. 19 , http://hudoc.echr.coe.int.

the State when defining the issues that affect its public policy or the interests of society as a whole, as well as the actions that will be implemented to protect such values, such situation does not prevent the Arbitral Tribunal, without thereby questioning such due deference, from examining the actions of the State in light of Article 5(1) of the Agreement to determine whether such measures are reasonable with respect to their goals, the deprivation of economic rights and the legitimate expectations of who suffered such deprivation. There must be a reasonable relationship of proportionality between the charge or weight imposed to the foreign investor and the aim sought to be realized by any expropriatory measure.[141] To value such charge or weight, it is very important to measure the size of the ownership deprivation caused by the actions of the state and whether such deprivation was compensated or not.[142] On the basis of a number of legal and practical factors, it should be also considered that the foreign investor has a reduced or nil participation in the taking of the decisions that affect it, partly because the investors are not entitle to exercise political rights reserved to the nationals of the State, such as voting for the authorities that will issue the decisions that affect such investors.

The European Court of Human Rights has defined such circumstances as follows:

Not only must a measure depriving a person of his property pursue, on the facts as well as in principle, a legitimate aim « in the public interest », but there must also be a reasonable relationship of proportionality between the means employed and the aim sought to be realised...[...]. The requisite balance will not be found if the person concerned has had to bear "an individual and excessive burden" [...] The Court considers that a measure must be both appropriate for achieving its aim and not disproportionate thereto.[143]

....non-nationals are more vulnerable to domestic legislation: unlike nationals, they will generally have played no part in the election or designation of its authors nor have been consulted on its adoption. Secondly, although a taking of property must always be effected in the public interest, different considerations may apply to nationals and non-nationals and there may well be legitimate reason for requiring nationals to bear a greater burden in the public interest than non-nationals.[144]

The Arbitral Tribunal understands that such statements of the Strasburg Court apply to the actions of the State in its capacity as administrator, not only to its capacity as law-making body.

123. During its operation of the Landfill, Cytrar breached a number of the conditions under which the Permit was issued, which have been referred to above. Such breaches were verified by PROFEPA. In the opinion of the Arbitral Tribunal, these are the breaches to the Permit that triggered the issuance of the Resolution, since those are the breaches on which the Resolution is based and to which it refers. This is the conclusion to be reached under

---

[141] European Court of Human Rights, *In the case of Mellacher and Others v. Austria*, judgment of December 19, 1989, 48, p.24; In the case of *Pressos Compañía Naviera and Others v. Belgium*, judgment of November 20, 1995, 38, p. 19, http://hudoc.echr.coe.int

[142] It has been stated that: "....on the whole [...] notwithstanding compliance with the public interest requirement, the failure to pay fair compensation would render the deprivation of property inconsistent with the condition of proportionality", Y. Dinstein, Deprivation of Property of Foreigners under International Law, 2 Liber Amicorum Judge Shigeru Oda, p. 849 *et seq.*; esp. p. 868 (2002).

[143] European Court of Human Rights*, In the case of James and Others,* judgment of February 21, 1986, 50, pp.19-20, http://hudoc.echr.coe.int

[144] *ibid.*, 63, pp. 24.

Mexican law, according to which administrative decisions must be duly grounded in order to have, among other things, the transparency required so that persons that disagree with such decisions may challenge them through all the available legal remedies.[145] The Resolution has not referred to the events related to the transportation and discharge of the hazardous waste of Alco Pacífico, as they took place under the terms of the permits and authorizations granted by the Mexican authorities, including INE, other than the Permit, and the violations committed by Cytrar in the performance of such activities have not been proved or penalized as infringements to the Permit. Therefore, without prejudice to the possibility of taking into account later on the effects of such events on the political and social considerations taken into account by INE upon issuing the Resolution —such considerations are generally referred to in the Resolution and in INE's correspondence addressed to Cytrar immediately before such Resolution— the Arbitral Tribunal considers that such infringements, that did not trigger the revocation or termination of the permits under which such transportation and discharge took place and that are not defined in the Permit's conditions, are not determinants of the Resolution. On the other hand, PROFEPA and SEMARNAP also stated that the violations in the transportation and discharge of the hazardous waste of Alco Pacífico should not be taken into account to determine if the Landfill's permit should be revoked upon answering a claim to that effect filed by a social group adverse to the Landfill.[146]

124. This Arbitral Tribunal considers that the violations to the Permit mentioned in the Resolution, to the extent they have been verified by PROFEPA or INE under the applicable Mexican law, are issues that the Tribunal does not need to review. However, the Arbitral Tribunal points out that such Resolution does not suggest that the violations compromise public health, impair ecological balance or protection of the environment, or that they may be the reason for a genuine social crisis. Additionally, when PROFEPA verified the existence of such violations in 1999, it applied the pertinent sanctions in the proportion it deemed appropriate to the importance of the violation. The sanction applied was in the form of a fine imposed after evaluating whether a greater or more serious sanction would have been applicable, such as the revocation of the Permit, and underscoring the fact that such violations did not compromise the condition of the environment, the ecological balance or the health of the population. With that, PROFEPA confirmed its statements in the note dated February 11, 1998, sent to Cytrar:[147]

> The inspections conducted by this Office to the landfill referred to several times, have not shown [sic in the Spanish original] any indication that risks for the population's health or the environment might exist.

On various occasions, the Municipality of Hermosillo[148] and the Minister of SEMARNAP, Ms. Julia Carabías Lillo,[149] have insisted that Cytrar's Landfill operation complies with the

---

[145] Declaration of expert witness Alfonso Camacho Gómez, Hearing held from May 20 to May 24, 2002, transcript of May 22, 2002, pp. 36-36 overleaf.
[146] Note signed by PROFEPA and SEMARNAP of December 18, 1997, 44, p. 21; document D93.
[147] Document D101, p. 2.
[148] Communication issued by the Municipality of Hermosillo dated March 26, 1998, document D114; Declaration 300398 issued by the Commission of Public Health of the Municipality of Hermosillo dated April 1998, document D116, Communication Forms of the Municipality of Hermosillo, document D117.
[149] Stenographic transcript of the declaration given by Julia Carabías Lillo in her appearance before the House of Representatives of the Federal Congress on September 10, 1999; pp. 10-11; document A69.

Mexican legal provisions on environmental protection and public health preservation or meets the requirements necessary not to impair the environment or public health. More specifically, in a document dated September 3, 1998,[150] SEMARNAP —which comprises both INE and PROFEPA as autonomous divisions—, on the basis of the statements made by PROFEPA, stated as follows:

…CYTRAR's handles hazardous waste in strict compliance with the law, that the last stage of the landfill has the maximum safety conditions required, which provide the necessary grounds to authorize the relevant operations.

125. In addition to the reference made to the infractions to conditions for the Permit and a brief statement about Cytrar's commitment to relocate, the Resolution does not specify any reasons of public interest, public use or public emergency that may justify it. According to the Respondent's allegations, such reasons would basically be the following:

1. The protection of the environment and public health, and

2. The need to provide a response to the community pressure resulting from the location of the Landfill and Cytrar's violations during the operation, which some groups interpreted as harmful to the environment or the public health and the social unease in Hermosillo originated in these circumstances.

126. One of the factors that undoubtedly underlies such reasons is the location of the Landfill with respect to Hermosillo's urban center. As the Respondent's counsel stated in its oral allegation:

I have stated several times and insisted that the problem was not a problem with a company or with an investor, but with a specific site.[151]

Such declaration does not differ from the statements made by Dr. Cristina Cortinas Nava, INE's General Director of Hazardous Materials, Waste and Activities in this regard:

I insist once again that, for us, the position was: let's come to a close with this site**;** it is the reason for the conflict. People keep coming to the place to see how it's being operated; they won't even let it operate with all that community pressure. Let's start from scratch in some other place, in the right manner and with all the mechanisms that we think might ensure that this operation could be acceptable for society.[152]

127. Actually, according to the evidence submitted in this arbitration proceeding, it is irrefutable that there were factors other than compliance or non-compliance by Cytrar with the Permit's conditions or the Mexican environmental protection laws and that such factors had a decisive effect in the decision to deny the Permit's renewal. These factors included

[150] Document A92.
[151] Oral allegation by the Respondent's counsel. Hearing held from May 20 to May 24, 2002. Transcript of the session of May 24, 2002, p. 37 overleaf.
[152] Hearing held from May 20 to May 24, 2002. Transcript of the session of May 21, 2002, p. 78.

"political circumstances". As stated by Dr. Cristina Cortinas Nava in the official communication sent to Cytrar on October 23, 1998,[153]

> It is publicly known that your company has assumed a relocation commitment as to the landfill you operate and that, as you have stated in point seven of the brief dated July, 15, 1998, there are political issues that have to be taken into account to render a resolution as to the renewal of the operation permit and an increase in the landfill capacity. Therefore, we suggest that you contact the authorities of the State and of the Municipality to define the steps to be followed to relocate the landfill.

In its note dated July 15, 1998, addressed to INE, Cytrar requests that INE issue its decision on Cytrar's application for an increase in the landfill capacity according to the alternatives that Cytrar had presented to INE while

> ....the actions to be taken are defined on the basis of the political events affecting Cytrar (relocation)...[154]

128. Therefore the Arbitral Tribunal has to evaluate, pursuant to Article 5(1) of the Agreement and from the perspective of international law, the extent to which such political circumstances —that in the opinion of the Arbitral Tribunal, on the basis of the evidence submitted, do not seem to go beyond the circumstances arising from community pressure— are the basis of the Resolution, in order to assess whether the Resolution is proportional to such circumstances and to other circumstances, and to the neutralization of the economic and commercial value of the Claimant's investment caused by the Resolution.

129. These socio-political circumstances are the reason why INE has considered the renewal of the Permit as an "exceptional case". As a consequence, INE, instead of deciding by itself —as it was empowered by law— as to the Permit's renewal on the basis of considerations exclusively related to INE's specific function linked to the protection of the environment, ecological balance and public health, it consulted with the mayor of the Municipality of Hermosillo and the Governor of the State of Sonora as to Cytrar's requests related to the expansion of cell Nº 2 and the construction of cell Nº 3 in the Landfill.[155] The only conclusion possible is that such consultation or inquiries were driven by INE's socio-political concerns, since it is not in dispute that INE and PROFEPA were the only entities legally authorized and technically competent to have a role in issues in which public health and the protection of the environment in connection with the Landfill were involved. None of the parties to which INE makes the inquiry expresses concerns as to the danger that the Landfill may pose to public health, ecological balance or the environment. To the contrary, their concerns are to ensure the relocation of the Landfill to a different site far away from Hermosillo, the immediate closing of the Landfill and, after depleting its authorized and installed capacity, the prohibition to grant new permits to confine hazardous waste at the Las Víboras site;[156] i.e. to put an end to the political problems —defined as "community

---

[153] Document A51.
[154] Document A50.
[155] Hearing held from May 20 to May 24, 2002. Declaration of Dr. Cristina Cortinas Nava, transcript of the session of May 21, 2002, pp. 70 overleaf /71.
[156] Note of November 18, 1998, of the Mayor of the Municipality of Hermosillo to INE's President, document D157.

pressure"— caused by the Landfill to the federal, state and municipal authorities, by permanently closing the Landfill.

130. The INE's General Director of Hazardous Materials, Waste and Activities, Dr. Cristina Cortinas Nava, sustains the political or social factor "…was one of the factors involved but not the main factor…",[157] and to the question of whether the influence on the Resolution of the unauthorized expansion of cell no. 2 was "strong, small, insignificant, decisive", the answer was "I would say it was important".[158] However, in fact, the absence of any statement in the Resolution and in the opinions rendered by the municipal and state officers consulted by INE prior to issuing the Resolution about these or the other infringements committed by Cytrar and mentioned in the Resolution being infringements seriously or imminently affecting public health, ecological balance or the environment, together with the confirmation by PROFEPA that such infringements did not pose such dangers, reveal that the Resolution was mainly driven by socio-political factors. Even the significance awarded by INE to the technical infringements committed during the operation of the Landfill, on which the Resolution is based, and therefore the relative relevance awarded by INE to such factors upon issuing the Resolution, were actually strongly influenced by the community pressure and the political consequences faced by INE since municipal and state authorities and opposing community associations interpreted the expansion of the Landfill and any other action intended to expand the Landfill capacity as a signal that such facility would not be relocated and that the Las Víboras site, close to Hermosillo's urban center, would continue to be a hazardous waste landfill site in violation of existing rules and regulations.[159] Indeed, Dr. Cristina Cortinas Nava considered that continuation by Cytrar of the expansion of cell no. 2 did not create current or future hazards for the protection of the environment or public health; she considered that such expansion increased INE's difficulties to manage community pressure and the related political consequences adverse to the Landfill:

> ..... as I had issued no written resolution authorizing the expansion of the cell, the fact that [Cytrar] commenced to expand the cell was a concern to me and I took it as evidence that the company was doing things before obtaining the permit it had applied for [...] I took that into account as one of the elements, but I insist: the circumstance that the company had not helped me create trust among local authorities as it expanded the cells without any authorization, whether issued by me or local authorities, was included among such elements...[160]

131. This item has been confirmed by the importance attributed to the relocation of Cytrar's operations to a site different from the Landfill. Such importance was actually motivated by the community's opposition to the Landfill's existing site and was not related to the fact that Cytrar's operations in the site or the site's appropriateness[161] or the way in which the Landfill was operated —as the municipal and state authorities and PROFEPA themselves

---

[157] Hearing held from May 20 to May 24, 2002. Declaration of Dr. Cristina Cortinas Nava, transcript of the session of May 21, 2002, pp. 71, overleaf.
[158] *Ibid.*, p. 80.
[159] *Ibid.*, p.82 overleaf.
[160] *Ibid.,* p.82 overleaf.
[161] *Ibid*, p.90 overleaf. "Because our interest was to recover the infrastructure that had already been created, and, as I have always held and still believe today, those premises were necessary for this State, they were located at the right site and, with an environmentally safe handling of hazardous waste**;** it was a good option".

admitted— entailed a risk for the environment or for the public health. The Landfill's still unresolved relocation, which, according to Dr. Cristina Cortinas Nava, was one of the motivations for the Resolution in that denying the renewal of the Permit —thus preventing Cytrar from operating the Landfill— was a strategy to put pressure on Cytrar to relocate, was then one of the factors that were closely related to the social and political tense circumstances surrounding the Landfill and its operation. INE thought it would placate such tensions by denying the renewal of the Permit instead of keeping the preservation of public health, ecological balance or the environment in mind.[162]

132. To sum up, the reasons that prevailed in INE's decision to deny the renewal of the Permit were reasons related to the social or political circumstances and the pressure exerted on municipal and state authorities and even on INE itself created by such circumstances. It will be necessary, then, for the purpose of establishing whether the Respondent breached Article 5(1) of the Agreement, to evaluate such reasons as a whole to determine whether the Resolution is proportional to the deprivation of rights sustained by Cytrar and with the negative economic impact on the Claimant arising from such deprivation.

133. There is no doubt as to the existence of community or political pressure —as both Parties have acknowledged and as made public by the local mass media and shown by the evidence submitted in these arbitral proceedings— against the Landfill. However, a substantial portion of the community opposition is based on objective situations that are beyond Cytrar or Tecmed's control or even beyond the Claimant's control. On the other hand, the Arbitral Tribunal should consider whether community pressure and its consequences, which presumably gave rise to the government action qualified as expropriatory by the Claimant, were so great as to lead to a serious emergency situation, social crisis or public unrest, in addition to the economic impact of such a government action, which in this case deprived the foreign investor of its investment with no compensation whatsoever. These factors must be weighed when trying to assess the proportionality of the action adopted with respect to the purpose pursued by such measure.

134. As highlighted before, the events related to the transportation and discharge of hazardous waste from Alco Pacífico belong to an operation safeguarded by legal instruments, licenses and permits that are different from the ones governing the Landfill. Therefore, any infringement or sanction imposed in connection with operations covered by such instruments, licenses and permits may not be regarded as infringements committed or sanctions imposed under the Permit or the legal provisions applicable to the activities specifically contemplated by such Permit. For that very same reason, any violation to such transport operation could not be part of the Resolution's grounds as the Resolution is based exclusively on violations to the legal provisions applicable to the activities covered by the Permit. However —as both Parties have admitted— the negative attitude that some social groups had with respect to the Landfill was taken as a result of the events related to the waste transportation from Alco Pacífico. Consequently, upon an overall examination of the impact of socio-political factors on the Resolution, such adverse attitude should be considered together with the real weight it had.

[162] Hearing held from May 20 to May 24, 2002. Declaration of Dr. Cristina Cortinas Nava, transcript of the session of May 21, 2002, pp. 72 overleaf-73, 75 oveleaf-76.

135. Actually, the negative reactions to the transportation of waste from Alco Pacífico to Hermosillo became apparent even before PROFEPA verified that Cytrar had committed certain violations when carrying out this operation. In the Respondent's words:

The landfill of Alco Pacífico's waste in Sonora generated reactions almost immediately. On January 14, 1997, a local newspaper published an article stating that Cytrar would confine imported hazardous waste that had been abandoned in Alco Pacífico's premises […]. On March 7, 1997, another article was published about the landfill of Alco Pacífico's hazardous waste in Sonora. On March 9, 1997, Manuel Llano Ortega, an engineer and a resident of Hermosillo, requested that the State Governor provide a response to the community's concerns about the landfill of Alco Pacífico's waste […]. On May 2, 1997, Sonora's Human Rights Academy filed a complaint against SEMARNAP, PROFEPA, the State Legislature and the State Governor. It held that the authorities had violated the State's sovereignty by authorizing the deposit of toxic waste from Baja California without the relevant permit by the competent local authorities. On May 15, 1997, the same association filed a complaint before the National Commission of Human Rights.[163]

136. Thus, community opposition to Cytrar's activities of transportation and discharge of Alco Pacífico's waste must be analyzed in light of the initial opposition shown by some citizens or associations to the decision of PROFEPA —which hired the transportation to Hermosillo of such waste with Cytrar— and INE —which granted the relevant permits for Cytrar to undertake such transportation activities—[164] as to whether such waste could be confined in Hermosillo. Undoubtedly, the Mexican authorities opted to choose or accept Hermosillo, Sonora, as the appropriate site for the landfill of Alco Pacífico's waste and they were responsible for that decision. The criticism by groups from Sonora on Cytrar's management of Alco Pacífico's waste transportation cannot be separated from such groups' repudiation of the authorities' decision to transport the waste from Alco Pacífico to Hermosillo, Sonora, to have it confined there, and at the same time such criticism was the evident expression of such repudiation. And it is not possible to state that it was Cytrar's management of such transportation activities, and not the previous decision of the authorities to have Alco Pacífico's waste confined in Hermosillo, the determinant of community opposition.

137. The truth is that PROFEPA did not choose the early termination of the agreement entered into with Cytrar because of community opposition; and under no circumstance did INE cancel or otherwise remove Cytrar's permit for the transportation or discharge of Alco Pacífico's waste. The infringements or irregularities found by PROFEPA in connection with these operations triggered the imposition of fines on Cytrar or brought about orders to amend its manner of operation, but apparently they did not originate any recommendation or action by PROFEPA for the cancellation of the permit or the termination of the agreement under which Cytrar operated. Neither Cytrar's shortcomings as to Alco Pacífico's waste transportation nor the community opposition that such transportation brought about seem to have originated emergency situations, genuine social crisis or public unrest or urgency, which, due to their severity, could have led the competent authorities to terminate the contractual relationship governing the transport operation or to revoke or

---

[163] Counter-memorial, pp. 44-45; 164 *et. seq*.
[164] INE's permit of January 23, 1997 for the transportation and discharge of waste from Alco Pacífico. Clause 11 (p. 3), (document D65) of this permit also allowed for the termination of the permit in the event of justified complaints or risk to the environment or to human life.

deny the renewal of the licenses or permits under which such transport operation was carried out. Upon the termination of Alco Pacífico's waste transportation agreement with Cytrar, PROFEPA did not make note of any breach or obligation under such agreement. Although in one of the provisions of the minutes evidencing the cessation of Cytrar's services under the agreement PROFEPA reserved its right to subsequently hold Cytrar liable "… for any hidden defects or non-performance and non-fulfillment of its obligations…",[165] no evidence has been brought forth to indicate that PROFEPA has enforced that right against Cytrar. There is no evidence that during the effective term of the agreement any actions against Cytrar were filed by the other parties to the contract for breach, whether seeking to terminate the contract on sufficient grounds as authorized by its clause 6,[166] to interrupt payments owed under the contract or to seek any other type of redress or compensation for breach of contract. There is no evidence either that Fomín, the company that under clause 5-D (p. 5) of such agreement was responsible for the supervision of Cytrar's services provided under the agreement, made any reservations, negative remarks or warnings about Cytrar's performance of its contractual obligations during the effective term of the agreement.

138. Therefore, if the level of opposition generated by the transportation and discharge by Cytrar of Alco Pacífico's waste did not trigger any decisive action by the competent federal authorities, including PROFEPA —such as revocation of the relevant permits or authorizations, the commencement of legal actions or the early termination of the agreement— to put an end to such activities and if such opposition is not of the essence in the Resolution, it is not appropriate to attribute any considerable significance to it upon taking into account and weighing factors to determine if the Resolution *per se* amounts to a violation of the Agreement.

139. Those events —not related to the transportation and discharge of Alco Pacífico's waste by Cytrar— which constitute material evidence of the opposition put up by community entities and associations to the Landfill or its operation by Cytrar, do not give rise, in the opinion of the Arbitral Tribunal, to a serious urgent situation, crisis, need or social emergency that, weighed against the deprivation or neutralization of the economic or commercial value of the Claimant's investment, permits reaching the conclusion that the Resolution did not amount to an expropriation under the Agreement and international law.

140. First of all, such opposition was mainly based —as recognized by the Respondent itself— on the site's proximity to Hermosillo's urban center and on the circumstance, not attributable to Cytrar, that the site's location violated the applicable Mexican regulations —i.e. NOM-055-ECOL-1993 issued by INE—,[167] a circumstance that was certainly known by Promotora upon selling the Landfill's assets to Cytrar and also by INE upon granting the different permits to operate the Landfill. As expressed by the Respondent, the Landfill's proximity to Hermosillo's urban center, and not concrete evidence that the Landfill's operation is harmful for the environment or public health, is the issue that concentrates the opposition of the groups that are against the Landfill. Therefore, since such groups could not obtain the Permit's revocation due to the lack of such evidence —as explained to them

[165] Document A76: Minutes executed by PROFEPA, Cytrar and Fomin on July 6, 1999. Provision 11.
[166] Agreement dated November 19, 1996, p. 6, document D64.
[167] Counter-memorial, 33, p. 9

by INE and the municipal authorities— their ultimate goal was to close down the Landfill and make Cytrar relocate its operations. SEMARNAP, INE, and the authorities of the Municipality and of the State of Sonora finally agreed with these objectives.

141. Tecmed and Cytrar were certainly aware of the existence of those regulations, but it is clear that those regulations did not apply to the Landfill, since when the Landfill was designed and built and specific technical procedures governing the Landfill's operation were established, such regulations were not effective and their application could not be retroactive, as confirmed by a note from PROFEPA to Cytrar.[168] Therefore, at the time the investment was made, Cytrar and Tecmed had no reason to doubt the lawfulness of the Landfill's location, regardless of the social and political pressure that appeared subsequently. These companies were not negligent upon analyzing the legal issues related to the Landfill's location.

142. As a result of the community pressure it ran into, Cytrar also agreed that the relocation —actively sought by the municipal and state authorities and by SEMARNAP— should take place. However, Cytrar conditioned the relocation, as was obviously to be expected from any operator of an on going business, to being able to transfer its activities to a new site. The minimum requirements for the relocation were the identification of the site, the completion of the studies to prove the site's adequacy for the landfill of hazardous waste, the acquisition of the site and the granting of the relevant authorizations and permits required to operate a hazardous waste landfill prior to closing down the Las Víboras site. As time went by, due to the growing pressure arising from the above-mentioned events and from the Mexican federal, state and municipal authorities, Cytrar or Tecmed agreed to assume a substantial portion of the cost of the acquisition and start-up of the new site as a hazardous waste landfill and of the cost of transferring the waste confined at the Las Víboras site to the new landfill site. The Mexican authorities were to find the site and issue the relevant permits, and they focused the search on the state of Sonora. An institution from Sonora, IMADES (Sonora's Environmental and Sustainable Development Institute) was in charge to look for the site. The evidence submitted has not proved that Cytrar breached, or had the intention to breach, any of its relocation commitments. In addition, there is not proof, and no evidence has been submitted, that the federal or state authorities or IMADES sent any notice to Cytrar or Tecmed demanding compliance with their relocation commitment to a concrete site identified by such authorities with or without the consent of Cytrar. Evidence is only available as to a number of sites identified by the state and federal authorities in the Municipality of Benjamín Hill which, in principle, were fit for the relocation of the Landfill, subject to the related studies. Cytrar agreed that the sites identified in such place were fit for the Landfill[169]. However, for reasons that, based on the evidence available, cannot be attributed to Cytrar, the relocation did not take place at such time or subsequently within that Municipality. Reportedly, such reasons were the community pressures that Mexican authorities did not deem advisable to contradict.[170]

[168] Note dated February 11, 1998. document D101.

[169] Counter-memorial, 270, p. 75.

[170] Opposition to the Landfill's relocation to Benjamín Hill, reportedly coming from the same groups that also opposed to the Las Víboras Landfill, continued even after the Resolution was issued, as shown by the journalistic evidence submitted: readers' opinions and articles published in Hermosillo newspaper *El Imparcial*, dated March 30, April 23, and May 4, 1999; letter from an environmental activist, Francisco

143. The evidence submitted does not lead to concluding that Cytrar's petitions to expand cell Nº 2 of the Landfill were actually a surreptitious way to postpone the relocation in order to continue operating the Landfill for the longest time possible, rather than a way to pursue an alternative solution to operating needs until the relocation was effective. In Cytrar's note to INE dated July 15, 1998,[171] in which Cytrar states the need to increase the Landfill's volume capacity by expanding cell Nº 2, Cytrar expressly relates such increase to the time required to continue operating the Landfill for a year, which was necessary for the relocation. That was precisely the minimum term estimated for that purpose by the Municipality of Hermosillo. INE never denied that that was the appropriate term to relocate nor did it state that the proposed additional landfill capacity was excessive compared to the Landfill's proposed additional term for operation by Cytrar until relocation or that it may have had the purpose of prolonging the Landfill's exploitation for a period longer than necessary –or indefinitely– to achieve such relocation. If the construction of cell Nº 3 — the authorization of which was also requested by Cytrar to INE "only in the event relocation was not completed after expanded cell Nº 2 was full"[172]— meant giving Cytrar landfill capacity at the Las Víboras site for a term longer than necessary to relocate, it would have been enough for INE to refuse to grant such authorization in order to dissuade Cytrar from delaying the relocation and it would not have been necessary for that purpose to dismiss the application for renewal of the Permit. INE, by itself or in association with IMADES, the Government of Sonora or the Municipality of Hermosillo, did not respond to the proposal included in the note dated July 15, 1998, with any other counter-offer. Until a few days before the Resolution, both Cytrar and Tecmed reaffirmed, through communications dated November 9, 12 and 17, 1998, their commitment to relocate the Landfill to any of the areas identified by the Mexican authorities and to bear the most significant costs associated with the relocation, including any costs related to the

---

Pavlovich, published in *El Imparcial* on April 16, 1999, (Press Dossier (I) exhibit A70). The same happened in connection with other places or sites located in Sonora according to the press information submitted by IMADES: note published in *El Imparcial* on March 25, 1999, about the towns of Carbó and Guaymas; notes published in *El Imparcial* on March 4 and April 15, 1999, about the town of Carbó, article published in *El Imparcial* on November 6, 1998 about the Agua Blanca site located in Benjamín Hill) (Press Dossier (I) exhibit A70). The approval by the Municipality of Benjamín Hill and the Mayor of this Municipality to commence the studies related to the identification of the site and the preliminary contract of sale of «El Pinito», a plot located in this Municipality, occurred in April 1999, i.e. quite a long time after the date of the Resolution. Such actions continue to be preparatory acts that have apparently not been implemented through concrete decisions or relocation proposals made by the authorities: Counter-memorial, 337, p. 96. On the other hand, according to the article published in *El Imparcial* on May 4, 1999, mentioned above, as well as to the article published in such newspaper on April 15, 1999, related to the construction of a landfill in "El Pinito", despite the resolutions of the authorities of Benjamín Hill, the community opposition to the relocation of the Landfill to that town continues and the issue does not seem to be definitively resolved. It is striking that as of February 22, 2000, almost a year later, the identification studies to determine whether that site would be definitely chosen by the authorities as a place fit for the relocation of the Landfill (letter of the Government of Sonora to Dra. Cristina Cortinas de Nava dated February 22, 2000, document D165) are still pending. In April 1999, IMADES had referred to another site located in Benjamín Hill, called "El Tilico". IMADES had reportedly obtained the permit of the authorities of such Municipality to construct the landfill (article published in *El Imparcial* on April 16, 1999, Press Dossier (I), exhibit A70). However, it seems that the authorities never carried this out.

[171] Document A50, 7.

[172] Cytrar's note to INE dated November 16, 1998, 5, p. 2, document A54.

construction of the new premises in the new site and the payment of part of the purchase price of the land.[173] INE and the Mexican authorities involved in the relocation arrangements did not indicate, in view of this statement and before the Resolution was issued, any site for such commitment, nor did they challenge Cytrar's technical, economic or operational capacity to fulfill its relocation commitment and operate in the new site under conditions that would guarantee the protection of the environment and the preservation of public health. The fact that such capacities were not controversial is confirmed by the fact that Cytrar and Tecmed continued negotiating to relocate the Landfill even after the Permit's renewal had been denied, at least during January 2000.[174]

144. Finally, the Respondent has not presented any evidence that community opposition to the Landfill —however intense, aggressive and sustained— was in any way massive or went any further than the positions assumed by some individuals or the members of some groups that were opposed to the Landfill. Even after having gained substantial momentum, community opposition, although it had been sustained by its advocates through an insistent, active and continuous public campaign in the mass media, could gather on two occasions a crowd of only two hundred people the first time and of four hundred people, the second time out of a community with a population of almost one million inhabitants, "… which makes it the city with the highest population in the state of Sonora".[175] Additionally, the "blockage" of the Landfill was carried out by small groups of no more than forty people.[176] The absence of any evidence that the operation of the Landfill was a real or potential threat to the environment or to the public health, coupled with the absence of massive opposition, limits "community pressure" to a series of events, which, although they amount to significant pressure on the Mexican authorities, do not constitute a real crisis or disaster of great proportions, triggered by acts or omissions committed by the foreign investor or its affiliates.

145. The fact that the real problem was the site of the Landfill and not the manner in which the Landfill was operated by Cytrar is confirmed by the fact that the Mexican federal, state and municipal authorities, including INE, did not hesitate to entrust Cytrar with the construction and operation of a new hazardous waste landfill located outside Hermosillo, with characteristics, activities and a scope apparently wider and more ambitious than the operation in Las Víboras. If these authorities had considered that Cytrar was not a suitable company to operate the Landfill in a prudent and responsible manner, and under technical conditions that ensured the protection of the environment, ecological balance and the health of the population, these authorities could not have agreed to —or even proposed— Cytrar's relocation, in good faith and without comitting a breach of their obligations. That would entail the possible and almost certain risk that Cytrar's unscrupulous and careless

---

[173] Counter-memorial, pp. 85, 304. Cytrar's note to the President of INE, dated November 9, 1998, document D94; Tecmed's notes dated November 12, 1998 sent to the Governor of Sonora, document D149 and to the Minister of SEMARNAP, Ms. Julia Carabías Lillo, document D150; Tecmed's note dated November 17, 1998 sent to the Director of INE, Ms. Cristina Cortinas Nava, document D154.
[174] Counter-memorial, p. 96, 337.
[175] Counter-memorial, p. 15, 54.
[176] Hearing held from May 20 to May 24, 2002. Transcript of the session of May 20, 2002. Declaration of Javier Polanco Lavín, pp 33 overleaf, 35, 42-43; transcript of the session of May 21, 2002, declaration of José María Zapatero Vaquero, p. 57 overleaf.

action, allegedly lacking meticulousness in public relations management or in the relationship with the people, would lead to new expressions of condemnation in addition to the predictable damage to the environment and public health. This confirms that it was political pressure mainly revolving around the physical location of the site rather than a condemnation of major consequences expressed by the community or a situation originating a serious social emergency due to Cytrar's behavior that motivated the refusal to renew the Permit.

146. The situation described above is not comparable to the situation that led to the case *Elettronica Sicula S.p.A.(Elsi)*, invoked by the Respondent.[177] First, the decision of the Mayor of Palermo, which brought about the US claim against Italy filed before the International Court of Justice[178] upon ordering that the foreign investor's plant be requisitioned, is expressly based on —and the preambular clauses thereof refer to— a serious emergency and social crisis related to the closing of the plant located in Palermo, Italy (the closing down of an important job source —the second one in significance of the district— with the consequent dismissal of around one thousand workers and negative consequences on the same number of families and the Palermo community in general, which added to the suffering caused by the earthquakes that had occurred in the area a few months before).[179] This emergency was also recognized by the Palermo courts in terms of significant public hardship related to the plant's closing and of the unexpected urgent need to adopt measures to alleviate the crisis.[180] Second, the closing and mass firing of workers were directly attributable to the decision of the controlling shareholders of the company that owned the plant —i.e. the foreign investors— not to make new capital contributions or to execute the necessary bonds as security to obtain financial resources that would allow the company to stay in business.[181]

147. In this case, there are no similar or comparable circumstances of emergency**,** no serious social situation, nor any urgency related to such situations, in addition to the fact that the Mexican courts have not identified any crisis. The actions undertaken by the authorities to face these socio-political difficulties, where these difficulties do not have serious emergency or public hardship connotations, or wide-ranging and serious consequences, may not be considered from the standpoint of the Agreement or international law to be sufficient justification to deprive the foreign investor of its investment with no compensation, particularly if it has not been proved that Cytrar or Tecmed's behavior has been the determinant of the political pressure or the demonstrations that led to such deprivation, which underlie the Resolution and conclusively conditioned it. On the contrary, the commitment by such companies to relocate the Las Víboras operation to a different site, although immediately motivated in the deeply reasonable —though non-altruistic— concern of being able to continue with the commercial exploitation they were engaged in makes it clear that, objectively, such commitment was intended to make a positive contribution to mitigate the socio-political pressure and to continue providing

[177] E.g., see p. 127, 452, Counter-memorial.
[178] Case *Elettronica Sicula S.p.A (ELSI) (United States of America v. Italy)*, July 20, 1989, ICJ Reports, 1989.
[179] *Ibid*. 30, pp. 21-22
[180] *Ibid*. 75, pp. 40-41
[181] *Ibid*. 17, p. 14

Mexico with hazardous waste landfill services from a new site. It should be underscored that, as argued in these arbitration proceedings, Mexico urgently needs these services due to a serious lack thereof.

148. Another factor should be added: Cytrar's operation of the Landfill never compromised the ecological balance, the protection of the environment or the health of the people, and all the infringements committed were either remediable or remediated or subject to minor penalties. The Resolution not only terminates the Permit, but also resolves to permanently close down the site at Las Víboras, and such circumstance irrefutably confirms that the problem concerned the location of the Landfill rather than Cytrar's operation of it. This is so, as such closing means that the Landfill may not be operated by Cytrar or by anyone else, even if it complied with INE's requirements as to the expansion of cell Nº 2, the prohibition to act as a transfer center or the requirements as to the type of waste to be confined or the temporary storage of such hazardous waste or any other action on which the Resolution was based. Such an extreme measure, the effects of which will have a permanent impact on the future, in view of the fact that the violations did not give rise to irreparable deficiencies in the operation of the Landfill, shows that INE concluded that the Permit granted to Cytrar should not be renewed and also that from then on nobody should be authorized to operate a hazardous waste landfill at the Las Víboras site, even if it was an operator whose behavior was so flawless that it could not give rise even to minor faults. Such conclusion was consistent with the requests of the Municipality of Hermosillo and the authorities of the state of Sonora with whom INE consulted.

149. While the Resolution is based on some of these violations to deny the renewal of the Permit, apparently through a literal and strict interpretation of the conditions under which the Permit was granted,[182] it would be excessively formalistic, in light of the above considerations, the Agreement and international law, to understand that the Resolution is proportional to such violations when such infringements do not pose a present or imminent risk to the ecological balance or to people's health, and the Resolution, without providing for the payment of compensation as required by Article 5 of the Agreement, leads to the neutralization of the investment's economic and business value and the Claimant's return on investment and profitability expectations upon making the investment. The Arbitral Tribunal does not agree with the Respondent's position denying that upon making its investment, the Claimant had legitimate reasons to believe that the operation of the Landfill would extend over the long term.[183] The political and social circumstances referred to above, which conclusively conditioned the issuance of the Resolution, were shown with all their magnitude after a substantial part of the investment had been made and could not have reasonably been foreseen by the Claimant with the scope, effects and consequences that those circumstances had. There is no doubt that, even if Cytrar did not have an indefinite permit but a permit renewable every year, the Claimant's expectation was that of a long-term investment relying on the recovery of its investment and the estimated return through the operation of the Landfill during its entire useful life.

---

[182] Counter-memorial, 314 *et. seq*., pp. 87-93; 489, p.143

[183] Closing statement of the Respondent's counsel, 124-126, pp. 65-66

150. Such circumstances are also included in the bid offer submitted by Tecmed under the bidding auction of the assets related to the Landfill, where it states that the investment will be applied for the benefit of the "...industries of the state of Sonora in the short, medium and long terms, and that to that effect no policies that might deplete the full capacity of the Landfill in the short term will be adopted...", and that "....Cytrar will increase its role as a regional plant, self-limiting its annual volume of waste acceptance from extra-regional sources to the level required to maintain a minimum profitability level ...".[184] In view of the above, it is clear the Cytrar would not have an operation level to reach a break-even point and obtain the expected rate of return in a short time. INE could not be unaware of this and of the need to act in line with such expectations to avoid rendering unfeasible any private investment of the scale required to confine hazardous waste in the United Mexican States under acceptable technical operating conditions. Both the authorization to operate as a landfill, dated May 1994, and the subsequent permits granted by INE, including the Permit, were based on the Environmental Impact Declaration of 1994, which projected a useful life of ten years for the Landfill.[185] This shows that even before the Claimant made its investment, it was widely known that the investor expected its investments in the Landfill to last for a long term and that it took this into account to estimate the time and business required to recover such investment and obtain the expected return upon making its tender offer for the acquisition of the assets related to the Landfill. To evaluate if the actions attributable to the Respondent —as well as the Resolution— violate the Agreement, such expectations should be considered legitimate and should be evaluated in light of the Agreement and of international law.

151. Based on the above; and furthermore considering that INE's actions (an entity of the United Mexican States "...in charge of designing Mexican ecological and environmental policy and of concentrating the issuance of all environmental regulations and standards")[186] are attributable to the Respondent under international law[187] and have caused damage to the Claimant, and the fact that the claim related to the violation of Article 5(1) of the Agreement attributable to the Respondent is admissible under Title II(5) of its Appendix because the date of the damage and the date on which the Claimant should have become aware of the alleged violation of Article 5(1) of the Agreement is the date of the expropriatory act —i.e. the Resolution— subsequent to the entry into force of the Agreement but always within three years before the date the request for arbitration was filed,[188] the Arbitral Tribunal finds and resolves that the Resolution and its effects amount to an expropriation in violation of Article 5 of the Agreement and international law.

---

[184] Tecmed's tender offer, Sections 1.1.1; 1.1.2, document A17.
[185] Document D21, 51, p. 33. Counter-memorial, 43, p. 13.
[186] Counter-memorial, p. 2, 11.
[187] J. Crawford, The International Law Commission's Articles on State Responsibility, 94-99 (Cambridge University Press, 2002).
[188] According to the certificate of registration issued on August 28, 2002, by the ICSID Interim Secretary-General, the Claimant's notice to commence this arbitration was received by the ICSID Secretariat on August 7, 2000. The three-year term established in Title II(5) of the Appendix to the Agreement, within which the Claimant became aware or should have become aware of the alleged violations of the Agreement on which its claims are based and of the related damage, is the period commencing on August 7 1997, and ending on August 7, 2000.

II. Fair and Equitable Treatment

152. According to Article 4(1) of the Agreement:

> Each Contracting Party will guarantee in its territory fair and equitable treatment, according to International Law, for the investments made by investors of the other Contracting Party.

153. The Arbitral Tribunal finds that the commitment of fair and equitable treatment included in Article 4(1) of the Agreement is an expression and part of the *bona fide* principle recognized in international law,[189] although bad faith from the State is not required for its violation:

> To the modern eye, what is unfair or inequitable need not equate with the outrageous or the egregious. In particular, a State may treat foreign investment unfairly and inequitably without necessarily acting in bad faith.[190]

154. The Arbitral Tribunal considers that this provision of the Agreement, in light of the good faith principle established by international law, requires the Contracting Parties to provide to international investments treatment that does not affect the basic expectations that were taken into account by the foreign investor to make the investment. The foreign investor expects the host State to act in a consistent manner, free from ambiguity and totally transparently in its relations with the foreign investor, so that it may know beforehand any and all rules and regulations that will govern its investments, as well as the goals of the relevant policies and administrative practices or directives, to be able to plan its investment and comply with such regulations. Any and all State actions conforming to such criteria should relate not only to the guidelines, directives or requirements issued, or the resolutions approved thereunder, but also to the goals underlying such regulations. The foreign investor also expects the host State to act consistently, i.e. without arbitrarily revoking any preexisting decisions or permits issued by the State that were relied upon by the investor to assume its commitments as well as to plan and launch its commercial and business activities. The investor also expects the State to use the legal instruments that govern the actions of the investor or the investment in conformity with the function usually assigned to such instruments, and not to deprive the investor of its investment without the required compensation. In fact, failure by the host State to comply with such pattern of conduct with respect to the foreign investor or its investments affects the investor's ability to measure the treatment and protection awarded by the host State and to determine whether the actions of the host State conform to the fair and equitable treatment principle. Therefore, compliance by the host State with such pattern of conduct is closely related to the above-mentioned principle, to the actual chances of enforcing such principle, and to excluding the possibility that state action be characterized as arbitrary; i.e. as presenting insufficiencies that would

---

[189] I. Brownlie, Principles of Public International Law, Oxford, 5th. Edition (1989), p. 19. It is understood that the fair and equitable treatment principle included in international agreements for the protection of foreign investments expresses "...the international law requirements of due process, economic rights, obligations of good faith and natural justice" : arbitration case *S.D. Myers, Inc.v. Government of Canada,* partial award of November 13, 2000; 134, p. 29 ; www.naftalaw.org.

[190] ICSID Arbitration no. ARB(AF)/99/2, *Mondev International Ltd v United States of America*, p.40, 116, October 11, 2002, www.naftalaw.org.

be recognized "…by any reasonable and impartial man,"[191] or, although not in violation of specific regulations, as being contrary to the law because:

...(it) shocks, or at least surprises, a sense of juridical propriety.[192]

155. The Arbitral Tribunal understands that the scope of the undertaking of fair and equitable treatment under Article 4(1) of the Agreement described above is that resulting from an autonomous interpretation, taking into account the text of Article 4(1) of the Agreement according to its ordinary meaning (Article 31(1) of the Vienna Convention), or from international law and the good faith principle, on the basis of which the scope of the obligation assumed under the Agreement and the actions related to compliance therewith are to be assessed.

156. If the above were not its intended scope, Article 4(1) of the Agreement would be deprived of any semantic content or practical utility of its own, which would surely be against the intention of the Contracting Parties upon executing and ratifying the Agreement since, by including this provision in the Agreement, the parties intended to strengthen and increase the security and trust of foreign investors that invest in the member States, thus maximizing the use of the economic resources of each Contracting Party by facilitating the economic contributions of their economic operators. This is the goal of such undertaking in light of the Agreement's preambular paragraphs which express the will and intention of the member States to "...intensify economic cooperation for the benefit of both countries..." and the resolve of the member States, within such framework, "....to create favorable conditions for investments made by each of the Contracting Parties in the territory of the other ...".

157. Upon making its investment, the fair expectations of the Claimant were that the Mexican laws applicable to such investment, as well as the supervision, control, prevention and punitive powers granted to the authorities in charge of managing such system, would be used for the purpose of assuring compliance with environmental protection, human health and ecological balance goals underlying such laws.

158. The evidence submitted reveals that when the authorities of the Municipality of Hermosillo, in the state of Sonora, of SEMARNAP and INE, perceived that the political problems mentioned above, closely related to the community opposition already described, made it necessary to relocate Cytrar's activities in the Landfill to a place outside Hermosillo, Cytrar, with Tecmed's support, agreed that its publicly known relocation proposal would become a commitment of Cytrar and of the Mexican federal, state and municipal authorities. Such evidence also shows that although Cytrar accepted or agreed to such relocation, it made it conditional upon having a new site to carry out its technical and business activities and that it expressed this condition before the Mexican authorities on several occasions. In its note dated June 25, 1998, to the President of INE, Cytrar defines the distribution of duties and obligations related to the relocation as follows:

[191] *Neer v. México* case, (1926) R.I.A.A. iv. 60.
[192] International Court of Justice Case: *Elettronica Sicula S.p.A. (ELSI) (United States of America v. Italy*), 128, p. 65, July 20, 1989, ICJ, General List No. 76.

....[Cytrar] will accept its relocation and, to that end, the municipal and state authorities will be in charge of finding, acquiring and delivering a new site, and they will also be in charge of carrying out any and all pertinent studies and of granting the related permits and licenses.[193]

159. There is no proof that INE or the state and municipal authorities challenged the distribution of the relocation obligations. Such allocation was only changed to the extent that Cytrar offered to assume a significant portion of the financial cost of the relocation. At no time, from the time the authorities communicated to the public the relocation of the Landfill to the date of the Resolution, did such authorities or IMADES express any disagreement as to conditioning the operation of the Landfill by Cytrar to the relocation of such operations to a different place, nor did they deny that the relocation was the result of an agreement with Cytrar on the basis of conditions agreed upon between Cytrar and such authorities. Dr. Cristina Cortinas Nava, INE's General Director of Hazardous Materials, Waste and Activities recognized this as follows:

......I recognize that the company stated that the relocation would take place after finding a new site. Therefore, the company expected to continue operating the Landfill at its current site until then. [...] I recognize that, and if you ask me why, then, at the time I made the decision that implied an interruption of the continuity sought by the company, why did I do it? [....] my answer is that it was because the circumstances in November were such that I am sure that if I had renewed the permit I would not have been able to guarantee to the company the continuity of its operations there. Because there were many objections to the continuity of the company's operations there.[194]

160. Cytrar may have understood in good faith that its operations at Las Víboras under the Permit would continue for a reasonable time until effective relocation. Although it is true that the relocation agreement has not been memorialized in an instrument signed by all the parties involved, the evidence submitted leads to the conclusion that there was such an agreement, as evidenced by the joint declaration of SEMARNAP, the Government of the state of Sonora and the Honorable Municipality of Hermosillo to that effect. Section 4 of such declaration states that "…the current landfill operated by CYTRAR shall be closed as soon as the new facilities are ready to operate".[195] On the other hand, the Resolution[196] itself stated that:

Furthermore, CYTRAR S.A. de C.V. agreed with the different levels of the federal, state and municipal government that the landfill would be relocated and made this agreement public.

There is no doubt that the agreement commenced to be performed, as evidenced by the joint visits of Cytrar and IMADES to sites that were possible locations for the relocated landfill. There is no evidence stating or suggesting that the parties to such agreement agreed that external factors stemming from community pressure —which the Mexican authorities were fully aware of upon reaching the agreement— would cause the closing of Cytrar's business

---

[193] Document A49. The relocation commitment project between the Mexican authorities and Cytrar referred to by the Respondent in the Counter-memorial, n. 324-329, pp. 93-94, which reportedly gives rise to a change in the allocation of obligations described above, has never been executed and was still subject to comments as of January 13, 1999. Therefore, such commitment cannot be taken into account to measure the allocation of the relocation obligations assumed by the parties in the stage prior to the issuance of the Resolution.

[194] Hearing held from May 20 to May 24, 2002; transcript of the session of May 21, 2002, pp. 77-77 overleaf.

[195] Document A88.

[196] Document A59.

at the Landfill without complying with the prior relocation of this business to another place. The incidental statements as to the Landfill's relocation in the correspondence exchanged between INE and Cytrar or Tecmed, and that constitute the immediate precedents of the Resolution, cannot be considered to be a clear and unequivocal expression of the will of the Mexican authorities to change their position as to the extension of the Permit so long as Cytrar's business was not relocated, nor can it be considered an explicit, transparent and clear warning addressed to Cytrar from the Mexican authorities that rejected conditioning the revocation of the Permit to the relocation of Cytrar's operations at the Landfill to another place, a rejection that should not have been expressed only by INE, but also by the other authorities responsible for deciding on the Landfill's relocation; i.e. the Municipality of Hermosillo, the Government of Sonora and SEMARNAP. The conclusion is that Cytrar may have reasonably trusted, on the basis of existing agreements and of the good faith principle, that the Permit would continue in full force and effect until the effective relocation date.

161. As stated above, on July 15, 1998, in a letter sent to the General Director of Hazardous Materials, Waste and Activities of INE, Dr. Cristina Cortinas Nava, Cytrar presented a number of proposals related to the expansion of cell Nº 2 and the construction of cell Nº 3 to address the company's commitments while the process to relocate its operations to a different site was carried out.[197] In spite of the urgency of the case and of the letter that Cytrar had sent to INE's President on June 25, 1998, reporting the need to increase the Landfill's capacity for those very reasons,[198] and reiterating Cytrar's commitment to relocate subject to the conditions expressed therein, INE took about three months to issue its reply to Cytrar. In its response, included in an official communication sent to Cytrar on October 23, 1998,[199] i.e. scarcely more than one month before the expiration of the Permit's term and when Cytrar had already requested the Permit's renewal in a letter sent to INE on October 19, 1998,[200] INE did not express the existence of any irregularity committed by Cytrar in the Landfill's operation or of any default by Cytrar of the conditions under which the Permit was granted that, in the opinion of INE, might jeopardize the Permit's renewal or its limited extension for a reasonable time so as to permit the relocation as proposed by Cytrar. INE could not have been unaware at the time of the existence of irregularities or infringements related to the expansion of cell Nº 2. The expansions seemed to be the biggest concern of the sectors that opposed the Landfill, as their interpretation was that the expansions, which had been communicated by PROFEPA to INE by means of an official communication received by INE on September 14, 1998,[201] were *sine die* the cause for the delay in closing the Landfill. As INE only stated that it would evaluate the request for the expansion of cell Nº 2 and construction of cell Nº 3 upon considering renewal of the Permit, without warning Cytrar of any breach or irregularity in the expansion of the Landfill's capacity that, in the opinion of INE, jeopardized the renewal of the Permit, INE significantly affected Cytrar's ability to cure such defaults or irregularities in due time and prevent the denial of the Permit's renewal upon its expiration. Although INE, in its official

[197] Letter sent to Dr. Cristina Cortinas Nava, document A50.
[198] Letter sent to Enrique Provencio, document A49.
[199] Official communication no. DOO-800/005262 of October 23, 1998, document A51.
[200] Cytrar's letter to Dr. Cristina Cortinas Nava, document A52.
[201] Document D133.

communication addressed to Cytrar on November 13, 1998,[202] in reply to the note sent by Cytrar on October 19, 1998, whereby it requested the renewal of the Permit, refers to these and other infringements, only six days before expiration of the Permit, it seems evident that, at that time, any meaningful effort to cure such infringement and prevent a denial of the permit's renewal was not feasible.

162. INE did not report, in clear and express terms, to Cytrar or Tecmed, before issuing the Resolution, its position as to the effect of these infringements on the renewal of the Permit. As a consequence, it prevented Cytrar from being able to express its position as to such issue and to agree with INE about the measures required to cure the defaults that INE considered significant when it denied the renewal without allowing a reasonable time to relocate Cytrar to another site. Providing an opportunity to Cytrar was reasonable and equitable, since at all times the parties considered that Cytrar would relocate the Landfill to another place, and such relocation and the necessity for the Landfill to continue operating at Las Víboras until the effective relocation, was the purpose of the recent correspondence exchanged between the parties. There was no disagreement that relocation could not be immediate and that it would require continued efforts, probably for many months, even for more than a year. There are clear inconsistencies or contradictions in the attitude of INE, which, on the one hand, did not challenge the technical capacity and operating qualifications of Cytrar upon entrusting it with the operation of a hazardous waste landfill that would be relocated to another site and that would operate under the more ambitious conditions —and surely with more responsibilities for the operator— of a Comprehensive Center for the Management of Industrial Waste, or CIMARI, and that, on the other hand, did not warn Cytrar about the curable defaults in its operations at Las Víboras sufficiently in advance so as to avoid the denial of the Permit's renewal. As shown, such defaults have not endangered public health, ecological balance or the environment. It should be noted that, although the official communication sent by INE to Cytrar on November 13, 1998, refers to an alleged violation by Cytrar of the specific condition 1.12 of the Permit, under which "....the presentation of repeated and justified complaints against the company or the occurrence of events due to problems in the Landfill's operation that may endanger public health...." (without going any deeper into this subject or expressly mentioning such events) are sufficient events to «*cancel*» the Permit (not to *deny its renewal*), such condition was not invoked among the grounds of the Resolution. After analyzing such inconsistencies, it may be concluded that the contradictions and lack of transparency in INE's attitudes vis-à-vis Cytrar, and the absence of clear signs from INE, did not permit Cytrar to adopt a behavior to prevent the non-renewal of the Permit, or that might at least guarantee the continuity of the permit for the period required to relocate the Landfill to a new site.

163. If INE's position was that relocation was to take place within a given period —which, as stated above, according to the Mexican authorities, should be about twelve months—[203] after the expiration of which the Permit would not be renewed, it would be reasonable to expect such situation to be reported to or agreed upon by Cytrar. Certainly, it is surprising that INE did not unequivocally and clearly specify the deadlines, terms and conditions that would apply to the relocation, as requested by the authorities of the Municipality of

[202] Document A53.
[203] Communication of the Mayor of the Municipality of Hermosillo, document D113.

Hermosillo a day before the Permit's expiration,[204] even when Cytrar and Tecmed had agreed to relocate Cytrar's business to any site selected by the Mexican authorities and regardless of the note sent by Tecmed to INE on November 17, 1998, in which Tecmed clearly requests the execution of an agreement with INE and the Mexican federal, state and municipal authorities containing a certain and specific relocation schedule.[205] There are also express inconsistencies between, on the one hand, the absence of such specifications and a notice to Cytrar warning it to agree to or abide by such conditions and, on the other hand, the use of the denial to renew the Permit as a factor to pressure Cytrar to relocate, as declared by INE's General Director of Hazardous Materials, Waste and Activities, who authored the Resolution:

> ......for them [the local authorities] if I continued renewing the Permit, that would [sic] extend ... For as long as the company could continue receiving waste, it would not assume a full commitment to perform the studies required to relocate the site ...[206]

This statement reveals the two goals pursued by INE upon issuing the Resolution. On the one hand it denies the renewal of Cytrar's Permit without any compensation whatsoever for the loss of the financial and commercial value of the investment. On the other hand, this denial is described as a means to pressure Cytrar and force it to assume a similar operation in another site, bearing the costs and risks of a new business, mainly because by adopting such course of action, INE expected to overcome the social and political difficulties directly related to the Landfill's relocation. Under such circumstances, such pressure involves forms of coercion that may be considered inconsistent with the fair and equitable treatment to be given to international investments under Article 4(1) of the Agreement and objectionable from the perspective of international law.[207]

164. If, on the other hand, INE's position was —as has actually been established— to close the Landfill inevitably, with or without relocation, INE should have expressed such position clearly. Regardless of the hypothesis contemplated, the decisive factor —for which Cytrar was not responsible— was the Landfill's location at the Las Víboras site and its proximity to Hermosillo's urban center, which was in violation of Mexican regulations and a source of community opposition and political unrest, but which was not —as confirmed by Mexican authorities— against the legitimacy of the Landfill's operation under Mexican law. If the inevitable consequence of this situation, evaluated by the Mexican authorities, was the refusal to renew the Permit and the closing of the site, such determination, from the Agreement's standpoint, should have been accompanied, as has already been decided, by the payment of the appropriate compensation. The lack of transparency in INE's behavior and intention throughout the process that led to the Resolution, which does not reflect in full the reasons that led to the non-renewal of the Permit, cover up the final and real

---

[204] Communication sent to INE's President by the Mayor of the Municipality of Hermosillo on November 18, 1998, in which the Mayor requests "the execution of a landfill relocation agreement between the Federation, the State, the Municipality and the company. A detailed, signed, legal agreement containing a schedule and fixed dates." Document D157.

[205] Document A 91.

[206] Hearing held from May 20 to May 24, 2002; transcript of the session held on May 21, 2002, p. 72.

[207] D.F.Vagts, Coercion and Foreign Investment Rearrangements, 72. The American Journal of International Law , pp. 17 *et seq*., specially p. 28 (1978) : "…the threat of cancellation of the right to do business might well be considered coercion."

consequence of such actions and of the Resolution: the definitive closing of the activities at the Las Víboras landfill without any compensation whatsoever, whether Cytrar agreed or not, in spite of the expectations created, and without considering ways enabling it to neutralize or mitigate the negative economic effect of such closing by continuing with its economic and business activities at a different place. Within the general context of the circumstances mentioned above, the ambiguity of INE's actions was even greater when it resorted to the non-renewal of the Permit to overcome obstacles not related to the preservation of health and the environment although, according to the evidence submitted, the protection of public health and the environment is where INE's preventive function should be focused. To the question about the factors or parameters that INE should take into account to decide on the renewal of authorizations such as the Permit, witness Dr. Cristina Cortina Navas answered:

> Provisions can have two different purposes: to evaluate environmental performance and to assess the management of companies. Thus, you will distinguish, among the conditions established, such conditions that allowed for the evaluation of the former and the conditions that allowed for the assessment of the latter. As regards management, there were a series of instruments, reports, records and issues that the company had to take care of. In turn, performance involved providing sufficient security that there would not be escapes, leaks or accidents during hazardous waste management, including transportation and storage. Any of these issues could be verified, and, in fact, before issuing any resolution we tried to gather all the elements necessary to be able to pass judgment on whether or not such purposes had been fulfilled.[208]

The refusal to renew the Permit in this case was actually used to permanently close down a site whose operation had become a nuisance due to political reasons relating to the community's opposition expressed in a variety of forms, regardless of the company in charge of the operation and regardless of whether or not it was being properly operated.

165. The Arbitral Tribunal considers that INE's behavior described above with respect to Cytrar, which had a material adverse effect on Cytrar's ability to get to know clearly the real circumstances on which the maintenance or validity of the Permit depended —it must be recalled that Cytrar could not operate without this Permit— is not an unprecedented action. INE's denial to renew the Permit belongs to the wider framework of the general conduct taken by INE towards Cytrar, Tecmed and, ultimately, the Claimant's investment.

166. The Arbitral Tribunal finds that INE's behavior, as analyzed in paragraphs 153-164 above and because of the "deficiencies" explained therein, conflicts with what a reasonable and unbiased observer would consider fair and equitable, and that this amounts to a violation of Article 4(1) of the Agreement. The Arbitral Tribunal also finds that such a behavior can be related, in terms of its prejudicial consequences, to the consequences of the Resolution; and that only after the Resolution was issued could the Claimant fully realize the breach of the Agreement incurred by such behavior and the resulting damage. Consequently, the Claimant's claims in connection with such behavior satisfy the requirements for admissibility contemplated in Title II(4) and (5) of the Appendix to the Agreement.

[208] *Ibidem*, pp. 68-68 overleaf

167. Notwithstanding the above, the Arbitral Tribunal considers it equally appropriate to place this behavior within the context of INE's prior conduct on the basis of the abundant arguments and evidence presented by the Parties in connection with such prior conduct and in view of the undeniable fact that the legal relationship between INE and Cytrar or Tecmed associated with the Landfill is one and only one, starting with the initial procedures in connection with the authorization to operate the Landfill and finishing with the Resolution —the immediate cause for the damage sustained by the Claimant. This conduct should also be analyzed in light of the fact that throughout a relationship of such nature, necessarily prolonged in time, the Claimant was entitled to expect that the government's actions would be free from any ambiguity that might affect the early assessment made by the foreign investor of its real legal situation or the situation affecting its investment and the actions the investor should take to act accordingly.

168. As a result of the judicial sale of the Landfill's assets, Tecmed and the Municipality of Hermosillo request from INE the "change of name" or the facilitation of such change, which, according to the administrative practice up to date, at least in connection with the Landfill, entailed the replacement of the holder of the permits necessary for the operation of the landfill at Las Víboras by such holder's successors. There is no evidence that INE has responded to such communications stating that Cytrar had actually to request a new permit, which may differ from the existing one, instead of requesting the replacement of the old holder with a new one; and no convincing evidence has been offered to support the Respondent's allegations as to the fact that, from the beginning, INE's officers instructed Cytrar to obtain a new "operating license" because, for example, as stated by the Respondent, the nature of the operation undertaken by Cytrar and the consequent expansion of the Landfill's installed capacity would so require it.[209] Among others, in the note dated June 5, 1996, sent to INE by Tecmed together with the MRP Form, containing information that INE should evaluate in connection with the individual or entity that was to be in charge of a hazardous waste landfill operation, Tecmed specifically requested from INE "...the change of the name appearing in the permit granted by INE to the new company for such purpose, CYTRAR S.A. de C.V."**.** Attached as Annex "A" to such presentation and Form, are the Establishment License granted on December 7, 1988, and the permit to operate the already existing Controlled Landfill, dated May 4, 1994, together with its expansion of August 25, 1994.[210]

169. Thus, there was no possible margin for error with respect to the request made by Tecmed and Cytrar with the support of the Municipality of Hermosillo in connection with the existing licenses or permits by virtue of which the Landfill had operated and was still operating. Considering such very clear requests, there is no evidence that INE had warned Cytrar that such requests could only be interpreted as petitions to be included in INE's listing of companies that would qualify for the operation of CIMARIS or Comprehensive Centers for Industrial Waste Management —to which the witness Jorge Sánchez Gómez, the INE's General Director of Hazardous Materials, Waste and Activities at that time[211] had made reference— or evidence of practices, resolutions or administrative regulations or legal

[209] Counter-memorial, 127, pp. 34-35
[210] Document D46
[211] Hearing held from May 20 to May 24, 2002. Transcript of the session of May 23, 2002, p. 57.

provisions leading to such sole and exclusive interpretation. On September 24, 1996, INE sent Cytrar an official communication signed by Jorge Sánchez Gómez, whereby Cytrar was informed that "In view of the request filed by the company Promotora e Inmobiliaria del Municipio de Hermosillo, OPD to change its name to Cytrar S.A. de C.V.," and considering that according to the recommendations of INE's "...Legal Affairs Department …" Cytrar had furnished "...the documents required by this General Office and had fulfilled all legal requirements that, in such Department´s understanding, are essential *for carrying out the necessary procedure,"*[212] Cytrar "... for all legal and administrative purposes..." had been "duly registered in this General Office under my charge".[213] It is not surprising that from this communication, Cytrar interpreted that INE had changed the corporate name appearing on the permits to operate the Landfill, as requested by Cytrar, Tecmed and the Municipality of Hermosillo.

170. Subsequently, it is no wonder to see Cytrar surprised when after Cytrar had been operating the Landfill under the existing permit dated May 4, 1994, in its capacity as new company authorized under the permit pursuant to INE's official communication dated September 24, 1996, as Cytrar was entitled to believe in good faith, INE demanded Cytrar to return such communication to be replaced by another, with the same date and an almost identical text, except for an annex whereby Cytrar was granted a permit to operate the Las Víboras landfill, dated November 11, 1996.[214] Such permit, in addition to terminating the prior permit dated May 4, 1994, in which Cytrar had requested the change of name, differed from the last one in some material respects. The most outstanding difference, which would only be appreciated upon refusal to renew the Permit in 1998, was that the permit of May 1994 had an indefinite duration and the permit of November 1996 had a term of one year that could be extended. As highlighted by the witness Jorge Sánchez Gómez, the purpose behind the annual renewal of permits was to facilitate INE's actions to put an end to the operations carried out by companies that, in INE's understanding, did not adjust their actions to the applicable legal provisions; the INE could refuse the extension or refuse to renew such permits at the end of each year. According to the witness, this allowed INE to dispense with the more cumbersome procedure —of uncertain success— of obtaining the revocation of the permit by PROFEPA, which required that a case be opened and that the party subject to sanctions be given the opportunity to express its argumentations and defenses:

….apparently, there is an alternative: that the agency that had to enforce the law; in this case, PROFEPA, carried out the execution. However, it was very difficult to have a company's registration withdrawn if there were no elements that would clearly allow verification of a breach. Revocation of permits is a very complicated procedure.....[215]

To emphasize INE's discretionary powers as to the continuation of Cytrar's operation of the Landfill and in accordance with INE's policy of facilitating the possibility of putting an end to such operation without having to start the proceeding to withdraw the permit, when

[212] Emphasis added by the Arbitral Tribunal
[213] Document A42
[214] Documents A43 and A44
[215] Hearing held from May 20 to May 24, 2002. Declaration of Jorge Sánchez Gómez, transcript for the session of May 23, 2002, p. 53 overleaf.

the Permit was granted —on November 19, 1997— it was determined that this Permit, instead of being "subject to extension" (as the previous permit stated), was subject to "renewal" upon request of the interested party. That is to say, it required a new permit at the end of each year, instead of extending its validity at the end of such period. In the words of the witness Jorge Sánchez Gómez:

...the notion of renewal is much easier to handle for the purpose of refusing a permit to a company that is not complying with the requirements.[216]

171. If the indefinite-duration permit dated May 4, 1994 had been transferred to Cytrar as requested to INE by Cytrar, Tecmed and the Municipality of Hermosillo, INE would not have been able to put an end to Cytrar's operation of the Landfill by means of the Resolution and the only remedy available for that purpose would have been the revocation of the Permit by PROFEPA. But such revocation would probably have not been successful on the basis of the infringements of the Permit used to justify the Resolution, which were not even considered by PROFEPA as deserving any sanction other than a fine. To sum up, INE unilaterally transformed a previous administrative act, which, as such, was presumed to be legitimate, had immediate effects and could only be interpreted in good faith as having accepted Cytrar's petition to be the transferee of the existing permits for the operation of the Landfill. The objective consequence of such transformation was to grant Cytrar a permit to operate the Landfill, which reduced Cytrar's entitlement to question actions that deprived it of the Permit or that had such effect. Subsequently, INE —also unilaterally— classified the petition as a request to be registered in a listing that Cytrar was not aware of, and regarding which, in any case, Cytrar had shown no interest. The same objective consequence is to be attributed to the transformation as from November 19, 1997, of Cytrar's permit to operate the Landfill, from a permit that was subject to extension to a permit that was subject to renewal.

172. The contradiction and uncertainty inherent in INE's actions as to Cytrar and Tecmed is evidenced, then, both in the initial stage of the processing of the necessary permits to operate the Landfill and when INE decided to put an end to such operation by means of the Resolution. Such actions belong to one and the same course of conduct characterized by its ambiguity and uncertainty which are prejudicial to the investor in terms of its advance assessment of the legal situation surrounding its investment and the planning of its business activity and its adjustment to preserve its rights. Such ambiguity and uncertainty are also present in the last stage of the relationship, analyzed under paragraphs 153-164 above, which led to the Resolution, and added their harmful effects to the damage resulting from the denial to grant the Permit. Although INE's initial behavior was before the effective date of the Agreement and the Arbitral Tribunal will not pass judgment on whether at that stage such conduct, considered in isolation, amounted to a breach of the provisions thereof before its entry into force, it cannot be ignored, in light of the good faith principle (Articles 18 and 26 of the Vienna Convention), that the conduct of the Respondent between the date of execution of the Agreement (in view of the Respondent's determination to ratify it subsequently) and the effective date thereof, is incompatible with the imperative rules deriving from Article 4(1) of the Agreement as to fair and equitable treatment. This is

[216] Transcript of the session of May 23, 2002, p. 59 overleaf.

particularly so since, according to Article 2(2) of the Agreement, it is applicable to investments made before its entry into force, a circumstance to be certainly considered when analyzing the conduct attributable to the Respondent that took place before that time but after the Respondent having executed the Agreement. INE's contradictory and ambiguous conduct at the beginning of the relationship between INE, Cytrar and Tecmed before the entry into force of the Agreement has the same deficiencies as those encountered in such conduct during the last stage of the relationship, immediately preceding the Resolution. Thus, INE's conduct during such time is added to the prejudicial effects of its conduct during the last stage, which breached Article 4(1) of the Agreement.

173. Briefly, INE's described behavior frustrated Cytrar's fair expectations upon which Cytrar's actions were based and upon the basis of which the Claimant's investment was made, or negatively affected the generation of clear guidelines that would allow the Claimant or Cytrar to direct its actions or behavior to prevent the non-renewal of the Permit, or weakened its position to enforce rights or explore ways to maintain the Permit. During the term immediately preceding the Resolution, INE did not enter into any form of dialogue through which Cytrar or Tecmed would become aware of INE's position with regard to the possible non-renewal of the Permit and the deficiencies attributed to Cytrar's behavior —including those attributed in the process of relocation of operations— which would be the grounds for such a drastic measure and, thus, Cytrar or Tecmed did not have the opportunity, prior to the Resolution, to inform of, in turn, their position or provide an explanation with respect to such deficiencies, or the way to solve such deficiencies to avoid the denial of renewal and, ultimately, the deprivation of the Claimant's investment. Despite Cytrar's good faith expectation that the Permit's total or partial renewal would be granted to maintain Cytrar's operation of the Landfill effective until the relocation to a new site had been completed, INE did not consider Cytrar's proposals in that regard and not only did it deny the renewal of the Permit although the relocation had not yet taken place, but it also did so in the understanding that this would lead Cytrar to relocate.

174. Such behavior on the part of INE, which is attributable to the Respondent, results in losses and damage[217] for the investor and the investment pursuant to Title II(4) of the Appendix to the Agreement coinciding both as to essence and time with those derived from the Resolution, whether such behavior is considered generically or only as to the stages mentioned and analyzed by the Arbitral Tribunal in paragraphs 153-164 above. The Respondent's behavior in such stages amounts, in itself, to a violation of the duty to accord fair and equitable treatment to the Claimant's investment as set forth in Article 4(1) of the Agreement and such behavior constitutes sufficient basis for the Claimant's claims founded on such violation to be admissible, given the time at which the damage occurred and the time when the damage and the violation of the Agreement were necessarily perceived by the Claimant (on the date of issuance of the Resolution), pursuant to Title II(4) and (5) of the Appendix to the Agreement.

III. Full Protection and Security and Other Guarantees under the Agreement

[217] "Damage" is not limited to the economic loss or detriment and shall be interpreted in a broad sense (J. Crawford, The International Law Commission's Articles on State Responsibility, 29-31 (Cambridge University Press, 2002).

175. The Claimant alleges that Mexican municipal and state authorities encouraged the community's adverse movements against the Landfill and its operation by Tecmed or Cytrar, as well as the transport by Cytrar of Alco Pacífico's waste. Further, the Claimant alleges that Mexican authorities, including the police and the judicial authorities, did not act as quickly, efficiently and thoroughly as they should have to avoid, prevent or put an end to the adverse social demonstrations expressed through disturbances in the operation of the Landfill or access thereto, or the personal security or freedom to move about of the members of Cytrar's staff related to the Landfill. It is the opinion of the Claimant that such behavior of the Mexican authorities, attributable to the Respondent, amounts to a violation of Article 3(1) of the Agreement, which provides that:

Each Contracting Party shall accord full protection and security to the investments made by the other Contracting Party's investors, in accordance with International Law and shall not, through legally groundless actions or discriminatory measures, hinder the management, maintenance, development, usage, enjoyment, expansion, sale, or, where applicable, disposition of such investments.

176. The Arbitral Tribunal considers that the Claimant has not furnished evidence to prove that the Mexican authorities, regardless of their level, have encouraged, fostered, or contributed their support to the people or groups that conducted the community and political movements against the Landfill, or that such authorities have participated in such movement. Also, there is not sufficient evidence to attribute the activity or behavior of such people or groups to the Respondent pursuant to international law.

177. The Arbitral Tribunal agrees with the Respondent, and with the case law quoted by it, in that the guarantee of full protection and security is not absolute and does not impose strict liability upon the State that grants it. At any rate, the Arbitral Tribunal holds that there is not sufficient evidence supporting the allegation that the Mexican authorities, whether municipal, state, or federal, have not reacted reasonably, in accordance with the parameters inherent in a democratic state, to the direct action movements conducted by those who were against the Landfill. This conclusion is also applicable to the judicial system, in relation to the efforts made to take action against the community's opposing demonstrations or to the attempt to reverse administrative measures which were deemed inconsistent with the legal rules applicable to the Landfill, such as the withdrawal by the Hermosillo's Municipal authorities of the license to use the Landfill's site.

178. Promotora's behavior, or INE's behavior attributable to the Respondent, regarding the sale of the assets related to the Landfill, the commitments undertaken in connection with such sale or the grant of the Permit to operate of November 11, 1996, and preceding events, all took place prior to the entry into force of the Agreement. With respect to Promotora, such behavior has not been considered by the Arbitral Tribunal due to the reasons described in paragraph 92 of this award, and will not be analyzed, even if it were hypothetically attributable to the Respondent, to determine whether there has been a violation of Article 3(1) of the Agreement or not.

179. With regard to INE's behavior prior to the entry into force of the Agreement, described above, and the subsequent stages following such date, the Arbitral Tribunal does

not consider, even at the time of its consummation and turning point —the refusal to renew the Permit— that such behavior has no legal grounds under Mexican law or that such behavior is discriminatory, as required by Article 3(1) of the Agreement in order to constitute a violation. The Arbitral Tribunal has not found that INE's denial to renew the Permit violated any Mexican laws or was issued beyond the Mexican legal framework. As provided below, the Arbitral Tribunal has not verified, either, the existence of discriminatory treatment detrimental to the Claimant in violation of the national and foreign treatment guarantees also set forth in the Agreement. Therefore, the Arbitral Tribunal considers that neither the Resolution nor the Respondent's behavior leading to such Resolution amount to a violation of Article 3(1) of the Agreement.

180. According to Article 4(2) of the Agreement, each Contracting Party guarantees the foreign investor a treatment that should not be less favorable... "than that accorded under similar circumstances [...] to investments made in its territory by investors from a third State". Pursuant to Article 4(5) of the Agreement, each Contracting Party, "In accordance with the restrictions and methods provided by the local laws [...] shall accord to the investments made by the other Contracting Party's investors a treatment that should not be less favorable than the treatment afforded to its own investors…". The Arbitral Tribunal observes, however, in its post-hearing brief, when referring to the alleged breach of the Agreement, that the Claimant omits any statement regarding the violation of the guarantees of non-discriminatory treatment (national or accorded to investors from a third State) provided in Articles 4(2) and (5) of the Agreement, which are not even mentioned, though the Claimant does sustain its allegations relative to the breach attributable to the Respondent of Articles 3 and 5 of the Agreement as alleged by the Claimant in the request for arbitration.[218]

181. In any case, the Arbitral Tribunal does not consider that the behavior attributable to the Respondent, to the extent such behavior commenced prior to the entry into force of the Agreement and was accomplished after such date, or occurred following the entry into force, such as, for instance in the latter case, the issuance of the Resolution, amounts to violations to the guarantee of national or foreign treatment set forth by the provisions of the Agreement referred to above. The Claimant has failed to furnish convincing or sufficient evidence to prove, at least *prima facie*, that the Claimant's investment received, under similar circumstances, less favorable treatment than that afforded to nationals of the State receiving the investment or of a third State, or that said investment was subject to discriminatory treatment upon the basis of considerations relative to nationality or origin of the investment or the investor. The Arbitral Tribunal further considers that the alleged discriminatory treatment attributed by the Claimant to the Respondent on the grounds of the unlimited duration of operation permits or licenses granted to Residuos Industriales Multiquim S.A. de C.V. (RIMSA), which would be owned by a foreign investor,[219] or to prior operators or owners of the landfill, all of which were government entities of the state of Sonora,[220] occurred and were entirely isolated events taking place prior to the

[218] Claimant's post-hearing brief, pp. 104-126.
[219] Memorial, p. 124.
[220] Memorial, p. 26

Agreement's entry into force, and will not be considered by this Arbitral Tribunal as stated in paragraph 67 of this arbitration award.

182. With regard to other forms of discrimination apparently originated in the allegedly different treatment accorded by INE to RIMSA's and Claimant's investments, the Arbitral Tribunal holds that the Respondent has furnished satisfactory evidence —not rebutted by the Claimant on this point— of the fact that the circumstances under which RIMSA's investment was made and concerning such investment materially differed from the investment in the Landfill. Thus, it is not possible to establish standards which allow a comparison of the treatment accorded to the investment in RIMSA's landfill and the investment in the Landfill. Further, it is the opinion of this Arbitral Tribunal that the Respondent has not breached Article 2(1) of the Agreement with respect to the promotion and admission of foreign investments, and that no evidence of such violation has been submitted; it being also relevant to point out that the Claimant itself has stated that if such violation existed, it should be the subject matter of a direct claim between the Contracting Parties[221] of the Agreement. The Arbitral Tribunal also holds that the denial of the Permit's renewal does not amount to a violation of Article 3(2) of the Agreement, pursuant to which each Contracting Party "within the local legal framework" shall grant the necessary permits with regard to the investments from the other Party, as the Arbitral Tribunal considers that there is no evidence proving the fact that INE's denial of the Permit is contrary to Mexican laws.

F. Compensation. Restitution in kind.

183. The Claimant's claim for compensation or restitution in kind is based upon the provisions of Title VII(1) of the Appendix to the Agreement, which contemplates those two options. The Claimant requests restitution in kind —which the Claimant considers "absolutely impossible"— only secondarily, as the Claimant primarily seeks monetary damages.[222] The Arbitral Tribunal considers that monetary damages paid to the Claimant as compensation for the loss of the investment constitutes an adequate satisfaction of the Claimant's claim under the Agreement. Therefore, and taking into account that the Claimant primarily seeks monetary damages, the Arbitral Tribunal will not consider the admissibility or inadmissibility of the restitution in kind in this case.

184. The Claimant calculates the amount to be paid as monetary damages under the discounted cash flow calculation method by which the Claimant intends to determine the Landfill's market value. Upon the basis of the report issued by the expert witness appointed by the Claimant, the amount to be paid as damages as of the date of the expropriation —November 25, 1998—totals US$ 52,000,000, plus interest. The Claimant further claims compensation for the damage allegedly caused to the Claimant's reputation, with arbitration costs to be borne by the Respondent.

185. The Respondent objects to the application of a discounted cash flow analysis, as the Respondent considers such calculation method to be highly speculative given the short term

---

[221] Memorial, p. 93.
[222] Memorial, pp. 142 – 144.

during which the Landfill operated as an on going business (about two years and a half), thus preventing the application of sufficient historical data to prepare the reliable estimates required by such calculation methodology. The Respondent has proposed the calculation of damages based on the investment made, upon which the investment's market value would be determined. In any case, the Respondent's expert witness challenges the discounted cash flow calculation methodology —as applied by the Claimant's expert witness— with regard to various aspects, including the price, costs, and market condition estimates, the failure to compute certain costs, such as remediation and maintenance of closed cells, and the discount rate applied by the Claimant's expert witness. Also, the Respondent's expert witness offers its own analysis under the discounted cash flow methodology, which in an "optimistic" version as such expert witness puts it, would be calculated in the amount of US$ 2,100,000 for the investment, and according to a "conservative" version such amount would total US$ 1,800,000.

186. The Arbitral Tribunal has noted both the remarkable disparity between the estimates of the two expert witnesses upheld throughout the examination directed by the parties and the Arbitral Tribunal at the hearing held on May, 20-24, 2002, and also the considerable difference in the amount paid under the tender offer for the assets related to the Landfill —US$ 4,028,788—[223] and the relief sought by the Claimant, amounting to US$ 52,000,000, likely to be inconsistent with the legitimate and genuine estimates on return on the Claimant's investment at the time of making the investment. The non-relevance of the brief history of operation of the Landfill by Cytrar —a little more than two years— and the difficulties in obtaining objective data allowing for application of the discounted cash flow method on the basis of estimates for a protracted future, not less than 15 years, together with the fact that such future cash flow also depends upon investments to be made —building of seven additional cells— in the long term, lead the Arbitral Tribunal to disregard such methodology to determine the relief to be awarded to the Claimant.[224]

187. In Article 5.2, the Agreement provides that, in the event of expropriation, or any other similar measure or with similar effects:

> Compensation shall be equivalent to the fair market value of the expropriated investment immediately before the time when the expropriation took place, was decided, announced or made known to the public (...) valuation criteria shall be determined pursuant to the laws in force applicable in the territory of the Contracting Party receiving the investment.

Also, Article 10 of the Mexican Federal Law on Expropriation provides that the applicable compensation shall indemnify for the commercial value of the expropriated property, which in the case of real property shall not be less than the tax value. There has been no evidence or allegations as to the interpretation of this rule in light of Mexican laws.

---

[223] Report by Fausto García y Asociados, p. 22

[224] Award of ICSID case No. ARB (AF)/97/1 *Metalclad Corporation v. United Mexican States*, 16 Mealey's International Arbitration Report, p. A-1 *et. seq*.; pp. A-14/A-15, 119-122 (2000). Award in case *Phelps Dodge Corp. and Overseas Private Investment Corp. v. The Islamic Republic of Iran*, 10 Iran-U.S. Claims Tribunal Reps., p. 121 *et. seq*.; 30, pp. 132-133 (1986-1); award of ICSID case No. ARB/98/4, *Wena Hotels v. Arab Republic of Egypt*, 41 I.L.M. 896 (2002), 122-125, pp. 918-919, award of December 8, 2000.

188. The Arbitral Tribunal considers that compensation to be awarded pursuant to such parameters —that is, the market value of the Landfill— shall be the total compensation for all the violations to the Agreement proved in this award, which, in relation to the Claimant, have the damaging effect of depriving the Claimant of its investment.

189. It is not in dispute that the assets forming the Landfill are owned by the "Tecmed Group", which belongs to the Actividades, Construcciones y Servicios group and thus has the Claimant as its parent corporation, into which, under Spanish accounting standards, the accounts of Tecmed and Cytrar are consolidated.[225] According to Articles 1(1)(b) and (2)(e) of the Agreement, the Claimant —the foreign investor— is the owner of the foreign investment in Mexico through the Claimant's subsidiaries. The Respondent has recognized that:

> The TECMED group, through the Mexican company TECMED, TECNICAS MEDIOAMBIENTALES DE MEXICO, S.A. de C.V., presently has the following environmental facilities in Mexico (in addition to the landfill, CYTRAR and its administrative offices).....[226]

It is also undisputed, at least after Cytrar obtained the permit from INE to operate the Las Víboras Landfill, that the related assets indirectly held by the Claimant constitute a hazardous waste landfill,[227] i.e. an integrated unit comprising tangible and intangible assets, including the Permit and other permits or licenses to operate as a hazardous waste landfill. Such unit must be valued by this Arbitral Tribunal upon rendering its award. Therefore, the Arbitral Tribunal concludes that the deprivation of the financial and business use of the Landfill's operation arising from the Respondent's actions and in violation of the Agreement has caused damage to the Claimant and its investment in the Landfill. Therefore, the Claimant is entitled to receive compensation in accordance with the provisions of the Agreement and on the basis of the market value of the assets the Claimant has been deprived of.

190. The Arbitral Tribunal also considers that, although the Arbitral Tribunal may consider general equitable principles when setting the compensation owed to the Claimant, without thereby assuming the role of an arbitrator *ex aequo et bono,*[228] the burden to prove the investment's market value alleged by the Claimant is on the Claimant. Such burden is transferred to the Respondent if the Claimant submits evidence that *prima facie* supports its allegation, and any difficulty in determining the compensation does not prevent the assessment of such compensation where the existence of damage is certain.[229]

---

[225] "2000 Annual Report of Actividades de Construcción y Servicios", document A7, Annex 8.1 "Consolidated Information", pp. 131-132 ; 133.
[226] Respondent's brief "Admissions and denials", p. 4.
[227] Respondent's brief "Admissions and denials", p. 32.
[228] Award in the case *Kuwait and the American Independent Oil Company (Aminoil)*, 21 I.L.M., p. 976 *et seq*. (1982), 77-78 p.1016 ; specially No.78 : "It is well known that any estimate in purely monetary terms of amounts intended to express the value of an asset, of an undertaking, of a contract, or of services rendered, must take equitable principles into account". To the same effect, award in the case *Himpurna California Energy Ltd. (Bermuda) v. PT (Persero) Perusahaan Listruik Negara (Indonesia),* 14 Mealey's International Arbitration Report, A-1 *et seq*. 441, p. 129 [A-44] (1999).
[229] ICSID case ARB/84/3, *Southern Pacific Properties (Middle East) Limited v Arab Republic of Egypt*, 8 ICSID Law Review-Foreign Investment Law Journal, p. 389, 215 (1993).

191. The Parties have not raised any dispute as to the fact that this market value is defined as the fair value of the transaction on an arms' length basis, where both parties to the transaction have knowledge of the applicable circumstances.[230] The Respondent acknowledges that the price obtained in a public tender "…is an efficient manner to determine the price of the assets sold...".[231] The Claimant has not challenged this allegation. The Arbitral Tribunal finds that upon the 1996 sale the Landfill's market value was US$ 4,028,788, and will take that figure as the starting point for a subsequent analysis. The Arbitral Tribunal also finds, on the basis of the evidence submitted, that the existence of a market supported by a sufficient number of similar transactions that may be used as a guide to determine the Landfill's market value as of November 25, 1998, has not been established.

192. In the task of establishing the market value as of such date —the moment when the expropriatory act occurred—, the Arbitral Tribunal will also take into account other factors in accordance with the practice of international arbitral tribunals in similar cases.

193. For such purposes and on the basis of Article 5(2) of the Agreement, although the Arbitral Tribunal will consider the existence of community pressure against the location of the Landfill at its current place and that such pressures and the location would have jeopardized the operations of the Landfill in the long run, the Arbitral Tribunal will not necessarily take into account the actions or determinations of the Mexican authorities that, echoing the community sentiment, in turn exerted pressure on Cytrar for it to relocate or that are part of the Respondent's actions considered to be in violation of the Agreement in this award or that contributed to the damage resulting from such violations,[232] and that may have an adverse effect on valuation of the compensation. Upon weighing such community pressure, the Arbitral Tribunal cannot ignore the relocation commitment assumed by Cytrar, supported by Tecmed, the performance of which would have mitigated or eliminated such pressure, and whose non-performance is not attributable to Cytrar or Tecmed, nor the responsibilities of the Municipality of Hermosillo and of INE, as the case may be, that were involved in the sale of the site to Cytrar or that authorized Cytrar to operate the site under the premise that its location was legitimate despite the fact that it did not comply with Mexican laws. Such legitimacy was terminated by the Resolution which, in practice, ignored such legitimacy in order to address social and political factors against such location.

194. The Arbitral Tribunal will also take into account the additional investments made as from the Landfill's acquisition until the date of the Resolution and will consider that Cytrar has contributed management and client development elements that caused, among other things, a 39% increase in the Landfill's operation by 1997, excluding the activities related

[230] American Appraisal report, p.2.

[231] Respondent's closing statement, 167, p. 76. Declaration of expert witness Christianson, hearing held from May 20 to May 24, 2002; transcript for the session of May 22, p. 50. Expert witness report of Fausto García y Asociados, p. 23.

[232] *Philips Petroleum Co. Iran v Iran*, 21 Iran-U.S. Claims Tribunal Reports, p. 79 *et seq*., specially 135, p. 133 (1989-1).

to Alco Pacífico,[233] and that also produced net income in the second year of operations, i.e. during a stage of entry into and consolidation in the market at the beginning of its operations. It cannot be denied that the investment in the Landfill was productive and added value to the former Landfill's operations as well as goodwill, nor can it be denied that the Claimant was deprived of its investment's profits, and value added and goodwill, or that the Claimant's losses also include lost profits. As acknowledged by the Respondent itself, this operation almost did not exist for a long time before Cytrar's acquisition of the Landfill and, in the short periods in which it did exist, such activities were reduced in scope from a financial and business standpoint.[234] It is logical to understand that, as activities increased due to Cytrar's operations, this increase must have required additional investments. Although upon assessing the Landfill's market value two of the nine cells of the Landfill were full, thus reducing the original landfill capacity from nine to seven cells, it must also be taken into account that the increased productivity of the Landfill was evidenced after Cytrar took over the Landfill's operation. Such increased productivity is necessarily based on Cytrar's managerial and organizational skills and on gaining new clients, to the extent that the Respondent is willing to acknowledge at least net income for one additional year for an amount of US$ 314,545.[235] On the basis of these considerations, it is legitimate to conclude that the Landfill's market value as of November 25, 1998, could not be lower than the acquisition price paid by Cytrar.

195. On the basis of its own valuation, taking into account the Landfill's market value of US$ 4,028,788 upon its acquisition and adding the investments made thereafter according to Cytrar's financial statements for 1996, 1997 and 1998, and the profits for two years of operation following the Resolution date, the Arbitral Tribunal finds that such market value as of November 25, 1998, was US$ 5,553,017.12.[236] Although the Claimant's expert witness assessed the value of such additional investments at US$ 1,951,473,[237] no documentary evidence has been filed to support such amount, and such evidence has not been alleged by the Claimant in its closing statement. The Respondent challenges such amount in its closing statement on the basis of accounting data by comparing the fiscal years mentioned above, and estimates such amount to be US$ 439,000.[238] This amount has been accepted by the Arbitral Tribunal. Regarding the profits for the two additional years of operation, the Arbitral Tribunal has calculated such profits at the amount of US$ 1,085,229.12. For this, the Arbitral Tribunal has considered that an informed buyer of the Landfill would have assumed that it had to be relocated due to the community pressure and that such relocation might take about two years. In such calculation, the Arbitral Tribunal has further considered that the projections clearly stated that Cytrar was increasing its

[233] Report of Fausto García y Asociados, p. 26.
[234] Respondent's brief "Admissions and Denials", p. 12.
[235] Counter-memorial, 598, p. 171.
[236] The Arbitral Tribunal finds that the Claimant has made its compensation claim in US dollars (memorial, p. 146), and that such claim has not been challenged by the Respondent, who also uses such currency in its allegations to denominate the amounts to which it resorts to challenge the Claimant's claims. The expert witnesses for both parties also translate into such currency the figures they use for their analyses. Therefore, the Arbitral Tribunal makes its determination in US dollars.
[237] Hearing held from May 20 to May 24, 2003; transcript for the session of May 23, pp. 7 overleaf / 8.
[238] Respondent's closing statement added by expert witness Lars Christianson, taken into account by the Arbitral Tribunal as a part of such closing statement according to the Arbitral Tribunal's decision of August 12, 2002, p. 8.

revenues, the value of its clientele and goodwill as an on going business related to the Landfill exploitation, and the other considerations included in this Chapter F, particularly the circumstances explained in paragraphs 189-190 and 193-194, which, in the opinion of the Arbitral Tribunal, cannot be ignored upon establishing the economic compensation owed to the Claimant for the loss of the market value of its investment. The Arbitral Tribunal finds that it is not appropriate to deduct from such amount, which also reflects the principle that compensation of such loss must amount to an integral compensation for the damage suffered, including lost profits,[239] the cost of closing down the Landfill due to a decision attributable to the Respondent that the Arbitral Tribunal has found to be in violation of the Agreement.

196. The Claimant requests that any compensation awarded to it accrue compound interest at a rate of 6%.[240] The Arbitral Tribunal has not found any specific allegation by the Respondent regarding this point. The application of compound interest has been accepted in a number of awards, and it has been stated that:

…compound (as opposed to simple) interest is at present deemed appropriate as the standard of international law in […] expropriation cases.[241]

In connection with this case, in the opinion of the Arbitral Tribunal, application of compound interest is justified as part of the integral compensation owed to the Claimant as a result of the loss of its investment.

197. Therefore, the amount of US$ 5,533,017.12 will accrue interest at an annual rate of 6%, compounded annually, commencing on November 25, 1998, until the effective and full payment by the Respondent of all amounts payable by the Respondent to the Claimant under this award.[242]

198. The Arbitral Tribunal finds no reason to award compensation for moral dammage, as requested by the Claimant,[243] due to the absence of evidence proving that the actions attributable to the Respondent that the Arbitral Tribunal has found to be in violation of the Agreement have also affected the Claimant's reputation and therefore caused the loss of business opportunities for the Claimant. In addition, the Arbitral Tribunal has not found that the adverse press coverage for Tecmed or Cytrar of the events regarding the Landfill,

---

[239] P.C.I.J, *Chorzów Factory* case, (1938) P.C.I.J., Ser. A, 17, p. 29, 47.

[240] Memorial, p. 146.

[241] Award in ICSID case ARB/99/6 *Middle East Cement Shipping and Handling Co.S.A v Arab Republic of Egypt*, April 12, 2002, 174 , p. 42, http://www.worldbank.org/icsid/cases/awards.htm. See also: award of December 8, 2000, in ICSID case ARB/98/4, *Wena Hotels Ltd. v Arab Republic of Egypt*, 41 I.L.M. 896 (2002), specially 128-129, p. 919; award in ICSID case No. ARB/96/1 *Compañia del Desarrollo de Santa Elena S.A. v Republic of Costa Rica*, 15 ICSID Law Review-Foreign Investment Law Journal, p. 167; specially 96-106, p. 200-202 (2000); award in ICSID case no. ARB(AF)/97/1 *Metalclad Corporation v United Mexican States*, 16 Mealey's International Arbitration Report, A-1; specially 128, pp. 41-42 (A-16) (2000).

[242] Award in ICSID case No. ARB/84 /3 *Southern Pacific Properties (Middle East) Limited v Arab Republic of Egypt*, 8 Foreign Investment Law Journal-ICSID Law Review, p 328, specially 234-235, p. 393 (1993).

[243] Memorial, pp. 141-142.

was fostered by the Respondent or that it was the result of actions attributable to the Respondent.

199. Promptly after effective payment to the Claimant of all sums payable to it by the Respondent under this award, the Claimant shall take all the necessary steps to transfer, or cause to be transferred, to the Respondent, or to a nominee designated by the Respondent, the assets forming the Landfill.

200. Taking into account that the Claimant has been successful only with respect to some of its claims and that the challenges or defenses filed by the Respondent were also admitted partially, each Party will bear its own costs, expenses and legal counsel fees. The costs incurred by the Arbitral Tribunal and ICSID will be shared equally between the Claimant and the Respondent.

G. Decision

201. Therefore, the Arbitral Tribunal finds as follows:

1. The Respondent has breached its obligations under the Agreement set forth in Articles 4(1) and 5(1).

2. The Respondent will pay the Claimant the amount of US$ 5,533,017.12, plus a compound interest on such amount at an annual rate of 6%, commencing on November 25, 1998, until the effective and full payment by the Respondent of all amounts payable by the Respondent to the Claimant under this award.

3. Promptly after effective and full payment to the Claimant of all sums payable to it by the Respondent under this award, the Claimant shall take all the necessary steps to transfer, or cause to be transferred, to the Respondent, or to a nominee designated by the Respondent, the assets forming the Landfill.

4. Each Party will bear its own costs, expenses and legal counsel fees. The costs incurred by the Arbitral Tribunal and ICSID will be shared equally between the Claimant and the Respondent.

5. Any claim or petition filed in this arbitration and not admitted herein will be considered rejected.

Rendered in Washington, D.C.

Mr. Carlos Bernal Verea Arbitrator Date and place of execution:	Prof. José Carlos Fernández- Rozas Arbitrator Date and place of execution:

Dr. Horacio A. Grigera Naón
Chairman of the Arbitral
Tribunal
Date and place of execution

CLA-000062

INTERNATIONAL CENTRE FOR SETTLEMENT OF INVESTMENT DISPUTES

WASHINGTON, D.C.

IN THE PROCEEDINGS BETWEEN

LG&E ENERGY CORP.

LG&E CAPITAL CORP.

LG&E INTERNATIONAL INC.

(CLAIMANTS)

AND

ARGENTINE REPUBLIC

(RESPONDENT)

ICSID Case Nº ARB/02/1

DECISION ON LIABILITY

Members of the Tribunal:

Dr. Tatiana B. de Maekelt, President

Judge Francisco Rezek, Arbitrator

Professor Albert Jan van den Berg, Arbitrator

Secretary of the Tribunal:

Claudia Frutos-Peterson

Date: 3 October 2006

Representing the Claimants

Mr. Eugene D. Gulland
Mr. Oscar M. Garibaldi
Mr. Eric D. Brown
Ms. Karin L. Kizer
Mr. Miguel López Forastier
Covington & Burling
Washington, D.C.
United States of America

Ms. Dorothy O'Brien
LG&E Energy LLC.

and

Dr. Horacio J. Ruiz Moreno
Dr. Gustavo Cedrone
Dr. Leonardo Orlanski
Hope, Duggan & Silva
Buenos Aires
Argentina

Representing the Respondent

H.E. Osvaldo César Guglielmino
Procurador del Tesoro de la Nación
Procuración del Tesoro de la Nación
Buenos Aires
Argentina

TABLE OF CONTENTS

I. THE PARTIES 1

II. THE ARBITRAL TRIBUNAL 2

III. PROCEDURAL BACKGROUND 3

IV. FACTUAL BACKGROUND 10

A. Late 1980s and 1990s 10
B. Economic Crisis and the Emergence of the Dispute – 1999-2001 15
C. The Emergency Law – 6 January 2002 18
D. Renegotiation of the Public Service Contracts 19
E. Request for Relief 20

V. PRELIMINARY MATTERS 22

A. Jus Standi 22
B. Law Applicable 23
1. Parties' Positions 23
2. Tribunal's Analysis 24
3. Tribunal's Conclusion 29

VI. LIABILITY 29

A. Article II(2)(a): Fair and Equitable Treatment 29
1. Parties' Positions 29
2. Tribunal's Conclusion Concerning Argentina's Guarantees to Investors 35
3. Tribunal's Analysis 36
4. Tribunal's Conclusion 40

B. Article II(2)(b): Discriminatory and Arbitrary Treatment 43
1. Discriminatory Treatment 43
(i) Parties' Positions 43
(ii) Tribunal's Analysis 44
(iii) Tribunal's Conclusion 45
2. Arbitrary Treatment 46
(i) Parties' Positions 46
(ii) Tribunal's Analysis 47
(iii) Tribunal's Conclusion 49

C. Article II(2)(c): The Umbrella Clause 50
1. Parties' Positions 50
2. Tribunal's Analysis 51
3. Tribunal's Conclusion 53

D. Considerations on Indirect Expropriation 53
1. Parties' Positions 53
2. Tribunal's Analysis 56
3. Tribunal's Conclusion 60

E. STATE OF NECESSITY 61
1. Parties' Positions 61
2. General Comments on Article XI 61
(i) Preliminary Considerations 61
(ii) The Question of Whether Article XI is Self-Judging 62
(iii) Necessary Nature of the Measures Adopted 64
a. Parties' Positions 64
b. Tribunal's Analysis 67
(iv) Consequences of the State of Necessity 79
(v) Conclusions of the Tribunal 80

VII. DECISION OF THE TRIBUNAL ON LIABILITY 80

I. THE PARTIES

1. Claimants, LG&E Energy Corp. and LG&E Capital Corp. are corporations created and existing under the laws of the Commonwealth of Kentucky, in the United States of America, with domestic and foreign operations.[1] LG&E International Inc. is a corporation organized and existing under the laws of the State of Delaware, United States of America. Claimants hereinafter will be referred to collectively as "LG&E" or "Claimants."

2. LG&E has a shareholding interest in three local, gas distributing companies in Argentina created and existing under the laws of Argentina by commandment of the Argentine Government: Distribuidora de Gas del Centro ("Centro"), Distribuidora de Gas Cuyana S.A. ("Cuyana") and Gas Natural BAN S.A. ("GasBan"), hereinafter collectively referred to as "the licensees". LG&E owns a controlling equity interest in Centro and minority equity interests in GasBan and Cuyana.

3. Respondent is the Argentine Republic, which along with the United States of America, is a party to the Convention on the Settlement of Investment Disputes between States and Nationals of other States ("ICSID Convention" or "Convention"), ratified by the Argentine Republic in 1994 and by the United States of America in 1966. The Bilateral Investment Treaty between the United States of America and the Argentine Republic Concerning the Reciprocal Encouragement and Protection of Investments was signed on 14 November 1991 ("BIT", "the Bilateral Treaty" or the "Treaty") (and entered into force on 20 October 1994).

---

[1] Until 1 December 2005, Claimants were LG&E Energy Corp., LG&E Capital Corp. and LG&E International Inc. However, on 26 January 2006, Claimants informed the Tribunal that the name of two of the companies had been modified: LG&E Energy Corp. is now E.ON.US LLC and LG&E Capital Corp. is now E.ON.US. Capital Corp. LG&E International Inc. kept its name. Upon request by the Tribunal, LG&E submitted documents that, in the Tribunal's opinion, only prove the change of name but not its effects. Respondent remained silent on this issue.

II. THE ARBITRAL TRIBUNAL

4. On 31 January 2002 the Centre's Secretary-General registered Claimants' Request for Arbitration in accordance with Article 36(3) of the ICSID Convention. In accordance with Rule 7 of the Rules of Procedure for the Institution of Conciliation and Arbitration Proceedings ("the Institution Rules"), the Secretary-General gave notice to the parties of the registration of Claimants' Request and invited them to constitute an Arbitral Tribunal as soon as possible.

5. Forthwith, the parties agreed that the Arbitral Tribunal should be formed by three arbitrators, one appointed by the Claimants, another by the Argentine Republic and the third one, called to preside over the Tribunal, would be appointed by the Centre's Secretary-General in accordance with the method agreed upon by the parties.

6. On 20 June 2002, the Claimants appointed Professor Albert Jan van den Berg, a national of the Netherlands, as an arbitrator for this case. Said appointment was ratified by the Claimants by letters to the Centre dated 15 and 28 August 2002. The Argentine Republic, by letter dated 26 August 2002, appointed Judge Francisco Rezek, a Brazilian citizen, as an arbitrator. On 7 November 2002, the Centre's Secretary-General, with the parties' agreement, appointed Dr. Tatiana B. de Maekelt, a citizen of Venezuela, as the Arbitral Tribunal's President.

7. On 13 November 2002, the ICSID's Secretariat, in accordance with Rule 6(1) of the Rules of Procedure for Arbitration Proceedings ("Arbitration Rules"), notified the parties that all the arbitrators had accepted their appointments and that the Tribunal was deemed to be constituted and the proceeding deemed to begun as from that date. On this same day, in accordance with Rule 25 of the ICSID Administrative and Financial Regulations, the parties were informed that Dr. Claudia Frutos-Peterson would act as the Tribunal's Secretary.

III. PROCEDURAL BACKGROUND

8. On 28 December 2001, ICSID received from LG&E a request for arbitration dated 21 December 2001 against the Argentine Republic.

9. By letter dated 24 January 2002 the Claimants filed with ICSID a supplement to their request for arbitration. Claimants asserted that Respondent had committed further violations of the BIT as a result of the enactment by the Government of the Public Emergency and Currency Exchange Law ("Emergency Law"), which allegedly adversely affected Claimants' investment in Argentina.

10. In accordance with Arbitration Rule 13, the Tribunal held its first session with the parties at the seat of the Centre in Washington D.C. on 19 December 2002. The parties agreed to set the following schedule for the written proceedure: Claimants were to file a Memorial on 31 March 2003. Upon receipt of Claimants' Memorial, Respondent could choose to file an answer within either 60 or 90 days. In its answer, Respondent was entitled to file exceptions on jurisdiction, and to the extent it deemed necessary, could respond to Claimants' arguments on the merits. In the event that the Respondent filed a Memorial on Jurisdiction, the Claimants were to file their Counter-Memorial on Jurisdiction within 30 days from their receipt of the Respondent's Memorial on Jurisdiction, followed by Respondent's Reply on Jurisdiction within 20 days following receipt of Claimants' Counter-Memorial on Jurisdiction, and Claimants' Rejoinder on Jurisdiction to be filed 20 days from receipt of the Respondent's Reply on Jurisdiction.

11. With respect to oral proceedure, it was also agreed during the first session to set the following schedule based on the written submissions. In the event that Respondent filed its answer within 60 days and if the Tribunal decided so, there was to be a hearing on jurisdiction between 22 and 23 September 2003. In the event that Respondent filed its answer within 90 days, the hearing on jurisdiction, if the Tribunal were in agreement, was to be held on 20 and 21

October 2003. The hearing on the merits was scheduled for 8 through 12 March 2004.

12. The Claimants filed their Memorial on 31 March 2003.

13. Subsequently, under covenant, the parties decided to amend the schedule of proceedings concerning the objections to jurisdiction. Respondent and Claimants informed the ICSID Secretariat of this amendment on 1 and 2 July 2003, respectively. Under the new schedule, Respondent's Memorial on Jurisdiction was to be filed on 21 July 2003; Claimants' Counter-Memorial on Jurisdiction, on 29 August 2003; Respondent's Reply on Jurisdiction, on 22 September 2003, and Claimants' Rejoinder on Jurisdiction, on 13 October 2003. It was also agreed that the hearing on jurisdiction was to be held on 20 and 21 October 2003, but subsequently, the Tribunal, in joint agreement with the parties, decided that the hearing on jurisdiction should be held between 20 and 21 November 2003, at The Hague, Netherlands.

14. In accordance with the terms set, on 21 July 2003, Respondent formally filed objections to ICSID's jurisdiction. In its Memorial on Jurisdiction, Respondent presented the grounds upon which it based said objections and attached documents in support of its arguments. On 29 August 2003, Claimants filed their Counter-Memorial on Jurisdiction. On 22 September 2003, the Argentine Republic filed its Reply on Jurisdiction, and on 14 October 2003, Claimants filed their Rejoinder on Jurisdiction.

15. On 30 October 2003, Respondent filed a motion to suspend the proceedings and requested, as an alternative measure, a stay of the hearing on jurisdiction. On 31 October 2003, the President of the Tribunal asked Claimants to submit their comments on said motion by 3 November 2003. On 3 November 2003, the Claimants filed an objection to the stay motion. On 5 November 2003, the members of the Arbitral Tribunal deliberated on the Argentine Republic's motion and denied Respondent's motions to suspend these proceedings and stay the hearing on jurisdiction scheduled for

20 and 21 November 2003.

16. The hearing on jurisdiction was held on the date set, at the seat of the Permanent Court of Arbitration in The Hague, the Netherlands. Messrs. Eugene D. Gulland and Oscar M. Garibaldi of the law firm of Covington & Burling from Washington, D.C. acted as counsel for the Claimants. Also present at the hearing were Ms. Dorothy O'Brien, Deputy General Counsel for LG&E Energy Corp. and Mr. S. Bradford Rives, Chief Financial Officer of LG&E Energy Corp.

17. Messrs. Carlos Ignacio Suárez Anzorena and Ignacio Pérez Cortés, on behalf of Dr. Horacio Daniel Rosatti, the then-Procurador del Tesoro de la Nación Argentina, atended the hearing on behalf of the Respondent.

18. During the hearing, the parties presented their arguments on the jurisdictional issues. The Tribunal posed questions to the parties in accordance with Rule 32(3) of the Arbitration Rules.

19. On 30 April 2004, the Tribunal issued its Decision on Objections to Jurisdiction, holding that the present dispute is within the jurisdiction of the Centre and the competence of the Tribunal. In so holding, the Tribunal considered the following criteria:

a. That the dispute should be between a Contracting State and a national of another Contracting State and that Claimants should have *jus standi* to act in these proceedings;

b. That the issue should be a dispute of a legal nature arising directly from an investment;

c. That the parties should have given their consent, in writing, to submit to arbitration and, specifically to the ICSID arbitration; and

d. That all the other requirements of both the ICSID Convention and the Bilateral Treaty should be met in order to submit a dispute to arbitration.

20. With respect to criteria (a), regarding *jus standi*, the Tribunal was of the opinion that, for purposes of the ICSID Convention and the Bilateral Treaty, Claimants should be considered foreign investors, even though they did not directly operate the investment in the Argentine Republic, but acted through companies constituted for that purpose in its territory (Decision on Jurisdiction, ¶ 63).

21. With respect to criteria (b), which requires that the issues before the Tribunal be a dispute of a legal nature arising directly from an investment, the Tribunal concluded that, at the jurisdictional phase, it was to be presumed that Claimants' claims were based on alleged breaches of the Bilateral Treaty affecting Claimants' investments within the meaning of the ICSID Convention and the Bilateral Treaty (Decision on Jurisdiction, ¶ 66).

22. With respect to criteria (c), requiring the consent of the parties to submit the dispute to ICSID arbitration, the Tribunal was of the opinion that the Argentine Republic's consent was given through Article VII(4) of the Bilateral Treaty. In turn, when Claimants resorted to ICSID, they decided to submit their investment disputes to the Centre's jurisdiction. It is noteworthy, in this case, that Claimants did not submit the dispute to the Argentine courts or to any other dispute settlement mechanism mentioned in Article VII of the Bilateral Treaty. For this reason, no question regarding the "fork in the road" provision arises in the present case (Decision on Jurisdiction, ¶ 69 *et. seq*.).

23. Finally, with respect to criteria (d), concerning verification of the other requirements of the ICSID Convention and the Bilateral Treaty, the Tribunal concluded that the claims are not time barred, and that the claims asserted in the additional request filed by Claimants are sufficiently sequential to the originally stated claims as to permit their review by this Tribunal for the sake of efficiency. The fact that the license holders may have begun negotiations with Respondent is outside this arbitral proceeding, inasmuch as the license holders, which are different legal entities, are pursuing that process from

their own (corporate) perspective. Thus, in view of the fact that more than six months elapsed from the date on which the dispute arose, i.e. 24 January 2002, there is no bar in initiating the arbitral proceedings (Decision on Jurisdiction, ¶ 80 *et. seq*.).

24. Based on these considerations, the Tribunal:

 a. Held that the present dispute is within the jurisdiction of the Centre and the competence of the Tribunal;

 b. Dismissed all of the Respondent's objections as to the admissibility of the dispute and all of the Respondent's objections to the jurisdiction of ICSID and the competence of this Tribunal;

 c. Ordered, pursuant to Rule 41(4) of the Arbitration Rules, the continuation of the proceeding;

 d. Reserved all questions concerning the costs and expenses of the Tribunal and the parties for future determination.

25. In accordance with Procedural Order No. 1 dated 4 May 2004, Respondent filed its Counter-Memorial on the merits on 18 June 2004, seeking dismissal of LG&E's claims. On 6 August 2004, Claimants filed their Reply.

26. Respondent filed its Rejoinder on the merits on 27 September 2004, in which it asked the Tribunal, among other legal and factual arguments, to exclude Claimants' witness, Mr. Patricio Perkins, from the hearing on the merits on grounds of an alleged conflict of interest. Claimants objected to Respondent's motion to exclude the witness on 1 November 2004.

27. By means of Procedural Order No. 3, dated 23 November 2004, the Arbitral Tribunal decided (i) to admit the witness depositions offered by Respondent; (ii) to grant Claimants the opportunity to offer additional evidence regarding the witness depositions produced by Respondent in its Rejoinder, at the latest on 20 December 2004 and to cross-examine said witnesses during the hearing on the merits; (iii) to admit the testimony of Mr. Patricio Perkins,

subject to cross-examination by Respondent.

28. In accordance with Procedural Orders Nos. 4 and 5, dated 13 and 18 January 2005, respectively, the hearing on the merits was held between 23 and 29 January 2005, at the seat of the Centre in Washington, D.C. The following persons were present at that hearing:

Arbitral Tribunal:

Tatiana B. de Maekelt, President

Francisco Rezek, Arbitrator

Albert Jan van den Berg, Arbitrator

Secretary of the Tribunal:

Claudia Frutos-Peterson

Counsel for Claimants:

Oscar M. Garibaldi (Covington & Burling, Washington, D.C.)

Eugene D. Gulland (Covington & Burling, Washington, D.C.)

Eric D. Brown (Covington & Burling, Washington, D.C.)

Miguel López Forastier (Covington & Burling, Washington, D.C)

Karin Kizer (Covington & Burling, Washington, D.C.)

Warda Henning (Covington & Burling, Washington, D.C.)

Harris Bor (Covington & Burling, Washington, D.C.)

Matthew Chester (Covington & Burling, Washington, D.C.)

Jadranka Poljak (Covington & Burling, Washington, D.C.)

Alma Ramírez (Covington & Burling, Washington, D.C.)

Karin Lui (Covington & Burling, Washington, D.C.)

Horacio Ruiz Moreno (Rosso Alba, Francia & Ruiz Moreno Abogados, Buenos Aires, Argentina)

Leonardo Orlanski (Rosso Alba, Francia & Ruiz Moreno Abogados, Buenos Aires, Argentina)

Also present on behalf of Claimants:

Dorothy O'Brien (LG&E Energy LLC)

Chris Hermann

Leonardo Massimino

Donaldo Sloog

Gabriel Wilkinson

Counsel for Respondent:

Osvaldo Guglielmino (Procurador del Tesoro de la Nación Argentina, Buenos Aires, Argentina)

Gustavo Adolfo Scrinzi (Subprocurador del Tesoro de la Nación Argentina, Buenos
Aires, Argentina)

Ana Badillos (Procuración del Tesoro de la Nación Argentina, Buenos Aires, Argentina)

Luz Moglia (Procuración del Tesoro de la Nación Argentina, Buenos Aires, Argentina)

Gabriel Bottini (Procuración del Tesoro de la Nación Argentina, Buenos Aires, Argentina)

Ignacio Pérez Cortés (Procuración del Tesoro de la Nación Argentina, Buenos Aires, Argentina)

Gastón Rosenberg (Procuración del Tesoro de la Nación Argentina, Buenos Aires, Argentina)

Also present on behalf of Respondent:

Carlos Garber (Ministerio de Relaciones Exteriores, Comercio Internacional y Culto, Buenos Aires, Argentina)

Alicia Federico (Ente Nacional Regulador del Gas (ENARGAS), Buenos
Aires, Argentina)

Charles Joseph Masano (Secretaría de Energía, Buenos Aires, Argentina)

Marcelo Masonni: (Embassy of the Argentine Republic, Washington, D.C.)

Court Reporters:

David A. Kasdan

Dante Rinaldi

29. The hearing commenced, as scheduled on Sunday, 23 January 2005 at 8:45 a.m. After a brief introduction by the Tribunal's President, Claimants' counsel, Messrs. Eugene Gulland and Oscar Garibaldi, made their oral presentation to the Tribunal, referring to the arguments indicated in their briefs. They also presented their witnesses for oral examination: Messrs. S. Bradford Rives, Eduardo A. Hurtado, Patricio Carlos Perkins, Rudolf Dolzer, Eduardo Schwartz, Carlos Lapuerta, Antoni Peris Mingot, and Jose E. Álvarez.

30. Thereafter, Messrs. Osvaldo César Guglielmino, Ignacio Pérez Cortés and Gabriel Bottini made their submissions on behalf of the Argentine Republic. The following witnesses testified on behalf of Respondent: Ms. Anne-Marie Slaughter and Messrs. Eduardo A. Ratti, Jorge G. Simeonoff, Cristian Folgar, Nouriel Roubini and Fabián Bello.

31. On 28 February 2005, the parties submitted Post-Hearing Briefs.

32. By letter dated 18 May 2005, the Tribunal informed the parties of its decision to appoint an independent expert to assist the Tribunal in evaluating the expert financial evidence. By letter of 14 September 2005, the ICSID Secretariat transmitted the report on the findings of the independent expert to the parties and invited them to comment on the report by 5 October 2005. The parties filed their observations with the Tribunal on that date.

IV. FACTUAL BACKGROUND

33. Before considering the merits of the dispute, the Tribunal deems it necessary to set forth the facts that it considered relevant for its decision.

A. LATE 1980S AND 1990S

34. The present claims are to be viewed against the historic background and

especially the economic upheaval in Argentina and the Government's reaction to the several economic crises suffered by the country in the late 1980s and 1990s.

35. In the late 1980s, Argentina underwent an economic crisis characterized by deep recession and hyperinflation. As part of its economic recovery plan, the Government began an ambitious privatization program with the enactment of the State Reform Law in August 1989. Within this framework, large Government-owned businesses and entities were privatized or granted on concession (Respondent's Counter-Memorial, ¶121).

36. One March 27, 1991, Argentina enacted Law No. 23,928, referred to as the *Convertibility Law*, which ordered the implementation of a fixed exchange rate, pegging the *austral* (the then-Argentine currency) to the United States dollar.[2] The Convertibility Law also banned price or value indexation.

37. One of the primary goals of the Government's plan was the privatization of *Gas del Estado S.E.*, the national natural-gas transport and distribution monopoly. Pursuant to the Government's privatization plan, investors could purchase shares in newly-formed, licensed private corporations that would offer gas transport and distribution services. Such shares were available to domestic and foreign investors.

38. To implement its plan, the Government enacted in June 1992, the *Ley del Gas* ("Gas Law"), which established a comprehensive regulatory structure for the provision of natural-gas transport and distribution services, and created a public agency, called *Ente Nacional Regulador del Gas* (ENARGAS) to oversee the industry.

39. The Gas Law adopted a tariff structure under which ENARGAS would collect tariffs on the price of gas paid by consumers. Under the provisions of

the Gas Law, ENARGAS was required to set the transport and distribution tariffs at fair and reasonable levels that would allow licensed utility providers to recoup a "reasonable rate of return," after accounting for costs, defined as a rate similar to that applied to activities of similar risk and adequately related to the level of efficiency and satisfactory performance of the transport or distribution service. Profitability was to be measured against other activities of comparable risk.

40. ENARGAS was to set maximum tariffs for a period of five years. At the end of the five-year period, the tariffs were to be reviewed and adjusted based on international market indicators that reflected changes in the value of the goods and services representative of the activities of service providers.

41. The Gas Law was implemented by regulations adopted on 28 September 1992 by Decree No. 1738/92. Pursuant to these regulations, transport and distribution tariffs were to be calculated in U.S. dollars and then expressed in Argentine pesos, and the Government could not rescind or modify the licenses without the consent of the licensees.

42. On 7 December 1992, the Government adopted Decree No. 2255/92, called *Reglas Básicas de la Licencia* (Basic Rules of the License), which supplemented the Gas Law and the above-mentioned regulation and approved prototype licenses for natural-gas transport and distribution. The prototype licenses included a schedule of the maximum tariffs for the first five-year period (1993-1997) of service. The Basic Rules of the License obligated the Government to compensate the licensees fully for any losses resulting from changes to the guaranteed tariff system. The Basic Rules of the License also implemented the semi-annual tariff review based on the U.S. Producer Price Index ("PPI"), to be conducted in January and June of each year ("PPI adjustment").

---

[2] The *austral* later was replaced by the *peso* at the rate of 1,000 *australs* to 1 *peso*.

43. Under this framework comprised of the Gas Law, its regulations and Basic Rules of the License, the five-year review was to be a comprehensive review of the method used to calculate tariffs.

44. By Decree No. 1189/92, published on 17 July 1992, Argentina approved the procedure for the privatization of *Gas del Estado S.E.* It was restructured into two distinct transport business units and eight separate distribution business units, each responsible for a geographic region of the country. Each of the ten business units were transferred to the newly-created companies, which were to operate with a license under the legal framework in force.

45. An international bidding process was set in place by Resolution No. 874/92 issued by the Ministry of Public Works and Services and conducted pursuant to the *Pliego de Bases y Condiciones para la Licitación* ("Bidding Rules"). Under these Bidding Rules, both foreign and domestic investors were free to bid on the shares. The purpose of the Bidding Process was the purchase and sale of the majority interest in each of the licensed companies created by Decree No. 1189/92. Three of those majority interests were sold during that bidding process: 60% of Cuyana's shares, 70% of GasBan's shares, and 90% of Centro's shares.

46. In December 1992, the Argentine Government awarded the contracts for the purchase of the majority of shares in the ten newly-formed licensees into which *Gas del Estado S.E.* had been restructured. The licenses relevant to this dispute were approved by Decrees Nos. 2454/92 for Centro, 2460/92 for GasBan and 2453/92 for Cuyana, and became effective on 22 December 1992.

47. The blocks of shares of Centro, GasBan and Cuyana that were subject to privatization were awarded to private investors: 90% of the shares of Centro were awarded to a consortium formed by *Società Italiana Per Il Gas S.p.A.* ("Italgas"), an Italian company, and *Sideco Americana S.A.*, an Argentine company ("Sideco"); 70% of the shares of GasBan were awarded to a

consortium formed by *Gas Natural SdG S.A.*, a Spanish company, *Compañía General de Combustibles S.A.* and *Manra S.A.*, both Argentine companies; and 60% of the shares of Cuyana were awarded to a consortium formed by Italgas and Sideco.

48. Three Argentine investment companies were created as vehicles for the acquisitions: (i) *Inversora de Gas del Centro S.A.* to acquire the privatized shares of Centro; (ii) *Invergas S.A.* to acquire the privatized shares of GasBan; and (iii) *Inversora de Gas Cuyana S.A.* to acquire the privatized shares of Cuyana. The successful bidders or their affiliates became shareholders of the respective investment companies, which then entered into Transfer Agreements with the Respondent concerning the shares subject to this arbitration.

49. The privatization scheme created by Respondent targeted foreign investors because foreign capital was deemed essential for the successful operation of the Government's economic recovery plan. Foreign investors were encouraged to purchase shares with guarantees, such as tariffs calculated in U.S. dollars, automatic and periodic adjustments to the tariffs based on the PPI, a clear legal framework that could not be unilaterally modified, and the granting of "licenses" instead of "concessions" with a view to offering the highest degree of protection to prospective investors.

50. As part of its marketing efforts, Argentina distributed an Information Memorandum in foreign markets, including the United States and Europe. The Information Memorandum summarized the legal framework governing the privatization, the terms and conditions for the bidding, the bidding process and the legal and the regulatory framework that would apply to the new industry after privatization. The information in the memorandum concerning the privatization, prepared and distributed by investment banks, contained descriptive information and included disclaimers to discourage investors from relying solely on the information therein.

51. During this period, Argentina undertook to provide enhanced legal protection to investors so as to attract foreign investment in support of its privatization scheme. The Respondent ratified several treaties relating to international investment obligations, such as the ICSID Convention and a great number of bilateral investment treaties, including the Argentina-U.S. Bilateral Investment Treaty at issue in this dispute. As mentioned above, the Convertibility Law, which pegged the peso to the U.S. dollar, was also enacted at this time.

52. In reliance on the legal guarantees offered by the Argentine Government for the privatized energy industry, and based on its positive prior experience investing in the privatized Argentine gas market in 1992, Claimants chose to purchase shares of three licensed companies in the gas-distribution market. In February 1997, LG&E purchased a 45.9% interest in Centro and a 14.4% interest in Cuyana. In March 1999, LG&E purchased a 19.6% interest in GasBan.

53. From 1993 until the end of 1999, Claimants agree that the gas-distribution licensees and Respondent abided by their respective obligations under the licenses and law governing the privatization scheme. According to Claimants, the licensees invested heavily in Argentina's natural-gas-distribution infrastructure. GasBan invested about US$372 million in a new plant and equipment, even though originally required to invest US$90.9 million; Centro invested US$92 million, although originally required to invest US$10 million; and Cuyana invested more than US$120 million, although originally required to invest US$10 million. In return, Argentina honored the provisions of the licenses and other legal obligations, including the semi-annual tariff adjustment under the PPI indicator, and calculation of the tariffs in U.S. dollars.

B. Economic Crisis and the Emergence of the Dispute – 1999-2001

54. A new economic crisis developed in Argentina in the late 1990s. In the third

quarter of 1998, the Argentine economy plunged into a period of recession that was to last four years and triggered, in Respondent's opinion, the worst economic crisis since Argentina's inception in 1810 (Respondent's Counter-Memorial, ¶ 782).

55. In 1999, Argentina's Gross Domestic Product ("GDP") decreased causing a dramatic fall in domestic prices. Private consumption and investments began falling in August 1998 and Argentina entered a deflationary period. The period was marked by widespread decline in the value of assets located in Argentina. By the end of the 1990s, many economists considered the peso as overvalued, and predicted that the currency board would have to be abandoned, which would inevitably devalue the peso. Argentina's country risk premium increased, gradually excluding the country from the international credit market. These economic indicators were accompanied by social problems –unemployment, poverty and indigence levels began to increase. On 10 December 1999, Mr. Fernando de la Rúa took office as the President of Argentina. His administration tried to maintain the peg of the Argentine peso to the U.S. dollar as mandated by the Convertibility Law.

56. Against this background, public services rates, as specified in the contracts, were due to be adjusted in January 2000 based on the PPI. At the time, the United States was experiencing a high inflationary period, while Argentina was experiencing a significant deflationary period. As established in the Gas Law, the tariffs were to be adjusted to reflect changes in the cost structure of utility providers (Gas Law, Article 41). Argentina considered that the pending tariff adjustments based on the U.S. rate were unreasonable because they would result in a significant increase in utility rates within a recessionary and deflationary context.

57. Argentina met with the gas-distribution licensees to discuss a temporary suspension of the semi-annual tariff adjustments. Two agreements that the Government and the licensees entered in 2000 formed part of Claimaints' original claim submitted to this arbitration.

58. On 6 January 2000, the Government and the licensees entered an agreement (*Acta Acuerdo*) whereby the licensees agreed to a one-time, six-month postponement of the tariff adjustment due in January 2000. Pursuant to the agreement, the tariffs would be recovered with interest from 1 July 2000 to 30 April 2001. Therefore, through resolutions published on 10 January 2000, ENARGAS approved the tariff effective as from 1 January 2000 without the PPI adjustment. The ENARGAS resolutions provided that the legal regime governing the tariffs would remain intact.

59. During the first six months of 2000, the situation in the Argentine economy continued to deteriorate. The semi-annual PPI adjustment would have forced a second tariff increase in a continued deflationary period. Although the licensees had agreed to only one-time tariff adjustment postponement, the Government urged the gas-distribution licensees to accept a second postponement of the tariff adjustments; including the previously postponed adjustments that were scheduled to be recovered beginning on 1 July 2000 in accordance with the *Acta Acuerdo* of 6 January 2000.

60. On 17 July 2000, by Decree No. 669/00, effective 4 August 2000, the licensees and the Government agreed to a second postponement of the tariff adjustments until 30 June 2002. Pursuant to the agreement, a stabilization fund would be created to recover the postponed amounts, subject to certain ceilings and floors, with interest. As with the previous agreement, this agreement reaffirmed the Government's commitments and guarantees provided to the licensees and their investors under the legal structure created for the privatization of the gas industry, specifically recognizing the enforcement of Argentina's bilateral investment treaties and the semi-annual PPI adjustments as an integral component of the tariff system.

61. On 3 August 2000, the Argentine National Ombudsman filed a lawsuit in an Argentine Federal Court, seeking an injunction against the operation of Decree No. 669/00. On 18 August 2000, the Court issued an order provisionally enjoining the application of Decree No. 669/00 and of the

agreement of 17 July 2000. On 5 October 2001, the Court of Appeal ratified the order and the case is presently pending before the Supreme Court (Respondent's Counter-Memorial, ¶ 255).

62. ENARGAS declared in November 2001 that no further adjustments to the tariffs would be approved until final judgment in the lawsuit. No further adjustments to the tariffs have occurred to date.

C. THE EMERGENCY LAW – 6 JANUARY 2002

63. Argentina's crisis deepened at the end of 2001. The Government experienced increased difficulties in repaying its foreign debt. As poverty and unemployment soared, Argentines feared that the Government would default on its debt and immobilize bank deposits. Therefore, savings were massively withdrawn from the banks. In response, the Government issued Decree No. 1570/01, known as "*Corralito,*" on 1 December 2001, restricting bank withdrawals and prohibiting any transfer of currency abroad. Amid widespread discontent and public demonstrations, including violence that claimed tens of lives, President De la Rúa and his Cabinet resigned on 20 December 2001. A succession of presidents took office and quickly resigned.

64. Finally, President Eduardo Duhalde took office and implemented a new economic plan, which contained measures that form the additional claim submitted by Claimants. On 6 January 2002, Congress enacted Law No. 25,561, the Public Emergency and Foreign Exchange System Reform Law (known as "the Emergency Law"). The Emergency Law abrogated the Convertibility Law so that the one-to-one peg of the Argentine peso to the United States dollar no longer existed. The Emergency Law provided for the switch into Argentine pesos of debts owed to the banking system, debts arising from management contracts governed by public law, and debts under private agreements. The law further provided for the renegotiation of private and public agreements to adapt them to the new exchange system.

65. The Emergency Law adopted measures modifying public-service contracts, such as establishing that tariffs and prices for public services were to be calculated in pesos, instead of U.S. dollars; abolishing all clauses calling for tariff adjustments in U.S. dollars or other foreign currencies; eliminating all indexing mechanisms; and directing the Executive Branch to renegotiate all public-service contracts.

66. By Presidential Decree No. 214 of 3 February 2002, the Government adopted a currency conversion scheme under which all obligations payable in dollars existing on the date of enactment of the Emergency Law would be converted into pesos at the fixed one-to-one exchange rate.

67. The switch into Argentine pesos, also called "pesification," which affected the entire Argentine economy, was characterized by Respondent as a necessary process to return the country to the path of economic stability.

D. RENEGOTIATION OF THE PUBLIC SERVICE CONTRACTS

68. On 12 February 2002, Argentina announced the renegotiation of all public service contracts. By Decree No. 293/02, licenses for transport and distribution of natural gas were subject to mandatory renegotiation by a Renegotiation Committee within the Ministry of Economy. Under the Decree, the Government could either sign a renegotiated agreement or rescind the contract. By Resolution No. 38/02, issued on 9 March 2002, ENARGAS was ordered to discontinue all tariff reviews and to refrain from adjusting tariffs or prices in any way.

69. After enactment of the Emergency Law, the licensees and the Argentine Executive launched three initiatives to implement an emergency increase in the natural gas and electricity tariffs. Each of these initiatives was successfully challenged by consumer organizations and ombudspersons in the Argentine judiciary and consequently did not become effective. The Argentine Government attempted twice more in 2003 to obtain tariff

increases through Presidential Decrees but both these efforts were also quashed by the judiciary.

70. On 25 May 2003, a new Argentine President, Dr. Néstor Kirchner, took office after a popular election was held on 26 April 2003, replacing the transition authorities that had been appointed by the Argentine Congress. Respondent states that with the new administration, a period of institutional stabilization at the federal level began (Respondent's Counter-Memorial, 317).

71. By Presidential Decree No. 311/03, published on 4 July 2003, and Law No. 25,790, passed on 22 October 2003, the Argentine Government extended the renegotiation process. Centro, Cuyana and GasBan have been involved in the renegotiation process under threat of rescission of contract. During the renegotiation process, the Government has not offered to restore the legal guarantees that were eliminated by the Emergency Law, or compensate Claimants for any losses incurred.

E. Request for Relief

72. Bearing in mind the background already described, Claimants request the following relief (Request for Arbitration, ¶ 111 as revised in Claimants' Memorial at ¶ 208):

(i) Declaring that the Respondent has breached its obligations under Article II(2)(c) of the Bilateral Treaty by failing to observe obligations that it entered into with regard to the Claimants' investment;

(ii) Declaring that the Respondent has breached its obligations under Article II(2)(a) of the Bilateral Treaty by failing to accord to the Claimants' investment fair and equitable treatment and by according treatment less than that required by international law;

(iii) Declaring that the Respondent has breached its obligations under Article II(2)(b) of the Bilateral Treaty by taking

arbitrary and discriminatory measures that impair the use and enjoyment of the Claimants' investment;

(iv) Declaring that the Respondent has breached Article IV(1) of the Bilateral Treaty by indirectly expropriating the Claimants' investment without complying with the requirements of the Bilateral Treaty, including observance of due process of law and payment of prompt, adequate, and effective compensation;

(v) Ordering the Respondent to pay the Claimants full compensation in the amounts set forth in the Memorial, plus pre- and post-award compound interest;

(vi) Ordering the Respondent to pay all costs and expenses of this arbitration proceeding, including the fees and expenses of the Tribunal and the cost of the Claimants' legal representation, plus interest thereon in accordance with the Bilateral Treaty; and

(vii) Such other or additional relief as may be appropriate under the Bilateral Treaty or may otherwise be just and proper.

73. According to Claimants' Reply (¶ 287), the relief they seek is stated as follows:

1. Finding the Argentine Republic to be in breach of its obligations under the Treaty;

2. Ordering the Argentine Republic to pay LG&E: (i) compensation in the amounts specified in Part VI of [the] Reply; (ii) all costs and fees of the arbitration, including reasonable attorneys' fees; and (iii) compound interest on the monetary award from the date of the award until the date of actual payment; and

3. Ordering such additional relief as may be appropriate under the applicable law or otherwise just and proper.

74. The monetary relief sought by Claimants is US$ 248 million or, if the Tribunal concludes that there was expropriation, US$ 268 million, plus compound pre-award and post-award interest and costs.

75. Respondent denies that it has violated the Treaty and seeks an order from

this Tribunal dismissing LG&E's claims and holding LG&E liable for costs. In asserting its defense, Respondent contends in the alternative that the circumstances warrant application of the state of necessity defense, thus exempting it from liability for any Treaty violations.

V. PRELIMINARY MATTERS

76. In the analysis below, the Tribunal has not only considered the positions of the parties as summarized in the various sections above, but also their numerous detailed arguments in support of those positions as well as the arguments made at the hearing. To the extent that these arguments are not referred to expressly, they must be deemed to be subsumed in the analysis below.

A. JUS STANDI

77. With respect to *jus standi*, the Tribunal re-affirms its conclusions adopted in the Decision on Objections to Jurisdiction of 30 April 2004. As determined in the Decision on Jurisdiction, the Centre has jurisdiction over LG&E's claims and this Tribunal is competent to decide on Claimants' claims.

78. Argentina continues to argue that this Tribunal shall only have jurisdiction if Argentina's non-compliance with an international obligation is verified (Respondent's Rejoinder, ¶ 521(a)). Pursuant to the Tribunal's Decision on Jurisdiction issued on 30 April, 2004, the Tribunal deems that all the obligations in discussion are international because they relate to the Treaty. Thus, LG&E's minority-shareholder status has no bearing on its standing to bring these claims or on the Tribunal's competence to rule upon them.

79. It should be pointed out that, as this Tribunal stated in the Decision on Jurisdiction, the subject matter of this arbitration focuses on the investments made by LG&E in the Argentine licensees. Accordingly, the Tribunal has insisted on the independent treatment of LG&E regarding the licensees, both from the point of view of the legal personality of each entity and from the

actions of each. This does not mean, however, that certain actions of the licensees, by the fact that they are the investment's beneficiaries, may have, in some cases, effects on the investment itself. For such reasons, on occasion, the Tribunal shall be bound to refer to the licensees and their actions without implying a reference to LG&E. One should bear in mind that the recognition of the independence among these entities was the basis on which the jurisdiction of the Centre and the competence of the Tribunal were supported.

B. LAW APPLICABLE

1. Parties' Positions

80. The Claimants argue that their claims asserted arise under the Treaty. The law that applies to the dispute is therefore the Treaty and general international law. Claimants contend that this approach comports with the first part of Article 42(1) of the ICSID Convention. In Claimants' view, Argentine law merely establishes a factual predicate for the claims under the Treaty and general international law (Claimants' Memorial, ¶¶ 155-56).

81. Respondent does not deny the application of the Bilateral Treaty to this dispute, but argues that in the absence of an agreement on the applicable law, the relationship between LG&E and the Argentine Government should be subject to the second part of Article 42(1) of the ICSD Convention, which establishes the precedence of sources of law; therefore, the Argentine law should be applied first. Respondent asserts that "where an investor makes an investment in a State it is subject –as are local investors– to the laws of the country where the investment is made" (Respondent's Counter-Memorial, ¶ 25). Argentina stresses the insufficiency of the Treaty to govern the dispute at issue, particularly in light of the substantive framework regarding the foreign investment's treatment under Argentine law.

2. Tribunal's Analysis

82. In accordance with Article 42(1) of the ICSID Convention:

> "(1) The Tribunal shall decide a dispute in accordance with such rules of law as may be agreed by the parties. In the absence of such agreement, the Tribunal shall apply the law of the Contracting State party to the dispute (including its rules on the conflict of laws) and such rules of International Law as may be applicable."

83. This rule grants the parties' autonomy in choosing the law applicable to the substance of the dispute in an arbitration administered by ICSID. If no applicable law is chosen, the Tribunal must resort to the second sentence of Article 42(1).

84. It is evident that the parties hereto had not agreed on the applicable law in this dispute. This is usually found in the investment agreement, though this does not hold in this case. Nor is there any express reference to the applicable law in other documents related to the investment by LG&E, a fact that would result in the application of the second part of Article 42(1).

85. It is to be noted that the Argentine Republic is a signatory party to the Bilateral Investment Treaty, which may be regarded as a tacit submission to its provisions in the event of a dispute related to foreign investments. In turn, LG&E grounds its claim on the provisions of the Treaty, thus presumably choosing the Treaty and the general international law as the applicable law for this dispute. Nevertheless, these elements do not suffice to say that there is an implicit agreement by the Parties as to the applicable law, a decision requiring more decisive actions. Consequently, the dispute shall be settled in accordance with the second part of Article 42(1).[3]

86. In addition to the indication of the applicable law, there are two other

---

[3] Schreuer, Christoph, *The ICSID Convention: A Commentary,* Cambridge University Press, 2001, p. 573.

concepts embedded in the second part of Article 42(1) which deserve comment —the references to private international law and to the rules of international law "as may be applicable".

87. As to the reference to the private international law, the Tribunal has not found in the ICSID records any case in which the Arbitral Tribunal has resorted to the rules of conflict of law of the State party to the dispute. It has been so observed in the *Amco v. Indonesia* case, in which the Arbitral Tribunal, presided by Berthold Goldman, affirmed that it did not deem it necessary to enter into a discussion on the rules of conflict, inasmuch as the parties make constant references to the law of the State party in the dispute and, moreover in "the dispute before the Tribunal relating to an investment in Indonesia, there is no doubt that the substantive municipal rules of law to be applied by the Tribunal are to drawn from Indonesian Law."[4] The Tribunal in this case shares the same criterion.

88. With reference to the rules of international law and, particularly, to the language "as may be applicable," found in Article 42(1) of the ICSID Convention, the Tribunal holds the view that it should not be understood as if it were in some way conditioning application of international law. Rather, it should be understood as making reference, within international law, to the competent rules to govern the dispute at issue.[5] This interpretation could find support in the ICSID Convention's French version that refers to the rules of international law "*en la matière.*"[6]

---

[4] *Amco Asia Corporation and others v. Republic of Indonesia,* Award of 20 November 1984, 1 ICSID Rep. 413 (1993).

[5] *"It simply means that the relevant rules of international law are to be applied."* Schreuer, Cristoph, *The ICSID Convention…op.cit.,* p. 622.

[6] *Convention CIRDI, Art. 42: "(1) (1) Le Tribunal statue sur le différend conformément aux règles de droit adoptées par les parties. Faute d'accord entre les parties, le Tribunal applique le droit de l'Etat contractant partie au différend—y compris les règles relatives aux conflits de lois—ainsi que les principes de droit international* ***en la matière***" (emphasis added). In: *http://www.worldbank.org/icsid/basicdoc-fra/partA-chap04.htm#s03*.

89. Likewise, applying the rules of international law is to be understood as comprising the general international law, including customary international law, to be used as an instrument for the interpretation of the Treaty. For example, where a term is ambiguous, or where further interpretation of a Treaty provision is required, the Tribunal will turn to its obligations under Articles 31and 32 of the Vienna Convention on the Law of Treaties, signed in 1969.

90. Having made this part clear, the Tribunal proceeds to analyze the extension of the remission to the domestic law contained in the second part of Article 42(1), whereby the Tribunal shall apply "the law of the Contracting State Party to the dispute…" The Argentine doctrine contributes to gaining insight into the remission's scope: "the situation is much clearer by virtue of the incorporation of the international law to the Argentine law and the hierarchical relation conferred by the 1994 constitutional reform to international treaties in Article 75, paragraph 22,[7] of the National Constitution."[8]

91. The Tribunal notes that as part of the Argentine legal system, the Bilateral Treaty prevails over domestic law, "especially, inasmuch as in most of the Bilateral Treaty's assumptions there is an express mention of international law, be it when referring to the treatment to be given to investments, or to the compensation in the event of expropriation or any other like measure, etc."[9]

92. This interpretation has been accepted in Argentina "as long as the litigation is linked to the violation of the BIT [bilateral investment treaty] and of international law and not to the mere pretensions of infringement of a local

---

[7] "… the treaties and concordats are hierarchically superior than laws …"
[8] Tawil, Guido Santiago, *Los conflictos en materia de inversión, la jurisdicción del CIADI y el Derecho aplicable: a propósito de las recientes decisiones en los casos* "*Vivendi*", "*Wena*" y "*Maffezini*", in *RAP*, October 2002 Year XXV, Nº 239, pp. 241 *et seq*., especially pp. 256-257.

contract and as the parties should have not provided expressly the law applicable to the first of said disputes, the decision shall be governed by the ICSID Convention, by the BIT and applicable international law. Thus, the BIT becomes the *lex specialis* regarding disputes appearing in matters of investment between the foreign investor and the Host State."[10]

93. It is this Tribunal's opinion that obviating application of international law, specifically of the ICSID Convention and the Bilateral Treaty, would entail ignoring the fact that "international treaties move away from the principle according to which foreign investment is subject to the law and jurisdiction of the host state and seek international solution of conflicts."[11] This thesis, held by part of the Argentine doctrine, indicates that when submitting the settlement of a dispute to an Arbitral Tribunal acting within the framework of an international agreement, like ICSID, the dispute falls under public international law; thus its rules are to be applied.[12] However, the problem is more complex as has been admitted by several scholars, who are of the opinion that it is necessary to "balance the weight that domestic law and international law should have upon the settlement of the dispute"[13], this is, to establish an order of precedence of the sources.

94. International law overrides domestic law when there is a contradiction since a State cannot justify non-compliance of its international obligations by asserting the provisions of its domestic law.

95. If this contradiction does not exist, it is not an easy task to establish the relationship between international law and domestic law. In the original draft of the ICSID Convention, the conjunction "and" was not present in the rule,

---

[9] *Idem,* p. 256. The author bases his opinion on the *Vivendi* case.
[10] *Ibidem.*
[11] *See Investment for foreigners in Argentina:* www.enplenitud.com/
[12] Grigera Naón, Horacio, *Choice of Law Problems in International Commercial Arbitration,* J.C.B. Mohr (Paul Siebeck) Tübingen, Germany, 1992, p. 115.
[13] Vives Chillida, Julio, *El Centro Internacional de Arreglos de Diferencias Relativas a Inversiones*

footnote cont'd

but rather the conjunction "or" was in its place, so that it read, "The Arbitral Tribunal shall decide the dispute submitted to it in accordance with such rules of law, whether national or international as it shall determine to be applicable."[14] The intention in the language of the original draft was not to establish an order of preference, but rather to establish the possibility of alternatives. Initially, scholarly authorities and some ICSID Tribunals admitted that the conjunction "and" meant that "and in case of lacunae, or should the law of the Contracting State be inconsistent with international law."[15] However, any limitation to the role of international law under these terms would imply accepting that international law may be subordinate to domestic law and would obviate the fact that there are a growing number of arbitrations initiated on the basis of bilateral or multilateral investment treaties.

96. It is this Tribunal's opinion that "and" means "and," so that the rules of international law, especially those included in the ICSID Convention and in the Bilateral Treaty as well as those of domestic law are to be applied. In the *Wena Hotels Limited v. Arab Republic of Egypt* case, the Tribunal affirmed that "and means and", but accepted the supremacy of international law.[16]

97. The Tribunal concludes, as the tribunal concluded in the *Asian Agricultural Products*, Ltd, *(AAPL) v. Democratic Socialist Republic of Sri Lanka,* Award of June 27, 1990, that the Treaty "is not a self-contained closed legal system limited to provide for substantive material rules of direct applicability, but it has to be envisaged within a wider juridical context in which rules from other sources are integrated through implied incorporation methods, or by

---

(CIADI), Madrid, McGraw Hill, 1998, p. 195.

[14] Schreuer, Christoph, *The ICSID Convention… op. cit.,* p. 623.

[15] Gaillard, Emmanuel and Banifetami, Yas, *The Meaning of "and" in Article 42(1), second sentence, of the Washington Convention: The Role of International Law in the ICSID choice of the law process,* ICSID Review, Foreign Investment Law Journal, 2003, Vol. 12, No. 2, pp. 375 et seq., especially pp. 381-382. See also: Schreuer, Christoph, *op. cit,* p. 263.

[16] *Wena Hotels Limited v. Arab Republic of Egypt,* ICSID Case Nº ARB/98/4, Decision on Application

footnote cont'd

direct reference to certain supplementary rules, whether of international law character or of domestic law nature."[17]

98. In short, one must also recall that between Argentina and LG&E there is no binding contractual agreement. The existence of such relationship would have allowed the parties to agree on stabilization clauses in the event of changes in certain circumstances. But, in the absence of such agreement, one is bound to resort to a legal system regulating those events. The fact that there is no contract between the Argentine Republic and LG&E favors in the first place, the application of international law, inasmuch as we are dealing with a genuine dispute in matters of investment which is especially subject to the provisions of the Bilateral Treaty complemented by the domestic law.

3. Tribunal's Conclusion

99. In order to settle this controversy, the present Tribunal shall apply first the Bilateral Treaty; second and in the absence of explicit provisions therein, general international law, and, third, the Argentine domestic law, particularly the Gas Law that governs the natural gas sector. The latter is applicable in view of its relevance for determining the Argentine Republic's liability and the defenses to which it may resort vis-à-vis the allegations made by Claimants.

VI. LIABILITY

A. ARTICLE II(2)(a): FAIR AND EQUITABLE TREATMENT

1. Parties' Positions

100. Based on the circumstances of this case as described in Section IV above,

for Annulment, Feb. 5, 2002, 41 ILM 933 (2002).

[17] *Asian Agricultural Products Ltd. (AAPL) v. Democratic Socialist Republic of Sri Lanka,* ICSID Case No. ARB/87/3, Final Award, June 27, 1990, 6 ICSID Review 533 (1991).

LG&E claims that the Argentine Republic breached Article II(2)(a) of the Bilateral Treaty, which guarantees that LG&E's investment in Argentina will at all times be accorded fair and equitable treatment.

101. In Claimants' view, by committing itself to the Treaty, Argentina made promises to the United States as to how it would treat the investments of U.S. nationals in Argentina. In Article II, Argentina agreed to maintain an investment environment that is even-handed towards all investors, foreign and domestic alike, free of arbitrary and discriminatory laws and regulations, and ultimately fair and equitable, offering full protection and security to the investments of U.S. nationals.

102. Claimants explain that fair and equitable treatment in the context of this Treaty, requires a stable and predictable legal framework for the investment. Claimants support their interpretation of the standard on the basis of the Preamble of the Treaty, which sets forth the object and purpose of the Treaty and specifically the provision on fair and equitable treatment, as well as three recent opinions of arbitral tribunals considering the question in a similar context.[18] Claimants contend that, under this standard, a State cannot grant treatment that affects the basic expectations that were taken into account by the foreign investor to make the investment. Considering that the Treaty's objective was to promote foreign investment, Claimants argue that the stability and predictability of the legal framework that laid the foundations for their investment and granted protection to its value are particularly important.

103. With respect to Respondent's reliance on the *Genin* case, Claimants argue

---

[18] *Técnicas Medioambientales Tecmed S.A. v. The United Mexican States*, ICSID Case No. ARB (AF)/00/02 Award ¶ 154 (29 May 2003); *MTD Equity Sdn. Bhd. and MTD Chile S.A. v. Republic of Chile*, ICSID Case No. ARB/01/7 Award ¶ 113 (25 May 2004); *Occidental Exploration and Production Company v. The Republic of Ecuador*, LCIA Case No. UN 3467 Final Award (1 July 2004).

that as the *Genin*[19] case is merely a standard for evaluating the fairness and equity of State procedures, such a standard should be evaluated in light of more recent cases.

104. Claimants also contend that the extent to which the fair and equitable standard relates to the minimum standard of treatment under customary international law makes no difference in this case because that standard has evolved since the *Mondev*[20] case to include the reasonable expectations of the investor.

105. Under this articulation of the standard, Claimants state that Argentina treated LG&E's investment in an unfair and inequitable manner. *First*, Argentina repudiated the guarantees that it had offered to the foreign investors at the time it induced them to invest in Argentina. *Second*, Argentina singled out the gas-distribution industry and other public utility industries, for treatment that was less favorable than the treatment granted to all other sectors of the economy. *Third*, Argentina publicized unfounded charges against the foreign investors and coerced the gas-distribution companies to waive their rights under the licenses and renegotiate the licenses. *Fourth*, Argentina held the licensees responsible for strict compliance with the terms of the licenses while the Government froze the gas-distribution tariffs. *Finally*, Claimants allege that Argentina foreclosed the licensees from pursuing judicial or arbitral remedies (Claimants' Memorial, ¶ 171).

106. Argentina had attracted Claimants with the guarantees derived from the Treaty and the legal framework for privatization, under which its laws and regulations guaranteed how Argentina would treat LG&E's investment. In making their decision to invest in Argentina, Claimants relied on Argentine

---

[19] *Alex Genin, Eastern Credit Limited, Inc. and A.S. Baltoil v. The Republic of Estonia,* ICSID Case No. ARB/99/2 Award, ¶ 367 (25 June 2001).

[20] *Mondev International Ltd. v. United States of America*, ICSID Case No. ARB(AF)99/2, Award, ¶ 116 (October 11, 2002).

laws that granted protection against currency fluctuation and inflation, while providing for adjustment of utility rates, thus ensuring reasonable rates of return and that the Argentine Government would not freeze utility rates, but rather maintain a dynamic tariff system, regulated by an expert agency.

107. Claimants did not expect their investment to be free of risk, or that Article II of the Bilateral Treaty should protect them from all risks associated with their investment. But they insist that the gas regulatory framework that Argentina put in place made their investment free from risk of regulatory alterations or changes in the rules in which they had invested. LG&E understood that it would bear what it calls "commercial risks," such as industry demand, recession and substitution of natural gas by alternative fuels (Hearing on the Merits, Perkins, 24 January, 2005, Spanish Transcript, p. 369; Claimants' Post-Hearing Brief, ¶ 8).

108. Claimants allege that, during the economic crisis, Argentina abandoned the guarantees that it made to investors in the gas-distribution sector. In January 2002, the Emergency Law swept away the protection against inflation. Argentina forced licensees to enter into two agreements postponing the PPI adjustments, after which an Argentine court issued an order that ENARGAS interpreted as an injunction against the PPI adjustment. The Emergency Law permanently abolished the PPI adjustment.

109. The Emergency Law also abandoned the protection against currency fluctuations. The Gas Law had guaranteed that the tariffs would be calculated in dollars and converted into pesos. In reliance on this protection against any sharp devaluation of the peso, Claimants decided to invest in the licensees.

110. In light of these prior measures, Claimants argue that Argentina repudiated its guarantee that generally prohibited the freezing or control of tariffs (Claimants' Post-Hearing Brief, ¶¶ 15-31).

111. While Claimants acknowledge that the material used by Respondent in order

to make the offer was not binding, the laws and promises referenced therein were (Claimants' Post-Hearing Brief, ¶ 9). Claimants add that if establishing the tariffs had been left to the State, investors would have never invested.

112. Respondent objects to the definition given to fair and equitable treatment. In Respondent's view, the standard should be defined by impartial and objective rather than personal and arbitrary criteria. They conclude that Claimants' interpretation of the standard is so vague as to ignore the parties' obligations and rights (Respondent's Counter-Memorial, ¶ 603-604).

113. Citing *Alex Genin, Eastern Credit Limited, Inc. and A.S. Baltoil v. The Republic of Estonia*[21] and *Robert Azinian, Kenning Davitian & Ellen Baca v. The United Mexican States*[22], Respondent concludes that the fair and equitable treatment principle refers to the international minimum standard of treatment owed to an investor, and as such, constitutes a minimum pattern for substantive justice (Respondent's Counter-Memorial, ¶ 620). Respondent also contends, citing *S.D. Myers Inc. v. The Government of Canada*[23] that a violation of the fair and equitable standard "occurs only when it is shown that an investor has been treated in such an unjust or arbitrary manner that the treatment rises to the level that is unacceptable from the international perspective" (Respondent's Counter-Memorial, ¶¶ 621-622).

114. Regarding the list of guarantees cited by Claimants, Respondent contends that the Gas Law does not provide for what Claimants call "exchange protection" (Respondent's Post-Hearing Brief, ¶ 74a). Respondent points out that, in fact, when Claimants' witnesses were examined, they were not able to identify where any such "protection" had been established. Respondent also asserts that the tariff calculation in U.S. dollars was linked to the

---

[21] See *Genin*, footnote No. 19 *supra.*
[22] *Robert Azinian and others v. United Mexican States,* ICSID Case No. ARB(AF)/97/2, Award, ¶¶ 83 and 87, (1 November 1999).
[23] *S.D. Myers, Inc. v. Government of Canada,* NAFTA Arbitration under UNCITRAL Rules, Partial

footnote cont'd

existing fixed rate of exchange between the peso and the U.S. dollar as established by the Convertibility Law. None of Claimants' witnesses was able to prove the opposite. Respondent adds that maintaining tariffs linked to the U.S. dollar after the convertibility system was abandoned lacks any economic logic. Respondent points out that none of the Government's guarantees address the abandonment of convertibility.

115. With respect to the tariff guarantee, Respondent argues that it is possible that the Argentine authorities had considered guaranteeing the calculation of the tariffs in U.S. dollars regardless of the Convertibility Law, but such plan was rejected due to the fact that the Government concluded that the Convertibility Law provided sufficient protection to the investment (Respondent's Post-Hearing Brief, ¶ 26).

116. With respect to the PPI adjustments, Respondent argues that from mid-1998, application of the PPI as the rate adjustment index became unreasonable and failed to fulfill the goal it was conceived for – namely, reflecting the changes in the value of the goods and services involved in the activity of service providers (Respondent's Post-Hearing Brief, ¶ 44). Additionally, Respondent states that the measure did not cause loss to the licensees. Citing the opinions of Schwartz and Lapuerta, Respondent contends that suspension of the PPI adjustment would have affected tariffs only by approximately 2% between August 2000 and October 2002 (Respondent's Post-Hearing Brief, ¶ 46).

117. Respondent agrees that the tariffs must be fair and sufficient, yet not abusive, something that would occur if the Claimants' position were sustained (Respondent's Post-Hearing Brief, ¶ 74c).

118. Regarding the claim that the Claimants were "induced" to invest in the Argentine Republic, Respondent argues that there is no proof of such

---

Award, ¶ 263, (13 November 2000).

inducement (Respondent's Counter-Memorial, ¶ 647). Respondent points out that the Claimants rely on non-binding documents, such as reports and minutes without any legal relevance. According to Respondent, these documents were irrelevant to the laws that should have been considered in deciding whether or not to invest in the Argentine gas-distribution market (Respondent's Post-Hearing Brief, ¶ 17).

2. Tribunal's Conclusion Concerning Argentina's Guarantees to Investors

119. The Tribunal concludes that the Gas Law and its implementing regulations made four guarantees to investors in the gas transport and distribution centers:

1. Article 41.1 of Decree No. 1738/92,[24] and Section 9.2 of the Basic Rules of the License[25] mandated that the tariffs would be calculated in U.S. dollars before conversion into pesos.

2. Section 9.4.1.1 of the Basic Rules of the License guaranteed that the tariffs would be subject to semi-annual adjustments according to the PPI.[26]

3. Article 38 of Law No. 24,076 provided that tariffs were to provide an income sufficient to cover all costs and a reasonable rate of return.[27]

---

[24] Article 41.1 provides: "Transportation and Distribution rates shall be calculated in United States dollars. The resulting Rate Schedule shall be stated in Argentine pesos and shall be convertible as stated in Law No. 23,928, using for the retranslation into Argentine pesos the parity set forth in Article 3 of Argentine Presidential Decree No. 2,128/91."

[25] Section 9.2 provides: "The tariff has been calculated in U.S. dollars. The adjustments referred to in point 9.3 will be calculated in U.S. dollars."

[26] Section 9.4.1.1 provides: "Distribution tariffs will be adjusted semiannually according to the variation operated in the PPI."

[27] Article 38 provides: "The services rendered by distributors will be offered at tariffs in line with the following principles:
a)To provide distributors who operate economically and prudently the opportunity to obtain sufficient income to meet all reasonable operating costs applicable to the service, taxes, amortization, and a

footnote cont'd

4. Section 9.8 of the Basic Rules of the License guaranteed that the tariff system would not be subject to freezing or price controls without compensation.[28]

120. The Tribunal also finds that as a matter of fact, the Emergency Law, passed on 6 January 2002, declared that the tariffs would no longer be calculated in U.S. dollars but directly in pesos (Article 8), and that there would be no further semi-annual tariff adjustments according to the PPI (Article 8). The Tribunal notes that since July 1999, there have not been any PPI adjustments in the tariffs relating to the licensees and the five-year review due in 2002 was not conducted – both affecting the level of the tariffs in the gas-distribution sector and, as a consequence, Claimants' rate of return on their investment. Argentina took these steps without compensating Claimants and forcing Claimants to renegotiate (a process in which an Argentine official recommended that investors waive their claims against the Government relating to the licenses) or face rescission of the licenses. (Decree No. 293/02, Article 2 and Claimants' Memorial ¶¶ 120 *et seq).*

3. Tribunal's Analysis

121. The question before the Tribunal is whether the measures implemented by Argentina violated Argentina's obligation under Article II(2)(a) of the Treaty to give fair and equitable treatment to LG&E's investment.

122. The Treaty does not define what is meant by fair and equitable treatment. In these circumstances, the Tribunal must interpret this provision in good faith, in accordance with the ordinary meaning to be given to the terms in their context, and in light of its object and purpose, as required by Article 31(1) of

---

reasonable rate of return, as determined in the following article."

[28] Section 9.8 provides: "Licensee's tariff system will not be subject to freezing, administration and/or price control. If, in spite of this stipulation, Licensee is forced to adapt to a price control system establishing a lower level than that arising from the Tariff, Licensee will have the right to be compensated by the Government in an equivalent amount."

the Vienna Convention.

123. The Treaty, following the general trend with investment treaties, provides for treatment applicable to investors in the host State through the establishment of a series of internationally recognized standards.[29] Due to the fact that such international standards have a generic nature and that their interpretation varies with the course of time and with the circumstances of each case, it becomes difficult to establish an unequivocal and static concept of these notions.

124. In considering the context within which Argentina and the United States included the fair and equitable treatment standard, and its object and purpose, the Tribunal observes in the Preamble of the Treaty that the two countries agreed that "fair and equitable treatment of investment is desirable in order to maintain a stable framework for investment and maximum effective use of economic resources." In entering the Bilateral Treaty as a whole, the parties desired to "promote greater economic cooperation" and "stimulate the flow of private capital and the economic development of the parties". In light of these stated objectives, this Tribunal must conclude that stability of the legal and business framework is an essential element of fair and equitable treatment in this case, provided that they do not pose any danger for the existence of the host State itself.

125. Several tribunals in recent years have interpreted the fair and equitable treatment standard in various investment treaties in light of the same or

---

[29] The notion of a standard appeared for the first time in a 1948 treaty, the Havana Charter for an International Trade Organization, and it was considered a protection against state actions violating internationally-accepted rules. In the 1960s it was related to the protection given to foreign properties. In international case law, the standard existed pursuant to the interpretation provided in the 1920s in the emblematic *Neer* case, which required that State conduct be deemed outrageous, wrongful, open injustice, an atrocity, bad faith or voluntary negligence of duty for a violation to be found. That interpretation is not the same that is given today. What was considered an "atrocity" in 1926 might not be so today, and what may be considered "violent" now, may not have been at that time. See *"Fair and Equitable Treatment Standard in International Investment Law"*, OECD, Working Paper on

footnote cont'd

similar language as the Preamble of the Argentina – U.S. BIT.[30] These tribunals have repeatedly concluded based on the specific language concerning fair and equitable treatment, and in the context of the stated objectives of the various treaties, that the stability of the legal and business framework in the State party is an essential element in the standard of what is fair and equitable treatment.[31] As such, the Tribunal considers this interpretation to be an emerging standard of fair and equitable treatment in international law.

126. Although the Chile - Malaysia BIT does not include express reference in its Preamble with respect to fair and equitable treatment, the tribunal in *MTD Equity Sdn. Bhd. and MTD Chile S.A. v. Republic of Chile* referred to the objectives of the Treaty set forth in the Preamble, and concluded that in light of these objectives, fair and equitable treatment meant treatment in an "even-handed and just manner, conducive to fostering the promotion of foreign investment."[32]

127. In addition to the State's obligation to provide a stable legal and business environment, the fair and equitable treatment analysis involves consideration of the investor's expectations when making its investment in reliance on the protections to be granted by the host State. Indeed, this view is reflected in the *Tecmed* decision, that has been adopted by a succession of tribunals:

International Investment, November 2003/4.

[30] See, e.g., *CMS Gas Transmission Company v. The Argentine Republic*, ICSID Case No. ARB/01/8 Award (12 May 2005) (Argentina-U.S. BIT*); Occidental Exploration and Production Company v. The Republic of Ecuador*, LCIA Case No. UN 3467 Final Award (1 July 2004) (U.S.-Ecuador BIT – almost identical language); *MTD Equity Sdn. Bhd. and MTD Chile S.A. v. Republic of Chile*, ICSID Case No. ARB/01/7 Award ¶ 113 (25 May 2004) (Malaysia-Chile BIT); *Metalclad Corporation v. United Mexican States*, ICSID Case No. ARB(AF)/97/1 Award ¶ 75 (30 August 2000). (An underlying objective of Article 102(1) of NAFTA is "to promote and increase cross-border investment opportunities and ensure the succesful implementation of investment initiatives").

[31] *CMS*, ¶ 274; *Occidental*, ¶183. See also *Metalclad,* ¶ 99 ("Mexico failed to ensure a transparent and predictable framework for Metalclad's business planning and investment").

[32] *MTD*, ¶ 113.

> "The Arbitral Tribunal considers that this provision of the [BIT], in light of the good faith principle established by international law, requires the Contracting Parties to provide to international investments treatment that does not affect the basic expectations that were taken into account by the foreign investor to make the investment. The foreign investor expects the host State to act in a consistent manner, free from ambiguity and totally transparently in its relations with the foreign investor, so that it may know beforehand any and all rules and regulations that will govern its investments, as well as the goals of the relevant policies and administrative practices or directives, to be able to plan its investment and comply with such regulations.[33]"

128. Similarly, the tribunal in *Waste Management, Inc. v. The United Mexican States,* interpreting the fair and equitable treatment standard under NAFTA Article 1105(1) concluded that in applying the fair and equitable treatment standard, "it is relevant that the treatment is in breach of representations made by the host State which were reasonably relied on by the claimant."[34] This means that violations of the fair and equitable treatment standard may arise from a State's failure to act with transparency –that is, all relevant legal requirements for the purpose of initiating, completing and successfully operating investments made, or intended to be made under an investment treaty should be capable of being readily known to all affected investors.[35]

129. The Tribunal is not convinced that bad faith or something comparable would ever be necessary to find a violation of fair and equitable treatment. The tribunal in *Alex Genin, Eastern Credit Limited, Inc. and A.S. Baltoil v. The Republic of Estonia*,[36] did not reach this conclusion either. The tribunal merely stated: "Acts that would violate this minimum standard *would*

---

[33] *Técnicas Medioambientales Tecmed S.A. v. The United Mexican States*, ICSID Case No. ARB(AF)/00/02, Award ¶ 154 (29 May 2003); *cited in e.g., MTD*, ¶ 114; *Occidental*, ¶ 185; *CMS*, ¶ 279.
[34] *Waste Management, Inc. v. The United Mexican States,* ICSID Case No. ARB(AF)/00/3, Award ¶ 98 (30 April 2004).
[35] See e.g., *Tecmed*, ¶ 154; *CMS*, ¶¶ 278-79 and *Occidental*, ¶ 185 (citing the *Tecmed* and *Metalclad* passages referring to transparency).

include acts showing a willful neglect of duty . . . or even subjective bad faith" (emphasis added).[37] The tribunal concluded that bad faith was not a requirement for a finding of a violation of fair and equitable treatment.[38]

130. It can be said that the investor's fair expectations have the following characteristics: they are based on the conditions offered by the host State at the time of the investment; they may not be established unilaterally by one of the parties; they must exist and be enforceable by law; in the event of infringement by the host State, a duty to compensate the investor for damages arises except for those caused in the event of state of necessity; however, the investor's fair expectations cannot fail to consider parameters such as business risk or industry's regular patterns.

131. Thus, this Tribunal, having considered, as previously stated, the sources of international law, understands that the fair and equitable standard consists of the host State's consistent and transparent behavior, free of ambiguity that involves the obligation to grant and maintain a stable and predictable legal framework necessary to fulfill the justified expectations of the foreign investor.

4. <u>**Tribunal's Conclusion**</u>

132. In light of the foregoing, the Tribunal concludes that Argentina violated the fair and equitable treatment provision in the Bilateral Treaty for the following reasons.

133. Emerging from the economic crisis of the late 1980s, Argentina created an

---

[36] *Genin,* ¶ 367.
[37] *Ibidem*.
[38] See, e.g., *Mondev*, ¶ 116 October 11, 2002 ("To the modern eye, what is unfair or inequitable need not equate with the outrageous or the egregious. In particular, a State may treat foreign investment unfairly and inequitably without necessarily acting in bad faith."); *see also Occidental*, ¶ 63 ("this is an objective requirement that does not depend on whether the Respondent has proceeded in good faith or not."); *see also Tecmed,* ¶ 153 (relying on *Mondev*); *Waste Management*, ¶ 93 (rejecting the standard set forth in the *Neer* case involving willful neglect of duty and bad faith).

economic recovery plan mainly dependent upon foreign capital. Argentina prepared with the investment banks an attractive framework of laws and regulations that addressed the specific concerns of foreign investors with respect to the country risks involved in Argentina. In light of these risks, Claimants relied upon certain key guarantees in the Gas Law and implementing regulations, such as calculation of the tariffs in U.S. dollars before their conversion into pesos, the semi-annual PPI adjustments, tariffs set to provide sufficient revenues to cover all the costs and a reasonable rate of return, and compensation in the event that the Government altered the tariff scheme. Having created specific expectations among investors, Argentina was bound by its obligations concerning the investment guarantees vis-à-vis public utility licensees, and in particular, the gas-distribution licensees. The abrogation of these specific guarantees violates the stability and predictability underlying the standard of fair and equitable treatment.

134. Specifically, it was unfair and inequitable to pass a law discarding the guarantee in Decree No. 1738/92 that the tariffs would be calculated in U.S. dollars and then converted into pesos. As pointed out by Claimants, this was not merely an economic and monetary policy of the Argentine Government which materialized through the Convertibility Law. Rather, it was a guarantee laid down in the tariff system. This guarantee was very important to investors to protect their investment, which was made in dollars, from a subsequent devaluation of the peso.

135. Argentina also acted unfairly and inequitably in the manner in which it abrogated the guarantees of the Gas Law and its implementing regulations, adversely affecting the gas-distribution sector but not affecting other sectors of the economy. For example, certain contracts, such as those in the export industry, were excluded from the forced conversion to pesos regulation, or the conversion was performed at a more favorable rate to the individual or company.

136. Argentina acted unfairly and inequitably when it prematurely abandoned the PPI tariff adjustments and essentially froze tariffs prior to the onset of the public disorder and threats to its essential security in December 2001, and when it refused to resume adjustments when conditions had normalized in April 2003, forcing instead the licensees to renegotiate.[39] History has shown that the PPI adjustments that initially were supposed to be postponed have been abandoned completely and are now being "negotiated" away.

137. Argentina also has acted unfairly and inequitably in forcing the licensees to renegotiate public service contracts, and waive the right to pursue claims against the Government, or risk rescission of the contracts. Even though the Gas Law provided for the renegotiation of public service contracts, in practice there was no real renegotiation, but rather the imposition of a process.

138. Likewise, the Government's Resolution No. 38/02 issued on 9 March 2002, which ordered ENARGAS to discontinue all tariff reviews and to refrain from adjusting tariffs or prices in any way, also breaches the fair and equitable treatment standard.

139. The Tribunal nevertheless recognizes the economic hardships that occurred during this period, and certain political and social realities that at the time may have influenced the Government's response to the growing economic difficulties. Certainly, LG&E was aware of the risks inherent in investing in a foreign State. But here, the Tribunal is of the opinion that Argentina went too far by completely dismantling the very legal framework constructed to attract investors.

---

[39] As described more fully below, Argentina is excused from liability for the measures taken during the extreme circumstances of December 2001 until April 2003 in order to maintain public order and protect its essential interests. It was fair that during this period of time, Argentina suspended the guarantees of the Gas Law and postponed the PPI tariff adjustments until such time as the Government could manage to resume its obligations.

B. ARTICLE II(2)(b): DISCRIMINATORY AND ARBITRARY TREATMENT

1. Discriminatory Treatment

(i) Parties' Positions

140. Claimants contend that the Argentine Government adopted measures that discriminated against the downstream gas sector (transport and distribution) compared to upstream businesses (production), large industrial customers, and other sectors not dominated by foreign investors, such as alternative energy and the public. In their view, such discrimination violates Article II(2)(b) of the Bilateral Treaty, which provides that "[n]either Party shall in any way impair by arbitrary or discriminatory measures the management, operation, maintenance, use, enjoyment, acquisition, expansion, or disposal of investments."

141. Claimants state that, from the time of the first PPI adjustment until the enactment of the Emergency Law of 6 January 2002, the gas industry received treatment different from that accorded to similarly situated public utilities, including electricity and water distribution companies. These other public utilities continued to enjoy the PPI adjustment until the enactment of the Emergency Law.

142. Claimants also support their contention by pointing out that, following enactment of the Emergency Law on 6 January 2002, the Government subjected most of the privatized public-utility sector, including the gas-distribution industry, to the least favorable of several regimes devised for the conversion of dollar obligation into pesos. Within the public-utility sector, Claimants also allege that the Government discriminated against the gas-distribution industry by excluding other public-service companies from the conversion of tariffs into pesos. The Government imposed upon the privatized gas-distribution companies what was considered the worst exchange and tariff system during the Argentine crisis.

143. Claimants stress that if one compares the measures that affected sectors such as gas production, alternative energy sources or even those of the public sector, with those affecting gas transportation or distribution, the Tribunal can only conclude that the Argentine Government discriminated against the gas distribution and transportation sectors. The alleged discrimination is particularly obvious in Claimants' view by the fact that most of the investors in the gas-distribution sector are foreigners.

144. Respondent argues that the measures it adopted were not discriminatory because they were general measures without any unreasonable distinction. Respondent questions whether Argentina's measures can be considered discriminatory, if one acknowledges, as Claimants have, that other industries related to public services were affected by the measures adopted regarding the PPI (Respondent's Counter-Memorial, ¶ 700).

145. Respondent explains that each public service is regulated by its own set of tariff rules, and for that reason, the effect may not have been exactly the same for all sectors, including the field of public services. Respondent alleges that "[i]t is irrational and illegitimate to compare one utility to a different one, subject to different rules, different agreements and different characteristics, and then hold that it is discriminatory to treat differently the different utilities at stake" (Respondent's Counter-Memorial, ¶ 703, emphasis omitted).

(ii) <u>Tribunal's Analysis</u>

146. In the context of investment treaties, and the obligation thereunder not to discriminate against foreign investors, a measure is considered discriminatory if the intent of the measure is to discriminate or if the measure has a discriminatory effect.[40] As stated in the *ELSI Elettronica*

---

[40] See Vandevelde, Kenneth J., *United States Investment Treaties: Policy and Practice,* Kluwer Law

footnote cont'd

Sicula SpA case (*United States of America v. Italy*), ICJ Report 1989 RLA 56 at 61-62 (20 July 1989), in order to establish when a measure is discriminatory, there must be (i) an intentional treatment (ii) in favor of a national (iii) against a foreign investor, and (iv) that is not taken under similar circumstances against another national.

(iii) <u>Tribunal's Conclusion</u>

147. While the Tribunal concludes that based on the evidence presented, Respondent treated the gas-distribution companies in a discriminatory manner, imposing stricter measures on the gas-distribution companies than other public-utility sectors, Claimants have however not proven that these measures targeted Claimants' investments specifically as foreign investments.

148. Certainly, all the gas-distribution companies were affected by the economic crisis and by the Government's measures like all other companies within the public-utility sector. However, Argentina suspended PPI adjustments for the gas industry two years before enacting the Emergency Law. It did not take the same action with respect to the public-utility companies such as the electricity and water distribution companies, in which case it continued to adjust their tariffs until enactment of the Emergency Law. Instead, the gas-distribution companies were subjected to unfavorable regimes devised for the conversion of dollar obligations and tariffs into pesos. Even though it was not proved that these measures had been adopted with the purpose of causing Claimants' foreign investments damage, discrimination against gas distribution companies vis-à-vis other companies, such as water supply and electricity companies, is evident.

---

and Taxation, 1992, p. 77.

2. Arbitrary Treatment

(i) Parties' Positions

149. Claimants characterize Argentine Government's course of conduct towards the gas-distribution licensees as arbitrary in violation of Article II(2)(b) of the Bilateral Treaty. Claimants articulate the standard for what constitutes an "arbitrary" act as "disregard for the rule of law" (Claimants' Memorial, ¶ 176).

150. Claimants argue that, in taking measures against the gas-distribution licensees and other public utilities, the Argentine Government acted in disregard for the rule of law. According to Claimants, the Government acted under the trappings of laws, decrees, resolution, regulations and court decisions, but by willfully repudiating the commitments it made to the gas-distribution licensees and their shareholders, the Government followed "the rule of power, not the rule of law" (Claimants' Post-Hearing Brief, ¶ 44). In Claimants' view, the Government's wholesale repudiation of the tariff system was unnecessary to achieve the stated aims of the PPI suspension or those of the Emergency Law, since the the tariff system was sufficiently flexible to allow Respondent to reduce tariffs unilaterally, for any reason, as long as it paid compensation to the licensees. Instead, the Government chose to dismantle the whole tariff system without granting due compensation (Claimants' Memorial, ¶ 176).

151. Claimants argue that when Respondent's Bilateral Treaty obligations and the promises made to the foreign investors became politically and economically inconvenient, Respondent ignored its obligations and repudiated the Gas Law's key provisions. These measures, they assert, not only surprise but also contradict any sense of Respondent's ownership of its legal obligations, and accordingly they are arbitrary in nature. Claimants refute as without evidence any assertion by Respondent that if the guarantees had not been abolished, tariffs would have tripled or quadrupled in price (Claimants' Post-

Hearing Brief, ¶ 44).

152. In its defense, Respondent contends that the measures were not arbitrary; on the contrary, they were reasonable and proportionate to the end pursued. In Argentina's view, the tariff system was not dismantled. Rather, it was modified by the measures that the Government was forced to put in place during the economic crisis. Respondent suggests that under the circumstances, the deferment of the PPI adjustment in the year 2000 was a reasonable measure. This position, as Respondent views it, is supported by both a decision of a court of first instance and by the Federal Court of Appeal (Cámara Federal de Apelaciones), which concluded that the adjustment at issue was unreasonable within the recessive economic context endured by the Argentine Republic. The stability that Claimants argue should characterize the legal system does not mean that the system will exist in perpetuity, immutability or immobility. Any requirement of "freezing the law" without considering the social and economic circumstances under which the laws were enacted, is transforming the Argentine legal system into a "frivolous rite" (Respondent's Counter-Memorial, ¶¶ 638-639).

153. Respondent contends that linking the tariff adjustments to the peso (pesificación) is not arbitrary or discriminatory. Had there been no link to the peso, many customers could not have had access to the gas service, which would have resulted in the collapse of the distribution industries themselves, and tariffs would have been no longer fair but abusive.

154. In Respondent's view, none of the measures adopted by the Argentine Government may be qualified as arbitrary or discriminatory. On the contrary, they were proportionate and reasonable under the circumstances and accordingly, not a violation of Article II(2)(b) of the Bilateral Treaty (Respondent's Post-Hearing Brief, ¶ 112).

(ii) Tribunal's Analysis

155. Article II(2)(b) of the Bilateral Treaty provides that "[n]either Party shall in

any way impair by arbitrary or discriminatory measures the management, operation, maintenance, use, enjoyment, acquisition, expansion, or disposal of investments."

156. The term "arbitrary" is left undefined by the Bilateral Treaty. Thus, the Tribunal looks to its plain meaning for international law to determine whether the measures adopted by Argentina could be classified as arbitrary.

157. According to international law, arbitrariness has been described as "a willful disregard of due process of law, an act which shocks, or at least surprises, a sense of juridical propriety."[41] The tribunal in *Ronald S. Lauder v. The Czech Republic*, referring to the Black's Law Dictionary, defined the term as "depending on individual discretion; (…) founded on prejudice or preference rather than on reason or fact."[42]

158. It is apparent from the Bilateral Treaty that Argentina and the United States wanted to prohibit themselves from implementing measures that affect the investments of nationals of the other Party without engaging in a rational decision-making process. Such process would include a consideration of the effect of a measure on foreign investments and a balance of the interests of the State with any burden imposed on such investments. Certainly a State that fails to base its actions on reasoned judgment, and uses abusive arguments instead, would not "stimulate the flow of private capital."[43]

159. The *Genin* case quoted by Respondent provides a good example of a State measure upholding a guarantee similar to the prohibition in the Estonia – U.S. BIT against arbitrary treatment. There, the tribunal concluded that the Bank of Estonia's annulment of a license occurred in the course of

---

[41] *Elettronica Sicula S.p.A.* (*ELSI*) (*United States of America v. Italy*), 1989 I.C.J. 15, 76 (Judgment of 20 July).
[42] *Ronald S. Lauder v. The Czech Republic*, Final Award ¶ 221 (3 September 2001) (*citing* Black's Law Dictionary 100 (7th ed. 1999)).
[43] Preamble, Argentina – U.S. BIT (1994).

exercising its statutory obligations to regulate the Estonian banking sector, and therefore was not arbitrary.[44] In so concluding, the tribunal accepted Estonia's explanation that the circumstances of political and economic transition prevailing in Estonia at the time justified heightened scrutiny of the banking sector, and that such regulation by a State reflects "a clear and legitimate public purpose."[45]

160. In contrast, the *Lauder* tribunal determined that the acts of the Czech Republic's Media Council were arbitrary. Such acts consisted in forcing a private investor in the newly-privatized company that held the state television license to exchange a direct participation in the company for a contractual relationship.[46] The tribunal reasoned that the act was motivated by fear of the political implications of having a foreigner influencing Czech television broadcasts.[47]

(iii) <u>Tribunal's Conclusion</u>

161. This case lands between the two cases mentioned above, but ultimately the Tribunal concludes that the acts of Argentina were not arbitrary, and therefore did not violate Article II(2)(b) for the following reasons.

162. While Claimants have alleged Argentina's political motivation to use foreign investors in the public utility sector as an excuse to justify the economic mistakes committed in the country, Argentina has explained that the Government's motivation was its desire to avoid its full economic collapse. To this end, it entered into agreements with the licensees in 2001, in addition to other actions taken. Bearing in mind the Tribunal's analysis, characterizing the measures as not arbitrary does not mean that such measures are characterized as fair and equitable or regarded as not having

---

[44] *Genin*, ¶ 370.
[45] *Ibidem.*
[46] *Lauder*, ¶ 222-32.

affected the stability of the legal framework under which gas transportation companies in Argentina operated. On the contrary, this means that Argentina faced severe economic and social hardships from 2001 onwards and had to react to the circumstances prevailing at the time. Even though the measures adopted by Argentina may not have been the best, they were not taken lightly, without due consideration. This is particularly reflected in the PPI adjustments which, before deciding on their postponement, Argentina negotiated with the investors. The Tribunal concludes that the charges imposed by Argentina to Claimants' investment, though unfair and inequitable, were the result of reasoned judgment rather than simple disregard of the rule of law.

163. Likewise, it was not arbitrary, though unfair and inequitable, not to restore the Gas Law or the other guarantees related to the gas distribution sector and to implement the contract renegotiation policy.

C. ARTICLE II(2)(c): THE UMBRELLA CLAUSE

1. Parties' Positions

164. LG&E claims that Argentina violated Article II(2)(c) of the BIT when it assumed certain fundamental obligations with regard to investments in its gas-distribution sector and the foreign investors and then repudiated each of these legal commitments without compensating Claimants for their loss.

165. As LG&E explains it, Argentina used foreign capital investment as the cornerstone of its economic recovery plan in the early 1990s. Respondent designed the privatization of *Gas del Estado S.E.* as an international bidding process, in which the conditions for bidding on local enterprises could be met only by a consortium involving foreign investors. Argentina wooed foreign investors with promises of return on investment that would always

[47] *Lauder*, ¶¶ 229, 232.

be reasonable, protections against currency exchange and inflation, adjustment of rates pursuant to international indexes, no unilateral changes and no price controls without indemnification. Argentina bound itself to these promises in the form of legal obligations.

166. According to Claimants, these are the promises that the umbrella clause is meant to address. The Tribunal need not decide that every commitment regarding investments embodied in general legislation or regulations gives rise to obligations that must be observed under that clause. Rather, liability derives from this article of the Treaty when in the particular circumstances of this case, Respondent failed to observe its obligations.

167. The problem with LG&E's claim, according to Respondent, is that it assumes that general legislation relating to the natural gas distribution and transportation industry falls within Article II(2)(c)'s parameter. Respondent suggests that such promises do not qualify as specific representations that make the umbrella clause effective.

168. Respondent also asserts that LG&E's claims are nothing more than claims of contractual breaches, which are to be considered under the specific jurisdictional clauses of the contract and not adjudicated in an international forum under application of the umbrella clause.

2. Tribunal's Analysis

169. Article II(2)(c) of the Treaty provides that "[e]ach party shall observe any obligation it may have entered into with regard to investments."

170. Such clause, referred to as an "umbrella clause," is a general provision included in a fairly large number of bilateral treaties that creates a requirement for the host State to meet its obligations towards foreign investors, including those that derive from a contract. Hence such obligations receive extra protection by virtue of their consideration under the bilateral treaty.

171. In many cases it has been considered that the umbrella clause is activated not by obligations set forth in municipal law, but in contracts between the State and the investor.[48] Several of those tribunals have concluded that the breach of a contractual obligation in a contract between the State and the investor gives rise to a claim under the umbrella clause.[49]

172. The issue for the Tribunal's consideration is whether the provisions of the Gas Law and its implementing regulations constitute (i) "obligations" (ii) "with regard to" LG&E's capacity as a foreign investor (iii) with respect to its "investment," such that abrogation of the guarantees set forth in the Gas Law and its implementing regulations give rise to a violation of the Treaty.

173. In this case, it will be necessary to establish whether LG&E's claims fall under the umbrella clause's protection.

174. In order to determine the applicability of the umbrella clause, the Tribunal should establish if by virtue of the provisions of the Gas Law and its regulations, the Argentine State has assumed international obligations with respect to LG&E and its investment. To this end, it is necessary to remember that the provisions of the Gas Law and its regulation fixed and regulated the tariff scheme ensuring the value of Claimants' investment; that the purpose of Claimants' investment was to increase the value of its shares in the Licensees through a fragile balanced management of profits and costs, represented by the tariffs fixed by Argentina in light of the already mentioned Gas Law and its regulation. In view of the statements above, the Tribunal concludes that these provisions were not legal obligations of a general nature.[50] On the contrary, they were very specific in relation to

---

[48] *See e.g., CMS,* ¶300 (citing cases).

[49] *CMS*, ¶ 303; *SGS v. Republic of the Philippines*, Decision on Jurisdiction, ICSID Case No. ARB/02/6 (29 January 2004), ¶¶ 127-28.

[50] *SGS v. Philippines,* ¶ 121 ("For [the umbrella clause] to be applicable, the host State must have assumed a legal obligation, and it must have been assumed vis-à-vis the specific investment – not as a matter of the application of some legal obligation of a general character.").

LG&E's investment in Argentina, so that their abrogation would be a violation of the umbrella clause.

3. Tribunal's Conclusion

175. As such, Argentina's abrogation of the guarantees under the statutory framework – calculation of the tariffs in dollars before conversion to pesos, semi-annual tariff adjustments by the PPI and no price controls without indemnification – violated its obligations to Claimants' investments. Argentina made these specific obligations to foreign investors, such as LG&E, by enacting the Gas Law and other regulations, and then advertising these guarantees in the Offering Memorandum to induce the entry of foreign capital to fund the privatization program in its public service sector. These laws and regulations became obligations within the meaning of Article II(2)(c), by virtue of targeting foreign investors and applying specifically to their investments, that gave rise to liability under the umbrella clause.

D. CONSIDERATIONS ON INDIRECT EXPROPRIATION

1. Parties' Positions

176. LG&E seeks a declaration from this Tribunal that Argentina expropriated LG&E's investment in the Argentine gas-distribution sector without compensation in violation of Article IV of the Treaty, which provides, in part:

> "1. Investments shall not be expropriated or nationalized either directly or indirectly through measures tantamount to expropriation or nationalization ("expropriation") except for a public purpose; in a non-discriminatory manner; upon payment of prompt, adequate and effective compensation; and in accordance with due process of law and the general principles of treatment provided for in Article II(2)."

177. LG&E articulates its expropriation claim as one of indirect expropriation. In other words, LG&E argues that the Argentine Government's treatment of Claimants' investment in the Licensees constitutes an indirect expropriation

of the investments because the value of LG&E's holdings in the Licenses has been reduced by more than 90% as a result of Respondent's abrogation of the principal guarantees of the tariff system (Claimants' Memorial, ¶ 180).

178. LG&E contends that, pursuant to Article IV of the Bilateral Treaty, it is entitled to compensation equivalent to the fair market value of the expropriated investment immediately before the expropriation was committed. Claimants pinpoint the date of expropriation in this case as the date on which Respondent's course of conduct finally resulted in the virtual destruction of the value of the investment –not later than August 2000, when the Argentine court enjoined implementation of the 17 July 2000 agreement and any further PPI adjustments (Claimants' Memorial, ¶ 181).

179. Under Claimants' theory, indirect expropriation occurs when government action substantially impairs the value of an investment (Claimants' Post-Hearing Brief, ¶ 53 *citing* Dolzer Reb., ¶ 56). In this case, the Claimants consider that the Argentine Government's actions had a substantial effect on LG&E's shares in the Licensees, which are an investment protected under Article I(1)(a) of the Treaty. The value of LG&E's investment was based on a tariff system and depended on the Respondent respecting the system. The value of LG&E's shares in the Licensees now fluctuates according to general speculation around the future tariff relief that Argentina may or may not grant (Claimants' Post-Hearing Brief, ¶ 53).

180. Claimants add that when it comes to establishing whether there was effectively an indirect expropriation, there is no relevance to the fact that the Licensees continue to operate or control their gas-distribution business, or as to whether Claimants hold title to the shares. In the case of indirect expropriation, it does not matter whether title to the licenses has been transferred to the State. It is enough to show that their investment has been impaired as a result of government action, which they claim is the case here as there allegedly has been a substantial appropriation of value by the State and transfer of wealth from the gas industry to gas consumers, especially

large industrial consumers (Claimants' Post-Hearing Brief, ¶¶ 53-54).

181. The Respondent denies that any expropriation under Article IV of the Bilateral Treaty has occurred. Respondent contends that, in order for the Argentine Government to have either directly or indirectly expropriated Claimants' investment, the measures at issue would have had to have been designed to transfer title to the investment to the State. The sole difference between direct and indirect expropriation in this case, according to Respondent, is that with indirect expropriation, no formal transfer of title is required, since its purpose is that of "masking, disguising the expropriating event and of eluding the resulting liability" (Respondent's Post-Hearing Brief, ¶ 103).

182. Respondent argues that Claimants have not proven that the PPI's suspension constitutes an expropriating event. Respondent contends that the suspension of the PPI adjustments would have affected tariffs by approximately 2%, and states that under no circumstance could a tribunal conclude that such a small loss qualifies as an expropriation subject to compensation.

183. Argentina argues that in any event there could not have been any expropriation during the economic crisis. The fact that the licensees may have been affected by the crisis, along with everyone else, does not lead to the conclusion that their investment was expropriated. Respondent denies any causal link between the measures adopted by the Argentine State during this time and the fluctuations in the value of LG&E's shares in the licensees. In its opinion, the fluctuation in the value of LG&E's investment is attributable to the "macroeconomic conditions affecting the Argentine Republic", rather than the measures adopted by the Argentine State (Respondent's Post-Hearing Brief, ¶ 109). Argentina points out that between 1997 and 2000, LG&E earned higher income than expected through its investments in the licensees.

184. Finally, after objecting the expropriation claim because the company

remains de facto and by law the owner of the investment, Respondent alleges that, in fact, the share prices of Claimants' investment have increased in value from the period immediately preceding the suspension of the PPI adjustments. As such, Respondent argues that where property is worth more today than it was prior to the measures' adoption, the property may not be deemed expropriated (Respondent's Post-Hearing Brief, ¶¶ 110-111).

2. <u>Tribunal's Analysis</u>

185. In order to establish the sustainability of an indirect expropriation, the Tribunal must define the concept. Generally, bilateral treaties do not define what constitutes an expropriation –they just make an express reference to "expropriation" and add the language "any other action that has equivalent effects." Likewise, Article IV of the Bilateral Treaty does not define the term "expropriation" and does not establish which measures, actions or conduct would constitute acts "tantamount to expropriation." Therefore, the Tribunal shall look to international law in determining the relevant criteria for evaluating this claim.

186. A State may, at its discretion, under Article IV of the Bilateral Treaty and in accordance with general principles of international law, make use of its sovereign power to expropriate private property with the purpose of satisfying a public interest. However, expropriation in any of its modalities requires due process and compensation under international law.

187. Although in scholarly authority two kinds of expropriation are known, we will obviously skip the direct one, understood as the forcible appropriation by the State of the tangible or intangible property of individuals by means of administrative or legislative action. The parties admit that the claim at issue does not involve a direct expropriation. In the case of the Argentine Republic, one could not say that it appropriated Claimants' investment, which is the indispensable requirement if one is to talk of direct expropriation. Instead, we shall limit ourselves to the assumption of the

indirect expropriation, one qualified by the Bilateral Treaty itself as "measures tantamount to expropriation."

188. Generally, the expression "equivalent to expropriation" or "tantamount to expropriation" found in most bilateral treaties, may refer both, to the so-called "creeping expropriation" and to the *de facto* expropriation. Their common point rests in the fact that the host State's actions or conduct do not involve "overt taking" but the taking occurs when governmental measures have "effectively neutralize[d] the benefit of property of the foreign owner."[51] Ownership or enjoyment can be said to be "neutralized" where a party no longer is in control of the investment, or where it cannot direct the day-to-day operations of the investment.[52] As to the differences, it is usual to say that indirect expropriation may show itself in a gradual or growing form —creeping expropriation— or through a sole and unique action, or through actions being quite close in time or simultaneous —*de facto* expropriation.

189. In order to establish whether State measures constitute expropriation under Article IV(1) of the Bilateral Treaty, the Tribunal must balance two competing interests: the degree of the measure's interference with the right of ownership and the power of the State to adopt its policies.

190. In evaluating the degree of the measure's interference with the investor's right of ownership, one must analyze the measure's economic impact – its interference with the investor's reasonable expectations – and the measure's duration.

191. In considering the severity of the economic impact, the analysis focuses on whether the economic impact unleashed by the measure adopted by the host State was sufficiently severe as to generate the need for compensation due to expropriation. In many arbitral decisions, the compensation has been denied

[51] *CME Czech Republic v. Czech Republic*, Partial Award, ¶ 604 (13 September 2001).

when it has not affected all or almost all the investment's economic value. Interference with the investment's ability to carry on its business is not satisfied where the investment continues to operate, even if profits are diminished.[53] The impact must be substantial in order that compensation may be claimed for the expropriation.

192. The tribunal in *Tecmed* required a finding that Claimant had been "radically deprived of the economical use and enjoyment of its investments, as if the rights related thereto –such as the income or benefits related to the [investment…]– had ceased to exist."[54] In other words, if due to the actions of the Respondent, the assets involved have lost their value or economic use for the Claimants and the extent of the loss.[55]

193. Similarly, one must consider the duration of the measure as it relates to the degree of interference with the investor's ownership rights. Generally, the expropriation must be permanent, that is to say, it cannot have a temporary nature, unless the investment's successful development depends on the realization of certain activities at specific moments that may not endure variations.

194. There is no doubt that the facts relating to the severity of the changes on the legal status and the practical impact endured by the investors in this case, as well as the possibility of enjoying the right of ownership and use of the investment are decisive in establishing whether an indirect expropriation is said to have occurred. The question remains as to whether one should only take into account the effects produced by the measure or if one should consider also the context within which a measure was adopted and the host State's purpose. It is this Tribunal's opinion that there must be a balance in

---

[52] *Pope & Talbot Inc. v. Canada*, Interim Award, ¶ 100 (26 June 2000).
[53] *Pope & Talbot*, ¶¶ 101-02.
[54] *Tecmed*, ¶ 115.
[55] *Ibidem*.

the analysis both of the causes and the effects of a measure in order that one may qualify a measure as being of an expropriatory nature. It is important not to confound the State's right to adopt policies with its power to take an expropriatory measure. "This determination is important because it is one of the main elements to distinguish, from the perspective of an international tribunal between a regulatory measure, which is an ordinary expression of the exercise of the state's police power that entails a decrease in assets or rights, and a *de facto* expropriation that deprives those assets and rights of any real substance."[56]

195. With respect to the power of the State to adopt its policies, it can generally be said that the State has the right to adopt measures having a social or general welfare purpose. In such a case, the measure must be accepted without any imposition of liability, except in cases where the State's action is obviously disproportionate to the need being addressed. The proportionality to be used when making use of this right was recognized in *Tecmed*, which observed that "whether such actions or measures are proportional to the public interest presumably protected thereby and the protection legally granted to investments, taking into account that the significance of such impact, has a key role upon deciding the proportionality."[57]

196. As is observed by *The American Law Institute's Restatement (Third) of the Foreign Relations Law of the United States*, "a state is not responsible for loss of property or for other economic disadvantage resulting from *bona fide* general taxation, regulation, forfeiture for crime, or other action of the kind that is commonly accepted as within the police power of the states, if it is not discriminatory…"[58]. This criterion was used by the Tribunal of Iran-United

---

[56] *Ibidem*.
[57] *Tecmed*, ¶122.
[58] *Restatement (Third) of the Foreign Relations Law of the United States*, American Law Institute,

footnote cont'd

States of America claims in the *Too v. Greater Modesto Insurance Associates.*[59]

197. As was stated in the *Oscar Chinn* affair of 1934, adopted by the Permanent Court of International Justice:

> "No enterprise… can escape from the chances and hazards resulting from general economic conditions. Some industries may be able to make large profits during a period of general prosperity, or else by taking advantages of a treaty of commerce or of an alteration in customs duties; but they are also exposed to the danger of ruin or extinction if circumstances change. Where this is the case, no vested rights are violated by the State."[60]

3. Tribunal's Conclusion

198. In the circumstances of this case, although the State adopted severe measures that had a certain impact on Claimants' investment, especially regarding the earnings that the Claimants expected, such measures did not deprive the investors of the right to enjoy their investment. As in *Pope & Talbot*, the true interests at stake here are the investment's asset base, the value of which has rebounded since the economic crisis of December 2001 and 2002.

199. Further, it cannot be said that Claimants lost control over their shares in the licensees, even though the value of the shares may have fluctuated during the economic crisis, or that they were unable to direct the day-to-day operations of the licensees in a manner different than before the measures were implemented.

200. Thus, the effect of the Argentine State's actions has not been permanent on the value of the Claimants' shares', and Claimants' investment has not ceased to exist. Without a permanent, severe deprivation of LG&E's rights

---

Volume 1, 1987, Section 712, Comment g.

[59] *Too v. Greater Modesto Insurance Associates,* 23 Iran-United States Cl. Trib. Rep. 378, Award of 29 December 1989.

[60] *Oscar Chinn* affair, P.C.I.J, 1934, Ser A/B, Case No. 63.

with regard to its investment, or almost complete deprivation of the value of LG&E's investment, the Tribunal concludes that these circumstances do not constitute expropriation.

E. State of Necessity

1. Parties' Positions

201. Respondent contends in the alternative that, if Argentina would have breached its Treaty obligations, the state of political, economic and social crisis that befell Argentina allowed it to take action contrary to the obligations it had assumed with respect to the gas-distribution licensees. Thus, even if the measures adopted by the State in order to overcome the economic crisis suffered during the years 1998 through 2003, resulted in a violation of the rights guaranteed under the Treaty to foreign investments, such measures were implemented under a state of necessity and therefore, Argentina is excused from liability during this period.

202. Respondent pleads its defense as a "state of necessity" defense, available under Argentine law, Treaty in Articles XI and IV(3), as well as customary international law.

203. Claimants reject Respondent's contentions regarding the alleged state of necessity defense. Claimants contend that Article XI is not applicable in the case of an economic crisis because the public order and essential security interests elements are intentionally narrow in scope, limited to security threats of a physical nature.

2. General Comments on Article XI

(i) Preliminary Considerations

204. Article XI of the Bilateral Treaty provides:

> "This Treaty shall not preclude the application by either Party of measures necessary for the maintenance of public order, the

> fulfillment of its obligations with respect to the maintenance or restoration of international peace or security, or the protection of its own essential security interests."

205. The Tribunal's analysis to determine the applicability of Article XI of the Bilateral Treaty is twofold. First, the Tribunal must decide whether the conditions that existed in Argentina during the relevant period were such that the State was entitled to invoke the protections included in Article XI of the Treaty. Second, the Tribunal must determine whether the measures implemented by Argentina were necessary to maintain public order or to protect its essential security interests, albeit in violation of the Treaty.[61]

206. The Tribunal reiterates that to carry out the two-fold analysis already mentioned, it shall apply first, the Treaty, second, the general international law to the extent that is necessary and third, the Argentine domestic law. The Tribunal underscores that the claims and defenses mentioned derive from the Treaty and that, to the extent required for the interpretation and application of its provisions, the general international law shall be applied (See section V. B *supra*).

(ii) <u>The Question of Whether Article XI is Self-Judging</u>

207. Before turning to its substantive analysis of Article XI, the Tribunal must determine whether Article XI is *self-judging*.

208. Respondent has argued that because Article XI is a self-judging provision, it is for the State to make a good faith determination as to what measures are necessary for the maintenance of public order, or the protection of its essential security interests. According to Respondent, under this self-judging exception, the Tribunal must decide only whether Argentina acted in good faith or not.

---

[61] Respondent has not relied upon the third element of Article XI, "the fulfillment of its obligations with respect to the maintenance or restoration of international peace or security."

209. Respondent considers Article XI is ambiguous and characterizes such ambiguity as a "strategic ambiguity" on the part of the United States, since it does not clearly define who should determine if the measures to maintain public order or protect essential security interests are necessary. Respondent recognizes that the United States' 1987 Model BIT, upon which the Argentina–U.S. BIT was based, does not clarify the United States' position, nor does any of the documentation related to the negotiation or ratification of the Argentina-U.S. BIT. However, Respondent contends that subsequent to the conclusion of the Argentina-U.S. BIT, the United States shifted its position permanently with regard to essential security clauses, stating in 1992 that the United States considered such clauses to be self-judging, presently and retroactively (Slaughter Witness Statement, ¶¶ 12-31).

210. Claimants disagree that Article XI is self-judging, and argue instead that its application requires that the Tribunal conduct its own analysis of whether the conditions necessitated measures to maintain public order or protect Argentina's essential security interests within the meaning of Article XI.

211. Claimants contend that neither the plain meaning of Article XI, nor the context or purpose of the Treaty suggest that Article XI is self-judging, and that the position of the United States at the time the parties signed the Treaty was that such clauses were not self-judging (Hearing on the Merits, 28 January 2005, Alvarez, Spanish Transcript, p. 925 *et seq.*). Claimants argue that Respondent has not proven that the parties to the Treaty intended Article XI to be self-judging, which they characterize as "an exceptional thing." (Hearing on the Merits, 28 January 2005, Alvarez, Spanish Transcript, p. 932 *et seq.*). Claimants contend that the United States did not consider essential security clauses as self-judging until the Russia-U.S. BIT of 1992 and the 1992 U.S. Model BIT, both of which post-date the Argentina-U.S. BIT, and both of which noted explicitly the change in the United States' policy that these provisions were to be self-judging.

212. Certainly, the language of the BIT does not specify who should decide what

constitutes essential security measures –either Argentina itself, subject to a review under a good faith standard, or the Tribunal. Based on the evidence before the Tribunal regarding the understanding of the Parties in 1991 at the time the Treaty was signed, the Tribunal decides and concludes that the provision is not self-judging.

213. The provisions included in the international treaty are to be interpreted in conformity with the interpretation given and agreed upon by both parties at the time of its signature, unless both parties agreed to its modification. In that case, the date to be considered is November 1991. It is not until 1992, with the ratification of the Russia – US BIT, that the United States begins to consider that the application of the essential security measures are *self judging*; both instruments post-date the bilateral treaty between the United States and the Argentine Republic and, in both cases, this change was explicitly clarified.

214. Were the Tribunal to conclude that the provision is self-judging, Argentina's determination would be subject to a good faith review anyway, which does not significantly differ from the substantive analysis presented here.

(iii) Necessary Nature of the Measures Adopted

a. Parties' Positions

215. Argentina defends the measures it implemented as necessary to maintain public order and protect its essential security interests. It contends that under any interpretation, the financial crisis, riots and chaos of the years 2000 through 2002 in Argentina constitute a national emergency sufficient to invoke the protections of Article XI (Slaughter Witness Statement, ¶ 45).

216. Concerning "public order", Respondent reinforces its arguments on the necessary nature of the measures it had implemented by pointing to numerous reports of waves of sudden economic catastrophe, massive strikes involving millions of workers, fatal shootings, the shut down of schools,

businesses, transportation, energy, banking and health services, demonstrations across the country, and a plummeting stock market, culminating in a "final massive social explosion" in which five presidential administrations resigned within a month (Slaughter Witness Statement, ¶¶ 46-49). Under these circumstances, Argentina argues that price controls by the Argentine Government would have been fully justifiable under the public order provisions of Article XI. Additionally, Respondent argues that actions to freeze price increases in the gas-distribution sector were justifiable to maintain the country's basic infrastructure, which was dependent on natural gas energy.

217. Argentina also defends its measures as necessary to protect its essential security interests. Argentina asserts that Article XI's "essential security interests" element encompasses economic and political interests, as well as national military defense interests. Respondent cites several United States' officials who have propounded a broad interpretation of "essential security interests" (Slaughter Witness Statement, ¶ 38).

218. Respondent attacks Claimants' basis for asserting that the clause is narrow, reserved only for military actions. Furthermore, in all of the cases cited by Claimants, the point was whether the use of military force was justifiable under international law – a narrow reading of essential security clauses in these cases would be expected.

219. Because economic stability, in Respondent's view, falls within a State's essential security interests, Respondent defends the measures it took as necessary to protect its economic interests. Respondent argues that during the crisis period, the health, safety and security of the Argentine State and its people were threatened, and that the economic melt-down had the potential to cause catastrophic state failure. Thus, the public emergency that Argentina declared and the Emergency Law the Government passed altering its financial arrangements were necessary to protect the State's essential security interests.

220. Claimants identify the four measures at issue here –suspension and abolishment of the PPI adjustment, freezing the gas-distribution tariffs, and abandonment of the calculation of the tariffs in dollars, all taken unilaterally– and contend that Respondent must prove that each measure was necessary in order to maintain public order and protect Argentina's essential security interests (Reply, ¶ 209). By the term "necessary," Claimants contend that these measures must have been the only option available to Argentina in order to invoke protection under Article XI.

221. Claimants define public order measures as "actions taken pursuant to a state's police powers, particularly in respect of public health and safety". Based on this definition, Claimants state that the measures in dispute in this case were not aimed at bringing calmness to the collapse that was threatening the country. Consequently, such measures cannot be deemed necessary to maintain public order.

222. With respect to "essential security interests," Claimants reiterate that such interests do not include economic interests –only defense or military concerns. They compare a State's interest in essential security to a national security threat, while a "national emergency," the alleged circumstance in which Respondent invokes the protection, has an entirely different meaning. In Claimants' view, economic crises should not be elevated to an essential security interest, and that doing so would disregard the object and purpose of the Treaty. They argue that an economic crisis is precisely when investors need the protections offered by a BIT.

223. Claimants argue that in any event, Article XI does not relieve Argentina of its obligations to compensate Claimants for damages suffered as a result of breaches of the Treaty.

224. Claimants also reject the possibility of applying the rule provided by Article IV(3) of the Treaty. They are of the opinion that this provision does not apply to economic crises, and it does not authorize the host State to revoke

or suspend the protections given to foreign investors (Reply, ¶ 229).

225. Claimants invoke Article 27 of the International Law Commission's Draft Articles on State Responsibility. Claimants contend that even if the state of necessity defense is available to Argentina under the circumstances of this case, Article 27 of the Draft Articles makes clear that Argentina's obligations to Claimants are not extinguished and Argentina must compensate Claimants for losses incurred as a result of the Government's actions. Article 27 provides that "invocation of a circumstance precluding wrongfulness in accordance with this chapter is without prejudice to (a) compliance with the obligation in question… (b) the question of compensation for any material loss caused by the act in question" (Reply, ¶¶ 226-228).

b. Tribunal's Analysis

226. In the judgment of the Tribunal, from 1 December 2001 until 26 April 2003, Argentina was in a period of crisis during which it was necessary to enact measures to maintain public order and protect its essential security interests.

227. The Tribunal does not consider that the initial date for the state of necessity is the effective date of the Emergency Law, 6 January 2002, because, in the first place, the emergency had already started when the law was enacted. Second, should the Tribunal take as the initial date the day when the Emergency Law became effective, it might be reasonable to take as its closing date the day when the state of emergency is lifted by the Argentine State, a fact that has not yet taken place since the law has been extended several times.

228. It is to be pointed out that there is a factual emergency that began on 1 December 2001 and ended on 26 April 2003, on account of the reasons detailed below, as well as a legislative emergency, that begins and ends with the enactment and abrogation of the Emergency Law, respectively. It should be borne in mind that Argentina declared its state of necessity and has

extended such state until the present. Indeed, the country has issued a record number of decrees since 1901, accounting for the fact that the emergency periods in Argentina have been longer than the non-emergency periods. Emergency periods should be only strictly exceptional and should be applied exclusively when faced with extraordinary circumstances. Hence, in order to allege state of necessity as a State defense, it will be necessary to prove the existence of serious public disorders. Based on the evidence available, the Tribunal has determined that the situation ended at the time President Kirchner was elected.

229. Thus, Argentina is excused under Article XI from liability for any breaches of the Treaty between 1 December 2001 and 26 April 2003. The reasons are the following:

230. These dates coincide, on the one hand, with the Government's announcement of the measure freezing funds, which prohibited bank account owners from withdrawing more than one thousand pesos monthly and, on the other hand, with the election of President Kirchner. The Tribunal marks these dates as the beginning and end of the period of extreme crisis in view of the notorious events that occurred during this period.

231. Evidence has been put before the Tribunal that the conditions as of December 2001 constituted the highest degree of public disorder and threatened Argentina's essential security interests. This was not merely a period of "economic problems" or "business cycle fluctuation" as Claimants described (Claimants' Post-Hearing Brief, ¶ 14). Extremely severe crises in the economic, political and social sectors reached their apex and converged in December 2001, threatening total collapse of the Government and the Argentine State.

232. All of the major economic indicators reached catastrophic proportions in December 2001. An accelerated deterioration of Argentina's Gross Domestic Product (GDP) began in December 2001, falling 10 to 15 percent faster than

the previous year. Private consumption dramatically dropped in the fourth quarter of 2001, accompanied by a severe drop in domestic prices. Argentina experienced at this time widespread decline in the prices and in the value of assets located in Argentina. The Merval Index, which measures the share value of the main companies of Argentina listed on the Buenos Aires Stock Exchange, experienced a dramatic decline of 60% by the end of December 2001. By mid-2001, Argentina's country risk premium was the highest premium worldwide, rendering Argentina unable to borrow on the international markets, and reflecting the severity of the economic crisis.

233. At this time, capital outflow was a critical problem for the Government. In the fourth quarter of 2001, the Central Bank of Argentina lost US$ 11 billion in liquid reserves, amounting to 40%. The banking system lost 25% of its total deposits.

234. While unemployment, poverty and indigency rates gradually increased from the beginning of 1998, they reached intolerable levels by December 2001. Unemployment reached almost 25%, and almost half of the Argentine population was living below poverty. The entire healthcare system teetered on the brink of collapse. Prices of pharmaceuticals soared as the country plunged deeper into the deflationary period, becoming unavailable for low-income people. Hospitals suffered a severe shortage of basic supplies. Investments in infrastructure and equipment for public hospitals declined as never before. These conditions prompted the Government to declare the nationwide health emergency to ensure the population's access to basic health care goods and services. At the time, one quarter of the population could not afford the minimum amount of food required to ensure their subsistence. Given the level of poverty and lack of access to healthcare and proper nutrition, disease followed. Facing increased pressure to provide social services and security to the masses of indigent and poor people, the Government was forced to decrease its per capita spending on social services by 74%.

235. By December 2001, there was widespread fear among the population that the Government would default on its debt and seize bank deposits to prevent the bankruptcy of the banking system. Faced with a possible run on banks, the Government issued on 1 December 2001 Decree of Necessity and Emergency No. 1570/01. The law triggered widespread social discontent. Widespread violent demonstrations and protests brought the economy to a halt, including effectively shutting down transportation systems. Looting and rioting followed in which tens of people were killed as the conditions in the country approached anarchy. A curfew was imposed to curb lootings.

236. By 20 December 2001, President De la Rúa resigned. His presidency was followed by a succession of presidents over the next days, until Mr. Eduardo Duhalde took office on 1 January 2002, charged with the mandate to bring the country back to normal conditions.

237. All of these devastating conditions –economic, political, social– in the aggregate triggered the protections afforded under Article XI of the Treaty to maintain order and control the civil unrest.

238. The Tribunal rejects the notion that Article XI is only applicable in circumstances amounting to military action and war. Certainly, the conditions in Argentina in December 2001 called for immediate, decisive action to restore civil order and stop the economic decline. To conclude that such a severe economic crisis could not constitute an essential security interest is to diminish the havoc that the economy can wreak on the lives of an entire population and the ability of the Government to lead. When a State's economic foundation is under siege, the severity of the problem can equal that of any military invasion.

239. Claimants contend that the necessity defense should not be applied here because the measures implemented by Argentina were not the only means available to respond to the crisis. The Tribunal rejects this assertion. Article XI refers to situations in which a State has no choice but to act. A State may

have several responses at its disposal to maintain public order or protect its essential security interests. In this sense, it is recognized that Argentina's suspension of the calculation of tariffs in U.S. dollars and the PPI adjustment of tariffs was a legitimate way of protecting its social and economic system.

240. The Tribunal has determined that Argentina's enactment of the Emergency Law was a necessary and legitimate measure on the part of the Argentine Government. Under the conditions the Government faced in December 2001, time was of the essence in crafting a response. Drafted in just six days, the Emergency Law took the swift, unilateral action against the economic crisis that was necessary at the time (Hearing on the Merits, 25 January 2005, Ratti, Spanish Transcript, pp. 415-419).

241. In drafting the Emergency Law, the Government considered the interests of the foreign investors, and concluded that it "could not leave sectors of the economy operating with the brutally dollarized economy –[the] system was in crisis, so we had to cut off that process, and we had to establish a new set of rules for everybody." (Hearing on the Merits, 25 January 2005, Ratti, Spanish Transcript, p. 417). Argentina's strategy to deal with the thousands of public utility contracts that could not be individually assessed during the period of crisis was to implement "across-the-board solutions" and then renegotiate the contracts (Hearing on the Merits, 26 January 2005, Roubini, Spanish Transcript, p. 635). The Tribunal accepts the necessity of approaching enactment of a stop-gap measure in this manner and therefore rejects Claimants' objection that Argentina's unilateral response was not necessary.

242. The Tribunal accepts that the provisions of the Emergency Law that abrogated calculation of the tariffs in U.S. dollars and PPI adjustments, as well as freezing tariffs were necessary measures to deal with the extremely serious economic crisis. Indeed, it would be unreasonable to conclude that during this period the Government should have implemented a tariff increase pursuant to an index pegged to an economy experiencing a high inflationary

period (the United States). The severe devaluation of the peso against the dollar renders the Government's decision to abandon the calculation of tariffs in dollars reasonable. Similarly, the Government deemed that freezing gas tariffs altogether during the crisis period was necessary, and Claimants have not provided any reason as to why such measure would not provide immediate relief from the crisis.

243. The Tribunal will now turn to Article IV(3) of the Treaty, which provides:

> "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*, insurrection, civil disturbance or other similar events 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, whichever is the more favorable treatment, as regards any measures it adopts in relation to such losses." (Emphasis added)

244. Article IV(3) of the Treaty confirms that the States Party to the Bilateral Treaty contemplated the state of national emergency as a separate category of exceptional circumstances. That is in line with the Tribunal's interpretation of Article XI of the Treaty. Furthermore, the Tribunal has determined, as a factual matter that the grave crisis in Argentina lasted from 1 December 2001 until 26 April 2003. It has not been shown convincingly to the Tribunal that during that period the provisions of Article IV(3) of the Treaty have been violated by Argentina. On the contrary, during that period, the measures taken by Argentina were "across the board."

245. In the previous analysis, the Tribunal has determined that the conditions in Argentina from 1 December 2001 until 26 April 2003 were such that Argentina is excused from liability for the alleged violation of its Treaty obligations due to the responsive measures it enacted. The concept of excusing a State for the responsibility for violation of its international obligations during what is called a "state of necessity" or "state of emergency" also exists in international law. While the Tribunal considers

that the protections afforded by Article XI have been triggered in this case, and are sufficient to excuse Argentina's liability, the Tribunal recognizes that satisfaction of the state of necessity standard as it exists in international law (reflected in Article 25 of the ILC's Draft Articles on State Responsibility) supports the Tribunal's conclusion.[62]

246. In international law, a state of necessity is marked by certain characteristics that must be present in order for a State to invoke this defense. As articulated by Roberto Ago, one of the mentors of the Draft Articles on State Responsibility, a state of necessity is identified by those conditions in which a State is threatened by a serious danger to its existence, to its political or economic survival, to the possibility of maintaining its essential services in operation, to the preservation of its internal peace, or to the survival of part of its territory.[63] In other words, the State must be dealing with interests that are essential or particularly important.[64]

---

[62]Article 25 of the Draft Articles on Responsibility of States for Internationally Wrongful Acts provides:

> 1. "Necessity may not be invoked by a State as a ground for precluding the wrongfulness of an act not in conformity with an international obligation of that State unless the act:
>
> a) Is the only way for the State to safeguard an essential interest against a grave and imminent peril; and
>
> b) 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.
>
> 2. In any case, necessity may not be invoked by a State as a ground for precluding wrongfulness if:
>
> a) The international obligation in question excludes the possibility of invoking necessity; or
>
> b) The State has contributed to the situation of necessity."

The ILC's Draft Articles, after some debate regarding the original prepared under the auspices of the Society of Nations in 1930, was abandoned and then resumed by the General Assembly in 1963. Its definitive version, due mainly to the works of Mssrs. Roberto Ago, Willem Riphagen and Gaetano Arangio-Ruiz, was approved in 1981 and subject to a revision in 1998, which was approved in 2001, during the 85th plenary session of the United Nations' General Assembly. (Session dated 12 December 2001, during the fifty-sixth session, Agenda item 162 of the Program, A/RES/56/83).

[63] United Nations, Report A/CN.4/318/ADD.5, p. 3.

[64] Strupp. K., *Les règles générales du Droit de la paix*, RECUEIL DES COURS, 1934 I, T. 47, pp. 259-595, especially p. 568. Similarly, the ILC has defined the state of necessity as that situation where the only means of safeguarding an essential interest of the State against a grave and imminent peril is an act that is not in conformity with an international obligation binding that State with another State. In shaping the concept of state of necessity, one must make a compulsory reference to the Russian seal furs case. There, the Russian government banned the hunting of seals near the Russian shorelines,

footnote cont'd

247. The United Nations Organization has understood that the invocation of a state of necessity depends on the concurrent existence of three circumstances, namely: a danger to the survival of the State, and not for its interests, is necessary; that danger must not have been created by the acting State; finally, the danger should be serious and imminent, so that there are no other means of avoiding it.

248. The concept of state of necessity and the requirements for its admissibility lead to the idea of prevention: the State covers itself against the risk of suffering certain damages. Hence, the possibility of alleging the state of necessity is closely bound by the requirement that there should be a serious and imminent threat and no means to avoid it. Such circumstances, in principle, have been left to the State's subjective appreciation, a conclusion accepted by the International Law Commission. Nevertheless, the Commission was well aware of the fact that this exception, requiring admissibility, has been frequently abused by States, thus opening up a very easy opportunity to violate the international law with impunity. The Commission has set in its Draft Articles on State Responsibility very restrictive conditions to account for its admissibility, reducing such subjectivity.[65]

249. James Crawford, who was rapporteur of the Draft Articles approved in 2001, noted that when a State invokes the state of necessity, it has full knowledge of the fact that it deliberately chooses a procedure that does not abide an

---

including international waters and founded such decision on the absolute need to adopt immediate provisional measures. In a communication addressed, on the occasion of this incident, by the Russian foreign Minister, Chickline, to the British Ambassador, Morier, the main elements of the state of necessity were established: the absolutely exceptional nature of the alleged situation; the imminent character of the threat against an important State interest; the impossibility of avoiding the risk with other means, and the necessarily temporary nature of this justification, linked to the due danger's persistence. *See* United Nations, Report of the International Law Commission on the work performed during its 32nd session, p. 87.

[65] United Nations, Report A/CN.4/315, p. 78.

international obligation.[66] This deliberate action on the part of the State is therefore subject to the requirements of Article 25 of the Draft Articles, which must concur jointly and without which it is not possible to exclude under international law the wrongfulness of a State's act that violates an international obligation.

250. Taking each element in turn, Article 25 requires first that the act must be the only means available to the State in order to protect an interest. According to S.P. Jagota, a member of the Commission, such requirement implies that it has not been possible for the State to "avoid by any other means, even a much more onerous one that could have been adopted and maintained the respect of international obligations. The State must have exhausted all possible legal means before being forced to act as it does."[67] Any act that goes beyond the limits of what is strictly necessary "may not be considered as no longer being, as such, a wrongful act, even if justification of the necessity may have been admitted."[68]

251. The interest subject to protection also must be essential for the State. What qualifies as an "essential" interest is not limited to those interests referring to the State's existence. As evidence demonstrates, economic, financial or those interests related to the protection of the State against any danger seriously compromising its internal or external situation, are also considered essential interests. Roberto Ago has stated that essential interests include those related to "different matters such as the economy, ecology or other."[69] Julio Barboza affirmed that the threat to an essential interest would be identified by considering, among other things, "a serious threat against the existence of the State, against its political or economic survival, against the

---

[66] Crawford, James, *Second Report on State Responsibility*, UN General Assembly, International Law Commission, 51st Session, Geneva, 23 July 1999, A/CN.4/498/Add 2, p. 27-28.
[67] United Nations, Report A/CN.4/SER.A/1980, pp. 155 and 175.
[68] *Ibidem.*
[69] United Nations, Report A/CN.4/SER.A/1980, p.174.

maintenance of its essential services and operational possibilities, or against the conservation of internal peace or its territory's ecology."[70]

252. James Crawford has stated that no opinion may be offered *a priori* of "essential interest," but one should understand that it is not the case of the State's "existence", since the "purpose of the positive law of self-defense is to safeguard that existence."[71] Thus, an interest's greater or lesser essential, must be determined as a function of the set of conditions in which the State finds itself under specific situations. The requirement is to appreciate the conditions of each specific case where an interest is in play, since what is essential cannot be predetermined in the abstract.[72]

253. The interest must be threatened by a serious and imminent danger. The threat, according to Roberto Ago, "must be 'extremely grave' and 'imminent.'"[73] In this respect, James Crawford has opined that the danger must be established objectively and not only deemed possible.[74] It must be imminent in the sense that it will soon occur.

254. The action taken by the State may not seriously impair another State's interest. In this respect, the Commission has observed that the interest sacrificed for the sake of necessity must be, evidently, less important than the interest sought to be preserved through the action.[75] The idea is to prevent against the possibility of invoking the state of necessity only for the safeguard of a non-essential interest.

255. The international obligation at issue must allow invocation of the state of

---

[70] *Ibidem.*
[71] Crawford, James, *Second Report on State Responsibility, op. cit.*, p. 30.
[72] *Ibidem*.
[73] United Nations, Report A/CN.4/318/ADD.5-7. p. 20.
[74] Crawford, James, *Second Report on State Responsibility op. cit*., p. 31. In fact, this is so reflected in Principle 15 of the Rio Declaration on Environment and Development, adopted by the United Nations' Conference on Environment and Development in 1992.
[75] United Nations, Report A/CN.4/318/ADD.5-7. p. 20.

necessity. The inclusion of an article authorizing the state of necessity in a Bilateral Investment Treaty constitutes the acceptance, in the relations between States, of the possibility that one of them may invoke the state of necessity.

256. The State must not have contributed to the production of the state of necessity. It seems logical that if the State has contributed to cause the emergency, it should be prevented from invoking the state of necessity. If there is fault by the State, the exception disappears, since in such case the causal relationship between the State's act and the damage caused is produced. The Tribunal considers that, in the first place, Claimants have not proved that Argentina has contributed to cause the severe crisis faced by the country; secondly, the attitude adopted by the Argentine Government has shown a desire to slow down by all the means available the severity of the crisis.

257. The essential interests of the Argentine State were threatened in December 2001. It faced an extremely serious threat to its existence, its political and economic survival, to the possibility of maintaining its essential services in operation, and to the preservation of its internal peace. There is no serious evidence in the record that Argentina contributed to the crisis resulting in the state of necessity. In this circumstances, an economic recovery package was the only means to respond to the crisis. Although there may have been a number of ways to draft the economic recovery plan, the evidence before the Tribunal demonstrates that an across-the-board response was necessary, and the tariffs on public utilities had to be addressed. It cannot be said that any other State's rights were seriously impaired by the measures taken by Argentina during the crisis. Finally, as addressed above, Article XI of the Treaty exempts Argentina of responsibility for measures enacted during the state of necessity.

258. While this analysis concerning Article 25 of the Draft Articles on State Responsibility alone does not establish Argentina's defense, it supports the

Tribunal's analysis with regard to the meaning of Article XI's requirement that the measures implemented by Argentina had to have been necessary either for the maintenance of public order or the protection of its own essential security interests.

259. Having found that the requirements for invoking the state of necessity were satisfied, the Tribunal considers that it is the factor excluding the State from its liability vis-à-vis the damage caused as a result of the measures adopted by Argentina in response to the severe crisis suffered by the country.

260. With regard to Article 27 of the United Nations' Draft Articles alleged by Claimants, the Tribunal opines that the article at issue does not specifically refer to the compensation for one or all the losses incurred by an investor as a result of the measures adopted by a State during a state of necessity. The commentary introduced by the Special Rapporteur establishes that Article 27 "*does not attempt to specify in what circumstances compensation would be payable*".[76] The rule does not specify if compensation is payable during the state of necessity or whether the State should reassume its obligations. In this case, this Tribunal's interpretation of Article XI of the Treaty provides the answer.

261. Following this interpretation the Tribunal considers that Article XI establishes the state of necessity as a ground for exclusion from wrongfulness of an act of the State, and therefore, the State is exempted from liability. This exception is appropriate only in emergency situations; and once the situation has been overcome, i.e. certain degree of stability has been recovered; the State is no longer exempted from responsibility for any violation of its obligations under the international law and shall reassume them immediately.

---

[76]Crawford, James, *The International Law Commission's Articles on State Responsibility,* Cambridge University Press, 2002, p. 178 *et seq*.

(iv) Consequences of the State of Necessity

262. Three relevant issues arise with respect to the Tribunal's finding Argentina is entitled to invoke the state of necessity as contemplated by Article XI, and general international law.

263. The first issue deals with the determination of the period during which the state of necessity occurred. As previously indicated, in the view of the Tribunal, the state of necessity in this case began on 1 December 2001 and ended on 26 April 2003, when President Kirchner was elected (*see* the Tribunal's Analysis). All measures adopted by Argentina in breach of the Treaty before[77] and after the period during which the state of necessity prevailed, shall have all their effects and shall be taken into account by the Tribunal to estimate the damages.

264. The second issue related to the effects of the state of necessity is to determine the subject upon which the consequences of the measures adopted by the host State during the state of necessity shall fall. As established in the Tribunal's Analysis, Article 27 of ILC's Draft Articles, as well as Article XI of the Treaty, does not specify if any compensation is payable to the party affected by losses during the state of necessity. Nevertheless, and in accordance with that expressed under paragraphs 260 and 261 *supra*, this Tribunal has decided that the damages suffered during the state of necessity should be borne by the investor.

265. The third issue is related to what Argentina should have done, once the state of necessity was over on 26 April 2003. The very following day (27 April), Argentina's obligations were once again effective. Therefore, Respondent should have reestablished the tariff scheme offered to LG&E or, at least, it should have compensated Claimants for the losses incurred on account of the

---

[77] The period before the state of necessity initiates with the injunction issued by the Argentine Court on 18 August 2000.

measures adopted before and after the state of necessity.

(v) Conclusions of the Tribunal

266. Based on the analysis of the state of necessity, the Tribunal concludes that, first, said state started on 1 December 2001 and ended on 26 April 2003; second, during that period Argentina is exempt of responsibility, and accordingly, the Claimants should bear the consequences of the measures taken by the host State; and finally, the Respondent should have restored the tariff regime on 27 April 2003, or should have compensated the Claimants, which did not occur. As a result, Argentina is liable as from that date to Claimants for damages.

VII. DECISION OF THE TRIBUNAL ON LIABILITY

267. For the foregoing reasons, the Tribunal renders its decision, partially granting LG&E's claims, as follows:

a. The claim for expropriation of the investment is hereby dismissed.

b. Argentina breached the standard of fair and equitable treatment, no less favorable treatment than that to be accorded under the international law, and adopted discriminatory measures, causing damage to LG&E. Argentina's abrogation of the guarantees under the statutory framework, as indicated under paragraph 175 *supra*, violated its obligations to Claimants' investments, giving rise to liability under the umbrella clause.

c. The standard prohibiting the adoption of arbitrary measures is not deemed to have been violated.

d. Between 1 December 2001 and 26 April 2003, Argentina was in a state of necessity, for which reason it shall be exempted from the payment of compensation for damages incurred during that period.

e. The Argentine Republic is liable for damages to Claimants for the aforementioned violations, except during the period of the state of necessity, which damages, including interest, as well as specification of the periods during which Respondent has incurred in violation of its international obligations, shall be determined in a next phase of the arbitration and in respect of which the Tribunal retains jurisdiction.

f. Any decision on the costs of the arbitration is reserved.

Made in Washington, D.C., in English and Spanish, both versions equally authentic.

(signed)	*(signed)*
Professor Albert Jan van den Berg	Judge Francisco Rezek
Arbitrator	Arbitrator
Date: 19 September 2006	Date: 21 September 2006

(signed)

Dr. Tatiana B. de Maekelt

President

Date: 26 September 2006

CLA-000063

International Centre for Settlement of Investment Disputes

ICSID Case No. ARB/05/16

RUMELI TELEKOM A.S.
AND
TELSIM MOBIL TELEKOMIKASYON HIZMETLERI A.S.,
CLAIMANTS

V.

REPUBLIC OF KAZAKHSTAN,
RESPONDENT

AWARD

RENDERED BY AN ARBITRAL TRIBUNAL COMPOSED OF

STEWART BOYD, ARBITRATOR
MARC LALONDE, ARBITRATOR
BERNARD HANOTIAU, PRESIDENT

Date of dispatch to the parties: July 29, 2008

TABLE OF CONTENTS

PAGE

CHAPTER I. THE PARTIES AND THE BACKGROUND OF THE DISPUTE 1

CHAPTER II. THE PROCEDURE 5
I. INSTITUTION OF THE PROCEEDINGS 5
II. PROCEDURAL RULES AND AGENDA: MINUTES OF THE FIRST SESSION..........7
III. FIRST REQUESTS FOR PRODUCTION OF DOCUMENTS: PROCEDURAL ORDER NO. 1..........8
IV. CLAIMANTS' SUBSTANTIATED REQUESTS FOR PRODUCTION OF DOCUMENTS: PROCEDURAL ORDER NO. 2 9
V. CLAIMANTS' REQUEST FOR FURTHER PRODUCTION OF DOCUMENTS: PROCEDURAL ORDER NO. 3 10
VI. SECOND REQUESTS FOR PRODUCTION OF DOCUMENTS: PROCEDURAL ORDER NO. 4 12
VII. EXCHANGE OF WRITTEN PLEADINGS 12
VIII. ORAL PLEADINGS..........14
IX. POST HEARING SUBMISSIONS 17
X. CLOSING OF THE PROCEEDINGS..........17

CHAPTER III. THE FACTS 18
I. UP TO THE TERMINATION OF THE INVESTMENT CONTRACT 18
A. The foundation of KaR-Tel..........18
B. The GSM license..........20
C. The Motorola loan..........21
D. The alteration of the participations in KaR-Tel 23
E. The Investment Contract..........23
F. The foundation of Telecom Invest and the introduction of Telsim 24
G. The development of KaR-Tel's Business 25
II. THE TERMINATION OF THE INVESTMENT CONTRACT AND ITS REPERCUSSIONS 26
A. The termination of the Investment Contract 26
B. The Extraordinary General Meeting of Shareholders of KaR-Tel..........26
C. The proceedings issued in Almaty City Courts 28
1. The Telecom Invest Claim..........28
2. The KaR-Tel Claim..........29
3. The Consolidation of Telecom and KaR-Tel cases 30
4. The forensic examination of KaR-Tel 30
D. The attempts to sell Telecom Invest's participation in KaR-Tel 31
E. Mr. Seysembayev's offer to purchase Claimants' participation in KaR-Tel..........32
F. Claimants' complaints to Respondent 32
G. The judgment of the Almaty City Court on June 6, 2003..........33
H. The appointment of a Working Group..........34
I. Criminal investigation..........35
J. The judgment of the Supreme Court of July 23, 2003..........36

K. The judgment of the Supreme Court Presidium of October 30, 2003 - The following restructuring of KaR-Tel – and the purchase of KaR-Tel by VimpelCom....36
1. The judgment of the Supreme Court Presidium....36
2. The restructuring of KaR-Tel....37
3. The sale of KaR-Tel to VimpelCom....37
III. CLAIMANTS SEIZED BY TSDIF....37

CHAPTER IV. THE JURISDICTION OF THE ARBITRAL TRIBUNAL....38
I. CLAIMANTS' POSITION....38
A. Respondent consented to ICSID jurisdiction over this dispute....39
1. Claimants' investments were fully legal....39
2. Claimants' investments did not violate the principle of good faith, the principle "*nemo auditur propriam turpitudinem allegans*," or international public policy....43
B. Claimants have standing to bring this arbitration....44
1. Rumeli and Telsim are the proper Claimants in this arbitration....44
2. There was no assignment of Claimants' claim to the TSDIF....49
3. The TSDIF was not subrogated to Claimants' claims....49
4. There is no reason to pierce the corporate veil....49
5. Respondent's allegation that Article 25 of the Convention imposes a control test must fail....50
6. TSDIF would satisfy the jurisdictional requirements of ICSID in any event....52
C. Claimants have gone far beyond establishing a *prima facie* case on the merits....53
D. Respondent is a proper party to this dispute....54
E. Claimants have standing to challenge the cancellation of the Investment Contract....54
F. The Foreign Investment Law is a valid secondary basis for establishing jurisdiction....55
II. RESPONDENT'S POSITION....56
A. Respondent did not consent to ICSID jurisdiction over this dispute....56
1. Claimants' investments were not legal....57
2. Claimants' investments violated the principle of good faith, the principle *nemo auditur propriam turpitudinem allegans* and international public policy....59
B. Claimants do not have standing to bring this arbitration....61
1. The Turkish State is the real party in interest in this arbitration....61
2. The assignment of Claimants' cause of action....67
3. The TSDIF was subrogated in Claimants' claim....67
4. Alter ego and piercing the corporate veil....69
5. *"Control"* and *"incorporation"*....69
6. The claim brought by TSDIF does not satisfy the jurisdictional requirements of ICSID....72
C. No *prima facie* case....76
D. Respondent is not a proper party to the dispute....76

E. Claimants do not have standing to challenge the termination of the Investment Contract 77
F. The Foreign Investment Law is not applicable 77
G. Admissibility 78
III. DECISION OF THE ARBITRAL TRIBUNAL 78

CHAPTER V. THE CLAIMS 86
I. OVERVIEW OF THE CLAIMS 86
II. THE PARTIES' POSITION ON RESPONDENT'S PURPORTED SCHEME 87
A. Claimants' position 87
1. The general context 87
a) Claimants' investment 87
b) The Republic of Kazakhstan and the involvement of President Nazarbayev's family 91
2. The termination of the Investment Contract 94
3. Telecom Invest and Respondent colluded to effect the illegal compulsory sale of Claimants' interest in KaR-Tel 98
a) The KaR-Tel EGM 98
b) The Injunctive relief proceedings 102
4. The actions of Respondent's police authorities 103
5. The attempt to sell Telecom Invest's participation in KaR-Tel 104
6. The actions of the Working Group 105
7. The actions of Respondent's Judiciary 107
8. The attempts to pay Claimants to go away 111
9. The sale of KaR-Tel to VimpelCom 112
10. General observations on the hearing and on circumstantial evidence 113
a) Observations on the hearing 113
b) Circumstantial evidence 116
B. Respondent's position 118
1. The general context 118
a) Claimants' investment 118
b) The Republic of Kazakhstan and the involvement of President Nazarbayev's family 120
2. The termination of the Investment Contract 121
3. On the purported collusion between Telecom Invest and Respondent to effect the compulsory sale of Claimants' interest in KaR-Tel 126
a) The KaR-Tel EGMs 126
b) The Injunctive relief proceedings 129
4. The actions of Respondent's police authorities 131
5. The attempt to sell Telecom Invest's participation in KaR-Tel 133
6. The actions of the Working Group 134
7. The actions of Respondent's Judiciary 138
8. The alleged attempts to pay Claimants to go away 144
9. The sale of KaR-Tel to VimpelCom 146
10. The conspiracy theory 147

III. ON THE PURPORTED BREACHES BY RESPONDENT OF ITS OBLIGATIONS 149
A. The legal framework 149
1. Claimants' position 149
2. Respondent's position 151
3. The applicable standards: Decision of the Arbitral Tribunal 152
B. Fair and equitable treatment 154
1. Claimants' position 154
a) The Standard 154
b) Application to the facts of the case 156
2. Respondent's position 157
a) The standard 157
b) Application to the facts of the case 161
3. Decision of the Arbitral Tribunal 161
a) The Standard 161
b) Application to the facts of the case 162
C. Denial of justice 165
1. Claimants' position 165
a) The standard 165
b) Application to the facts of the case 167
2. Respondent's position 169
a) The standard 169
b) Application to the facts of the case 170
3. Decision of the Arbitral Tribunal 172
a) The Standard 172
b) Application to the facts of the case 173
D. Full protection and security 174
1. Claimants' position 174
a) The standard 174
b) Application to the facts of the case 175
2. Respondent's position 176
a) The standard 176
b) Application to the facts of the case 177
3. Decision of the Arbitral Tribunal 177
a) The Standard 177
b) Application to the facts of the case 178
E. Unreasonable, arbitrary, or discriminatory measures 178
1. Claimants' position 178
a) The standard 178
b) Application to the facts of the case 179
2. Respondent's position 181
a) The standard 181
b) Application to the facts of the case 181
3. Decision of the Arbitral Tribunal 181

a) The Standard 181
b) Application to the facts of the case 182
F. Expropriation 183
1. Claimants' position 183
a) The standard 183
b) Application to the facts of the case 184
2. Respondent's position 185
a) The standard 185
b) Application to the facts of the case 186
3. Decision of the Arbitral Tribunal 186
a) The Standard 186
b) Application to the facts of this case. 189

CHAPTER VI. COMPENSATION AND DAMAGES 194
I. PRELIMINARY REMARKS ON CLAIMANTS' CLAIM FOR DAMAGES 194
A. Respondent's position 194
B. Claimants' position 194
II. GENERAL PRINCIPLES 195
A. The compensation in international law. 195
1. Claimants' position 195
2. Respondent's position 196
B. Valuation standards 196
1. Claimants' position 196
2. Respondent's position 198
C. The valuation date 200
1. Claimants' position 200
2. Respondent's position 202
D. Causation 203
III. CALCULATION OF DAMAGES AND QUANTUM 205
1. Claimants' position 205
a) The position developed in Claimants' Memorials 205
b) The position developed in Claimants' Post-Hearing Memorial 207
2. Respondent's position 209
IV. DECISION OF THE ARBITRAL TRIBUNAL 214
A. The principles of compensation 214
B. The calculation of the compensation and its amount 216
V. COSTS 226

AWARD 227

CHAPTER I. THE PARTIES AND THE BACKGROUND OF THE DISPUTE

1. Claimants in this arbitration are Rumeli Telekom A.S. ("*Rumeli*") and Telsim Mobil Telekomunikasyon Hizmetleri A.S. ("*Telsim*"), (collectively "*Claimants*"). Both Rumeli and Telsim are telecommunications companies, incorporated in Turkey as an "*anonim sirket*" (joint stock company). Both companies' address is Mehmet Akif Mah/Inonu Cad., Star Sokak No. 2, Ikitelli 34540 Istanbul, Republic of Turkey. Claimants are represented in this arbitration by Mr. Hamid G. Gharavi and Ms. Brenda Horrigan, SALANS, 9 rue Boissy d'Anglas, 75008 Paris, France.

2. Respondent in this arbitration is the Republic of Kazakhstan ("*Respondent*," or the "*Republic*"). It is represented in this arbitration by Mr. Timur Issabekov, Director of the Department of International Law, Ministry of Justice of the Republic of Kazakhstan, and by Mr. David Warne, Mr. Gautam Bhattacharyya and Ms. Chloe J. Carswell, Reed Smith, Beaufort House, 15 St Botolph Street, London EC3A 7EE, United Kingdom. Respondent was initially represented by Mr. John Emmott, Michael Wilson & Partners, Ltd, 5th floor, 36 Samal-1 Almaty 050059, Republic of Kazakhstan and Ms. Azhar Kuzubayeva, Almira & Co LLP, 50 Long Acre, London WC2E 9JR, UK.

3. On May 16, 1998, Rumeli and Investel, a Kazakhstan closed joint stock company, entered into a Foundation Agreement for the creation of the joint venture KaR-Tel in the form of a Kazakhstan limited liability partnership, for the provision of mobile telecommunications services on the territory of the Republic.

4. At the creation of KaR-Tel, Rumeli owned 70% of KaR-Tel and Investel owned 30%. The initial charter capital of KaR-Tel was 750,000 Tenge (equivalent to approximately USD 10,000 at the time).

5. Immediately after the execution of the Foundation Agreement, KaR-Tel prepared to participate in the auction for the second GSM 900 license issued in Kazakhstan (the

"*License*"), held by the Ministry of Transportation and Telecommunications ("*MTT*") of the Republic.

6. The auction for the License took place on July 31, 1998 and KaR-Tel won the License with a bid of USD 67,500,000. The License Agreement between KaR-Tel and the MTT was signed on August 10, 1998. It set forth the conditions for the sale by the MTT to KaR-Tel of "*the right to use the radio-frequency spectrum for the creation and operation of a GSM-standard communications network in the Republic of Kazakhstan"* for a period of 15 years.

7. Around October 1998, KaR-Tel started to negotiate with the State Committee on Investment an agreement granting KaR-Tel investment incentives. On May 20, 1999, KaR-Tel and the Investment Committee executed Contract N° 0123-05-99 (the "*Investment Contract*"). The Investment Contract characterized the object of the investment activity as *"the creation and exploration of digital cellular radiotelephone connection of the GSM (900) standard on the territory of the Republic of Kazakhstan*." It granted KaR-Tel tax and other benefits. The term of the Investment Contract was set to expire on July 31, 2009.

8. On December 31, 2000, Telsim acquired 15% of the partnership from Rumeli and was officially registered as a participant in KaR-Tel on July 27, 2001. During this same period, Investel's participatory interest – which had increased from 30% to 40% in the spring of 1999 – was transferred to Telecom Invest, a separate Kazakhstan limited liability partnership.

9. Claimants allege to have undertaken important "*investments*" on the territory of the Republic by means of establishment of KaR-Tel, by providing know-how and marketing services in the field of telecommunications, by establishing a national administrative and commercial network and by providing extensive financing and guarantees to KaR-Tel, with the consequence that KaR-Tel became one of the leading GSM operators in the Republic.

10. According to Claimants, once KaR-Tel's success was assured, the local partner's shareholders, themselves Kazakhstan officials and/or members of the empire of the President of Kazakhstan, devised a scheme to orchestrate Claimants' expulsion from KaR-Tel in a definitive manner and to keep all of KaR-Tel for their sole benefit. It is Claimants' allegation that:

- the local partners exploited their political and personal ties with Respondent to obtain from the Investment Committee the termination of the Investment Contract;
- the local partners then alleged that Claimants were responsible for this termination and that the latter caused significant damages to KaR-Tel;
- the local partners called a general meeting of the shareholders of KaR-Tel without sending a notice to Claimants;
- at this purported general meeting, where Claimants could not have been present, it was unilaterally decided by the local partners, that, because of the harm caused by Claimants to KaR-Tel, Claimants' shareholding had to be compulsorily transferred to KaR-Tel to the final benefit of its remaining shareholders, *i.e.,* the local partners;
- this decision to sell Claimants' 60% stake in KaR-Tel was taken in violation of Kazakh law and was irregularly confirmed by the Kazakh Judiciary;
- the Kazakh Judiciary set the value of the shares at a mere USD 3,000, whereas, less than a year later, the local partners (and other parties in interest) sold 100% of KaR-Tel to another investor (VimpelCom) for the sum of USD 350 million.

11. Therefore, Claimants invoke Respondent's collusion with the local partners and a violation of international law, encompassing, *inter alia*, Respondent's wrongful termination of the Investment Contract, its resulting denial of Claimants' right to challenge the termination, its eviction of Claimants from KaR-Tel through the Judiciary and its failure to grant Claimants adequate compensation.

12. According to Claimants, these actions, together with further acts and omissions detailed below, constitute breaches of Respondent's obligations under international law, under the Agreement between the Republic of Kazakhstan and the Republic of Turkey concerning the Reciprocal Promotion and Protection of Investments, dated May 1, 1992 (the *"Bilateral Investment Treaty,"* or *"BIT"*), and under the Law of the Republic of Kazakhstan on Foreign Investments dated December 27, 1994 (the *"Foreign Investment Law"* or *"FIL"*).

13. Claimants' allegations are strongly denied and disputed by Respondent.

CHAPTER II. THE PROCEDURE

I. INSTITUTION OF THE PROCEEDINGS

14. On July 20, 2005, ICSID received a Request for the institution of arbitration proceedings under the ICSID Convention on behalf of Rumeli and Telsim against the Republic.

15. On July 21, 2005, The ICSID Secretariat (the "Secretariat") transmitted copies of the Request and of its accompanying documentation to the Republic.

16. On August 2, 2005, the Secretariat asked Claimants to provide their observations concerning the text of the three versions (English, Russian and Turkish) of Article VII(2) of the Bilateral Investment Treaty in relation to the issue whether the provision subjects the recourse to arbitration to the pre-condition of recourse to local courts.

17. Claimants answered in a letter dated August 4, 2005, which was transmitted by the Secretariat to the Republic.

18. In their letter, Claimants set forth that the Turkish language version of Article VII(2) of the Bilateral Investment Treaty was the only one subjecting the recourse to arbitration to the pre-condition of recourse to local courts and that the text of the other language versions (English, Russian) did not. Claimants further alleged that even if recourse to local courts was required, Respondent had, through its unfair, inequitable, arbitrary, discriminatory and unlawful measures deprived Claimants of the possibility of meaningfully exercising any such action, and Respondent therefore could not rely on any such alleged obligation to resist jurisdiction. Claimants further submitted that they additionally relied, through the Most Favorable Nation Clause contained in Article II of the Bilateral Investment Treaty, on the other bilateral treaties entered into by Kazakhstan that do not contain any such prerequisite to ICSID arbitration. Claimants finally submitted that they relied on the Foreign Investment Law as an alternative basis for ICSID jurisdiction.

19. By letter of August 30, 2005, in accordance with Article 36 of the ICSID Convention, the Secretary-General of ICSID registered the Request for Arbitration and, on the same day, notified the parties of the registration, inviting them to proceed to the constitution of the Arbitral Tribunal as soon as possible.

20. By letter of September 6, 2005, Claimants proposed that the Tribunal consist of three arbitrators, one to be appointed by each party by September 30, 2005; if either party failed to appoint its arbitrator within this deadline, such arbitrator would be appointed by the Secretary-General of ICSID. Claimants further proposed that the third arbitrator, who would be the President of the Tribunal, be appointed by agreement of the two party-appointed arbitrators. If the two arbitrators failed to agree on the appointment of the third arbitrator within fifteen days of the date by which both arbitrators had accepted their appointment, the third presiding arbitrator would be appointed by the Secretary-General of ICSID. Finally, Claimants proposed that the Secretary-General of ICSID be allowed to appoint arbitrators outside the ICSID Panel of Arbitrators but only arbitrators who would have experience in ICSID arbitration, whether as counsel or arbitrator.

21. By letter of September 29, 2005, Respondent agreed to Claimants' proposal on the method and timetable for the constitution of the Tribunal and requested the postponement of the September 30, 2005 date proposed by Claimants for the appointment of the party-appointed arbitrators.

22. By letter of September 30, 2005, Claimants agreed to postpone the date of the appointment of the party-appointed arbitrators until October 21, 2005, subject to an express confirmation of the method and timetable for the constitution of the Tribunal by Respondent by no later than October 7, 2005.

23. By letter of October 6, 2005, Respondent expressly accepted Claimants' proposed method and timetable and requested the postponement to October 30, 2005 of the October 21, 2005 date proposed by Claimants for the appointment of the party-appointed arbitrators.

24. By letter of October 7, 2005, Claimants agreed to postpone the date of the appointment of the party-appointed arbitrators until October 30, 2005.

25. Thereafter, by letter of October 31, 2005, the Secretariat acknowledged receipt of a letter of September 29, 2005 from Respondent informing that it had appointed Mr. Stewart Boyd CBE Q.C., a national of the United Kingdom, as its arbitrator. In its letter, the Secretariat also acknowledged receipt of a letter of October 30, 2005 from Claimants informing that they had appointed Mr. Marc Lalonde P.C., O.C., Q.C., a national of Canada, as their arbitrator. Both arbitrators accepted their appointment on November 2, 2005.

26. Following an extension of the time limit to appoint the third presiding arbitrator, on December 9, 2005, the Secretariat informed the parties that Messrs. Boyd and Lalonde had notified the Centre on December 8, 2005 of their appointment of Mr. Bernard Hanotiau, a national of Belgium, as the President of the Tribunal. The Secretariat, on behalf of the Secretary-General of ICSID, also informed the parties that, having received from each arbitrator the acceptance of his appointment, the Arbitral Tribunal was deemed to have been constituted, and the proceedings were deemed to have begun on December 9, 2005.

27. In accordance with ICSID Arbitration Rule 6, Mrs. Martina Polasek, Counsel at ICSID, was designated to serve as Secretary of the Tribunal. On May 31, 2007, the Secretariat informed the Arbitral Tribunal and the parties that Mrs. Polasek would be temporarily replaced by Ms. Eloïse Obadia, Senior Counsel, from June 1, 2007. Mrs. Polasek returned to her functions in this case on November 26, 2007.

II. PROCEDURAL RULES AND AGENDA: MINUTES OF THE FIRST SESSION

28. The first session of the Arbitral Tribunal concerning the procedural rules and the agenda of the arbitration was held on January 30, 2006, by telephone conference among the Members of the Tribunal and the Secretary of the Tribunal. The parties had agreed that the Tribunal hold the first session without the parties.

29. The first session considered matters listed on an agenda circulated to the parties by the Secretary on January 12, 2006, as well as the parties' joint proposals of January 27, 2006 regarding these matters (attached to the Minutes as Annex 1). Counsel for Respondent had by communication of January 29, 2006 added an observation to the parties' joint proposals which was equally taken into consideration.

30. Following the first session, by communications to the parties of January 31 and February 10, 2006, the Tribunal made certain proposals regarding items Nos. 2, 3, 4, 14 and 17 of the agenda. The parties responded to certain of the proposals by a joint communication of February 2, 2006 and individual communications of February 14, 2006 (from Claimants) and February 14, 15 and 23, 2006 (from Respondent). The above-mentioned communications were attached to the Minutes as Annex 2.

31. The Minutes of the first session, signed by the President and the Secretary of the Tribunal, were transmitted to the parties on March 20, 2006.

III. FIRST REQUESTS FOR PRODUCTION OF DOCUMENTS: PROCEDURAL ORDER NO. 1

32. The agreed timetable of the arbitration provided for a first joint submission of requests for production of documents to be submitted by March 17, 2006. On that date, the parties filed a joint submission of their respective requests, including any objections to the other party's requests, in tabular form.

33. On March 17, 2006, Respondent informed the Arbitral Tribunal that it would file additional remarks by Friday, March 24, 2006; however, the Tribunal did not receive any remarks by that date.

34. On March 28, 2006, the Arbitral Tribunal granted Respondent until Friday, March 31, 2006 to file its additional remarks on Claimants' request for production of documents; Claimants were granted the possibility to comment on Respondent's remarks by April 4, 2006.

35. Also on March 28, 2006, Respondent supplied to the Arbitral Tribunal an English translation of article 518 of the Tax Code of the Republic of Kazakhstan, requested by the Arbitral Tribunal on March 27, 2006.

36. On March 31, 2006, Respondent filed with the Secretary-General of ICSID objections to the jurisdiction of the Tribunal.

37. On April 3, 2006, the Arbitral Tribunal informed the parties that in accordance with ICSID Arbitration Rule 41(3) and (4), the proceedings on the merits were suspended and the parties were requested to file observations on whether the objections to jurisdiction should be dealt with as a preliminary question or should be joined to the merits of the dispute. Claimants were invited to file their observations by April 7, 2006, Respondent was invited to file its reply observations by April 12, 2006 and Claimants their rejoinder by April 17, 2006. The parties filed submissions according to the calendar.

38. The parties also filed additional remarks on production of documents on April 24 and 25, 2006.

39. On April 26, 2006, the Tribunal decided, in accordance with Rule 41(4) of the ICSID Arbitration Rules, to join the objections on jurisdiction to the merits of the dispute.

40. In its Procedural Order No. 1 dated April 28, 2006, the Arbitral Tribunal allowed some of the requests for production of documents. The Tribunal also reserved its decision on other requests, considering that it was not sufficiently informed to make a reasoned decision. It therefore invited Claimants to make additional submissions by May 4, 2006, and Respondent to further comment on the issue by May 10, 2006.

IV. CLAIMANTS' SUBSTANTIATED REQUESTS FOR PRODUCTION OF DOCUMENTS: PROCEDURAL ORDER NO. 2

41. In accordance with Procedural Order No. 1, Claimants further substantiated their request No. 11 for production of documents by letter dated May 4, 2006, and Respondent commented on it by letter dated May 10, 2006.

42. In accordance with Procedural Order No. 1, Respondent further substantiated its objections to Claimants' request No. 13 for production of documents by letter dated May 5, 2006 and Claimants commented on it by email of May 11, 2006.

43. In its Procedural Order No. 2 dated May 16, 2006, the Arbitral Tribunal ordered the production of certain requested documents.

V. CLAIMANTS' REQUEST FOR FURTHER PRODUCTION OF DOCUMENTS: PROCEDURAL ORDER NO. 3

44. In their letter dated July 24, 2006, Claimants requested a further production of documents. In their Request, they pointed out that on July 11, 2006, Respondent had submitted an initial first list of 249 documents ("List 1") representing the documents in *"its possession or custody or power"* and responsive to Procedural Order No. 1. On July 12, 2006, Respondent retracted this list to replace it with a second list of 229 responsive documents ("List 2"). When Respondent produced the documents responsive to Procedural Order No. 1, on July 20, 2006, it then enclosed a third list of 229 documents ("List 3") which Claimants considered identical to List 2.

45. Claimants submitted that the documents removed from List 1 were exchanges between various Ministries of Respondent as well as minutes of internal meetings of such ministries. Therefore, according to Claimants, the disputed documents clearly fell within the scope of the documents that Respondent was ordered to produce under Procedural Order No. 1. Claimants therefore requested the Arbitral Tribunal to order Respondent to immediately produce the disputed documents.

46. On July 28, 2006, in its letter in response to Claimants' request, Respondent submitted that the disputed documents were privileged by reason of the fact that they were confidential documents passing between Respondent's legal advisers (including internal legal advisers) and Respondent (including its Ministries) for the purpose of seeking or providing legal advice, and/or were created with the sole or dominant purpose of litigation arising out of the matters underlying this dispute.

47. In its Order of July 31, 2006, the Arbitral Tribunal decided the following in relation to the disputed documents:

> *We are not satisfied from the description of the documents listed in Annex 3 attached to the Claimant's letter of 24 July 2006 that any of them are privileged, but are prepared to allow the Respondents until 4 August 2006 to provide any further material in support of their claim for privilege, e.g. by identifying in the case of each document the litigation (if any) for which the relevant communication was prepared, and the legal adviser (if any) by whom or to whom the communication was sent.*

48. On August 5, 2006, the Arbitral Tribunal issued the following Direction:

> *1. With reference to paragraph 1 of the Tribunal's order of July 31, 2006, the August 4, 2006 deadline for the Respondent's response is extended until August 9, 2006. The Respondent should send its response directly to the Claimants, all Members of the Tribunal and the Secretariat on August 9. No further extension will be granted.*
>
> *2. The Tribunal will issue its decision on August 10, 2006.*
>
> *3. The Claimants should be prepared to file their memorial by close of business on August 11, 2006.*
>
> *4. If the Tribunal were to decide that all or part of the documents are not privileged and should be produced, it will order their immediate production and will consider granting a very short extension for the filing of the Claimants' memorial."*

49. On August 9, 2006, Respondent sent to the ICSID Secretariat a letter containing the substantiation of its claim that the disputed documents were privileged.

50. In its Procedural Order No. 3 dated August 10, 2006, the Arbitral Tribunal, taking into consideration the parties' observations and comments, considered that certain documents were privileged and ordered the production of certain other documents.

VI. SECOND REQUESTS FOR PRODUCTION OF DOCUMENTS: PROCEDURAL ORDER NO. 4

51. The agreed timetable of the arbitration provided for a second joint submission of requests for production of documents to be submitted within three weeks of the filing of Respondent's Counter-Memorial. This time period was subsequently extended.

52. The parties exchanged correspondence on this matter on January 10 and 12, February 5, 7, 12, 13, 15 and 27, 2007. On March 7, 2007, the parties filed a joint submission of their respective requests in tabular form. Respondent filed an additional observation on March 7, 2007.

53. The Tribunal, in a Procedural Order No. 4 dated March 22, 2007, took note of the parties' agreement on certain requests; it granted some of the parties' further requests, and dismissed others.

VII. EXCHANGE OF WRITTEN PLEADINGS

54. The timetable contained in the Minutes of the first session of the Arbitral Tribunal was amended by letters dated March 28, 2006, April 26, 2006, August 10, 2006, September 12, 2006, December 6, 2006, May 7, 2007 and June 29, 2007. Each party filed its written submissions pursuant to these amended directions.

55. Claimants filed a Memorial dated August 21, 2006, together with exhibits and legal authorities.

56. Respondent filed a Counter-Memorial dated December 14, 2006, together with exhibits and legal authorities.

57. Claimants then filed a Reply dated February 27, 2007, together with exhibits and legal authorities.

58. Respondent subsequently filed a Rejoinder dated May 23, 2007, together with:

- exhibits;

- legal authorities;
- an expert report on Kazakh procedural law by Mr. Mukhamedshin;
- an expert report on Kazakh criminal law by Ms Suleimenova;
- an expert report on Kazakh civil law by Professor Kaudyrov and Professor Klimkin;
- an expert report on quantum by Mr. Kaczmarek of Navigant Consulting; and
- an expert report on Turkish law by Mr. Erkam.

59. On June 29, 2007, the Secretariat of ICSID informed the parties that, in respect to the letters from Claimants dated June 26, 2007 concerning the difficulty for Claimants to find a Kazakh law expert willing to testify, and the letters from Respondent dated June 26 and 27, 2007 concerning Claimants' response to Respondent's case on jurisdiction, the Arbitral Tribunal issued the following directions:

> *In relation to Kazakh law we invite counsel for the Claimants to appoint themselves a non-Kazakh law expert. The report should be filed by July 31, 2007.*
>
> *The Arbitral Tribunal also authorizes the Claimants to file an additional submission strictly limited to jurisdiction, including a rebuttal expert report on Turkish law limited to jurisdiction by July 31, 2007.*

60. On August 3, 2007, Claimants filed:

- a Rejoinder on jurisdiction;
- witness Statements of Mr. Bora Agilönü and Dr. Yasar Akgun;
- an expert report of Professor Ziya Akinci onTurkish law; and
- an expert report of Professor A. P. Sergeyev on Kazakh law.

61. On the same date, Respondent filed witness statements of Mr. Mirbulat Abuov, Mr. Aidan Karibjanov, Mr. Alexander Podporin, Mr. Imin Sabirov, Mr. Iskander Yerimbetov and Mr. Vadim Zverkov.

62. On September 19, 2007 Claimants filed a request on some procedural issues. On September 24, 2007, the Secretariat of ICSID informed the parties that, after careful

consideration of Claimants' request and Respondent's answer of September 21, 2007, the Arbitral Tribunal had decided as follows:

> *1. (...)*
>
> *2. The Arbitral tribunal takes note that the parties agree that Respondent may file a witness statement by Judge Begaliev limited to the question of bribery raised in Mr. Agilonu's statement. The Tribunal decides that the filing of this witness statement must take place no later than October 5 and that Claimants will have the right to file a rebuttal witness statement by Mr. Agilonu, limited to the points covered by Judge Begaliev, no later than October 16.*
>
> *3. Respondent's request No. 2 [permission to amend their Memorials to include new allegations found in a witness statement filed by the Claimants] is denied. Given the proximity of the hearings, the Arbitral Tribunal finds more appropriate that the issue raised by Respondent be dealt with in the course of the oral submissions and testimonies.*
>
> *4. The Arbitral Tribunal takes note that Respondent has not made any objection against the filing by Claimants of a witness statement by Mr. Koksaldi. The Tribunal decides that the filing of this witness statement must take place no later than October 5."*

63. On October 5, 2007, Respondent filed the witness statement of Judge Bakhytbek Adilkhanovich Begaliev. On the same date, Claimants filed the witness statement of Mr. Huseyin Koksaldi.

VIII. ORAL PLEADINGS

64. On September 11, 2007, the Secretariat of ICSID informed the parties that, after careful consideration of the letters of August 21, September 7, and September 10, 2007 from Respondent and the letters of August 10 and September 6, 2007 from Claimants, the Tribunal had issued the following direction regarding the arrangements for the hearing scheduled for October 19 and from October 22 to 26, 2007:

> *The Arbitral Tribunal has noted the agreement of the parties on the following issues:*
>
> > *1. The hearing will take place in Paris. The venue will be decided by ICSID.*

> *2. The parties will not use livenotes. There will be daily transcripts.*
>
> *3. There will be post-hearing submissions, the time limit and contents to be determined by the Tribunal after consultation with the parties.*

As far as the other disputed issues are concerned, the Arbitral Tribunal has taken the following decisions:

> *1. The Arbitral Tribunal considers that written opening submissions are not necessary since the opening submissions will be transcribed by the court reporter.*
>
> *2. The Arbitral Tribunal would like the parties to prepare a common core bundle to be submitted to the Tribunal at the hearing.*
>
> *3. The Arbitral Tribunal has no objection to the submission of a bundle containing the Kazakh legislation. For its preparation, the parties should consult with each other as to its presentation and contents.*
>
> *4. The Arbitral Tribunal agrees that Mr. Prokofiev be retained as translator/interpreter. The parties may retain additional interpreters if they wish, in order to check the accuracy of Mr. Prokofiev's translations/interpretation.*
>
> *5. The Arbitral Tribunal also invites the parties to inform them whether there are at this moment other outstanding procedural issues to be decided and/or discussed during a telephone conference.*

65. On September 19, 2007 Claimants filed a request on some procedural issues. On September 24, 2007, the Secretariat of ICSID informed the parties that, after careful consideration of Claimants' request and Respondent's answer of September 21, 2007, the Arbitral Tribunal had decided as follows:

> *Pursuant to article 34(2)(a) of the ICSID Arbitration Rules, the Arbitral Tribunal calls upon Respondent to produce as witness at the hearings, Mr. Kulibayev and Mr. Orazbekov. Respondent is invited to inform the persons concerned of the Tribunal's decision and to ask them to attend the hearings. On the other hand, the Arbitral Tribunal is also ready to send*

itself a letter to these persons and, in that respect, requests their precise address in Kazakhstan by return fax.

(...)

66. On September 24, 2007, the parties transmitted an agreed timetable and framework for the hearing to the Secretary of the Arbitral Tribunal.

67. On October 10, 2007, the Secretariat of ICSID sent a letter, on behalf of the Arbitral Tribunal, to Mr. Orazbekov inviting him to attend the hearing, in person or by video-link, to serve as a witness.

68. On October 21, 2007, Respondent informed the Arbitral Tribunal that Mr. Orazbekov was willing to give evidence to the Arbitral Tribunal by video link from Khazakstan.

69. The hearing took place at the World Bank's offices, Avenue d'Iena in Paris, as scheduled, on October 19 and from October 22 to 26, 2007. The hearing was audio recorded and transcribed by a court reporter, Ms. Emma White, Boscen Reporting Services.

70. The parties submitted an agreed core bundle at the hearing.

71. After opening statements by Counsel, the hearing was devoted to the examination and cross-examination of the parties' witnesses:

   - In the first place, Counsel for Respondent cross-examined the following factual witnesses of Claimants: Mr. Huseyin Koksaldi, Mr. Yasar Akgun and Mr. Bora Agilönü on October 22 and 23, 2007.
   - Subsequently the Turkish law expert, Mr. Coskan Erkam, was examined by Counsel for Respondent and cross-examined by Counsel for Claimants on October 23, 2007, and the Turkish law expert, Professor Ziya Akinci, was examined by Counsel for Claimants and cross-examined by Counsel for Respondent on the same date.

- Then, the hearing was devoted to the examination and cross-examination of the following factual witnesses of Respondent: Mr. Alexander Podporin and Mr. Karibjanov on October 23, 2007; Ambassador Vadim Zerkhov on October 23, 2007 and October 24, 2007; Mr. Kairat Orazbekov (by video conference), Mr. Iskander Yerembetov, Mr. Imin Sabirov and Judge Bakhytbek Begaliev on October 24, 2007 and finally, Mr. Mirbulat Abuov on October 25, 2007.
- The three Kazakh law experts were then cross-examined: Professor Aleksander Sergeyev and Professor Tolesh Kaudyrov on October 25, 2007 and Professor Rinat Mukhamedshin on October 25 and 26, 2007.
- Finally, on October 26, 2007, Professor Gulnar Z. Suleimenova, financial expert for Respondent, was cross-examined by Counsel for Claimants. This was followed by a presentation by Mr. Andrew Wright, financial expert for Claimants and a presentation by Mr. Brent Kaczmarek, financial expert for Respondent and their respective cross-examination.

IX. POST HEARING SUBMISSIONS

72. According to the directions of the Arbitral Tribunal given on October 26, 2007, and pursuant to the deadline extension which was agreed by the parties on December 12, 2007, the parties filed their post-hearing memorials on December 19, 2007.

73. With respect to costs, pursuant to the directions of the Tribunal given on October 26, 2007, and the deadline extension which was granted on January 14, 2008, the parties' post-hearing submissions on costs were filed on January 25, 2008.

X. CLOSING OF THE PROCEEDINGS

74. Pursuant to Arbitration Rule 38(1), the Arbitral Tribunal closed the proceedings on June 16, 2008.

CHAPTER III. THE FACTS

I. UP TO THE TERMINATION OF THE INVESTMENT CONTRACT

A. The foundation of KaR-Tel

75. Rumeli Telefon, the holding company of Rumeli, was created by members of the Uzan family, namely: Kemal Uzan (20%), Hakan Uzan (24%), Cem Uzan (24%) and Aysegul Akay (22%), to operate a small number of mobile telephony operations in Central Asia.

76. Telsim is Turkey's second largest mobile telephone operator. It was created by Standart Telekom, a company owned by Hakan Uzan, Cem Uzan, Aysegul Akay and Rumeli Telefon.

77. In the first half of 1998, Rumeli and Telsim began investigating the possibility of establishing a GSM network in Kazakhstan. To this end, they established a business plan which covered the period from 1999 to 2008. At that time, Kazakhstan had no GSM mobile telephony network on its territory. Kazakhtelecom, the state-owned telecommunications operator, held a general license, according to which it had the status of "*the sole national operator ensuring [the] development, introduction, maintenance of the Public switched Telecommunications Network (PSTN), and performing its functions as the PSTN operator and exclusive operator of domestic long-distance and international services"* in Kazakhstan.

78. Investel was incorporated on February 11, 1998 as a closed joint stock company under the laws of the Republic. It was founded by two Limited Liability Partnerships ("LLPs") created under the laws of the Republic: Almex LLP ("*Almex*") and Giramat LLP ("*Giramat"*), which took respectively 51% and 49% of the shares in Investel.

79. Investel was incorporated to act as a single purpose vehicle for the exploitation of opportunities in the telecommunications sector in Kazakhstan and, in particular for the proposed joint venture with Rumeli, to acquire and operate a mobile telephony licence in the Republic.

80. On May 16, 1998, three months after the incorporation of Investel, Investel and Rumeli entered into an agreement in writing to found a new Kazakh limited liability partnership (LLP) to carry out their joint venture (the *"Foundation Agreement"*). This new LLP was to be called KaR-Tel LLP. Rumeli held 70% of the shares and Investel 30%. The Foundation Agreement was signed, on behalf of Investel, by Mr. Alexander Podporin.

81. Article 4.3 of the Foundation Agreement set out the respective roles and obligations of Rumeli and Investel in respect of KaR-Tel. Rumeli was *"[t]o make a lump sum investment on incorporation of the company, and to make additional investments during first operation years of the company*" and *"[t]o carry out marketing, to provide assistance and know-how for operations of the company*." As for Investel, it was *"[t]o obtain necessary permissions and licenses from official bodies of Kazakhstan Republic (Governmental Investment Committee, Kazakhtelecom etc.)*" and *"[t]o provide office places and buildings for the company*."

82. Pursuant to Article 5.1 of the Foundation Agreement, KaR-Tel had three organs of control: the General Meeting of Shareholders, the Board of Directors and the General Manager. The General Manager was to have full day-to-day operational control of KaR-Tel, but the General Meeting of Shareholders was the supreme organ of the partnership. It was empowered to determine acceptance or removal of partners in KaR-Tel, as well as appointing the Board of Directors.

83. The Board of Directors was comprised of three persons: two were nominated by Rumeli and one, Mr. Podporin, was nominated by Investel. Although the General Manager was initially appointed by the Board of Directors, this responsibility was subsequently transferred to the General Meeting of Shareholders pursuant to an amendment to KaR-Tel's Charter on April 20, 2001 which included an abandonment of the Board of Directors as an organ of the Company.

84. The position of General Manager was filled at all times until after the termination of the Investment Contract (see below) by an appointee of Claimants: from May to July 1998

Mr. Sabri Fedai, from July 1998 to August 17, 1999 Mr. Hussein Köksaldi; from August 17, 1999 to April 2002 Mr. Bora Agilönü.

B. The GSM license

85. In February 1998, the MTT announced that it proposed to issue the first GSM license which would be awarded following a competitive auction. On July 17, 1998, Rumeli advanced to KaR-Tel USD 1,650,000 to pay for the guarantee required from all participants in the auction for the License (the *"Tender Guarantee"*).

86. The auction for the License took place on July 31, 1998 and KaR-Tel won the License with a bid of USD 67,500,000. KaR-Tel then turned to the negotiation of the terms of the License agreement required for the acquisition of the License from the MTT. Investel took the lead role on behalf of KaR-Tel in these negotiations.

87. On August 10, 1998, KaR-Tel and the MTT executed a License agreement ("the *License"*) setting out, together with the annex to the License (the *"Annex*"), the conditions and rights and obligations of the parties in respect of the grant of the GSM 900 frequency license. It was signed on behalf of KaR-Tel by Mr. Podporin.

88. The material clauses of the License were as follows:

- the License was granted for 15 years (clause 1.2);
- the cost of the License was USD 67,500,000, less the amount already advanced as Tender Guarantee, payment of which was to be made within ten days (clause 2.2.1);
- within three calendar days after such payment, the MTT was required to issue the License to KaR-Tel (clause 2.1.2);
- KaR-Tel was to ensure that the technical requirements laid out in Order No. 106 of the MTT dated May 22, 1998 were fulfilled (clause 2.2.2);
- the MTT was entitled to monitor the performance by KaR-Tel of its obligations (clause 3.1.1);

- the MTT was entitled to terminate the License Agreement unilaterally if KaR-Tel failed to fulfill its obligations set out in clause 2.2.2 (clause 3.1.2).

89. The Annex set out more specific details of the obligations of KaR-Tel:

- KaR-Tel had specific obligations for the extent of its network coverage at the end of each of the first five years of the License (clause 2.1 Annex);
- KaR-Tel was to take all measures to provide for the use within its network and the connection thereto only of terminal equipment which complied with the respective international standards (clause 4.1 Annex).

90. It was also announced at the time of the bidding for the License that once the first GSM license had been issued, the State telecommunications corporation, Kazakhtelecom, would be entitled to acquire a second GSM license on identical terms from Respondent. In September 1998, Kazakhtelecom did acquire such a license through a joint venture which it formed for this purpose with a Turkish telecommunications joint venture, FinTur. At the time, FinTur had two Turkish shareholders, Turkcell and Cukurova Group, and the Finnish telecommunications company, Sorena. Turkcell was Claimants' largest rival in the Turkish market and the joint venture brand name was K-Cell. K-Cell thus began operating in the Republic after KaR-Tel.

91. On August 20, 1998, thanks to the money obtained through the Motorola Loan (below C), the License fee was paid and the License was issued to KaR-Tel.

C. <u>The Motorola loan</u>

92. In the course of the summer of 1998, KaR-Tel focused its efforts on obtaining the necessary financing to pay the License fee and to purchase telecommunications equipment. Rumeli was able to obtain a loan from Motorola. In this context, it procured a company subject to the same beneficial ownership and control, Telsim, to issue an irrevocable and unconditional guarantee (the *"Loan Guarantee"*) to Motorola. At that time, Telsim was not a participant in KaR-Tel.

93. By a loan facility agreement dated August 14, 1998, Motorola agreed to lend to KaR-Tel up to USD 160 million in a series of tranches for the purposes of acquiring the GSM license and then purchase equipment (the *"Motorola Loan Facility*"). It was clear at that time that there would not be sufficient time to finalise the Motorala Loan Facility in order to make the payment required of USD 65,850,000 by August 20, 1998. Consequently, Rumeli and Telsim entered into a Memorandum of Understanding and KaR-Tel, by its General Manager, Mr. Sabri Fedai, entered into a separate Bridging Loan Agreement with Motorola to secure the payment by Motorola of USD 65 million on August 19, 1998. By these agreements, Motorola agreed to lend KaR-Tel USD 65 million, secured by a Telsim guarantee for the same, to be used USD 60 million for the License fee and USD 5 million for the purchase of equipment by KaR-Tel from Motorola.

94. The Motorola Loan was originally repayable on or before November 16, 1998 (clause 3.1), but that 90 days period could be extended by a further 90 days to February 15, 1999 (clause 3.2). As KaR-Tel missed the February 15, 1999 payment deadline, amendments to the Motorola Loan were made starting on May 6, 1999, extending the repayment date but also increasing the size of the Loan.

95. The final Loan Extension and Amendment Agreement was entered into on September 29, 2000 and extended the deadline for repayment until April 30, 2001.

96. KaR-Tel did not make any payment and on May 22, 2001, Motorola issued a notice of failure to pay to KaR-Tel and demanded repayment in full within 10 days.

97. On August 15, 2002, Motorola served KaR-Tel with a final demand for immediate repayment of the amount outstanding under the Motorola Loan: USD 107,461,784.14. In the autumn of 2002, Motorola initiated proceedings in the Kazakh Courts to put KaR-Tel into liquidation and recover its debt.

98. On February 12, 2003, a Kazakhstan Court refused to declare KaR-Tel bankrupt considering that such an application was premature.

D. <u>The alteration of the participations in KaR-Tel</u>

99. On April 14, 1999, a General Meeting of Shareholders of KaR-Tel was held. At this meeting, it was agreed and resolved that Rumeli and Investel's participations in KaR-Tel would be altered from the existing respective participations of 70% and 30% to 60% for Rumeli and 40% for Investel.

E. <u>The Investment Contract</u>

100. On February 28, 1997, the Republic passed Law number 75 on State Support of Direct Investment in the Republic of Kazakhstan ("*the Investment Support Law"*). Pursuant to the Investment Support Law, a State Committee on Investment was created at ministerial level under the office of the First Deputy Prime Minister to negotiate incentive contracts with "*investors contributing direct investments in the Republic of Kazakhstan*." These contracts were intended to provide financial incentives for investors to invest in the Republic, including reduction in, or exemption from, taxation.

101. It was in KaR-Tel's interest to obtain the benefit of such an investment contract with the Investment Committee. On May 20, 1999, KaR-Tel and the Investment Committee executed Contract No. 0123-05-99 ("*the Investment Contract"*) pursuant to the aforementioned legislation.

102. Clause 2 of the Investment Contract set out the reasons for its granting: "*for the purpose of providing different measures of stimulation and state support in the course of investment activity in the sphere of wireless and cellular communications in rural areas."* The incentives were granted by the Investment Committee in order to encourage KaR-Tel to progress the development of its network quickly and to ensure that it provided its network equally in the less profitable rural areas of Kazakhstan, as well as in the highly profitable main cities. This was further particularized in the 5-year "*Working Programme*" annexed to the Investment Contract wich set out the respective population centres and areas of the Republic to which KaR-Tel's network coverage had to extend over the course of the five-year period.

103. The Investment Contract obliged KaR-Tel to make investments, to apply advanced technology and to provide the Investment Committee with regular and detailed information on the progress of the investment programme. In return, KaR-Tel was granted tax and other benefits, including a five-year total exemption from corporate and property tax, and reduced rates for the five years thereafter. The Investment Contract was to expire on July 31, 2009.

F. <u>The foundation of Telecom Invest and the introduction of Telsim</u>

104. On September 29, 2000, Almex and a Mrs. Elena Petrovna Gutova entered into an agreement to found a new Kazakh LLP called Telecom Invest LLP ("*Telecom Invest*") with a minimum charter capital of 100,000 Tenge. The participatory interests were divided as follows: 87.5% to Almex and 12.5% to Mrs. Gutova.

105. At a General Meeting of Shareholders of KaR-Tel held on October 10, 2000, the founders of KaR-Tel resolved that:

- Investel be permitted to sell its participation in KaR-Tel to a third party for 300,000 Tenge;
- Rumeli be permitted to sell a part of its participation equivalent to 15% of the total participation rights in KaR-Tel to a third party.

106. In late 2000, Investel transferred its participation interest in KaR-Tel to Telecom Invest for 300,000 Tenge. On December 31, 2000, Rumeli sold a 15% participation in KaR-Tel to Telsim. Pursuant to Articles 22(2) and 12 of the Kazakh Law on Limited and Additional Liability Partnerships, Telsim became successor to Rumeli's obligations under the Foundation Agreement.

107. These changes necessitated the amendment of KaR-Tel's Charter, which was approved at a General Meeting of Shareholders on April 20, 2001. Further amendments were made the same day:

- the registered capital was reallocated as follows: Telecom Invest (40%), Rumeli (45%) and Telsim (15%);
- the Board of Directors was removed as an organ;
- as a result of the removal of the Board of Directors, the former powers of that organ, and in particular the power to appoint or remove the General Manager of KaR-Tel, was transferred to the General Meeting of Shareholders.

108. On September 9, 2001, Mr. Podporin was officially appointed the General Manager of Telecom Invest.

G. <u>The development of KaR-Tel's Business</u>

109. Claimants' and Respondent's position on the business development of KaR-Tel and on the investments allegedly made by Claimants differ substantially.

110. In a nutshell, Claimants allege that by the end of the year 2001, KaR-Tel had a work force of approximately 193 well-qualified employees, the number of subscribers and revenues reached almost 160,000 and USD 60 million respectively; and that the number of subscribers reached 380,000 by April 2002. Claimants further allege that this success was the result of their very important efforts and investments.

111. According to Claimants, Respondent itself recognized and praised KaR-Tel's achievement in a letter of the Ministry of Transportation and Telecommunications of the Republic of Kazakhstan dated May 11, 2000. Moreover, KaR-Tel was generating positive EBITDA margins – *i.e.* generating a positive operating cash flow – in both 2001 and early 2002, when Claimants were suddenly evicted from KaR-Tel.

112. On the contrary, Respondent alleges that the level of subscribers and revenues was grossly overstated and that there is no evidence that Claimants really invested in KaR-Tel.

II. THE TERMINATION OF THE INVESTMENT CONTRACT AND ITS REPERCUSSIONS

A. The termination of the Investment Contract

113. On February 21, 2002, the Investment Committee took the decision to terminate the Investment Contract. By a letter dated February 21, 2002, it gave KaR-Tel notice in writing that, as a result of its repeated breaches of said Contract and more specifically on the basis that KaR-Tel had not complied with its reporting obligations pursuant to the Investment Contract, the Investment Contract would terminate 30 days later.

114. By letter dated March 27, 2002, the Investment Committee recorded the Formal Order of Termination of the Investment Contract at a meeting on March 25, 2002 on the basis that KaR-Tel had failed to comply in a timely manner with a requirement in the Investment Contract to submit reports on the economic activities of the partnership and on the implementation of the investment project.

B. The Extraordinary General Meeting of Shareholders of KaR-Tel

115. In view of this development, an Extraordinary General Meeting of the Shareholders of KaR-Tel ("EGM") was called by Telecom Invest. According to Respondent, Mr. Podporin sent to Rumeli and to Telsim formal notices calling this EGM. These notices set out that:

- an EGM of KaR-Tel would be held on April 11, 2002 at 18.00 at an address in Almaty;
- in case Claimants' representatives did not attend the EGM on April 11, the EGM would then be adjourned to April 15 at 18.00 at the same address;
- if Claimants' representatives failed again to attend the adjourned EGM on April 15, 2002, decisions on the proposed agenda for the meeting would be taken in their absence.

116. The three points on the agenda for this meeting were: (1) consideration of the damage caused to KaR-Tel by Rumeli and Telsim; (2) consideration of the compulsory

redemption of the participations of Rumeli and Telsim and their removal from the partnership; (3) the temporary change of the General Manager of KaR-Tel.

117. With respect to the compulsory redemption of Claimants' shareholding, Article 34 of the Limited and Additional Liability Partnership Law (the "*LLP Law*") provides that :

> *"1. When a participant of a limited liability partnership causes harm to a partnership or its participants, they shall have the right to claim for compensation of damages from such person.*
>
> *2. In the event when material harm is caused, the limited liability partnership aside from its claim to compensate damages and raising the issue on forced purchase by the partnership of the participating interest of the guilty participant who has caused the harm shall also have the right to require his retirement from the participants.*
>
> *3. The forced purchase of a participating interest shall be carried out in a judicial procedure."*

118. In addition, Article 82 of the Kazakh Civil Code provides that:

> *"In the event a participant of the limited liability partnership fails to fulfill its obligation towards the partnership, as established by legislative acts or foundation documents, the partnership, in compliance with a decision of the general meeting, may demand in Court the forced buy-out of the participating interests owned by such participant at a price determined by an agreement between the partnership and the participant. In the event an agreement is not reached, the price for the share being forcedly bought out shall be established by the court."*

119. Claimants, however, allege that they were not notified of these meetings, and that this is why they were not present at the first meeting which took place on April 11, 2002 and at the adjourned meeting which subsequently took place on April 15, 2002.

120. On April 15, 2002, Telecom Invest proceeded to consider the matters on the agenda in Claimants' absence. The following resolutions were passed:

- to prepare all necessary documents, including financial analyses, demonstrating the damage caused to KaR-Tel by the activity and/or inactivity of Rumeli and Telsim;

- to issue proceedings in the Almaty City Court for the compulsory redemption of Claimants' participation in KaR-Tel;
- to dismiss Mr. Agilönü as General Manager of KaR-Tel and to replace him temporarily by Mr. Iskander Yerimbetov and to seek the Court's approval of this amendment.

C. The proceedings issued in Almaty City Courts

1. The Telecom Invest Claim

121. On April 19, 2002, Telecom Invest issued proceedings against Claimants in the Almaty City Court ("*the Telecom Invest Claim*") for the compulsory redemption of Claimants' participation in KaR-Tel. Telecom Invest also sought an injunction to freeze the assets and records of KaR-Tel.

122. On April 23, 2002, Mrs. S. G. Ivanovna, sitting as the presiding judge of the Almaty City Court, considered Telecom Invest's application for an injunction. Judge Ivanovna held that in accordance with the Law on National Security, it was necessary to grant the injunction freezing the partnership's assets, property and records in order to ensure that the performance of KaR-Tel's network continued uninterrupted. At the time, the Republic had only two mobile telephony networks and these were considered to be critical strategic interests.

123. Judge Ivanovna ordered that, pending a decision on the merits of the case:

- all property of KaR-Tel be frozen to secure the claim;
- access to objects which ensured the uninterrupted operation of KaR-Tel's cellular network and to financial, technical and other documents and computer databases was to be restricted to those with written permission of the temporary General Manager Mr. Yerimbetov.

124. On the same day, April 23, 2002, the Court bailiffs took steps to ensure compliance with the order of the Court. The bailiffs did this by attending at KaR-Tel's premises with a representative of Telecom Invest, Mr. Aidan Karibjanov, and with a security escort.

125. This first decision on injunctive relief was made *ex parte*. It was thus decided on the basis of the application and without any hearing. Claimants appealed the decision to the Supreme Court on May 2, 2002. On June 11, 2002, the Supreme Court set aside the second part of Judge Ivanovna's Order, requiring access to KaR-Tel to be restricted to those with written permission from Mr. Yerimbetov.

2. The KaR-Tel Claim

126. In late May 2002, whilst Claimants' appeal of the injunction to the Supreme Court was still pending, KaR-Tel, acting through its new temporary General Manager, Mr. Yerimbetov, commenced proceedings against Claimants in identical terms to those brought by Telecom Invest.

127. On May 22, 2002, Mr. Agilönü called an EGM of the partnership. As soon as he was notified of this, Mr. Yerimbetov, on behalf of KaR-Tel, applied to the Almaty City Court for a further injunction preventing the holding of the intended EGM.

128. On June 3, 2002, the Almaty City Court granted the injunction and:

- suspended the EGM called by Mr. Agilönü for June 7, 2002;
- enjoined Mr. Agilönü from exercising the rights and performing the functions of General Manager of KaR-Tel pending a decision on the merits of the case;
- enjoined Claimants from calling or holding any general meetings of KaR-Tel pending a decision on the merits of the case.

129. Court bailiffs enforced the injunction by entering the conference room in which the General Meeting of Shareholders was held at the AnKaRa Hotel on June 7, 2002 and asked Mr. Agilönü and Claimants to stop the meeting.

130. Claimants appealed this second injunction before the Supreme Court of the Republic. On or about August 1, 2002, the Supreme Court allowed Claimants' appeal in part and set aside part of Judge Ivanovna's order insofar as it related to constraints on the action of Mr. Agilönü, on the grounds that he was not a party to the proceedings. The Supreme Court also dismissed as entirely without foundation Claimants' allegation that the grant of the injunction demonstrated bias and partiality on the part of the Almaty City Court.

3. The Consolidation of Telecom and KaR-Tel cases

131. One month before, by an order dated July 1, 2002, Judge Ivanovna of the Almaty City Court had ruled that the proceedings brought by Telecom Invest and the proceedings brought by KaR-Tel should be consolidated into a single proceeding, on the basis that the claims were very similar and against the same defendants.

4. The forensic examination of KaR-Tel

132. On July 31, 2002, Judge Begaliev of the Almaty City Court issued a ruling appointing the Forensic Examination Centre of the Kazakh Ministry of Justice to prepare an integrated accounting and commercial forensic examination. The examination was to address the issue of whether Claimants had caused significant damage to KaR-Tel by their actions, and to assess the value of KaR-Tel as at April 2002. In this respect, Judge Begaliev posed 6 specific questions to the Forensic Examination Centre:

- what is the annual turnover of KaR-Tel?;
- did KaR-Tel sustain a loss as a result of the cancellation of the Investment Contract; if so, in what amount?;
- what was the average market value at the time of purchase of the equipment purchased by KaR-Tel from Telsim; what price did KaR-Tel in fact pay to Telsim; what is the difference, if any, between these two figures?;
- what was the average market value at the time of purchase of the telephone handsets purchased by KaR-Tel from Telsim; what price did KaR-Tel in fact pay to Telsim?;

- what is the total value of investments made by Rumeli and Telsim in the context of their obligations under the Foundation Agreement; how were these investments used?; and
- what is the balance sheet value of KaR-Tel and the shareholdings of Rumeli and Telsim therein?

133. On or about August 9, 2002, Claimants appealed Judge Begaliev's order. The Supreme Court dismissed the appeal regarding the appointment of the Forensic Examination Centre on September 19, 2002. It held that:

  - it was normal and proper for Judge Begaliev to have appointed the Centre to review those matters prior to holding a hearing on the merits;
  - it was incorrect to allege that the claim was stayed due to the appeal of the injunction;
  - Judge Begaliev's order did not go beyond the scope of the claims.

D. The attempts to sell Telecom Invest's participation in KaR-Tel

134. In August 2002, Telecom Invest and Claimants entered into discussions concerning the sale of Telecom Invest's 40% in KaR-Tel to Claimants. A Stock Purchase Agreement was negotiated and initialed by the parties on October 13, 2002, subject to the signature of their highest executives.

135. The purchase price for Telecom Invest's 40% stake was set at USD 12 million. Ultimately, however, the agreement was not finalized.

136. In late autumn 2002, KaR-Tel's General Manager, Mr. Yerimbetov, and a Kazakh businessman, Mr. Margulan Seysembayev, approached Almex and Mrs. Gutova with an offer to acquire KaR-Tel. The parties entered into discussions, and it was eventually agreed to sell Telecom Invest itself to Mr. Seysembayev.

137. The purchase, effected through 6 companies which were beneficially owned and controlled by Mr. Seysembayev, was concluded informally by amendment of Telecom

Invest's Charter at a shareholders meeting on December 19, 2002. This amendment was registered on January 17, 2003 and was for nominal consideration.

E. Mr. Seysembayev's offer to purchase Claimants' participation in KaR-Tel

138. In or about April 2003, Mr. Seysembayev, the owner of Telecom Invest, attempted to purchase Claimants' 60% interest in KaR-Tel. He indicated to Claimants that he was prepared to offer them USD 12 million to USD 15 million for their participation. Claimants refused this offer.

F. Claimants' complaints to Respondent

139. On April 2, 2003, Rumeli wrote to the Prime Minister of the Republic and sent further copies of the letter to the President, the Minister of Foreign Affairs, the Minister of Transport and Communications, the Minister of Industry and Trade, the Minister of Finance, the Chairman of the Investment Committee and the Turkish Ambassador to Kazakhstan. On April 3, 2003, Telsim sent an identical letter to the same recipients.

140. These letters were complaints by Claimants that the termination of the Investment Contract had been wrong because:

- KaR-Tel had complied with all of its investment obligations under the Investment Contract;
- KaR-Tel had complied with all of its reporting obligations under the Investment Contract;
- the Investment Committee had violated the contractual procedure for termination "*in that any termination could take place only if the Contract had been suspended first and the investor failed to remedy the situation*."

141. Claimants also threatened to launch ICSID proceedings if their dispute with the Investment Committee was not resolved to their satisfaction.

G. The judgment of the Almaty City Court on June 6, 2003

142. As explained above, on July 1, 2002, the Almaty City Court had ordered that the proceedings brought by Telecom Invest and those brought by KaR-Tel be consolidated. The claim was for the Court to order that Claimants' participation in KaR-Tel be compulsory redeemed. Claimants defended these proceedings with the assistance of local counsel and engaged three Kazakh academics to provide expert evidence on the disputed issues.

143. There were two central issues for the Almaty City Court to determine:

- the validity of KaR-Tel's EGM resolution to bring the claim;
- whether the claim for compulsory redemption was made out.

144. With respect to the first issue, the Court:

- held that pursuant to Article 45(2) of the LLP Law, "if, despite requests by members, the executive body does not convene a general meeting, it may be convened by the members themselves," where they hold more than 10% of the total voting equity in the partnership;
- found as a fact that on the balance of the evidence Mr. Agilönü had indeed received the requests in the form of letters dated March 4, 2002 and March 20, 2002; and therefore,
- held that the EGMs on April 11 and 15 were properly convened by Telecom Invest;
- determined that the meeting on April 15, 2002 was quorate and that the resolutions had been passed in a procedurally correct manner and with the requisite quorums and majorities. The resolution was therefore valid and was upheld.

145. With respect to the second issue, *i.e.* KaR-Tel's claim for compulsory redemption of Claimants' shares, the Court found that Claimants had caused KaR-Tel to suffer harm in the amount of USD 40,662,765, being the loss caused to KaR-Tel by the termination of

the Investment Contract and trough transactions with related companies. The Court decided that this was indeed material harm entitling KaR-Tel compulsorily to redeem Claimants' shareholdings, which the Court then ordered.

146. It was recorded in the Court's judgment that, pursuant to Article 32(3) of the LLP Law, the value of the interest to be purchased was to be established by the parties in the first place and that the Court would only make such determination in circumstances where the parties would be unable to agree. The Court thus left the issue of the value of Claimants' shareholding to be determined by agreement between Claimants and Telecom Invest.

H. <u>The appointment of a Working Group</u>

147. On June 9, 2003, the Investment Committee wrote to Claimants to inform them that Respondent's Government's decision to establish an inter-departmental Working Group to "*conduct an audit on KaR-Tel LLP on the execution of the terms of the contract by KaR-Tel LLP, including investments obligations.*"

148. The Working Group reached a decision on July 17, 2003. Its findings were the following:

- in breach of clause 6.2 of the Investment Contract, KaR-Tel had failed to use advanced technologies in implementing the investment project. Instead, KaR-Tel had imported second hand and outdated BTS base sections;
- in breach of clause 3 of the Investment Contract, between May 1999 and March 2002, KaR-Tel made direct investments of only USD 13,308,749. This equated to only 11.7% of the pro-rated direct investment of USD 113,643,000 required under clause 3;
- in breach of the Work Programme at Annex 1 to the Investment Contract and in breach of clause 2.1 of the same, between 1999 and 2002, KaR-Tel had achieved only 56% of the progress required under the Work Programme. In particular, the rural areas of Kazakhstan had been largely without coverage;

- Article 13 of the Law on State Support for Direct Investments permits the Investment Committee to terminate an investment contract where the investor fails to comply with its obligations or breaches terms of the contract. There is no provision in the Law for suspension of an investment contract prior to its termination. Additionally, even under the terms of the Investment Contract, a prior suspension of the Contract is a right rather than an obligation of the Investment Committee;
- although the Investment Contract was terminated for KaR-Tel's failure to submit reports, the only reason why it was not terminated for the breaches set out above was that the failures to report prevented the Investment Committee from having information from which it could have identified the breaches;
- KaR-Tel itself had expressed to the Working Group that it did not dispute the termination of the Investment Contract.

I. Criminal investigation

149. On June 24, 2003, Mr. Yerimbetov filed a criminal complaint against five former KaR-Tel employees who would have signed expenses authorization forms in order to take money directly from KaR-Tel's petty cash reserve. The total sum so transferred was 27,053,748 Tenge, which at the time equated approximately USD 192,663. The executives and employees concerned were:

- Bora Agilönü, KaR-Tel's General Manager;
- Mustafa Bash, KaR-Tel's Director of Sales;
- Erdal Osornec, KaR-Tel's Finance Director;
- Bulent Gurel, KaR-Tel's Chief Accountant; and
- Zhuldys Kaden, a secretary.

150. On July 1, 2003, Major Yun, a senior investigator in the Almaty police force, decided to issue a criminal indictment against these employees. They fled the country. The proceedings were suspended on September 1, 2003.

J. The judgment of the Supreme Court of July 23, 2003

151. On June 20, 2003, Claimants appealed the Almaty City Court's judgment to the Supreme Court of Kazakhstan. Claimants repeated the points on which they had relied before the first Court, and requested the Supreme Court to:

- overturn the decision of the Almaty City Court;
- refuse KaR-Tel's claim for compulsory redemption;
- invalidate the calling of the EGM on April 15, 2002 and all decisions adopted at that meeting;
- discharge the injunctions dated April 23, 2002 and June 2, 2002.

152. KaR-Tel also filed an application to the Supreme Court to have the valuation exercise conducted on Claimants' participation in KaR-Tel.

153. The Supreme Court reviewed the Almaty City Court decision and left it unchanged. It dismissed all of the appeals and the application filed by KaR-Tel to have the valuation exercise conducted. It therefore remained for the parties to agree on a price for the compulsory redemption of Claimants' shareholding.

K. The judgment of the Supreme Court Presidium of October 30, 2003 - The following restructuring of KaR-Tel – and the purchase of KaR-Tel by VimpelCom

1. The judgment of the Supreme Court Presidium

154. On September 15, 2003, KaR-Tel appealed the Supreme Court's decision to the Presidium of the Supreme Court ("*the Presidium*"), the highest instance for civil cases in the Kazakh legal system. The purpose of KaR-Tel's appeal was to ask the Presidium to determine the valuation of Claimants' participation in KaR-Tel.

155. The Presidium considered that it had jurisdiction to determine the price since it was established that the parties, *i.e.* KaR-Tel on the one hand and Claimants on the other hand, were not able to reach agreement. The Presidium then valued Claimants'

participation in KaR-Tel at 337,500 Tenge for Rumeli (approximately USD 2,281) and 112,500 Tenge for Telsim (approximately USD 760.43).

2. The restructuring of KaR-Tel

156. Shortly thereafter, on November 10, 2003, KaR-Tel's Charter was amended to reflect that the founders were Telecom Invest (40%) and Steiner and Zingermann JV LLP, a law firm (60%). Steiner and Zingermann had purchased that shareholding from KaR-Tel following Telecom Invest's waiver of its right of pre-emption. They subsequently transferred their shareholding to another of Mr. Seysembayev's companies, Kertean LLP, in January 2004.

157. Under its management, Mr. Yerembetov restructured the company. He made new investments and started negotiations with Motorola to restructure the loan. In April 2004, Mr. Yerembetov was finally able to reach a deal with Motorola whereby the loan would be discounted to USD 35 million and repaid in full in the short term.

158. Mr. Yerembetov managed to persuade KazKommertz Bank to lend it the USD 35 million required to repay Motorola.

3. The sale of KaR-Tel to VimpelCom

159. On August 27, 2004, VimpelCom announced that it had won a public tender to purchase KaR-Tel for USD 350 million.

III. Claimants Seized By TSDIF

160. In February 2004, the Turkish Savings Deposit Insurance Fund (the "*TSDIF*"), seized control of over two hundred companies allegedly belonging to, or controlled by, the Uzan family, among which Rumeli and Telsim.

CHAPTER IV. THE JURISDICTION OF THE ARBITRAL TRIBUNAL

161. The first issue to be decided in this arbitration is the jurisdiction of this Arbitral Tribunal. It is indeed disputed by Respondent, as is further explained below.

I. CLAIMANTS' POSITION

162. According to Claimants, the requirements of Article 25 of the ICSID Convention and ICSID Rule 2(1)(c) are fulfilled. Claimants have consented to the jurisdiction of ICSID by virtue of their Request for Arbitration and the ICSID arbitration clause contained in the BIT. Respondent has consented to ICSID jurisdiction on the date of entry into force of the BIT, namely August 10, 1995 and/or on the date of entry into force of the FIL, namely on December 28, 1994.

163. According to Claimants, the BIT states that two authentic copies (in four different languages) of the BIT have been executed, "*each in Turkish, Kazak [sic], English and Russian*." There does not appear, however, to exist any Kazakh language version. There is no requirement under the English or Russian versions of a prior submission of the dispute to local Courts before initiation of arbitration proceedings before ICSID. On the other hand, Article VII of the Turkish version contains such a requirement. According to Claimants:

- no requirement of prior initiation and completion of local proceedings as a prerequisite to ICSID arbitration should be imposed, as two of the three official versions of the BIT do not provide for such a requirement;
- such a requirement would constitute a violation of the Most Favorable Clause contained in the BIT, since it would create a barrier to arbitration not found in the dispute resolution clauses of other BITs entered into by the Republic of Kazakhstan;
- in any case, Respondent, through its behavior, has deprived Claimants of the possibility of meaningfully exercising any such action.

164. It is finally Claimants' position that none of Respondent's objections to the jurisdiction of this Tribunal has any merit.

A. Respondent consented to ICSID jurisdiction over this dispute

165. According to Claimants, Respondent's consent to ICSID jurisdiction is contained in both the BIT and the FIL. As far as Claimants are concerned, they first expressed their intention to initiate arbitration in April 2003, when they wrote letters to Respondent indicating that they had "*the right to submit the dispute for final resolution to the International Center for Settlement of Investment Disputes (ICSID) and have firm intentions to do so if no agreement is reached with the Republic of Kazakhstan in the nearest future*." Claimants completed their consent by filing their ICSID Request for Arbitration on July 15, 2005. Thus, all parties have consented to ICSID jurisdiction over this dispute by no later than July 15, 2005.

166. Nevertheless, nearly two years after the Request for Arbitration was filed, Respondent alleges that it did not consent to ICSID jurisdiction over this dispute on the ground that Claimants' investments violated the laws and regulations of Kazakhstan. Claimants consider that Respondent's allegations are wholly without merit and should be dismissed accordingly.

1. Claimants' investments were fully legal

167. Claimants deny that their investments did not comply with Kazakhstan's laws and regulations. In any event, the standards that would need to be satisfied in this regard for ICSID jurisdiction to be defeated are very high. Respondent, which bears the burden of proof, has not advanced, let alone provided, evidence of any factual and legal support for its allegations.

168. To defeat the Tribunal's jurisdiction based on a BIT's requirement that the disputed investments be in conformity with the host State's laws and regulations, a certain level of

violation is required. As determined by the Arbitral Tribunal in the *LESI*[1] case, such a provision will exclude the protection of investments only if they have been made in breach of fundamental legal principles of the host country ("*en violation des principes fondamentaux en vigueur*").

169. Moreover, mere allegations are not enough. According to Claimants, Respondent does not substantiate its allegations with any factual evidence of fraud. Nor does it invoke any laws or regulations of Kazakhstan that Claimants' investments would have supposedly violated. Rather, Respondent relies upon an unrelated New York Court judgment applying American law and refers to that Court's assessment of acts and omissions that took place in Turkey regarding separate transactions, to reach the conclusion that *"*[*i*]*n circumstances where the entire basis of the Claimants' alleged investment in KaR-Tel was to further their worldwide fraud, the investment was not in conformity with the laws of Kazakhstan."*

170. Claimants submit that the Tribunal should rather follow the holding of *Tokios Tokelés*,[2] where the registration of Claimants' investments indicated that they had been made in accordance with the laws and regulations of the host State. Similarly here, it is not in dispute that Respondent registered KaR-Tel, granted KaR-Tel Kazakhstan's second GSM license through a free and transparent bidding process, and willingly registered all corporate changes to KaR-Tel.

171. According to Claimants, Respondent's attempt to try to link to KaR-Tel acts and omissions in Turkey of the Uzan family, relating to third party transactions, is irrelevant. The manner in which the Uzans conducted their business outside of Kazakhstan has no relation to the case at hand. According to Claimants, the Uzans' alleged fraud was related to the T. Imar Bankasi TAS (the "*ImarBank*") banking practices in Turkey. They had nothing to do with Claimants' investments in Kazakhstan. Similarly, Respondent's

[1] *LESI, S.p.A. and Astaldi S.p.A. v. People's Democratic Republic of Algeria* (ICSID Case No. ARB/05/3), Decision on Jurisdiction of July 12, 2006 [hereinafter *LESI v. Algeria*].

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

justification for depriving Claimants of their majority stake in KaR-Tel, which was based on an alleged failure to file reporting documents, was unrelated to the Uzans' fraud.

172. The only evidence put forward by Respondent in support of the proposition that Claimants' investments were fraudulent is a July 13, 2003 judgment rendered in the United States against the Uzans. A judgment of a Court of first instance in New York applying American law does not bind an arbitral tribunal dealing with claims under international law. In any event, that judgment did not rule on the legality of Claimants' investment in Kazakhstan.

173. The New York judgment could not have found evidence that KaR-Tel played a role in an illegal scheme with respect to the Motorola loans as Respondent alleges. As noted in Judge Rakoff's findings of fact, two Motorola loans were made in relation to KaR-Tel:

- the largest loan was the USD 60,000,000 loan made on August 19, 1998. As it did not cover the total price of the GSM License, Claimants paid the remaining USD 5,850,000. Therefore, the Uzans obviously could not have used this loan for illegal purposes;
- the second Motorola loan was for USD 13,723,00.99. But Judge Rakoff's findings of fact did not specifically conclude that this loan was used improperly and not for the purchase of equipment from Motorola. Respondent has failed to prove any fraud whatsoever in connection with this loan.

174. Claimants further allege that, with respect to Respondent's allegation that Claimants defrauded KaR-Tel itself by causing it to enter into transactions with Telsim at excessive prices, no neutral expert has ever determined that these transactions with Telsim were in fact at excessive prices. Rather, Bülent Yağci, a professor of the Istanbul Technical University, reviewed the prices at which Telsim sold KaR-Tel equipment and found that the "*cost [was] reasonable*." He moreover determined that the prices were lower than those of the market. In any case, sales at a high price do not constitute a violation that

would rise to the "*violation of fundamental principles*" standard needed to defeat jurisdiction.

175. According to Claimants, contrary to Respondent's allegations, the entire basis of their investments in KaR-Tel was obviously not to further a worldwide fraud. They had only one purpose: to create a profitable cellular telecommunications business in Kazakhstan. In this respect, Rumeli and Telsim expended significant financial and human resources to create and develop KaR-Tel's operations and GSM network:

- they made significant investments in KaR-Tel. The bid process by which KaR-Tel received Kazakhstan's second GSM License was wholly legal. The License was legally paid for;
- the telecommunications network that Claimants built was in compliance with the local laws and technical regulations of Kazakhstan;
- in or around July 1998, Claimants' managers flew to Kazakhstan with a team of six or seven Turkish specialists from the Rumeli/Telsim group for the purpose of developing KaR-Tel's operations and GSM network;
- Rumeli conducted in-depth market research and analyses and established a ten-year business plan for KaR-Tel;
- KaR-Tel's success increased under Claimants' management due to their continued investments;
- Rumeli and Telsim made significant investments in KaR-Tel during the period of 1998-2002;
- in 2000, Claimants further invested approximately USD 13,000,000, and KaR-Tel revenues reached approximately USD 11,000,000, with the number of subscribers reaching over 57,000.

176. Therefore, Claimants allege that KaR-Tel was a legitimate business and a success story. It was not a company set up to further a worldwide fraud, but rather a legitimate, growing and dynamic telecommunications company in Kazakhstan. It was also a company of significant value as its sale to VimpelCom in 2004 for USD 350,000,000 attests.

2. Claimants' investments did not violate the principle of good faith, the principle "*nemo auditur propriam turpitudinem allegans*," or international public policy

177. Claimants allege that their investments did not violate the principle of good faith. Respondent's argument in this respect is based on Respondent's repetitive allegation that the investment was part of a worldwide fraud, which is untrue and which Respondent has failed to substantiate.

178. According to Claimants the *Inceysa* case[3] relied upon by Respondent must be distinguished from the present case. Indeed, the circumstances were very different in *Inceysa*. *Inceysa's* violations of the principle of good faith were shockingly clear: *Inceysa's* investment was the result of winning a bid, which *Inceysa* won only by presenting wholly falsified information. On the contrary, no false information was ever presented to Respondent with respect to Claimants' investments in Kazakhstan.

179. Claimants' investment did not violate the principle *nemo auditur propriam turpitudinem allegans*. Once again, the *Inceysa* decision relied upon by Respondent is irrelevant since the current arbitration does not remotely resemble the facts of the *Inceysa* case.

180. Claimants' investment did not violate international public policy. Respondent again invokes *Inceysa*, whereas *Inceysa's* very investment was secured by fraudulent misrepresentations. Again, Claimants allege that no false information was ever presented to Respondent with regard to Claimants' investments in Kazakhstan.

181. The *World Duty Free* decision[4] invoked by Respondent to stand for the principle that no jurisdiction is permissible where an investment violates public policy is also irrelevant to the present case. Indeed, according to Claimants, in *World Duty Free,* Kenya alleged that the agreement on which the claims in the arbitration were based was obtained through a

---

[3] *Inceysa Vallisoletana S.L. v. Republic of El Salvador* (ICSID Case No. ARB/03/26), Award of August 2, 2006 [hereinafter *Inceysa v. El Salvador*].

[4] *World Duty Free Company Limited v. The Republic of Kenya* (ICSID Case No. ARB/00/7), Award of October 4, 2006 [hereinafter *World Duty Free v. Kenya*].

bribe. The tribunal agreed, and went on to hold that, since bribery is contrary to international public policy, claims based on contracts obtained by corruption could not be upheld by the tribunal. Here, by way of contrast, Respondent has made no case against Claimants of any bribe.

182. Claimants finally point out that a mere presumption of fraud is insufficient. It has to be positively proved. Moreover, the fraud must be particularized and must directly relate to the precise issue at hand, namely Claimants' investment in Kazakhstan.

B. Claimants have standing to bring this arbitration

1. Rumeli and Telsim are the proper Claimants in this arbitration

183. ICSID's arbitration mechanism was designed to protect investments of foreign nationals, like Telsim and Rumeli. They are legal entities registered in Turkey and as such are nationals of another Contracting State. Article 25 of the ICSID Convention defines a "*National of another Contracting State*" as "*any juridical person which had the nationality of a Contracting State other than the State party to the dispute on the date on which the parties consented to submit such a dispute to conciliation or arbitration*." Rumeli and Telsim qualify as such because they were incorporated and headquartered in Turkey both at the time the dispute arose and at the time of their consent to ICSID arbitration.

184. According to Claimants, today, Rumeli and Telsim:

- remain legal entities incorporated in Turkey;
- remain commercially registered legal entities;
- have employees and own assets;
- have full legal capacity;
- pay social charges and taxes and are not immune from enforcement;
- are not owned, but merely managed by TSDIF.

185. Claimants further allege that they were never created for treaty-shopping purposes. Nor did they become controlled by TSDIF for this purpose. At the time of Respondent's wrongful actions, Claimants were actively engaged in telecommunications operations both in Turkey and abroad. When Telsim and Rumeli indicated that they would initiate ICSID proceedings in April 2003, they were fully-operational telecommunications companies. This was still the case when they perfected their consent to initiate proceedings by filing their Request for Arbitration on July 15, 2005.

186. Claimants dispute Respondent's allegation that Claimants are mere shell companies. In any event, even if Rumeli and Telsim were indeed "*shell*" companies, this would not constitute a bar to this Tribunal's jurisdiction under either the ICSID Convention or the BIT. Indeed, nowhere in Article 25 – nor in the ICSID Convention – is there a basis for denying ICSID jurisdiction to a shell company. This has been confirmed by a recent ICSID decision on jurisdiction. In *Aguas del Tunari*,[5] Respondent, Bolivia, argued that the claimant – a local company – could not claim that it was an entity "*controlled directly or indirectly*" by "*nationals*" of the Netherlands because, *inter alia*, the ultimate Dutch controlling corporation was a shell company actually controlled by an American company. As is clear from the decision, the tribunal rejected Respondent's position on the basis that the Dutch corporation was not a corporate shell specifically set up to gain ICSID jurisdiction over the dispute.

187. In the present case, even if Rumeli and Telsim are deemed today to be "*shell*" companies, it cannot be seriously argued that they were created in 1993 for "*treaty-shopping*" purposes, *i.e.* to gain ICSID jurisdiction.

188. Therefore:

- the fact that Telsim may or may not have substantial activities following the sale of Telsim assets to Vodafone is irrelevant for jurisdictional purposes. If Kazakhstan

[5] *Aguas del Tunari S.A. v. Republic of Bolivia* (ICSID Case No. ARB/02/3), Decision on Respondent's Objections to Jurisdiction of October 21, 2005 [hereinafter *Aguas del Tunari v. Bolivia*].

had wanted, as a condition for the BIT protection, that the Turkish corporate investors have substantial activities in Turkey, from the first day of their investment to the date of the rendering of an ICSID award, it could have included such an exceptional condition in the definition of "*investor*" in the BIT. It did not do so;

- Rumeli which owned a larger stake than Telsim in KaR-Tel – has not sold its assets. Consequently, the "*shell*" argument is not in any case relevant with respect to Rumeli;
- finally, to allege, as Respondent does, that once an arbitration has legitimately started, a company cannot sell its assets to another company, is simply wrong.

189. Moreover, according to Claimants, the BIT does not provide a basis for looking beyond Rumeli and Telsim on the alleged basis that they are shell companies. Article I(1)(b) of the BIT defines the term "*investor*" as "*corporations…incorporated under the law in force of either of the parties and having their headquarters in the territory of that party*." Accordingly, the BIT adopts the State of incorporation and the State of the seat as criteria for determining the nationality of a claimant. It does not exclude shell companies from its scope of application nor requires a search beyond the designated claimant whenever it is a shell company.

190. In this context, it is neither for Respondent nor for an arbitral tribunal to substitute its views of the definition of the term "*investor*" to that of the Contracting Parties to a BIT. This is the position recently adopted in *Saluka*.[6] In that case, the arbitral tribunal decided that the applicable BIT expressly gave standing to a legal person constituted under the laws of the Netherlands and did not expressly empower the tribunal to add any other criteria in this respect, irrespective of whether such a legal person was a shell company.

191. In addition, according to Claimants, the TSDIF's appointment of managers at Telsim and Rumeli did not in any way put an end to the corporate existence of Claimants or to Claimants' ownership of their claims against Kazakhstan. This is supported by decisions

[6] *Saluka Investments BV (The Netherlands) v. The Czech Republic* (UNCITRAL), Partial Award of March 17, 2006 [hereinafter *Saluka*].

such as in the *Autopista* case,[7] where the respondent argued that, even if the parties to the applicable agreement had agreed to treat the local company as a United States national because of the majority shareholding, "*the pervasive control by Mexican nationals over, and involvement in the affairs of*" the local company should lead the tribunal to decline jurisdiction under Article 25 of the ICSID Convention. The tribunal rejected respondent's argument.

192. Claimants further allege that given the fact that Claimants brought the claim in their names, the issue of what would have happened had TSDIF brought the claims itself is purely academic.

193. Claimants also submit that Respondent's attempts to imply that TSDIF already would have brought a claim in its own name against Respondent and that this would confirm that the real parties in interest would be TSDIF and the Turkish Treasury, is also incorrect. In fact, the "*proceedings*" to which Respondent refers is merely a Payment Order which was addressed to KaR-Tel and was issued by the TSDIF on October 7, 2004, shortly following the sale of KaR-Tel to Vimpelcom. Such USD 5.5 billion payment order was sent to over 200 Uzan-associated companies in October 2004. This was just an unsuccessful payment request by the TSDIF, not the institution of proceedings in the name of Telsim or Rumeli against Respondent.

194. Likewise, Claimants submit that Respondent's assertion that "*it is telling that Motorola brought its proceedings against the Republic of Turkey and the TMSF (TSDIF) and even more telling that the Republic of Turkey and the TMSF settled those proceedings*" is irrelevant to the dispute at hand. Moreover, it is factually wrong. The settlement agreement was entered into by Telsim, Rumeli, Bayindirbank A.S., Motorola Inc., Motorola Credit Corporation, Motorola Limited, and Motorola Komunikasyon Ticaret Ve Servis Ltd. STI. Neither the Republic of Turkey nor TSDIF were signatories. Therefore, according to Claimants, the fact that an arbitration initiated by Motorola against the

[7] *Autopista Concesionada de Venezuela, C.A. v. Bolivarian Republic of Venezuela* (ICSID Case No. ARB/00/5), Decision on Jurisdiction of September 27, 2001, para. 52 [hereinafter *Autopista*].

Republic of Turkey and TSDIF was settled in an agreement to which the Republic of Turkey and the TSDIF were third parties, and which they did not even sign, cannot be evidence that Claimants lack standing to bring this claim.

195. As for the letter of Dr. Yaşar Akgün, Deputy Chairman of Rumeli, to VimpelCom stating that Rumeli was now a "*state concern*," it is by no means an admission of the assimilation of Claimants' Rumeli and Telsim to the Turkish State for purposes of jurisdiction. Rather, it is a mere declaration that the TSDIF was naturally concerned as the managing authority of Claimants.

196. Furthermore, according to Claimants, the issue of who is the beneficial owner of the Rumeli and Telsim's claim is also largely irrelevant. Not only would Claimants directly benefit from any award, but the only ICSID decision to closely examine the question of the beneficial owner of a claim, the *CSOB* decision,[8] held quite clearly that beneficial ownership of a claim was irrelevant to the issue of standing. This position is supported by the expert witness statement of Professor Ziya Akinci, who confirms that the possible ultimate transfer of proceeds of any resulting award to third parties, be they State entities or private entities, would not in any event deprive Claimants of their commercial status.

197. Finally, Claimants allege that, with respect to ownership of the companies, neither Claimant is owned by the TSDIF or the Republic of Turkey. Claimants' shareholders remain private individuals. In any event, even ownership of a claimant by a State does not warrant examining the standing of the public entity that owns that claimant. The task of an ICSID tribunal in such a case is, as decided in *CSOB,* limited to reviewing the nature of the activities of the named claimant.

198. In sum, Claimants point out that they are neither the Turkish State nor the TSDIF, and that Article 25 of the ICSID Convention and the BIT plainly grant this Tribunal jurisdiction *rationae personae* to rule on the dispute.

---

[8] *Československa obchodní banka, a.s. v. Slovak Republic* (ICSID Case No. ARB/97/4), Decision on Objections to Jurisdiction of May 24, 1999 [hereinafter *CSOB*].

2. There was no assignment of Claimants' claim to the TSDIF

199. According to Claimants, they never assigned their claim to the TSDIF. The TSDIF was granted the authority pursuant to Turkish laws to appoint Claimants' management following the ImarBank banking violations. While TSDIF did appoint Claimants' management and played an instrumental role in the sale of the Uzans' assets, it never became the owner of Claimants' claim against Respondent.

200. Therefore, Claimants retained ownership of their claim. As noted in Professor Ziya Akinci's expert witness statement, Rumeli and Telsim had and retain standing to sue under Turkish law.

3. The TSDIF was not subrogated to Claimants' claims

201. According to Claimants, Respondent's allegation that the relationship between the TSDIF and Claimants should be viewed as one of subrogation is equally artificial. There was no subrogation and the economic consequences are entirely different from those of a subrogation. Indeed, as noted by Professor Schreuer, in the case of subrogation, "*the insurer succeeds to all the rights of the beneficiary who has received compensation under the insurance contract.*" Here, however, there was no insurance contract between Rumeli and Telsim and a national insurance agency, and Rumeli and Telsim received no compensation under such an imaginary insurance contract. There has also been no transfer of economic risk as in *CSOB*. In other words, nobody has compensated Claimants for their losses.

4. There is no reason to pierce the corporate veil

202. According to Claimants, the Arbitral Tribunal should also dismiss Respondent's claim that Claimants' corporate veils should be pierced.

203. In support of this position, Respondent relies on two cases, namely *Barcelona Traction*[9] and *Tokios Tokelés*.[10] It is true that in *Barcelona Traction*, the International Court of

[9] *Case Concerning The Barcelona Traction, Light and Power Company, Limited (Belgium v. Spain),* Judgment of February 5, 1970, I.C.J. Reports, p. 3 [hereinafter *Barcelona Traction*].

Justice held that piercing the corporate veil might be justified to prevent the misuse of the relevant company's legal personality in the case of fraud or malfeasance, to protect creditors or purchasers, or to prevent the evasion of legal requirements or obligations. However, none of these conditions is present here.

204. In *Tokios Tokelés*, the Tribunal rejected respondent's arguments to pierce the corporate veil on the basis that the claimant had made no attempt to conceal its national identity from the respondent and had not created the claimant companies to gain access to ICSID jurisdiction. Similarly, Claimants did not conceal their Turkish juridical identity from Respondent and were clearly not created for the purpose of gaining access to ICSID arbitration.

205. Moreover, nowhere in the ICSID Convention is there a basis for piercing the corporate veil of a designated claimant. This has been confirmed in the *ADC* ICSID award[11] where the arbitral tribunal confirmed that the principle of piercing the corporate veil "*only applies to situations where the real beneficiary of the business misused corporate formalities in order to disguise its true identity and therefore to avoid liability*."

206. In the present case, it cannot be seriously argued that the Turkish State or the TSDIF "*misused corporate formalities*." Rumeli and Telsim were incorporated in 1993, long before the start of these proceedings, and conducted substantial activities in the telecommunications sector for many years, both in Turkey and abroad.

5. Respondent's allegation that Article 25 of the Convention imposes a control test must fail

207. According to Claimants, the rule as to standing is clearly set forth in Article 25(1) of the ICSID Convention: "*The jurisdiction of the Centre shall extend to any legal dispute arising directly out of an investment, between a Contracting State…and a national of another Contracting State…*" The general rule as to the meaning of "*national of another*

---

[10] *Tokios Tokelés*, Decision on Jurisdiction of April 29, 2004.

[11] *ADC Affiliate Limited and ADC & ADMC Management Limited v. The Republic of Hungary* (ICSID Case No. ARB/03/16), Award of October 2, 2006, para. 335 et seq. [hereinafter *ADC v. Hungary*].

Contracting State" for legal entities, is set forth in the first clause of Article 25(2)(b), which provides that a national of another Contracting State means "*any juridical person which had the nationality of a Contracting State other than the State party to the dispute on the date on which the parties consented to submit such dispute to conciliation or arbitration*." However, for legal entities, Article 25(2)(b) provides an exception. It states that a national of another Contracting State also means "*any juridical person which had the nationality of the Contracting State party to the dispute on that date and which, because of foreign control, the parties have agreed should be treated as a national of another Contracting State for the purposes of this Convention*."

208. Therefore, according to Claimants, the control test provided under the second clause of Article 25(2)(b), was specifically inserted to broaden the scope of ICSID jurisdiction, not to limit it. It is precisely to fulfill this purpose in favor of jurisdiction that it has been applied by ICSID tribunals, such as in *SOABI*.[12]

209. In this respect, Claimants allege that all the cases cited by Respondent, *i.e. Vacuum Salt v. Ghana, Letco v. Liberia*,[13] and others relate to the second clause of Article 25(2)(b) and focus on the situation where the investor was an entity incorporated in the respondent State, and where control in the context of the second clause of Article 25(2)(b) was therefore relevant, which is not the case here.

210. Claimants finally allege that Respondent misstates the legal doctrine relating to the second clause of Article 25(2)(b). Respondent misreads Mr. Amerasinghe's article and Mr. Broches' statements to stand for the proposition that a flexible approach is taken under the Convention to determine standing. In the *Tokios Tokelés* Decision on

---

[12] *Société Ouest Africaine des Bétons Industriels [SOABI] v. State of Senegal* (ICSID Case No. ARB/82/1), Decision on Jurisdiction of August 1, 1984, 2 ICSID Reports 175 [hereinafter *SOABI v. Senegal*].

[13] *Vacuum Salt Products Ltd. v. Republic of Ghana* (ICSID Case No. ARB/92/1), Award of February 16, 1994, 4 ICSID Reports 345 [hereinafter *Vacuum Salt*]; *Liberian Eastern Timber Corporation v. Republic of Liberia* (ICSID Case No. ARB/83/2), Interim Award of October 24, 1984, 2 ICSID Reports, pp. 349 -351 [hereinafter *LETCO*].

Jurisdiction,[14] the arbitral tribunal strongly criticized that incorrect reading and highlighted the limited circumstances where the use of a control-test is justified: "*[t]he second clause of Article 25(2)(b) limits the use of the control-test to the circumstances it describes, i.e., when Contracting Parties agree to treat a national of the host State as a national of another Contracting Party because of foreign control… ICSID Tribunals ... have interpreted the second clause of Article 25(2)(b) to expand, not restrict jurisdiction ....*"

6. TSDIF would satisfy the jurisdictional requirements of ICSID in any event

211. According to Claimants, even if TSDIF were somehow the "*real party*" to this dispute, the tribunal would in all likelihood still have jurisdiction to hear it. Indeed, as stated by Mr. Broches in his article, a state-owned entity qualifies as a national of another Contracting State unless it acts as an agent for the government or discharges an essentially governmental function.

212. In the only ICSID case were this situation was addressed, *i.e.* the *CSOB* case,[15] it was decided that the sole determining factor is the nature of the activities of the relevant entity: "*While it cannot be doubted that in performing the above-mentioned activities, CSOB was promoting the governmental policies or purposes of the State, the activities themselves were essentially commercial rather than governmental in nature.*" Furthermore, the *CSOB* tribunal went even further and reasoned that the standing of a state-owned entity under Article 25 of the ICSID Convention should be reviewed not on the basis of the acts and function of the state-owned entity in general, but rather on the basis of its acts and function in connection with the actual dispute under review.

213. In this respect, Claimants point out that Respondent mischaracterized their position by stating that "*the test formulated by Broches and applied by the CSOB tribunal would be quite meaningless if the question was whether it was an essentially governmental function*

[14] *Tokios Tokelés*, Decision on Jurisdiction of April 29, 2004, paras. 45-47.

[15] *CSOB*, Decision on Objections to Jurisdiction of May 24, 1999, para. 20.

to bring litigation." Indeed Claimants do not argue that the Broches test as applied by the *CSOB* tribunal would grant the tribunal jurisdiction whenever a State agency brings litigation. Rather, the point is that, following the ImarBank banking violations, the TSDIF appointed managers to Rumeli and Telsim. These new managers continued to run Rumeli and Telsim as telecommunications companies. In April 2003, as any commercial entity would do when faced with the expropriation of a valuable asset, the previous managers of Rumeli and Telsim wrote to Respondent stressing that they intended to submit the dispute to the International Centre for Settlement of Investment Disputes. When Rumeli and Telsim's previous management was replaced by TSDIF appointed management, the new managers simply carried out the previous managements' commercial plans to submit Rumeli and Telsim dispute with Kazakhstan for final resolution to ICSID. The TSDIF-appointed managers did not exercise any special prerogatives in fulfilling the previous managements' "*firm intentions*."

214. According to Claimants, the Cayman Islands case *TMSF v. Wisteria Bay* cited by Respondent in this context is totally irrelevant for the following reasons:

- in that case, the TSDIF was a party to the proceedings; and
- the TSDIF was exercising special privileges to confiscate assets.

215. Finally, and in any event, even if the TSDIF was acting in this arbitration pursuant to public prerogatives, the closest analogy to its role would be that of a receiver. Bringing a claim in such a circumstance is perfectly legitimate in all developed municipal legal systems. To deny a receiver the right to bring such a claim would undermine any possibility of protecting the rights of the insolvent company's creditors through an arbitration procedure.

C. Claimants have gone far beyond establishing a *prima facie* case on the merits

216. According to Claimants, the Arbitral Tribunal cannot follow Respondent's allegation that Rumeli and Telsim have failed to establish a *prima facie* case on the merits so as to satisfy the jurisdictional requirements for their claim. Indeed, according to Claimants, all

the measures that were implemented by the Republic of Kazakhstan and led to the expropriation of Claimants' property as well as their multiple violations of international law are fully documented by Claimants and firmly establish their claim.

D. **Respondent is a proper party to this dispute**

217. Contrary to Respondent's allegation, this dispute is not a dispute between two private parties or related to contractual claims. Neither is it a dispute limited to the ownership of KaR-Tel. Rather, Claimants' claims are premised on Respondent's collusion with the local partner and violation of the BIT and international law, encompassing, *inter alia*, Respondent's wrongful termination of the Investment Contract, its resulting denial of Claimants right to challenge the termination of said Contract, its eviction of Claimants from KaR-Tel, its intimidation measures against Claimants' executives, and its failure to grant Claimants adequate compensation for what amounted to the expropriation of their shares.

E. **Claimants have standing to challenge the cancellation of the Investment Contract**

218. Claimants dispute Respondent's allegation that:

- Claimants do not have standing to challenge the termination of the Investment Contract because they were not parties thereto;
- even if Claimants had standing, such a claim would fall outside the scope of this Tribunal's jurisdiction since it would amount to a contractual claim which is not encompassed by the jurisdictional provisions of the Investment Contract.

219. According to Claimants, none of these arguments are founded:

- this arbitration is not based on the Investment Contract;
- it is not solely related to the termination of the Contract;
- the wrongful termination of the Investment Contract is but one element of Respondent's wrongful conduct, and in fact is the catalyst and pretext for

Respondent's ultimate expropriation of Claimants' investment without adequate compensation;

- this arbitration arises out of Respondent's violation of the BIT and international law.

F. **<u>The Foreign Investment Law is a valid secondary basis for establishing jurisdiction</u>**

220. According to Claimants, the Foreign Investment Law of the Republic of Kazakhstan constitutes an alternative basis for the jurisdiction of this tribunal. Indeed, under Article 27(2) of the Law, a foreign investor is expressly permitted to choose ICSID arbitration as the means for solving disputes with the Republic relating to its investments and, once that choice has been made, the consent of the Republic of Kazakhstan is "*presumed to have been granted*."

221. Claimants also submit, contrary to Respondent's allegation, that the fact that the Foreign Investment Law was repealed as of January 8, 2003 does not have any impact on ICSID jurisdiction as it was valid and effective at all times relevant to this dispute. Moreover, Article 6(1) of the Law specifically grants foreign investors protection against adverse changes in legislation for a period of ten years from the date they made their investment, or for the entire duration of a contract exceeding ten years entered into with authorized State bodies. Claimants meet both of these two alternative conditions. The relevant investments were made by Claimants from 1998 to 2002, and the Investment Contract dated May 20, 1999 between Claimants and Respondent was valid until July 31, 2009, *i.e.* for a period of more than ten years.

222. Respondent consented to ICSID arbitration on December 28, 1994, the date of the entry into force of the Foreign Investment Law, which remains applicable to the dispute pursuant to its Article 6(1). As for Claimants, they have completed their consent to ICSID jurisdiction by filing their Request for Arbitration.

II. RESPONDENT'S POSITION

223. According to Respondent, there are a number of grounds which demonstrate that this Tribunal does not have jurisdiction to entertain or determine Claimants' claims. In substance, Respondent alleges that this case is an attempt by a foreign State, the Republic of Turkey, through one of its agencies, to use the ICSID arbitration facility to render a host State, Respondent, responsible for decisions made by its Courts in proceedings between a private foreign investor and a privately-owned company incorporated in the Republic of Kazakhstan and owned, controlled and operated at all material times by private Kazakh citizens.

A. Respondent did not consent to ICSID jurisdiction over this dispute

224. It is Respondent's case that its consent, as expressed either in the Turkey-Kazakhstan BIT or the Foreign Investment Law, does not extend to this dispute because it was limited to investments made in conformity with Kazakh law. The Tribunal must therefore analyze the scope of Respondent's consent and determine whether or not this dispute arises out of an investment that falls within the scope of that consent.

225. In this respect, in the ICSID case *Inceysa v. El Salvador*,[16] the arbitral tribunal found that arbitral jurisprudence had developed three fundamental principles :

- absence of a presumption in favor of or against jurisdiction;
- the need for the identification of the will of the Contracting States; and
- an interpretation according to the principle of good faith.

226. Taking into consideration the above elements, Respondent alleges that both the BIT and the FIL contain clear limitations in relation to Respondent's consent. Article 1 of the BIT limits the protection afforded by the BIT only to those investments made in conformity with the laws and regulations of the Republic of Kazakhstan. The effect of this type of clause was recognized by the *Inceysa* tribunal. The will of the parties to the BIT was to

[16] *Inceysa v. El Salvador*, Award of August 2, 2006.

exclude from its scope of application and protection disputes arising from investments which were not made in conformity with the laws of the host State.

227. In the same vein, the FIL refers in its Article 4(1) to: "*any form of foreign investments and activities which are associated therewith, which are not prohibited by the current legislation of the Republic of Kazakhstan,….*" This language has the same effect as the language in the BIT. Consequently, investments which are contrary to Kazakh law are outside Respondent's consent and the Tribunal's jurisdiction.

1. Claimants' investments were not legal

228. Respondent alleges that its consent to arbitration has only been given to cases involving legal investments. That is the reason why the context in which the "*investments*" of Claimants took place in the Republic of Kazakhstan is highly material and more specifically the Uzans' fraud. Indeed, the Uzans' actions constituted a systematic attempt to commit a worldwide and wholesale fraud both on Motorola and Nokia, as well as on the Uzans' own companies around the world, including KaR-Tel.

229. On January 28, 2002, Motorola, together with Nokia Corporation, initiated legal proceedings in the United States District Court for the Southern District of New York against the Uzan family members and certain of their corporations. The claim alleged acts of racketeering in breach of the US Racketeer Influenced and Corrupt Organizations Act (RICO).

230. On July 31, 2003, the United States District Court for the Southern District of New York gave judgment in favor of Motorola and Nokia for over USD 4 billion. The judgment provides valuable insights into the *modus operandi* of the Uzan family and their corporations which are relevant to the present proceeding. Amongst the findings of the Court which are of relevance, the following points are highlighted by Respondent:

- the Uzans failed to disclose to Motorola that they intended to divert some of the proceeds of the Motorola loan to KaR-Tel for non KaR-Tel purposes;

- Telsim was given a final repayment deadline of April 2001 in respect of USD 700 million of loans which had been granted to it;
- on May 22, 2001, Motorola issued a notice of default in respect of the USD 700 million that remained unpaid from April;
- the Uzans saw Motorola's loans as a great opportunity to funnel vast sums into their control and then divert them wherever they chose, whether to prop up other companies in their far-flung enterprise or to simply launder monies into their own pockets;
- at least USD 552 million was laundered into the control of Uzan-controlled companies by the device of reimbursing them for fraudulently overstated expenses.

231. Respondent further points out that whereas providing funding was one of Rumeli's principal obligation under the Foundation Agreement, Rumeli did not in fact make any investment at all, electing instead to burden KaR-Tel with huge debts.

232. In this context, the funds advanced under the Motorola loan, for which KaR-Tel had assumed an obligation to repay, were never received by KaR-Tel. Rather, they were paid directly to Rumeli, which paid the balance of USD 60 million to the Ministry of Finance for the License. The remaining USD 5 million, which was subsequently increased to over USD 17 million, was never received by KaR-Tel at all. Respondent understands that these sums were retained and used by Telsim and/or Rumeli, despite KaR-Tel being liable for the debt created thereby.

233. In the same vein, pursuant to clause 6 of the Investment Contract, KaR-Tel was obliged to use advanced technology in developing its network in Kazakhstan. It emerges from various audits and the Court-appointed forensic merchandising examination of KaR-Tel by the Forensic Examination Centre of the Ministry of Justice during the course of the Kazakh Courts proceedings, that Telsim had been selling obsolete second-hand equipment to KaR-Tel at inflated prices. Indeed:

- between February 1, 2001 and April 25, 2002, Mr. Agilönü caused KaR-Tel to enter into contracts with Telsim for the purchase of handsets for a total of USD 9,270,970. An average market value for the handsets was approximately USD 4,395,556;
- by contract IEPA 29 dated May 10, 2000, KaR-Tel purchased from Telsim telecommunications equipment for a total price of USD 5,840,797.74. These products were available at the time from a different supplier for USD 1,898,728.

234. Therefore, according to Respondent, the reality of the situation appears to have been that Claimants were pursuing with KaR-Tel precisely the same strategy that they had adopted in relation to other mobile telecommunications ventures around the world. KaR-Tel was merely a small part of the overall project. What made Claimants' action towards KaR-Tel worse was that they deliberately indebted it twice. Indeed, KaR-Tel was liable for its borrowing from Motorola of USD 17 million, which it never received and which appears to have been retained or used by Telsim and, in addition, was caused or procured by Claimants' executives who operated KaR-Tel to enter into further loan agreements with Telsim for the provision of overpriced and obsolete equipment.

235. Therefore, it is Respondent's allegation that in circumstances where the entire basis of Claimants' alleged investment in KaR-Tel was to further their worldwide fraud, the investment was not in conformity with the laws of Kazakhstan. Respondent submits that the Tribunal should adopt the same approach as the *Inceysa* tribunal, which identified three general principles of international law against which the conduct of the claimant must be compared: good faith, *nemo auditur propriam turpitudinem allegans*, and international public policy.

2. Claimants' investments violated the principle of good faith, the principle *nemo auditur propriam turpitudinem allegans* and international public policy

236. According to Respondent, being part of a worldwide fraudulent scheme, Claimants' investment was made in violation of the principle of good faith. Therefore, Claimants did not make their investment in conformity with Kazakh law.

237. Moreover, no legal system based on rational grounds would allow a party which has committed an illegal act to benefit from it. Therefore, Claimants cannot enjoy the protection granted by Respondent, such as access to international arbitration under the ICSID system.

238. In the same vein, the *Inceysa* tribunal found that international public policy consists of a series of fundamental principles that constitute the very essence of the State and the essential function of which is to preserve the values of the international legal system against actions contrary to it. One of those values is respect for the law. If the Tribunal were to assume jurisdiction to resolve the dispute brought before it by Claimants, it would recognize the existence of rights for Claimants arising out of their illegal conduct. That would violate the respect for the law which is a principle of international public policy.

239. Respondent finally sets forth that violation of international public policy was held to be a self-standing ground for refusing to accept jurisdiction over a claim by the tribunal in the *World Duty Free* case.[17] There, the tribunal found that the contracts which formed the basis of the investor's claim had been procured by bribes. The tribunal then cited a passage from the decision of Judge Lagergren in ICC Case No. 1110: "*Jurisdiction must be declined in this case… Parties who ally themselves in an enterprise of the present nature must realize that they have forfeited any right to ask for the assistance of the machinery of justice (national courts or arbitral tribunals) in settling their disputes*."[18]

240. Fraud is contrary to the international public policy of most, if not all, States. It follows that claims based upon investments which were part of a fraud, cannot be admitted by the ICSID mechanism.

[17] *World Duty Free v. Kenya*, Award of October 4, 2006.

[18] *Id.*, para. 148, citing *ICC Case No. 1110*, Award of 1963, [1994] International Arbitration at 277.

B. Claimants do not have standing to bring this arbitration

1. The Turkish State is the real party in interest in this arbitration

241. According to Respondent, the nominal Claimants to these proceedings are not the real claimants or the real parties in interest in this arbitration. The true claimant is in fact the TSDIF, which is indisputably an agency of the Turkish State and does not itself have standing to bring these proceedings.

242. Respondent points out that, on February 14, 2004, the TSDIF seized Claimants. Since then, it cannot be argued that Claimants have existed as independent commercial entities in any meaningful sense.

243. According to Respondent, this seizure of Rumeli and Telsim is part of the consequences of the worldwide fraud committed by the Uzans and the collapse of their bank. The TSDIF is an agency of the Turkish Government. Its Board of Directors is appointed by the Turkish Council of Ministers. It is obliged to report its activities and financial position to the Turkish Parliament and its budget is approved by the Turkish Treasury. Membership of the TSDIF is mandatory for all banks operating in Turkey. The TSIDF's purpose is to guarantee deposits held in both domestic and foreign banks operating in Turkey as to 100%.

244. If a Turkish bank collapses, the TSDIF's function is to reimburse depositors for the full amount of their deposits held by the bank. Prior to 1999, this role was undertaken directly by the Turkish Government.

245. On June 12, 2003, the Turkish Ministry of Energy annulled the Concession Agreements under which Çukurova Elektrik ("*ÇEAS*") and Kepez Elektrik, the two most profitable companies owned and managed by the Uzan family, supplied electricity in Turkey's Mediterranean region.

246. At the same time, the Turkish Banking Regulatory and Supervisory Board (the "*BDDK*") was becoming concerned about the activities of ImarBank, also owned by the Uzans.

The loss of ÇEAS and Kepez Elektik caused concern in the Turkish market and led a significant number of depositors to remove their deposits from ImarBank. On July 3, 2003, the BDDK revoked ImarBank's license and began an investigation into its activities. Control over ImarBank then passed to the TSDIF.

247. According to Respondent, the ensuing investigation into the management of ImarBank by the Uzan family revealed that the bank had under-declared its true level of deposits. ImarBank had declared its deposits at around USD 600 million. It quickly became clear that more than USD 5 billion had been deposited and concealed using a sophisticated double accounting system. Consequently, in August 2003, warrants for the arrest of Kemal Uzan and Hakan Uzan were issued, the two individuals having fled the country shortly before the takeover of ImarBank.

248. The scale of the Uzans' fraud on Imarbank meant that the TSDIF was unable to meet the full extent of the bank's liabilities so that the Turkish Treasury was forced, for the first time since the TSDIF was established, to settle the depositors' claims on ImarBank.

249. According to Respondent, this meant that action was taken by the Turkish Government to seize every Uzan-related asset they could locate. At the end of July 2003, Law 4969 was passed by the Turkish Government which extended the scope of assets that could be frozen and therefore conserved to settle the debts owed by ImarBank and ultimately borne by the Turkish State. Some 259 companies controlled by the Uzan family were affected. In late 2003, a further law, Law 5020, was passed by the Turkish Government, which provided for the transfer of management and control of companies owned by affiliates and shareholders of ImarBank to the TSDIF. The TSDIF, on behalf of the Turkish State, began reimbursing ImarBank depositors on January 23, 2004.

250. On February 14, 2004, the TSDIF exercised its powers under Law 5020 in respect of Claimants in this Arbitration, Rumeli and Telsim. Within two days, the TSDIF had appointed a new executive board of directors headed by Mehmet Tasaltin, a former

executive of Turkish Telecom, to administer all communication companies within the Uzan group of companies.

251. Following Telsim's seizure by the TSDIF in February 2004, Motorola and Nokia demanded the TSDIF to settle their US judgment debt of over USD 2 billion.

252. During the course of 2004 and 2005, the TSDIF restructured Telsim in preparation for a sale. On December 13, 2005, the Telsim brand, its assets and business were auctioned with Vodafone successfully bidding a reported USD 4.55 billion to acquire them.

253. In October 2005, under the agreement reached with the TSDIF, Motorola was to receive 20% and Nokia 7.5% of the proceeds of the Vodafone sale, in settlement of their judgment debt. The remaining 72.5% of the sale proceeds passed to the Turkish State to reduce the loss it had suffered in paying back depositors of ImarBank.

254. Consequently, according to Respondent, since February 14, 2004, the TSDIF has been the only entity with any real interest in Claimants. It is misleading to suggest that there are genuine private shareholders of Claimants who exercise any function at all in relation to Claimants. In this respect, the documents reluctantly disclosed by Claimants show that the nominal shareholders continue to be the members of the Uzan family who are fugitives from Turkish justice since 2003, two years before this arbitration was initiated.

255. Respondent further points out that TSDIF, with the assistance of the Turkish Treasury, had already paid Motorola USD 500 million as an initial payment prior to the sale of Telsim. This payment, together with the agreement to make further payments following Telsim's sale, was the settlement agreed in the ICSID proceedings Motorola brought against the Republic of Turkey and the TSDIF, not Telsim or Rumeli. In that arbitration, Motorola alleged that the TSDIF's seizure of Telsim had expropriated Motorola's "*investment*" in Telsim, in the form of several billion dollars of loans that remained owing to Motorola.

256. According to Respondent, it is telling that Motorola brought its proceedings against the Republic of Turkey and the TSDIF and even more telling that the Republic of Turkey and the TSDIF settled those proceedings. If the TSDIF's assertions in this arbitration that Rumeli and Telsim are the only and the true parties in interest were genuine, it is surprising, to say the least, that the TSDIF and the Turkish State adopted the view that they needed to settle the ICSID claim brought against them in respect of Rumeli and Telsim by paying well over USD 1 billion to Motorola and Nokia.

257. According to Respondent, it is established by the above that:

- TSDIF is in total control of both Claimants;
- Telsim's assets and business have been sold;
- Telsim, without any assets or business, is a mere shell;
- no part of the sums received in respect of the sale of Telsim's business and assets has been retained by Claimants themselves;
- nor has any part of the sums so received been paid to the official "*shareholders*" or "*owners*" of Claimants;
- it is disingenuous for Claimants to attempt to perpetuate the fiction of private ownership by the Uzans, who are reportedly fugitives from Turkish justice;
- the sole power over Claimants not held by the TSDIF, namely the right to receive dividends, did not prevent it from removing all of the proceeds of sale of Telsim from Claimants;
- in fact, the sums received by Telsim have been used by the TSDIF to satisfy settlement terms agreed by the Republic of Turkey with Motorola and Nokia arising out of their ICSID proceedings;
- the real parties in interest in this claim are not Claimants, but the TSDIF and the Turkish Treasury.

258. The fact that the real parties in interest are the TSDIF and the Turkish Treasury is further confirmed by the existence of proceedings brought by the TSDIF in its own name against

KaR-Tel in Turkey seeking to recover USD 5.5 billion in relation to the same subject matter as this arbitration.

259. According to Respondent, none of the arguments set forth by Claimants to support the allegation that Claimants are the proper parties to this arbitration, has any merit. In this respect, Claimants point out that they are "*commercially registered legal entities*." However, Respondent does not dispute that Claimants continue to be in existence. Rather, it disputes that they are in existence in anything other than a shell form and for any other purpose than attempting to maintain standing for the purposes of this arbitration. This is confirmed by:

- Respondent's Expert Report on Turkish Law;
- the announcement by Mr. Yusuf Adigüzel after the sale of Telsim's assets and business that: "*the aim of TSDIF is to sell the assets of the companies managed by it to reduce the amount of public debt and to liquidate the companies. Telsim A.S. will be liquidated in the near future*."

260. According to Respondent, Claimants' argument that they have a number of employees and own a number of assets including immovable property, credits and receivables, also does not support Claimants' position. Indeed, the fact that TSDIF may not yet have laid-off absolutely all of Claimants' employees or sold off all of their office buildings is irrelevant to the issue of whether or not they are mere shell companies. Claimants' reliance on *Saluka* and *Aguas del Tunari* misses the point. Both of those cases concerned genuine commercial entities, with no hint of unusual conduct sufficient to justify piercing the corporate veil. More importantly, in neither case was there any issue of State involvement.

261. In the same vein, according to Respondent, Claimants' allegation that they "*have full legal capacity and can thus commence legal proceedings or be sued before the courts*" is curious. Indeed, it is strange that other Court cases relating to Rumeli and Telsim are brought by the TSDIF in its own name. It is also strange, in such circumstances, that

Motorola and Nokia issued ICSID proceedings against TSDIF and the Republic of Turkey rather than commercial arbitration or Court cases against Claimants.

262. Respondent further submits that Claimants' allegation that "*the fact that Claimants may or may not have substantial activity at this time neither bars them from taking up such activity at a later stage, nor renders them shell companies*" says everything. The important point is that at the time of instituting these proceedings, the TSDIF had agreed to sell the Telsim brand name, its business and all of its assets for USD 4.55 billion; both Rumeli and Telsim had been completely under TSDIF control for well over a year and neither Claimant had any material ongoing commercial activity.

263. As expressed by Dr. Yasar Akgün, a TSDIF appointee to Claimants' boards, in two letters to VimpelCom dated August 27, 2004, "*our company is now a state concern*." Accordingly, Respondent alleges that the reality is that Claimants' existence is perpetuated as vehicles for the TSDIF and the Turkish State to abuse the ICSID arbitration mechanism and evade its clear jurisdictional requirements.

264. With respect to the *CSOB* case invoked by Claimants, Respondent submits that it is substantially different from the present case. In *CSOB*, the tribunal considered that standing in an international forum was determined by reference to the date on which proceedings are instituted and noted that the assignments of the claims had taken place over a year after the registration of the Request for Arbitration.

265. Respondent finally alleges that one of the strange features of this case is that Claimants have failed to give any explanations about what was going on within their companies. They know the facts, but they have declined to go into them on the basis that the Uzan fraud has nothing to do with Kazakhstan. In this context, Respondent points out that in his evidence before the Tribunal, Mr. Akgün admitted that the TSDIF had recently decided to file a law suit in Turkey against Claimants' former directors and auditors. Mr. Akgün also stated that Claimants did not investigate the allegations made against the Uzans in the US proceedings in relation to what was there termed the "*KaR-Tel Scheme*."

2. The assignment of Claimants' cause of action

266. Respondent submits that the TSDIF's seizure is identical in legal and economic effect to an assignment of Claimants' cause of action.

267. It is a question of fact for determination by the Tribunal whether or not the terms of the host State's consent to ICSID arbitration extend to the assignee and/or permit assignment of rights and obligations arising out of an investment relationship. As underlined by Schreuer, where the host State is unaware of, or has resisted, an assignment, "*it is unlikely that a tribunal will decide that party status under the Convention has been transferred*."

268. According to Respondent, even if it were possible to construe Respondent's consent to ICSID arbitration as extending to an assignee (which is not accepted), such consent could not be deemed to extend to a State or State agency.

269. The legal and economic effect of the TSDIF's seizure of Claimants is identical to an assignment. Had the TSDIF received such a voluntary assignment, this Tribunal would be bound to reject jurisdiction over this claim. According to Respondent, the TSDIF cannot be placed in a better position because it seized Claimants and thereby forcibly took over the alleged causes of action than if it had taken a voluntary assignment.

3. The TSDIF was subrogated in Claimants' claim

270. According to Respondent, another way of viewing the relationship between the TSDIF and Claimants is one of subrogation. Indeed, the economic consequences of the TSDIF's seizure of Claimants is the same as if it had been subrogated to their rights. On this additional or alternative basis, Respondent submits that this Tribunal does not have jurisdiction under Article 25 of the ICSID Convention.

271. During the negotiation of the ICSID Convention, the situation in relation to State-operated investment insurance funds was considered. The possibility was explicitly discussed of ICSID's arbitration facilities being made available to a governmental

subrogee under such an insurance fund by virtue of an ICSID clause between the investor and the host State. Ultimately, however, this possibility was removed as it was felt that it might well lead to the Centre becoming a forum for inter-State confrontations.

272. On the other hand, if the subrogee were a private insurer and, like the investor, a "*national of another Contracting State*," there would appear to be no difficulty in it appearing as a party in ICSID proceedings in place of the investor, assuming the host State had consented to the subrogation. The position is markedly different where the subrogee is a governmental or inter-governmental entity. Such an entity cannot avail itself of the investor's right to ICSID arbitration against the host State.

273. Professor Schreuer cites three main reasons for the denial of party status to a State-owned investment insurance agency, each of which applies in this arbitration:

- the Convention provides for the settlement of disputes between States and nationals of other States. The clear wording of Article 25(1) cannot be reinterpreted to cover disputes involving States, State agencies or international organizations on the investor's side;
- one of the Convention's objectives is to depoliticize disputes;
- the Convention's '*travaux préparatoires*' show that a conscious decision was made to exclude States, State agencies or international organizations from access to ICSID proceedings on the investor's side.

274. Therefore, according to Respondent, an indemnifying State fund cannot take advantage of the right the investor may have had under an appropriate ICSID clause. Further more, the State Fund does not have the right to bring such proceedings in the investor's name.

275. It is true that according to Broches, this general exclusion of a State fund would not prevent that fund requiring an indemnified investor to pursue its remedies under the Convention to offset the insurer's net payments under the insurance scheme. However, in such circumstances, a plea of non-admissibility might be invoked against the claim on the basis that the investor has been indemnified. In this respect, Respondent points out

that Claimants have no interest whatsoever in the outcome of this arbitration. They are not trading entities and they will not see the benefit of any sums recovered, which will instead go directly to the Turkish Treasury.

276. Respondent finally submits that, under Turkish law, the TSDIF is much more than a subrogate. It is granted the right to seize all assets of the shareholders of a collapsed bank and pursuant to Article 12 of the Turkish Regulation Relating to Liquidation of Companies Controlled by TSDIF, it is the legal successor in title to any of the companies it seizes.

4. Alter ego and piercing the corporate veil

277. According to Respondent, there is another way of viewing the TSDIF's undoubted absolute control over and operation of the remaining shells of Claimants. The TSDIF is effectively the *alter ego* of Claimants.

278. Another view would be to consider the bringing of this claim through the doctrine of piercing the corporate veil: the filing of the claim by the nominal Claimants is a sham designed to conceal the reality of a claimant which fails to satisfy the ICSID jurisdictional requirements. These doctrines have been expressly held to be applicable in the international law context by the International Court of Justice in the *Barcelona Traction* case and by an ICSID tribunal in the *Tokios Tokelés* case.

279. If the corporate veil is pierced, what remains is a claim brought by, and on behalf of the Turkish State. Such a case does not fall within the bounds of ICSID jurisdiction pursuant to Article 25 of the Convention as a result and the claim should be rejected.

5. *"Control"* and *"incorporation"*

280. Respondent disputes that Claimants' contention that Article 25 of the ICSID Convention only requires the claimant to have the nationality of another Contracting State and that the management of a designated claimant is irrelevant to the analysis under Article 25.

281. Respondent submits that under the ICSID Convention, a broad approach is taken which looks at the reality of the position and is not based solely upon the outdated notion of share ownership relied on in the pre-*Barcelona Traction* jurisprudence. In this sense, Mr. Amerasinghe has stated that "*[a] tribunal may regard any criterion based upon management, voting rights, shareholding or any other reasonable theory as being reasonable for the purpose. The point is that the concept of 'control' is broad and flexible….*" Mr. Broches, too, has written that, whilst the Convention begins from the premise that incorporation determines nationality, an ICSID tribunal should take account not only of formal criteria such as incorporation, but also of economic realities such as ownership and control.

282. In contrast to the general principle that Claimants seek to derive erroneously from the *Autopista* decision on jurisdiction, the tribunal in the *Vacuum Salt* case came to the opposite conclusion. In *Vacuum Salt*,[19] only 20% of the shares of *Vacuum Salt* were in foreign hands. The tribunal proceeded to examine the other possible elements of control over the company, and especially its management, but found that there was nothing which dispelled the overall impression of Ghanaian control. The tribunal held that to assume jurisdiction under those circumstances would have been contrary to the purpose of the Convention.

283. In *LETCO*,[20] the question of control did not raise any factual problem as there was 100% share ownership by a juridical national of another Contracting State. Nonetheless, the tribunal still found it appropriate to also base its finding on the company's decision-making structure and management.

284. In reality, there are a number of examples of ICSID tribunals having looked beyond the signatories to an investment agreement to take account of the true parties in interest. In

---

[19] *Vacuum Salt*, Award of February 16, 1994.

[20] *LETCO*, Interim Award of October 24, 1984.

the *Holiday Inns*[21] decision on jurisdiction, in order to find that the parent companies of the investor, which were not themselves parties to the investment agreement, were proper parties to the proceedings, the tribunal looked specifically to their actual participation in the carrying out of that investment agreement. By the same token, in the *Klöckner v. Cameroon* case,[22] the tribunal found that it had jurisdiction over Klöckner for the purposes of the government's counterclaim even in relation to an investment agreement which had been concluded between a company which was not Klöckner but in which Klöckner had a majority interest, and the government. The basis for this finding was that Klöckner had negotiated the investment agreement and was the real party in interest.

285. According to Respondent, and as suggested by Schreuer, the better approach would be "*a realistic look at the true controllers, thereby blocking access to the Centre for juridical persons that are controlled directly or indirectly by nationals of non-Contracting States or nationals of the host State*."[23] This is the prevailing view adopted by ICSID tribunals.

286. According to Respondent, if such an approach is adopted in order to block claims which can be qualified as abusive of the ICSID mechanism – because they are in reality brought by nationals of non Contracting States or of the host State – the same approach must be followed where claims are brought by another State.

287. It is true that in many of the cases cited, the issue arose because the investor was an entity incorporated in the respondent State. However, according to Respondent, the principle is of more general application. It is in ICSID's interest to guarantee the continued depoliticization of its system by blocking claims brought by one Contracting State against another.

---

[21] *Holiday Inns S.A. and others v. Morocco* (ICSID Case No. ARB/72/1), Decision on Jurisdiction of May 12, 1974 [hereinafter *Holiday Inns*].

[22] *Klöckner Industrie-Anlagen GmbH and others v. United Republic of Cameroon and Société Camerounaise des Engrais* (ICSID Case No. ARB/81/2), Award of October 21, 1983, 2 ICSID Reports 9, at 17 [hereinafter *Klöckner*].

[23] Christoph H. Schreuer, *The ICSID Convention: A Commentary*, 2001, p. 318, para. 563 [hereinafter *Schreuer*, The ICSID Convention].

288. It is also true that in the *AMCO* case,[24] the tribunal held in general terms that it did not consider an enquiry into the indirect controllers of an investor to be the correct approach. However, the tribunal nonetheless accepted that the true nationality of the controller would have to be taken into account where, for political or economic reasons, it matters for the host State to know the nationality of the controller and where the host State, had it known this nationality, would not have agreed to the arbitration clause.

289. Respondent alleges that in the present arbitration, it matters for Respondent and for the Tribunal to know the true identity of the controller of Rumeli and Telsim. Had Respondent known that Rumeli and Telsim had been seized by the TSDIF, it would not have agreed to arbitrate a dispute arising between them before an ICSID tribunal. It is for this reason that a distinct mechanism for the determination of disputes between the Republic of Turkey and the Republic of Kazakhstan is provided for in Article VII of the BIT.

290. According to Respondent, the facts lead therefore to the conclusion that control of Claimants is relevant, and the circumstance that in the present case such control is exercised exclusively by the Turkish State and its agencies for their sole benefit, means that the case brought by Claimants is an action which seeks to abuse the ICSID mechanism and should be blocked by this Tribunal.

6. The claim brought by TSDIF does not satisfy the jurisdictional requirements of ICSID

291. According to Respondent, if it is accepted that the TSDIF is the true claimant in this arbitration, it becomes necessary to address Claimants' argument that the TSDIF would satisfy the jurisdictional requirements of ICSID as a State-owned entity. Equally, if Rumeli and Telsim are found to be the true claimants, it becomes necessary to consider whether they are effectively State-owned corporations and whether, in consequence, they themselves fall within the boundaries of ICSID jurisdiction.

[24] *Amco Asia Corporation and others v. Republic of Indonesia* (ICSID Case No. ARB/81/1), Decision on Jurisdiction of September 25, 1983, 1 ICSID Reports 396 [hereinafter *Amco I*].

292. In the Commentary to the Preliminary Draft of Convention, it was acknowledged that State-owned corporations could be party to proceedings brought under the Convention. This was not, however, repeated in the Executive Directors' Report on the final Convention text. Schreuer states that the best guidance on this issue is still that formulated by Mr. Broches in his 1972 Hague Academy Course: "*[I]n today's world, the classical distinction, between private and public investment, based on the source of the capital, is no longer meaningful, if not outdated…for the purposes of the Convention a mixed economy company or government-owned corporation should not be disqualified as a 'national of another Contracting State' unless it is acting as an agent for the government or is discharging an essentially governmental function.*"

293. However, according to Respondent, Mr. Broches was writing during the cold war, when, for a multilateral treaty to be effective, he needed to address the peculiarities of genuinely commercial enterprises which happened to be State-owned for political reasons. He did not have in mind the situation in which a State party seized a private company. Respondent therefore submits that the test formulated by Broches has no application in this arbitration. Even if it was applicable, Claimants and/or the TSDIF should still be excluded from ICSID jurisdiction since they are agents of the Turkish government discharging an essentially governmental function.

294. According to Respondent, the TSDIF is indeed an agency of the Turkish government. This conclusion is supported by the following considerations:

- two letters dated August 27, 2004 which expressly refer to the TSDIF as a State agency (Exhibits RM98 and RM99);
- the findings of the Court of Appeals of the Cayman Islands on the basis of submissions made last year by the TSDIF itself in proceedings before that Court. The TSDIF had seized a yacht which the plaintiff had purchased from the Uzan family prior to the seizure of their assets by the TSDIF. An injunction was granted by the Cayman Grand Court ordering the TSDIF not to sell the yacht. The TSDIF relied upon the defense of sovereign immunity in relation to the plaintiff's challenge

to its actions. The TSDIF argued that it was an agency of the Turkish State performing governmental and sovereign acts. And, precisely, the Court of Appeals of the Cayman Islands began its judgment by referring in the very first line thereof to the TSDIF as "*an agency of the Turkish government*."

295. The second, and alternative, ground formulated by Mr. Broches on the basis of which a State-owned corporation or entity would be disentitled from using the ICSID mechanism is where it discharges an essentially governmental function. Respondent emphasizes the fact that Mr. Broches considered either ground to be sufficient alone to exclude an entity from bringing a claim under the Convention mechanism. Respondent accepts that in relation to the second ground, State-ownership, whilst important, is not determinative. What matters is the nature of the functions carried out. According to Respondent, there is no question that TSDIF's activities in general, and in particular in seizing and selling off the assets of shareholders of banks, are governmental functions:

- they are not functions that can be performed by any private person or organization;
- as Mr. Erkam states in his Expert Report on Turkish Law, property seized by the TSDIF is regarded under Turkish law as State-property;
- this is confirmed by the statements made by the Mr. Akgün where he states: "*our company is now a state concern.*"

296. According to Respondent, the test is thus whether the entity discharges in general a governmental function and not as suggested by Claimants, whether the particular act in question is of a governmental nature. To support their position, Claimants rely on a passage from the *CSOB*[25] decision on jurisdiction which states that: "*Respondent has failed to sustain its contention that the Centre lacks jurisdiction and the Tribunal competence to hear this case on the ground that Claimant was acting as an agent of the State or discharging essentially governmental activities as far as this dispute is concerned*" (emphasis added).

[25] *CSOB*, Decision on Objections to Jurisdiction of May 24, 1999, para. 27.

297. According to Respondent, Claimants' interpretation is untenable. The test would indeed be meaningless if the question was whether it was an essentially governmental function to bring litigation. The answer would, naturally, be the same in every case. Therefore, the meaning of the phrase in *CSOB* is to reflect that tribunal's previous observation that the dispute in that arbitration related to investment banking transactions which it found to be of a corporate nature. In the present arbitration, on the contrary, the function being performed by the TSDIF is the attempted realization of funds from the seized property of Turkish nationals charged with criminal offences.

298. Alternatively, Respondent submits that if it is not accepted that the TSDIF is the real claimant in this case, and one takes into consideration the nominal Claimants, Respondent's case continues to be that in pursuing this claim, they are exercising a governmental function. The claim is being funded by the Turkish State, directed by officials of the Turkish State and is designed to recoup a large amount of foreign currency for the Turkish Treasury. None of those things is a function carried out by a private party. The recovery of State debts through litigation or any other means is plainly not an act *jure gestionis*.

299. Respondent further alleges that there is a manifest difference between *CSOB* invoked by Claimants and the present arbitration in that there is a difference between a State-owned investment bank like in *CSOB*, and a defunct shell corporation seized by the State pursuant to domestic criminal laws and operated for the purpose of recovering State debts.

300. Ultimately, irrespective of whether the correct approach is to examine the nature and function of the TSDIF or to take into consideration the nominal Claimants themselves, it is clear that this claim is brought and driven by the TSDIF in an attempt to recover the losses suffered by the Turkish State as a result of the Uzan family's massive-scale worldwide frauds. It is a claim which is brought by the TSDIF pursuant to its statutory and sovereign powers and, as such, falls outside the requirements for jurisdiction set forth by Article 25 of the Convention.

C. No ***prima facie*** case

301. According to Respondent, the fact that Claimants do not even have a *prima facie* case is another obstacle to the jurisdiction of this Tribunal.

302. The *onus* is indeed on Claimants to demonstrate that they have such a case. They have not discharged this burden. Indeed, they have not demonstrated a *prima facie* case of any of the internationally wrongful acts that they allege against Respondent.

303. According to Respondent, Claimants' case is only a string of unspecific and generalized allegations that many diverse Kazakh parties and entities, with no apparent communality of interest, conspired together – for no apparent reason – to mistreat them.

304. Furthermore, Claimants' position that the Kazakh Courts grossly misapplied Kazakh law is unfounded. The evidence on Kazakh law upon which Claimants rely is of limited value. They indeed rely on opinions of Kazakh law professors, in particular those of Professor Suleimenov and Professor Didenko, which the latter wrote in support of Claimants' position before the Kazakh Courts. However, neither of these experts has provided a new expert report on these matters for the purposes of this arbitration. The opinions they have given in the context of the Kazakh proceedings have no status in this arbitration. Moreover, while having provided an expert opinion before the Kazakh proceedings in favor of Claimants, Professor Didenko, shortly after the conclusion of the proceedings, produced an academic article in which he expressly referred to those proceedings and changed his position in relation to a number of important issues.

D. Respondent is not a proper party to the dispute

305. Respondent also alleges that it is not a proper party to these proceedings, as it is not involved in the underlying dispute, which, in reality, is a dispute between private parties as to the ownership of KaR-Tel.

E. **Claimants do not have standing to challenge the termination of the Investment Contract**

306. It is moreover Respondent's contention that Claimants were not parties to the Investment Contract and therefore have no standing to challenge its termination. In addition, even if they did have standing, such a claim would not fall within the jurisdiction of ICSID by reason of:

- the fact that it is contractual claim and not a treaty claim;
- the express jurisdiction provisions of the Investment Contract.

307. According to Respondent, the Investment Contract does not permit ICSID arbitration as a forum for disputes unless there have been written objections to consideration of the dispute by the Courts of Kazakhstan. Furthermore, the Investment Contract expressly restricts the right of action to the "*investor*" which is a term defined in Article 1.3 as KaR-Tel LLP. Finally, if shareholders of an investor company have standing to bring arbitration proceedings in respect of their investment, the specific contractual wording of the Investment Contract does not permit Claimants to bring a treaty claim under it.

F. **The Foreign Investment Law is not applicable**

308. According to Respondent, Claimants' purported reliance on the FIL as founding jurisdiction for this Arbitral Tribunal is also misplaced. Indeed, the consent to arbitrate disputes relating to foreign investment under the FIL was no longer effective at the time of the commencement of these proceedings, as the FIL had been repealed. Claimants' contention that the consent to ICSID arbitration survives this repeal by reason of Article 6 (1) FIL is misconceived. This is only true in the case where the investor has accepted the offer of ICSID jurisdiction in writing whilst the legislation was still in force. In the present case, the FIL had been repealed prior to the registration of the Request for Arbitration, and cannot found jurisdiction for this arbitration.

G. <u>Admissibility</u>

309. If the Tribunal finds that it has jurisdiction in this arbitration, Respondent submits that it should deny the admissibility of Claimants' claims on the ground that they constitute an attempt by a Contracting State to abuse the ICSID arbitration mechanism.

III. DECISION OF THE ARBITRAL TRIBUNAL

310. Respondent challenges the jurisdiction of this Arbitral Tribunal on various grounds. First, it contends that Respondent did not consent to ICSID jurisdiction over this dispute because Claimants' investments were not legal, violated the principle of good faith, the principle *nemo auditur propriam turpitudinem allegans* and international public policy. Respondent further alleges that Claimants do not have standing to bring this arbitration because the Turkish State is the real party in interest, Claimants' cause of action has been assigned to TSDIF or TSDIF was subrogated in Claimants' claim or at least can be considered the *alter ego* of Claimants. They also allege that Claimants do not satisfy the conditions of Article 25 of the ICSID Convention to the extent that they are controlled by the Turkish State and its agencies for their sole benefit. Finally, Respondent submits that Claimants were not parties to the Investment Contract and therefore have no standing to challenge its termination, that in any case Respondent is not a proper party to the dispute, which is a dispute between private parties as to the ownership of KaR-Tel. Moreover, Claimants would not have a *prima facie* case.

311. As to the Foreign Investment Law, Respondent alleges that this Arbitral Tribunal has no jurisdiction on the basis of the FIL since it was no longer effective at the time of the commencement of these proceedings.

312. The jurisdiction of the Centre is based on the conditions set forth in Article 25 of the ICSID Convention which provides:

> *"(1) The jurisdiction of the Centre shall extend to any legal dispute arising directly out of an investment, between a Contracting State (or any constituent subdivision or agency of a Contracting State designated to the Centre by that State) and a national of another Contracting State, which*

the parties to the dispute consent in writing to submit to the Centre. When the parties have given their consent, no party may withdraw its consent unilaterally.

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

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

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

313. In this case, Claimants are companies incorporated and existing under the laws of Turkey. Turkey has ratified the ICSID Convention on March 3, 1989. Claimants appear therefore *prima facie* as nationals of a Contracting State in the meaning of Article 25.

314. Respondent is the State of Kazakhstan which has also ratified the ICSID Convention on September 21, 2000 and therefore also qualifies as a Contracting State within the meaning of Article 25 of the ICSID Convention.

315. On the other hand, the parties gave their consent to ICSID Arbitration in Article VII of the Agreement between the Republic of Turkey and the Republic of Kazakhstan concerning the Reciprocal Promotion and Protection of Investments of May 1, 1992. Article VII entitled "Settlement of Disputes Between One Party and Investors of the Other Party" indeed provides :

1. Disputes between one of the Parties and one investor of the other Party, in connection with his investment, shall be notified in writing,

including a detailed information, by the investor to the recipient Party of the investment. As far as possible, the investor and the concerned Party shall endeavour to settle these disputes by consultations and negotiations in good faith.

2. If these disputes cannot be settled in this way within six months following the date of the written notification mentioned in paragraph I, the dispute can be submitted, as the investor may choose, to:

(a) the International Centre for Settlement of Investment Disputes (ICSID) set up by the "Convention on Settlement of Investment Disputes Between States and Nationals of Other States," (in case both Parties become signatories of this Convention)

(b) an ad hoc court of arbitration laid down under the Arbitration Rules of Procedure of the United Nations Commission for International Trade Law (UNCITRAL), (in case both parties are members of U.N.)

(c) the Court of Arbitration of the Paris International Chamber of Commerce, provided that, if the investor concerned has brought the dispute before the courts of justice of the Party that is a party to the dispute and final award has not been rendered within one year.

3. The arbitration awards shall be final and binding for all parties in dispute. Each Party commits itself to execute the award according to its national law.

316. Claimants completed their consent by filing their ICSID Request for Arbitration on July 15, 2005.

317. By contrast with the Turkish version, the English and Russian versions of the Treaty do not require a prior submission of the dispute to local courts before initiation of arbitration proceedings before ICSID. The Arbitral Tribunal considers therefore that no such requirement had to be fulfilled by Claimants before starting this arbitration.

318. Notwithstanding the above, Respondent alleges that it did not consent to ICSID jurisdiction over this dispute on the ground that Claimants' investment violated the laws and regulations of Kazakhstan.

319. Indeed, in order to receive the protection of a bilateral investment treaty, the disputed investments have to be in conformity with the host State laws and regulations. On the other hand, as was determined by the arbitral tribunal in the *Lesi* case, investments in the host State will only be excluded from the protection of the treaty if they have been made in breach of fundamental legal principles of the host country.

320. After careful examination of Respondent's submissions, the Arbitral Tribunal has reached the conclusion that Respondent did not prove that Claimants' investment would have been fraudulent or would have violated any laws or regulations of Kazakhstan. The allegations of fraud perpetrated by the Uzan Family in Turkey and the judgment rendered on July 13, 2003, in the United States against the Uzans in relation to Motorola loans, are not evidence that the investment made by Claimants in Kazakhstan were themselves fraudulent or illegal. As noted by Claimants (see above para. 173), the New York judgment does not bring any evidence that the two Motorola loans made in relation to KaR-Tel were used improperly or for illegal purposes.

321. Moreover, notwithstanding Respondent's allegations, the record does not contain conclusive evidence that Claimants defrauded KaR-Tel by causing it to enter into transactions with Telsim at excessive prices.

322. From the record, it appears that Claimants made significant investments in KaR-Tel during the period 1998-2002. They legally obtained the second GSM license and paid for it; they developed a telecommunications network in compliance with the local laws and technical regulations of Kazakhstan. Respondent's allegation that Claimants' investment was fraudulent does not find any foundation in the record.

323. The Tribunal has also not found in the record any conclusive evidence that Claimants' investment would have violated the principle of good faith, the principle of *nemo auditur propriam turpitudinem allegans* or international public policy.

324. Respondent further challenges the jurisdiction of this Arbitral Tribunal arguing that Rumeli and Telsim are not the real parties to this arbitration, that the real party in interest

is TSDIF, that Rumeli and Telsim are just empty shells and that the benefit of this award, if any, will go to the Turkish State.

325. We have noted that following the problems encountered by Imar Bank in Turkey, owned by the Uzan family, the Turkish Parliament enacted various laws which empowered the TSDIF, a State agency, to take over the control of companies previously controlled directly or indirectly by the Uzan family and in particular, to take over the management of these companies. It is on this basis that the TSDIF appointed managers to Rumeli and Telsim. These new managers continued to run Claimants as telecommunications companies. In April 2003, the previous managers of Rumeli and Telsim wrote to Respondent stressing that they had intended to submit the dispute to ICSID. The new managers carried out the previous management commercial plans and started ICSID arbitration. The TSDIF is not however Claimant in this arbitral procedure. The case was initiated by Rumeli and Telsim. They are the real Claimants in this arbitration.

326. Even if it is correct that Telsim's assets have been sold to Vodaphone and that Telsim may or may not have substantial activities since that sale, it is still a company incorporated and existing under the laws of Turkey. So also is Rumeli which has not sold its assets. Moreover, the companies have existed since 1993 and have certainly not been created for treaty shopping purposes. The fact that Telsim is no longer an active company in the field of telecommunications is no bar to ICSID jurisdiction. The BIT does not provide a basis for looking beyond a company on the alleged basis that it would be a shell company and does not exclude such companies from its scope of application from the moment it is incorporated in another contracting State. The TSDIF's appointment of managers for Telsim and Rumeli did not in any way put an end to their corporate existence or to Claimants' ownership of their claims against Kazakhstan.

327. The record also confirms that the TSDIF is not the owner of Claimants' shares. It is also incorrect to state that if Claimants are successful, the Turkish State will be the only beneficiary of the moneys allocated to Claimants by the award. The moneys will be used to pay all Claimants' creditors, according to the relevant rules of Turkish law. The role

of the TSDIF may be compared to some extent to the role of a receiver or liquidator or judicial manager. The presence of such an entity as manager of the company in accordance with the law is no bar to the jurisdiction of the Centre. The Arbitral Tribunal does not have to anticipate what would be the status of Claimants in case the two companies would be put into liquidation, since so far no such decision of liquidation has been taken.

328. The record also does not support Respondent's allegation that Claimants' claim was assigned to the TSDIF or that the TSDIF was subrogated to Claimants' claims. Moreover, the Tribunal does not see any reason to "pierce the corporate veil" as requested by Respondent. As pointed out by the *ADC* award, the principle of piercing the corporate veil only applies to situations where the real beneficiary of the business misused corporate formalities in order to disguise its true identity and therefore to avoid liability. This is not the case here.

329. Finally, the Arbitral Tribunal also considers that Article 25(2)(b) stating that a national of another contracting State also means "*any juridical person which had the nationality of the Contracting State party to the dispute on "the date on which the parties submitted the dispute to arbitration" and which, because of foreign control, the parties have agreed should be treated as a national of another Contracting State for the purposes of this Convention*" was inserted to broaden the scope of ICSID jurisdiction and not to limit it, as evidenced by the awards invoked by Respondent, such as the *SOABI*, the *Vacuum Salt* and *LETCO* cases.

330. Respondent's final allegation that Claimants would not have standing to challenge the termination of the Investment Contract because they were not parties thereto and that in any case such a claim would fall outside the scope of this Tribunal's jurisdiction since it would amount to a contractual claim, which is not encompassed by the jurisdictional provisions of the Investment Contract, are unfounded. Claimants' request is not based on the Investment Contract. It is not solely related to the termination of the Contract. The wrongful termination of the Investment Contract is but one element of Respondent's

alleged wrongful conduct. Claimants' Request for Arbitration and subsequent memorials clearly establish that this arbitration arises out of Respondent's alleged violation of the BIT and international law.

331. The Arbitral Tribunal therefore considers that Claimants have standing to bring this arbitration and that this Tribunal has jurisdiction to hear the dispute under Article 25 of the ICSID Convention and Article 7 of the BIT.

332. The Arbitral Tribunal also considers that it has jurisdiction on the basis of the Foreign Investment Law.

333. Under Article 27 of the FIL, a foreign investor is expressly permitted to choose ICSID arbitration as the means for solving disputes with the Republic relating to investments and, once that choice has been made, the consent of the Republic of Kazakhstan "*shall be presumed to have been granted*" (Article 27(3)). The fact that the Foreign Investment Law was repealed as of January 8, 2003, does not have an impact on ICSID jurisdiction. The FIL was indeed valid and effective at all times relevant to this dispute. Article 6(1) of the Law provides that "*[i]n the case of a deterioration of the position of a foreign investor, which is a result of changes in the legislation and (or) entering into force and (or) changes in the provisions of international treaties, to foreign investments during ten years the legislation shall be applied which had been current at the moment of making the investment, and with respect to the investments which are carried out in accordance with the long-term (more than ten years) contracts with the authorized State bodies, until the expiry of the effect of the contract, unless the contract stipulates otherwise.*" In other words, Article 6(1) grants foreign investors protection against adverse changes in legislation for a period of ten years from the date they made their investment, or for the entire duration of the contract exceeding ten years entered into with authorized State bodies. This is the case here. The relevant investments were made by Claimants from 1998 to 2002, and the Investment Contract entered into between Claimants and Respondent on May 20, 1999, was valid until June 31, 2009, i.e., for a period of more than ten years.

334. Respondent has expressed its consent to ICSID arbitration on December 28, 1994, the date of the entry into force of the FIL, and it remains applicable to the dispute pursuant to Article 6(1). On the other hand, Claimants have consented to ICSID jurisdiction by filing their Request for Arbitration. The Arbitral Tribunal has therefore jurisdiction under the FIL.

335. Besides Article 6(1), it is also well established in international law that a State may not take away accrued rights of a foreign investor by domestic legislation abrogating the law granting these rights. This is an application of the principles of good faith, estoppel and *venire factum proprium*.

336. The Arbitral Tribunal has therefore jurisdiction under the FIL. It notes however that the FIL is invoked by Claimants only as an alternative basis for the jurisdiction of this Tribunal. In this respect, the Tribunal has reached the conclusion that since the protection granted to foreign investors by the FIL is fully covered by the provisions of the BIT, it needs not refer to it to decide the claims submitted by the parties in this arbitration.

CHAPTER V. THE CLAIMS

I. OVERVIEW OF THE CLAIMS

337. According to Claimants, Respondent took the following actions, which were in breach of its obligations under the BIT, international law and the Kazakh Foreign Investment Law:

- Respondent's Investment Committee unlawfully terminated the Investment Contract in breach of the suspension and early termination mechanism set forth therein;
- Respondent's Courts colluded with Telecom Invest by granting its request for injunctive relief and thus ratifying Telecom Invest's choice of General Manager;
- Respondent's police authorities enforced the foregoing injunctive relief and ousted Claimants' representatives from KaR-Tel's premises;
- Respondent's Courts ratified Telecom Invest's actions by ordering the compulsory redemption of Claimants' stake in KaR-Tel, in clear contravention of Kazakhstan law;
- Respondent set up a Working Group over a year after the termination of the Investment Contract to examine alternative grounds for the termination of the Contract rather than to examine the legality of the grounds on which the Contract was actually terminated in March 2002. Furthermore, Claimants were *de facto* excluded from the meetings of the Working Group;
- Respondent initiated, under false pretenses and/or in a discriminatory/arbitrary manner, criminal proceedings against Claimants' executives, thereby forcing them to leave the country;
- the decision of the Working Group validated the termination of the Contract on entirely different grounds than those forming the basis for the termination;
- Respondent's Courts ordered the compulsory redemption of Claimants' 60% stake in KaR-Tel for a mere USD 3,000.

338. According to Claimants, Article 4 of the Articles on the Responsibility of States for Internationally Wrongful Acts (the "*ILC Articles*") attributes to the State the conduct of

"*any State organ…whether the organ exercises legislative, executive, judicial or any other functions, whatever position it holds in the organization of the State….*" Therefore, Claimants allege that each of the above acts and omissions, individually and collectively, constitutes a breach of each of Respondent's international obligations, namely, its obligations:

- to afford fair and equitable treatment;
- not to deny justice;
- to ensure full protection and security;
- not to impose unreasonable, arbitrary and/or discriminatory measures;
- not to expropriate absent certain specific conditions.

II. THE PARTIES' POSITION ON RESPONDENT'S PURPORTED SCHEME

339. As pointed out above, Claimants allege that each of the acts and omissions allegedly wrongfully committed by Respondent, individually and collectively constitute a breach of Respondent's international obligations. Before analyzing the various legal grounds invoked by Claimants, the parties' positions are hereinafter summarized.

A. CLAIMANTS' POSITION

1. The general context

a) Claimants' investment

340. Contrary to Respondent's allegation, Claimants submit that they have made considerable investments in Kazakhstan as per the terms of the BIT and of the FIL. Indeed, the BIT provides that: "*the term 'investment'…shall include every kind of asset in particular, but not exclusively: i) shares, stocks or any other form of participation in companies, ii) returns reinvested, claims to money or any other rights to legitimate performance having financial value related to an investment.*" The FIL defines "*investment*" as "*all types of proprietary and intellectual values invested into objects of entrepreneurial activity with the purpose of obtaining profit….*" The FIL further specifies that "*foreign investments*" are "*investments made in the form of participation into an authorized capital of legal*

entities of the Republic of Kazakhstan, as well as granting of loans (advances) to legal entities of the Republic of Kazakstan, in which the foreign investors have the right to control decisions adopted by such legal entities."

341. According to Claimants, their combined 60% stake in KaR-Tel thus constitutes an "*investment*" under the BIT and the FIL. Moreover, Claimants paid the entire initial charter capital contribution of approximately USD 10,000 when they acquired a 70% stake in KaR-Tel in May 1998 (which was subsequently reduced to 60%).

342. Claimants also granted lines of credit to KaR-Tel totaling up to USD 40 million and, pursuant thereto, extended loans to KaR-Tel of USD 16,953,455.88 and USD 16,285,835 (by Rumeli and Telsim respectively). According to Claimants, although these loans initially were to be subject to interest rate, this was immediately changed. In any event, Claimants allege that even if the loans had been subject to interest, this would have no bearing on the fact that the law considers such loans to constitute investments.

343. Claimants further allege that Rumeli pledged its own funds as security under loan agreements between KaR-Tel and Bank Turan Alem. After Bank Turan Alem collected USD 2,580,000 pledged by Rumeli, this latter became a creditor of KaR-Tel for this amount, and this constitutes another investment.

344. Furthermore, according to Claimants, in light of Respondent's forensic expert reports that concluded that Claimants indeed provided more than USD 33 million to KaR-Tel, Respondent's allegation that there is "*no evidence of alleged investment of USD 33 million"* is no more than a misrepresentation of the facts.

345. Claimants allege that they were forced to structure their investments as loans and commodity credits since the parties-in-interest behind Investel/Telecom Invest refused to participate to capital increases. Claimants' willingness to make investments in the form of increased capital contributions is evidenced by article 2.7 of both Contracts on Temporary Financial Support which provided that, after expiration of the repayment

term, the loans extended by Rumeli could be considered as additional capital contribution by Rumeli to KaR-Tel upon a decision of KaR-Tel's board of directors.

346. Claimants' financial obligations pursuant to KaR-Tel's Foundation Agreement were limited to an obligation "*to ensure provision of the investments*," *i.e.,* to assist KaR-Tel in negotiations with third parties to obtain financing. According to Claimants, given the significant amount of the Motorola Loan and the Bank Turam Alem loan – the first guaranteed by Telsim, the other pledged by Rumeli – Claimants obviously fulfilled their obligations under the Foundation Agreement. In this context, it is Claimants' position that the circumstances surrounding the Motorola Loan are irrelevant to the question of their investment.

347. Claimants further allege that Telsim, which guaranteed the Motorola Loan, was a highly valuable company, with a value higher than its borrowings. This is confirmed by the fact that Telsim ultimately honored its payment obligations towards Motorola and was sold for USD 4.55 billion in December 2005.

348. Claimants also submit that Respondent's attempt to challenge the existence of Claimants' investments is absurd in light of the fact that the local partner in KaR-Tel – which did not provide any monetary, management, or know-how assistance, nor the necessary office space to KaR-Tel – was able to sell a 100% stake in KaR-Tel for USD 350 million.

349. Claimants further point out that:

- the Working Group established by Respondent itself recognized that Claimants made millions of dollars of direct capital investment in KaR-Tel;
- they had no obligation under the Investment Contract, which was concluded between the Investment Committee and KaR-Tel;
- KaR-Tel had no obligation to achieve any specific portion of the USD 184,405,000 investment mentioned in article 3 of the Investment Contract;
- in any case, the Investment Contract was terminated exclusively for the failure to file reports and not for the alleged unsatisfactory level of investment.

350. Moreover, Respondent's allegation that KaR-Tel overpaid Telsim by over USD 8 million for "*obsolete*" second-hand equipment and handsets does not withstand scrutiny:

- the equipment was advanced and fully met KaR-Tel's operational and technical needs;
- the expert, Mr. Bulent Yagci, testified in the Kazakhstan Court proceedings that the second-hand base stations worked properly and satisfied KaR-Tel's objectives and were provided on favorable terms;
- Telsim provided guarantee services, spare parts, and training of KaR-Tel employees to use the equipment.

351. By the same token, according to Claimants, Respondent's allegation that Telsim sold telephone sets to KaR-Tel at a price higher than the market is also unfounded. Respondent's Courts made such a finding solely on the basis of the conclusions drawn by Respondent's own forensic experts and wholly ignored the evidence adduced by Claimants.

352. Finally, Claimants dispute Respondent's challenge of the quality of the support, know-how and training provided by Claimants on the basis that KaR-Tel was allegedly insolvent at the time that Claimants were ousted from Kazakhstan:

- Claimants did provide a great deal of this support, know-how and training, which constitutes an investment;
- Respondent provides no evidence that such training or support was somewhat inadequate;
- KaR-Tel – at the time that Claimants were ousted – was far from being insolvent.

353. In any case, Respondent's conduct and various acts and omissions, in collusion with the influential local partner, deprived Claimants of their investment for a derisory sum. Even if the alleged wrongdoings of Claimants were somehow true, they could not justify the expropriation of Claimants' majority shares without compensation.

354. It is therefore Claimants' position that they made investments within the meaning of Article 25 of the ICSID Convention and ICSID jurisprudence, their investments being long term (the GSM License was granted for a renewable 15-year period and the Investment Contract's duration exceeded 10 years); they involved regularity of profit and return; they were substantial, risky and strategic for the development of the Republic of Kazakhstan.

b) The Republic of Kazakhstan and the involvement of President Nazarbayev's family

355. According to Claimants, Kazakhstan has not yet succeeded in breaking with the vestiges of Soviet bureaucracy. Since 1989, the country is governed by President Nursultan Nazarbayev, whose last election, with a purported 91.15% of the votes, failed to meet OSCE and international standards for democratic elections. The Judiciary has limited judicial independence. Moreover, corruption is prevalent at every stage and level of the judicial process. The regime is hard with any kind of opposition and with the media.

356. According to Claimants, President Nazarbayev succeeded in concentrating most of the powers in his own hands, but he also successfully established direct and indirect (through his family and/or executives) control over the most important sectors of the Kazakhstan economy.

357. According to Claimants, in this context, once KaR-Tel's success was assured thanks to Claimants' considerable efforts and investments, the local partner's shareholders devised a scheme to orchestrate Claimants' expulsion from KaR-Tel with the unconditional support of Respondent. The local partners' shareholders exploited their close personal and political ties with Respondent to oust Claimants from their investments. In this framework, Claimants allege that the following elements demonstrate that some members' of the President Nazarbayev's empire were the real parties in interest behind Investel/Telecom Invest.

358. *First*, Claimants' initial local partner, Investel, was co-founded by Almex, a company that was itself founded by President Nazarbayev's brother, Mr. Bulat Nazarbayev. Other

shareholders in Almex included President Nazarbayev's second daughter, Ms. Dinar Nazarbayeva, and her husband, Mr. Timur Kulibayev. During the course of their investment, Claimants were also told that, in addition to Almex, the Minister of Transportation and Telecommunications of the Republic of Kazakhstan, at the time Mr. Serik Burkitbaev, was also a shareholder in Investel. By November 2000, Mr. Kulibayev held 50% in Almex, with his wife holding a 20% stake therein and Mr. Abuov (Mr. Kulibayev's 'right-hand man') holding the remaining 30%. When Telecom Invest replaced Investel, Almex remained the majority 87.5% shareholder of Telecom Invest until the end of 2002.

359. *Second,* irrespective of whether he formally held an official position in Investel/Telecom Invest, Mr. Kulibayev acted as executive director of Investel and later Telecom Invest:

- KaR-Tel's successive General Managers met in person with him in that capacity on many occasions;
- Mr. Agilönü sent monthly reports of KaR-Tel's financial data to Mr. Kulibayev.

360. *Third,* the amendment to KaR-Tel's charter with respect to the replacing of Claimants on November 10, 2003 was registered by the Almaty District Division of the Ministry of Justice the very next day. According to Claimants, this is not feasible for such a re-registration to take merely one day, absent some extra influence such as Respondent's interest in the re-registration.

361. According to Claimants, Respondent's allegation that there is no basis upon which a State can bear legal responsibility for the actions of the President's son-in-law oversimplifies the present case. Indeed, Mr. Kulibayev is not only the son-in-law of the President, he has also held, at various times, governmental functions both as a member of the Investment Committee and as top executive of various State-owned energy companies. According to Claimants, it is undisputed that Mr. Kulibayev maintained ties with the Investment Committee and knew Mr. Zverkov, the Chairman of the Investment Committee who terminated the Investment Contract. Therefore, his actions cannot be

viewed in a vacuum and cannot be dissociated from his privileged relationship with Respondent.

362. It is also undisputed that the primary obligation of Telecom Invest/Investel in KaR-Tel was precisely lobbying before the organs of Kazakhstan. The local partner did use that influence at the outset and during the course of the project to secure and obtain, from organs of the Republic of Kazakhstan, the License, the Investment Contract, the easy-to-remember '333' prefix and favorable treatment from Kazakhstan Customs Authorities. It is also Claimants' case that the local partner and Mr. Kulibayev could do and undo things at the Investment Committee.

363. In this context, it is Claimants' allegation that the fact that, by late 2002/early 2003, Mr. Seysembayev, through some companies, and not Almex, was *de jure* the controlling shareholder of Telecom Invest has no bearing on Claimants' case. Indeed, a subsequent change in ownership of Telecom Invest, does not somehow undo Respondent's prior collusion with the previous shareholders. Nor does such a change preclude Respondent from continuing to collude even with the new owners.

364. Moreover, this change of ownership was for "*nominal consideration*," which does not at all exclude the likelihood that an arrangement may have been reached between Telecom Invest's prior owners and Mr. Seysembayev. Indeed, it is still unknown who received the USD 350 million paid by VimpelCom.

365. Claimants further allege that even if Telecom Invest's shareholders could be deemed to be independent and private third parties, Respondent would still be liable for breaching its international obligations. Indeed, collusion between the State, judicial authorities, and the local party-in-interest can amount to a denial of justice, and a State can expropriate an investment for the benefit of a third party.

366. Finally, even if there is no such a collusion, Respondent would still be liable for its acts and omissions, namely the wrongful termination of the Investment Contract, the eviction

of Claimants from KaR-Tel by the police, the Courts' decision that grossly misapplied Kazakhstan law and the derisory compensation paid to Claimants.

2. The termination of the Investment Contract

367. According to Claimants, by mid-2001, the local partner took the decision to oust Claimants from KaR-Tel. This is confirmed by Mr. Abuov. The task of identifying the options to carry out this decision was entrusted to Mr. Karibjanov from Visor Investment Solutions, who declared that his "*involvement in KaR-Tel commenced at some point between August and December 2001.*" In the fall of 2001, Respondent set in motion the impetus that would eventually result in the total expropriation of Claimants' investment in favor of President Nazarbayev's family and empire.

368. On September 10, 2001, the Investment Committee, which was under the influence of Mr. Kulibayev sent KaR-Tel a warning letter, requesting that KaR-Tel submit various financial statements and information that it had not previously requested. Indeed, prior to September 10, 2001, there had been no Investment Committee investigations or warnings on this issue. Ambassador Zverkov's testimony to the contrary is not supported by any documentary evidence. From this point, Telecom Invest, Mr. Kulibayev and Mr. Abuov suddenly became unreachable.

369. On February 21, 2002, Respondent's Investment Committee sent KaR-Tel a notification letter purporting to terminate the Investment Contract within thirty days on the alleged basis that KaR-Tel had not complied with its reporting obligations pursuant to the Contract. During this period, KaR-Tel challenged this abrupt termination, continued its best efforts with the assistance of its auditors to comply with the filing requirements and sought an extension of time. This extension was granted, at the very least, according to Mr. Zverkov's own admission, until March 23, 2002.

370. However, contrary to Respondent's allegations, the Investment Committee Members were not waiting at the Investment Committee premises on March 23, 2002 to receive Claimants' reports. Mr. Zverkov's declarations in this respect are not credible since

March 23, 2002 was a Saturday, which is a day off in Kazakhstan. Moreover, the Investment Committee was also closed on Friday, March 22, 2002 since it was Norouz, a public holiday in Kazakhstan. It is therefore obvious that on March 23, a Saturday immediately following a public holiday, the Investment Committee was also closed.

371. According to Claimants, it cannot therefore be disputed that, even assuming for the sake of argument that Respondent granted Claimants an extension only until Saturday, March 23, 2002 for the filing of the requested reports, such extension extended automatically until Monday, March 25, 2002, the very first working day after Norouz. Furthermore, as confirmed by the documents and by Respondent's own Ministry of Economy and Budget Planning, KaR-Tel submitted the materials requested on March 25, 2002.

372. Claimants point out that the Investment Contract was terminated by the Investment Committee on March 25, 2002 on the only basis of the alleged failure to submit reports. Respondent seeks today to justify the termination of the Contract on the basis that, in any event, it was justified on substantive grounds since KaR-Tel allegedly did not comply with its investment obligations. However, as emphasized by the *Amco I*[26] and *II*[27] decisions, regardless of the examination of the substantive grounds relied upon by a State agency in the framework of the revocation of a license, "*the mere lack of due process would have been an insuperable obstacle to the lawfulness of the revocation*." Respondent's attempt to justify *ex post* the termination of the Investment Contract is unconvincing.

373. The Investment Contract was wrongfully terminated. It was terminated prior to the expiration of the deadline for submitting the reports, which were filed on March 25, 2002, *i.e.* within the deadline. Moreover, even assuming, *arguendo*, that certain reports were not submitted in a timely manner, the Investment Committee could only suspend the Contract and not terminate it.

---

[26] *Amco I v. Indonesia*, Decision on Jurisdiction of September 25, 1983.

[27] *Amco Asia Corporation and others v. Republic of Indonesia* (ICSID Case No. ARB/81/1), Award in the Resubmitted Case of June 5, 1990, 1 ICSID Reports 569, para. 70 [hereinafter *Amco II*].

374. Indeed, the early termination mechanism of the Investment Contract explicitly set forth in the Contract provided that early termination could only occur on the basis of specific grounds listed at article 19.3 ("*refusal of the Investor to cure the reasons which have caused the decision on the suspension of the Contract, or a failure to cure these reasons during the term established by the Agency").* This basis presupposed that:

- there had been a suspension of the Contract in accordance with the terms of article 19.2; and
- the reasons for such suspension were notified.

375. According to Claimants, none of these conditions was satisfied, a fact which has been recognized by Respondent itself in two letters dated May 14, 2003 from the Ministry of Finance and from the Ministry of Economy and Budget Planning. Respondent tries to downplay the significance of these letters. However, they were executed by vice-ministers and are unequivocal in several respects.

376. As recognized by Respondent itself, the Investment Committee did not suspend the Contract. Respondent alleges that the lack of formal suspension was in the interest of KaR-Tel since the suspension of the Contract would have required KaR-Tel to make ordinary tax payments until the suspension was lifted. However, according to Claimants:

- it is not for Respondent to decide what was in the interest of KaR-Tel; and
- in any event, had the investment Committee suspended the Contract, KaR-Tel could have remedied any alleged breaches and the suspension would have been lifted.

377. According to Claimants, Respondent's further attempt to justify its failure to suspend the Contract by relying on article 13 of the Investment Support Law is also unconvincing. Indeed, although this Law grants the Investment Committee the right to terminate a contract without first suspending the same, the express terms of each individual contract can supplement this right. In the present case, the parties, as they were entitled,

specifically conditioned in their Contract the right of the Investment Committee to terminate a contract to the mandatory prerequisite of its prior suspension.

378. Even assuming, for the sake of argument, that article 13 of the Investment Support Law does support Respondent's position, a State cannot rely on its internal law to invalidate its own undertakings. Moreover, Respondent's position was discredited at the hearing by its own expert, professor Kaudyrov, who agreed that a foreign investor in Kazakhstan would have had a reasonable expectation that the terms of the Investment Contract, and specifically the provisions calling for suspension, were valid.

379. Claimants further allege that Exhibit RM32 invoked by Respondent as another example of a telecom company whose investment was terminated in the same conditions than Claimants, is, on the contrary, clear evidence that some contracts must be suspended prior to termination.

380. Finally, contrary to Respondent's allegation, it was only KaR-Tel and not Claimants, who had legal standing to challenge the termination of the Investment Contract. This was confirmed at the hearing by Respondent's own law expert, Professor Kaudyrov. In addition, on April 22, 2002, KaR-Tel's General Manager, Mr. Agilönü, indeed contested the unlawful termination of the Contract. However, he was unable to pursue his recourse since he was ousted from KaR-Tel. In this respect, even after the Supreme Court amendment to the April 23, 2002 injunction requiring a written permission of Mr. Yerimbetov to access KaR-Tel's documents, Claimant continued *in fact* to be denied access to KaR-Tel's premises and documents.

381. Claimants finally point out that the local partner did not engage in any effort to assist Kar-Tel in the Investment Contract control process. On the contrary, the local partner vanished during the investigation process. In this respect, Mr. Abuov disingenuously suggested that he might have disappeared during these key months because he was gone on a particularly long business trip and was therefore unreachable. This was clearly false. There can be no doubt that the local partner "strategically" disappeared.

382. The reality is that, in February and March 2002, the local partner, with the help of lawyers and of Mr. Karibjanov from Visor Investment Solutions, was trying to implement its decision to get rid of Claimants.

383. In this context, the local partner colluded with the Investment Committee to terminate the Investment Contract. That collusion was established by the testimony of Mr. Abuov and by the evidence that Mr. Kulibayev had the power to cause the Investment Committee to implement the local partner's decision to get rid of the majority shareholders in KaR-Tel through the cancellation of the Investment Contract.

384. According to Claimants, Mr. Abuov's argument that the local partner had no reason to terminate the Investment Contract simply does not stand. The local partner had two very strong incentives to terminate this Contract. The first was the implementation of his plan to get rid of Claimants. The second was to minimize the necessity of payment by KaR-Tel for Claimants' 60% shares.

3. Telecom Invest and Respondent colluded to effect the illegal compulsory sale of Claimants' interest in KaR-Tel

a) The KaR-Tel EGM

385. According to Claimants, Telecom Invest used the cancellation of the Investment Contract as the pretext for calling an extraordinary meeting of KaR-Tel shareholders (EGM) to remove Claimants from KaR-Tel. In this respect, Mr. Podporin of Telecom Invest claims to have sent two letters to Mr. Agilönü on March 4, 2002 and March 20, 2002 requesting Mr. Agilönü, as General Director of KaR-Tel, to call an EGM to discuss the cancellation of the Investment Contract.

386. Mr. Agilönü testified that he never received these letters. Mr. Podporin, who was in direct contact with Mr. Agilönü on a daily basis, admitted that he never followed up with Mr. Agilönü, whether in person, telephone or other means, to determine whether the letters were in fact received.

387. On March 26, 2002 – the day after the Investment Committee issued its order terminating the Investment Contract, but one day before such order was even sent to KaR-Tel – Mr. Podporin allegedly sent notices to Claimants in Turkey to convene an EGM of KaR-Tel for April 11, 2002. Therefore, according to Claimants, given the timing of this "*notice*," it is clear that Telecom Invest and its shareholders were, at the very least, privy to the termination decision. Claimants did not receive these notices.

388. An EGM was then held on April 11, 2002. It is not disputed between the parties that the April 11, 2002 meeting could not proceed and take decision without a quorum being present. Otherwise, there would have had no need for the alleged follow-up meeting on April 15, 2002. At the hearing, Mr. Podporin indicated that no decisions were taken at this meeting because of the lack of quorum, in the absence of Claimants. This testimony is contradicted by the evidence. Indeed, the resolution of the meeting dated April 11, 2002, which was signed by Mr. Podporin, indicates that the meeting did in fact proceed on that date in the absence of a quorum. The resolution records that Telecom Invest, the sole attendee and minority shareholder of KaR-Tel, voted at the April 11, 2002 meeting:

- to prepare all necessary documents, including financial analyzes, demonstrating the damage caused to KaR-Tel by the activity and/or inactivity of Rumeli and Telsim;
- to issue proceedings in the Almaty City Court for the compulsory redemption of Claimants' participation in KaR-Tel;
- to dismiss Mr. Agilönü as General Manager of KaR-Tel and to replace him temporarily by Mr. Iskander Yerimbetov and to seek the Court's approval of this amendment.

389. According to Claimants, the resolution is thus invalid on its face since a non-quorate meeting cannot take decisions. Nevertheless, on April 19, 2002, Telecom Invest filed a claim based solely on the April 11, 2002 resolution, seeking a Court decision on the forced buyout of Telsim and Rumeli's interest in KaR-Tel. Neither the claim filed, nor the Court's April 23, 2002 decision granting injunctive relief mention anything about any

postponement of the April 11 meeting or about any follow-up meeting on April 15 or any other date.

390. According to Claimants, following an attempt by Mr. Agilönü to call a general meeting of KaR-Tel shareholders for June 7, 2002 to discuss, *inter alia*, "*the wrongfulness and illegality of the April 11, 2002 KaR-Tel general shareholders' meeting and resolutions*," KaR-Tel separately petitioned the Court for an injunction prohibiting this meeting. Claimants allege that, unlike the earlier Telecom Invest petition – which had been made prior to any challenge by Claimants to the validity of the April 11, 2002 resolution – this second KaR-Tel petition referred only to the resolution of a purported April 15, 2002 meeting. This meeting had not even been mentioned before. The resolution purportedly adopted at this alleged follow-on meeting was virtually identical (other than the date) to that of the April 11 meeting.

391. Claimants further point out that neither the purported resolution of April 15, nor the petition to the Court based on that resolution, mentioned the fact that the April 15 meeting would have been called as a "*follow-on*" meeting after the failure of Claimants to attend the April 11 meeting. Therefore, the April 15 resolution was also invalid.

392. In any case, according to Claimants, both April 2002 meetings were not validly constituted and held, for the following reasons:

- Claimants were not notified of the meetings, contrary to article 46 (1) of the LLP;
- moreover, with respect to the notice issue, if there is no quorum at the original meeting, a new general meeting is to be convened at least 15 days prior to the repeated meeting. This is to ensure that there will be a second attempt by the partnership to notify the participants. This was not the case since the notice of the repeated meeting was included in the notice of the original meeting. As confirmed by Professor Sergeev, the Kazakh Courts made a serious mistake when considering that it is possible to notify the participants about two meetings in one notice. Respondent's experts' position to the contrary: the allegation that a

follow-up meeting could be held as little as two hours after the original non-quorate meeting, is simply not credible. It violates the basic principle of the provision related to notices, which is to ensure that the partners have the opportunity to participate in the activity of the company;

- pursuant to the LLP Law, article 46, the 15-day notice period is triggered when the participants have been notified rather than when the notice has been issued. Therefore, even assuming that Claimants received the notices of the meeting on April 1, 2002, the notice period for the original meeting (April 11, 2002) was insufficient as the 15-day time period began on the date following receipt (April 2, 2002). Neither was the repeated meeting properly notified since there were only 14 days between the alleged notice and the day of such meeting;
- article 47 (4) of the LLP Law provides that a general meeting can adopt decisions only if there is a quorum, *i.e.* more than 50% of the total votes are present. If less than 50% of the total votes are present, a general meeting can be convened again, which is deemed to have a quorum regardless of the votes present (art. 47(5)). If less than 50% of the votes are present, the meeting has the right to adopt decisions only on questions which do not require a qualified majority vote or unanimity (art. 47(5)). As confirmed by Professor Suleimenov before the Kazakhstan Courts, article 48(2) and 43(2)(9) of the LLP law provide that the compulsory redemption of a shareholder's interest requires a qualified majority of votes of three quarters of the votes present and a quorum of two-thirds of the total number of votes. Claimants' presence – holding 60% of the votes – was thus required;
- pursuant to article 47(9) of the LLP Law, it is necessary to certify that there is a quorum immediately prior to voting;
- in violation of article 34 of the LLP Law, the minutes of the April 15, 2002 did not indicate that any evidence was presented of any significant damage to KaR-Tel presumably caused by Claimants;
- although a shareholder whose shares are being redeemed may not participate in the voting of its own compulsory redemption (art. 48(2) of the LLP Law), if a general meeting contemplates the compulsory redemption of two of its

shareholders, the presence of at least one shareholder whose interest is subject to the redemption is required at the meeting. Even assuming that Respondent's Judiciary properly applied the LLP and that the presence of the participant whose interest is being forcefully bought out is not necessary, there were here two participants whose interests were bought out. Therefore, separate decisions should have been taken. When the question of whether to buy out the interest of the first participant is put to a vote, even if such participant cannot vote on this decision, the second participant can vote, and vice versa;

- more generally, as stated by Professor Suleimenov, "on no conditions the sharer which possesses the small interest of shares in the company may not bring up the question about compulsory redemption of shares of the sharer which possesses the majority interest in the share capital of the company. Otherwise the situation may be carried to an absurdity: several sharers holding 10% of shares may determine on the question about compulsory redemption of the share of sharers holding 90% of shares in the share capital. It may be very suitable mechanism for usurpation of companies." Professor Sergeev reached identical conclusions.

b) The Injunctive relief proceedings

393. According to Claimants, Telecom Invest and its shareholders then sought the assistance of Respondent's judiciary to ratify their illegal conduct. In this context, they obtained, *ex parte*, the injunctive relief of April 23, 2002 to secure the forced removal of Rumeli and Telsim.

394. According to Claimants, the injunction was granted whereas the resolutions of the shareholders meetings were blatantly in violation of the LLP law. In this respect, Claimants emphasize, *inter alia*, that neither the claim filed, nor the Court's decision granting injunctive relief, mention anything about the April 15 meeting. It is undisputed that there was no quorum at the April 11 meeting to take decisions so that the *ex parte* decision rendered on April 23, 2002 was based on a resolution which was procedurally and patently invalid on its face. Moreover, by appointing Mr. Yerimbetov, the very same

General Manager that had been unilaterally appointed by Telecom Invest in the course of the April meetings, and not an independent administrator – pending a decision on the merits of the case – the Court effectively prejudged the merits while denying Claimants the right to manage and benefit from their investment as well as to access data necessary for the defense of their interests in KaR-Tel.

395. According to Claimants, the defects in the Court's April 23 decision are so egregious as to permit no other conclusion than one of bias and discrimination by the Court in favor of Telecom Invest.

396. Finally, even if Claimants recognize that the April 23, 2002 injunction was subsequently amended by the Supreme Court so as to remove the requirement of a prior written permission of Mr. Yerimbetov for Claimants to access KaR-Tel's premises and documents, they *in fact* continued to be denied access, as evidenced by Claimants' numerous requests to KaR-Tel and to the Court that remained unanswered.

4. The actions of Respondent's police authorities

397. According to Claimants, by the end of the business day on April 23, 2002, the Kazakhstan armed police – led by Mr. Aidan Karibjanov, a senior executive of the firm Visor Investment Solution (consultant to Telecom Invest) – seized all of KaR-Tel' offices. The police physically barred from access only KaR-Tel's Turkish management executives. Even after the amendment of the injunction in June 2002, they continued to be denied access to the KaR-Tel premises.

398. According to Claimants, even if Respondent tries to make a distinction between its unarmed Court bailiffs that enforced the April Injunction, and its armed police, its remains that the seizure of KaR-Tel premises and the ousting of the Turkish employees was executed by Court bailiffs who are State officials, a real organ of the State, and were accompanied by a police escort. The mere presence of private security forces in KaR-Tel was insufficient to give rise to a case of necessity justifying the presence of the police.

399. Claimants also point out that they were not informed of the Court's injunction or its enforcement and were thus not invited to be present when Respondent's Court bailiffs and police seized KaR-Tel, in stark contrast to Telecom Invest who was represented on the ground by Mr. Karibjanov.

400. In their Post-Hearing Memorial, Claimants further point out that, at the hearing, Respondent's witnesses confirmed that the Court bailiffs were accompanied by officers from Kuzet Security Services ("*Kuzet*"), which is a specialized security subdivision of internal affairs bodies of the Republic of Kazakhstan. Their guards wore uniforms and carried weapons. Kuzet was acting pursuant to a contract with Telecom Invest. As this contract could only have been formed on or before the April 23, 2002 injunction of Judge Ivanovna, this means that Claimants' local partner was privy to Judge Ivanovna's decision before it was made public.

5. The attempt to sell Telecom Invest's participation in KaR-Tel

401. According to Claimants, after they were forcibly removed from KaR-Tel's premises on April 2002, Telecom Invest continued to exploit its privileged relationship with Respondent to capitalize on its influence on Respondent's various organs.

402. Indeed, the local partner and/or associated individuals sought to extract cash from the partnership and its stake therein and asked Claimants to purchase its 40% stake in KaR-Tel.

403. A Stock Purchase Agreement was negotiated. In this context, it appeared that the Investment Committee continued to be under the influence of Telecom Invest which was in a position to instruct the Committee to reinstate the Contract. However, Claimants decided not to sign because:

- there was no guarantee that once the USD 12 million stipulated in the agreement would have been paid, Telecom Invest would not further collude with Respondent to extract more money from Claimants;

- there was a risk that KaR-Tel had entered into transactions that were not in its interest as a result of having been managed by Telecom Invest.

6. The actions of the Working Group

404. On June 9, 2003, Claimants were informed of the constitution of a Working Group in charge of the examination of the termination of the Investment Contract. It was tasked with seeing if there existed any grounds on which the Investment Committee could have terminated the Contract. According to Professor Sergeev, this expansion of the scope of its review was illegal: "*the Working Group should have cancelled the order of termination of the Contract. The question of compliance by the Investor with the terms of the Contract and existence of grounds for its termination should have been determined by the Committee in compliance with procedures established by the Contract.*"

405. Claimants allege that several circumstances resulted in the *de facto* exclusion by Respondent of Claimants from the meetings of this Group, preventing Claimants from defending their position:

    - they were only verbally invited to a meeting just two days before this meeting;
    - the meeting was not to take place at a neutral place but at KaR-Tel's offices which were under the control of Telecom Invest;
    - rumors circulated that Respondent had initiated wholly unfounded criminal proceedings against Claimants executives on July 1, 2003 - *i.e.*, the very same day that it extended an informal invitation to attend the meeting.

406. With respect to these criminal charges, Claimants allege that:

    - contrary to Respondent's assertions, Mr. Ozonerk did not admit that the charges were founded. He merely stated that the amounts at issue consisted of "*working advance payments*" and had been approved by Rumeli's management;
    - the investigation related to mere cash advances totaling less than USD 200,000, which are customary in emerging countries in a major business operation;

- the fact that the charges were also brought against Ms. Kaden, a Kazakhstan national, only serves to support Claimants' argument that the charges were brought only against Turkish executives and for an ulterior purpose. Indeed, Ms. Kaden was the assistant of KaR-Tel's General Manager. The police thus wanted to hold someone close to Claimants accountable in the event it would not be able to sanction the Turkish nationals;
- the farcical nature of these criminal proceedings is obvious: Mr. Agilönü was charged with "*grand theft*" on the basis that he was in arrears for 74,435 Tenge in petty cash used for business expenses (approximately USD 580). The potential sanctions for such charges, however, were very real. As acknowledged by Respondent's expert on Kazakh Criminal Law, the penalty for such charges could "*go up to 12 years in prison.*"

407. The Working Group then validated the termination of the Contract, but it did it on entirely different grounds than those forming the basis for the initial decision. Moreover, it relied on the fact that KaR-Tel had not challenged the termination, which is ludicrous given the fact that Respondent had placed KaR-Tel under the control of Telecom Invest, which had no interest to challenge the termination.

408. Claimants further allege that Respondent's attempt to validate the investigation of the Working Group by asserting that it ultimately found that KaR-Tel had not complied with its investment obligations is hopeless. Indeed, nowhere in the Investment Contract was it required that KaR-Tel invest specific amounts on a yearly basis. The Contract only sets forth a lump sum objective as investment obligation over ten years.

409. According to Mr. Sabirov, Chairman of the Working Group, a primary ground for the termination of the Investment Contract was that KaR-Tel did not comply with the timetable set out in the Working Program and had failed to make the required amount of investments. Yet, the Investment Contract provides no timetable for making monetary investments. When asked how the Working Committee found that Claimants had not been making the requisite investments, Mr. Sabirov had no answer. When the Tribunal

questioned whether a timing requirement for investments under the Investment Contract was imposed by article 278 of the Civil Code - on equal allocation of obligations over time - Mr. Sabirov again had no answer. On the contrary, Professor Sergeev addressed this question and established that article 278 would apply only where nothing is stipulated by the Contract. Since the Contract attached a Working Program setting out dates by which certain actions (rather than investments of amounts) had to be taken, Professor Sergeev concluded that the requirement of article 278 did not apply.

410. In any event, irrespective of whether there may have been legitimate grounds for the revocation of the Contract, the whole approach leading to its termination and the confirmation thereof by the Working Group lacked in transparency and in due process.

411. Claimants finally allege that if the unlawful termination of the Investment Contract had presumably caused enough damage to KaR-Tel to justify the compulsory redemption of Claimants' shareholding, it is surprising, to say the least, that Telecom Invest (through KaR-Tel) did not seek to challenge the termination or to reinstate the Contract.

7. The actions of Respondent's Judiciary

412. According to Claimants, Respondent's Courts then continued to further the goals of the local partner's shareholders by rendering decisions in contravention of Kazakhstan law. They culminated in a decision of the Supreme Court of October 30, 2003 which set the value of the shares to approximately USD 2,281 for Rumeli's 45% stake and to USD 760.43 for Telsim's 15% stake, granting Telecom Invest (with only 40% interest in KaR-Tel) the necessary official judicial blessing to acquire Claimants' 60% interest at virtually no cost.

413. According to Claimants, the decisions of Respondent's Judiciary were so grossly unjust that no competent judge could have reasonably issued such decisions. This clearly demonstrates the collusion between the Kazakh Courts and the individuals controlling Telecom Invest.

414. According to Claimants, the first outrageous misapplication of Kazakh law lies in the Courts' decision that *the April 2002 resolutions* of the Extraordinary General Meeting were valid, whereas they were *prima facie* invalid.

415. Claimants submit that Respondent's Judiciary misapplied the law in collusion with the local partner through the delivery of the *April 23, 2002 ex parte injunction*.

416. According to Claimants, the next legal concept grossly misapplied by Respondent's Judiciary relates to the appreciation of the facts that allegedly gave rise to Telecom Invest's right to buy out Claimants' shareholding. Indeed, the LLP Law allows the forceful buy out of a participant only if such participant caused significant harm to the partnership.

417. At the April 15, 2002 meeting, Telecom Invest discussed the potential harm that KaR-Tel might suffer. At that time, no real harm existed. Respondent's Judiciary ignored that rule, concluding that there was a future loss.

418. The law also requires that there exist a causal link between the action or inaction of a participant and the harm. The Courts ignored this requirement. Indeed:

- such link was not established since Claimants were neither a party to the Investment Contract nor responsible for its termination, which resulted from KaR-Tel's alleged failure to file reports with the Investment Committee;
- rather, it is the local partner that failed to comply with its contractual obligations in this respect. Pursuant to article 4.3 of the Foundation Agreement, Investel/Telecom Invest – and not Claimants – assumed the obligation to assure the relations with the Investment Committee;
- in any event, the local partner had equal access to all of KaR-Tel's financial information so that it cannot be said that Claimants were solely responsible for the wrongful termination of the Investment Contract.

419. The LLP and the Civil Code also require that all of *the reasons* to buy out a participant be discussed at the General Meeting and does not allow the partnership to raise new reasons during subsequent Court hearings. Indeed, it is the partnership, and not its participants, that may bring a claim to forcefully buy out a participant. Therefore, the partnership's claim before the Courts must be based on a decision taken by the General Meeting. If the partnership advances arguments that were not discussed, such arguments are *ultra vires* and may not be reviewed and accepted by the competent Court. However, this clear principle was ignored. The Courts based their decisions on the alleged lack of investment by Claimants and the alleged overpricing of the equipment they supplied, neither of which were the basis for the resolution purportedly adopted by the General Meeting.

420. According to Claimants, those outrageous violations of Kazakh law culminated in Judge Begaliev's decision dated June 6, 2003 ruling on Telecom Invest's claim for expulsion of Claimants from KaR-Tel and on the compulsory redemption of their shares.

421. In this respect, Claimants point out, *inter alia,* that, in his decision, and in total contradiction with the documentary evidence, Judge Begaliev wrongfully concluded that the termination of the Investment Contract was the result of Claimants' non-performance of their purported obligation to secure investments for KaR-Tel.

422. Judge Begaliev's decision rejected Claimants' counterclaim challenging the validity of the April 11 and April 15 resolutions despite their glaring deficiencies. In this respect, Claimants underline that it was not until this decision by Judge Begaliev on June 6, 2003, *i.e.* more than one year after the April 23, 2002 injunction was first issued, that there was mention in the Court's decisions of the idea that the April 15 meeting was held as a "*follow-on"* meeting arising from the lack of presence of a quorum at the April 11 meeting.

423. Similarly, Judge Begaliev's decision that a secretive EGM called by minority shareholders, calling for the compulsory redemption of Claimants' majority stake, was valid, was manifestly wrong as a matter of law.

424. Claimants further stress as an example of the behavior of Judge Begaliev, his approach to expert evidence, such as the legal opinion of Professor Suleimenov and others, which were rejected on the basis that "*the indicated individuals do not possess the right to interpret the law.*"

425. According to Claimants, the above mentioned defects in the Court's decision are so glaring that they can only be the result of bias, corruption and/or bad faith on the part of Judge Begaliev. In this respect, Claimants submit the testimony of Mr. Agilönü, who testified that Judge Begaliev had requested from him EUR 400,000 to rule in Claimants' favor, but then had informed Mr. Agilönü that "*he had received instructions from the highest authorities to rule against us, and that ruling in [Claimants] favor would jeopardize his and his family's life.*" Judge Begaliev denied that allegation in his testimony. However, he had a clear personal interest in such denial, as he could be imprisoned or lose his job if he admitted this discussion, whereas Mr. Agilönü had no such personal interest.

426. Claimants finally submit that the decision of the Presidium of the Supreme Court constituted the final step in the State-sponsored scheme to expropriate their investment in KaR-Tel. Indeed:

- they were not given notice of the Presidium hearing and were thereby prevented from making any submissions as to the valuation of their shareholdings in KaR-Tel;
- the Presidium acted *ultra vires* even in considering the appeal since Telecom Invest did not request in its claim or in any of the Court proceedings prior to the June 6, 2003 decision of the Almaty City Court, that the Court decide on the valuation of Claimants' shares;
- the Presidium's valuation of their shareholdings in KaR-Tel was "*unjust and outrageous*," particularly in light of the true value of the entire KaR-Tel company, as evidenced by its resale price of USD 350 million. Moreover, the Court grossly

misapplied Kazakh law establishing a price by reference to the concept of "*equity interest*" and not by taking into account "*market price*;"

- finally, Claimants allege that the conclusion of forensic experts that Claimants made *no investment* is so grossly incorrect that no reasonable judge should have accepted it.

8. The attempts to pay Claimants to go away

427. According to Claimants, several attempts were made by Respondent and/or various members of President Nazarbayev's empire to pay Claimants to go away.

428. KaR-Tel was first to offer to purchase Claimants' combined 60% for approximately USD 3,000 only. Claimants obviously refused.

429. Then, in April 2003, Mr. Seysembayev offered to purchase Claimants' stake for USD 12 to 15 million. In the context of these discussions, he informed Claimants of the criminal charges that had been raised against their personnel. Claimants refused the offer which they considered too low.

430. In August 2004, as Claimants were preparing to commence the present arbitration, they were contacted by the President of Altel, Mr. Zhanarbek Umirzhanov, to discuss the purchase of Claimants' 60% interest and the resolution of the difficulties faced by Claimants in Kazakhstan. According to Claimants, Altel is ultimately owned and controlled by the Republic. In this context, Claimants also met Mr. Kairat Orazbekov, the Vice Chairman of Arlan (also referred to as Orlon by Respondent) Holding Company, a company which was controlled by one of the daughters of President Nazarbayev. Mr. Orazbekov stated that the Arlan/Altel Group was willing to purchase Claimants' 60% interest in KaR-Tel for USD 20 million.

431. According to Claimants, Respondent's offer to purchase Claimants' shares at USD 20 million is an admission that Respondent violated its international obligations. Indeed, by making such an offer, Respondent implicitly recognized that the decisions of its Courts would not stand international scrutiny and that Claimants still held a combined

shareholding interest with significant value. Indeed, in light of the fact that KaR-Tel's charter had already been amended to remove Claimants as shareholders by early November 2003, such a proposal from Respondent nearly a year later can only be viewed as an admission of liability.

9. The sale of KaR-Tel to VimpelCom

432. On August 27, 2004, just three days after Claimants had answered negatively to the USD 20 million proposal to purchase their stake, they learned that VimpelCom had purchased 100% of KaR-Tel for USD 350 million.

433. In this respect, Claimants further point out that:

- in its Annual Report for the year ended December 31, 2004, VimpelCom seemed to attach great importance to having a local partner with "*local knowledge*" in connection with its investment in KaR-Tel;
- VimpelCom noted that it had "*heard assertions regarding possible questionable payments to government authorities in connection with certain legal proceedings in which KaR-Tel was involved prior to our acquisition*."

434. Claimants submit that the USD 350 million price is in marked contrast with the Supreme Court's valuation of Claimants' 60% stake at USD 3,000, less than a year before. In this respect, Claimants dispute the arguments set forth by Respondent to support the idea of a subsequent improvement of KaR-Tel's situation that would have justified a much higher valuation of the company:

- Claimants dispute Respondent's allegation that Mr. Yerimbetov entered into negotiations with Motorola and was able to reduce KaR-Tel's debts by USD 72 million. Respondent produces no documents to support this statement;
- Claimants also dispute Respondent's allegation that the reasons why Mr. Yerimbetov was able to negotiate a reduction of the amount to be repaid to Motorola were that the 3-year limitation period for bringing a claim was to expire and Mr. Yerimbetov understood that Motorola had already written off KaR-Tel's

debt from its accounts. According to Claimants, the statute of limitations stops and runs anew if a creditor files a claim, and the writing-off of a debt in one's books cannot constitute a waiver of its rights. Therefore, these reasons cannot explain the purported reduction of the debt towards Motorola.

435. Claimants further point out that, as explained by Andrew Wright from Analysys, an expert in the telecom business with nearly 20 years of experience, "*it is inconceivable to me that a company could go from zero value to an enterprise value of USD 450 million in around about two years. It was never zero in the first place.*"

436. In the same vein, Claimants make several comments on the argument raised by Respondent that the USD 3,000 valuation of KaR-Tel by the Kazakh Courts was based on the reports of independent experts and in particular PWC:

- those reports simply took information and assumptions presented by KaR-Tel's new management;
- in its report, PWC cautioned that "it did not verify the credibility" of the information provided and that "a more detailed analysis is required to express an opinion on the price";
- it is clear from the PWC report that there were issues with the management assumptions provided to PWC;
- PWC indicated in its report that it could not "*make any guarantees or warranties (direct or indirect) with respect to the accuracy, fullness or admissibility of this report for any purposes*."

10. General observations on the hearing and on circumstantial evidence

a) Observations on the hearing

437. Claimants make three general remarks on the developments that occurred at the hearing. First, Respondent continued its pattern of obstruction of justice by refusing to produce as a witness Mr. Kulibayev, despite the Arbitral Tribunal's order dated September 24, 2007.

Mr. Kulibayev and his wife, the daughter of President of Kazakhstan, owned a controlling stake in Claimants' local partner. He has exercised a variety of key, high-level State functions and is one of the leaders of a group of individuals that exercises significant control and/or influence over the organs of the Republic of Kazakhstan. According to Claimants, had Mr. Kulibayev come to the hearing, he:

- could have explained the precise role he played in the local partner's decision of mid-2001 to dissociate itself from Claimants;
- could have answered Claimants' allegations of collusion with the Investment Committee;
- could have explained why the Investment Committee, under Ambassador Zverkov's leadership, abruptly terminated KaR-Tel's Investment Contract;
- could have explained why he did not satisfy his and his subordinates' lobbying obligations or good faith obligations as shareholders and partners to provide assistance;
- could have explained how and why Visor Investment Solutions, a company that he had tasked with getting rid of Claimants, promised Claimants in October 2002 to "*cancel*" the termination of the Investment Contract in order to facilitate the sale of his company's minority shares in KaR-Tel to Claimants; and
- could have explained whether the Republic of Kazakhstan ever contacted him to provide testimony.

438. Second, Respondent did everything possible to avoid producing Mr. Orazbekov for examination at the hearing. On September 24, 2007, the Arbitral Tribunal ordered Respondent to produce Mr. Orazbekov as witness. Respondent did not comply, but, instead, sent on October 5, 2007, a letter providing the Tribunal with an address of Mr. Orazbekov. On October 10, 2007, the Tribunal wrote to Mr. Orazbekov asking him to be present to give witness testimony. On October 12, 2007, Respondent produced a very short letter from Mr. Orazbekov denying that he had ever discussed with anyone the matter of purchasing Claimants' stake in KaR-Tel and stating that he would not appear to testify. Yet, Respondent suddenly shifted its position, after Claimants' counsel protested

against this obstruction of justice, indicated the questions that he would have put to Mr. Orazbekov, and requested that adverse inferences be drawn from his absence.

439. Respondent then wrote a letter on October 22, 2007 stating that it had "*obtained a business address for him*" (which made no sense as Mr. Orazbekov's address had already been provided) and that he would be available for cross-examination. At the hearing, Mr. Orazbekov conceded that he had never been informed of these ICSID proceedings prior to October 12, 2007. However, Respondent has denied, since the time of its Counter-Memorial dated December 14, 2006 that any offers had been made to purchase Claimants' shares in August 2004. According to Claimants, it is simply unacceptable for Respondent to have strongly denied such important facts without having contacted Mr. Orazbekov beforehand.

440. Third, it is Claimants' position that Respondent's witnesses lied at the hearing:

- for instance, nearly all of Respondent's witnesses and experts, including those that did not have any direct knowledge of the facts alleged, included in their statements the magic words – (Motorola) "*loan,*" (Uzan) "*fraud*," "*obsolete equipment*" and "*amount supposed to be invested*" in a clear attempt to bias the Tribunal against Claimants and to find belated justifications for the wrongful termination of the Investment Contract;
- Ambassador Zverkov refused at the hearing to even confirm what he said in his own letter, namely that the Investment Committee granted an extension to file the requested reports, at the very least until March 23, 2002. He also engaged in conflicting justifications when confronted with the fact that March 23, 2002, the day he claimed the Investment Committee members were waiting at the Investment Committee to receive Claimants' reports, was a Saturday, and that the previous day was Norouz, a public holiday;
- Mr. Orazbekov admitted that Mr. Akgün and Mr. Salih Oktar, representatives of Claimants, were invited by the State company Altel to attend a meeting with him on March 24, 2004. Yet, Mr. Orazbekov claimed that these two gentlemen were

not invited to be extended any offer for the settlement of their KaR-Tel claims, but rather to discuss further business opportunities in Kazakstan. According to Claimants, this is unconvincing: Mr. Orazbekov failed to describe, even in any general fashion, much less to provide any specifics, the alleged business opportunities the parties discussed at the meeting he attended. In any case, these companies were undergoing crises in Turkey and had had their investment expropriated in Kazakhstan. Therefore, the likelihood is slim that they would have attended a meeting to discuss further business opportunities in Kazakhstan.

441. Claimants request that the Arbitral Tribunal draw adverse inferences as a result of these multiple obstructions of justice, misrepresentations and improper conduct.

b) Circumstantial evidence

442. The Arbitral Tribunal asked Claimants to explain the weight that the Tribunal should give to circumstantial evidence. In this connection, Claimants note that they rely primarily on Respondent's admissions in this arbitration and on the direct evidence that has been produced to demonstrate Respondent's breaches of the Bilateral Investment Treaty. Some circumstantial evidence has also been advanced, however, particularly with regard to the collusion between the powerful local partner and organs of Respondent. Claimants request that the Arbitral Tribunal give full weight to the circumstantial evidence that has been presented for the following reasons.

443. Article 34(1) of the ICSID Arbitration Rules provides that the Arbitral "*Tribunal shall be the judge of the admissibility of any evidence adduced and of its probative value.*" Therefore, the Tribunal is not bound by any legal system of procedure. It is free to determine the probative value of any evidence that has been produced, be it circumstantial or otherwise.

444. In general, international tribunals have given full weight to circumstantial evidence. Two independent factors are considered by Arbitral Tribunals when assessing the weight that should be given to such evidence:

- the first factor is the party's attitude in the proceedings. If a party, as was the case with Respondent, does not comply with its obligations, for instance by refusing to produce the requested documents and witnesses, the Arbitral Tribunal is authorized to draw adverse conclusions from the party's behavior. The same applies when witnesses manifestly lack independence, as was the case with those produced by Respondent;
- the second factor is whether direct evidence of fact is unavailable. In this respect, the International Court of Justice decided in the *Corfu Channel* case that "*[T]he other State [the claimant], the victim of a breach of international law, is often unable to furnish direct proof of facts giving rise to responsibility. Such a State should be allowed a more liberal recourse to inferences of facts and circumstantial evidence. This indirect evidence is admitted in all systems of law, and its use is recognized by international decisions*."[28] In *AAPL v. Sri Lanka,* an ICSID Arbitral Tribunal listed the international rules regarding evidence and concluded: "*Finally, in cases where proof of a fact presents extreme difficulty, a tribunal may thus be satisfied with less conclusive proof, i.e. prima facie evidence.*"[29]

445. In this arbitration, Claimants rely on circumstantial evidence primarily to show collusion between the powerful local partner and the organs of the Republic of Kazakhstan. It is undisputable that submission of direct evidence on these points is very difficult, and even more so given that the Republic of Kazakhstan is a party to this dispute and has in general not been cooperative in the fact finding procedure.

446. Furthermore, in some circumstances, the endemic nature of a fact alleged in certain countries has been considered to be circumstantial evidence of the facts alleged. For instance, in ICC arbitration No. 3916, the widespread nature of corruption in Iran was

---

[28] *Corfu Channel (United Kingdom of Great Britain and Northern Ireland v. Albania),* Judgment of April 9, 1949, [1949] ICJ Report Rep. 4, para. 18 [hereinafter *Corfu Channel v.Albania*].

[29] *Asian Agricultural Products Ltd. v. Republic of Sri Lanka* (ICSID Case No. ARB/87/3), Final Award of June 27, 1990, (1991) 30 ILM 580, paras. 37-45 [hereinafter *AAPL v. Sri Lanka*].

considered to be circumstantial evidence for the existence of corrupt practices.[30] Similarly, in the case at hand, the international reports and widely published articles submitted prove the two points on which circumstantial evidence is most relevant, namely general lack of impartiality of the organs of Respondent and collusion between powerful groups of the ruling family in Kazakhstan.

447. According to Claimants, there is no doubt that the two independent and alternative factors described above for the use of circumstantial evidence are present. Additionally, admissions have been secured and direct evidence submitted on related subjects that reinforce the circumstantial evidence submitted in support of Claimants' position on collusion. Claimants also produced the witness statement of Mr. Agilönü who confirmed that Respondent's judiciary was not only corrupt in this matter, but also under the influence of the powerful local partner against the interest of which it could not possibly rule.

448. Therefore, Claimants allege that they have satisfied their burden of proof on collusion. They finally allege that, in the event that the Arbitral Tribunal were to find otherwise, that would have no impact on Respondent's liability for breaches of the Bilateral Investment Treaty since Respondent, independently of the issue of collusion, breached multiple obligations under the Treaty, as proven by the admissions made by Respondent and the direct evidence submitted in this arbitration.

B. RESPONDENT'S POSITION

1. The general context

a) Claimants' investment

449. According to Respondent, there was nothing to expropriate since Claimants did not make any investment. The highest Claimants are able to put their case is that they granted KaR-Tel lines of credit or procured for KaR-Tel loans from third parties, and particularly from Motorola. Respondent alleges that the only capital contribution not in the form of

[30] *ICC Case No. 3916* (1982), Collection of ICC Arbitral Awards 1974-1985, at 507.

an interest-bearing loan is Rumeli's partial contribution towards the charter capital of KaR-Tel.

450. According to Respondent, it is not clear on what basis Claimants can allege that the loans made to KaR-Tel constitute the investment they were obliged to make under the Foundation Agreement and/or the Investment Contract. In any event, they were anything but interest-free: they were subject to interest at LIBOR +2%.

451. Moreover, it appears that Rumeli deposited a sum in a bank account at Bank TuranAlem in order to permit KaR-Tel to borrow further funds. Once again, rather than actually investing in KaR-Tel, Rumeli further indebted the company.

452. It is also Respondent's allegation that Claimants did not transfer equipment on very favorable terms to KaR-Tel. On the contrary, they sold obsolete equipment to KaR-Tel at a significant overvalue, in breach of the requirements of the Invetsment Contract to use advanced technology.

453. Respondent accepts that Telsim guaranteed the Motorola Loan for KaR-Tel, but this cannot be termed an investment by Claimants: it simply created further indebtness on KaR-Tel and was done at a time when Telsim was not a shareholder of KaR-Tel. When Motorola demanded repayment of the Motorola Loan from Telsim, that demand was not met in whole or in part.

454. Respondent further submits that there is no evidence of the additional investment of USD 33 million allegedly made by Claimants between 1999 and 2001 and, indeed, none was provided to the Kazakh Courts nor found by the independent forensic experts appointed by the Kazakh Courts or the leading auditors appointed by Telecom Invest or KaR-Tel during the course of the proceedings in 2002 and 2003.

455. Finally, Respondent submits that the quality of the support know-how and training provided by Claimants was not very good and that in the opinion of several leading

auditors KaR-Tel was insolvent and unable to continue trading without significant restructuring.

b) The Republic of Kazakhstan and the involvement of President Nazarbayev's family

456. According to Respondent, despite the repeated references to collusion and conspiracy and acting in concert, Claimants do not provide any evidence of even a suspicion of collusion or conspiracy.

457. Respondent further submits that no attempt is made by Claimants to link its generalized allegations of corruption and dishonesty to the matters in dispute in this arbitration. For instance, it is unclear which members of the President Nazarbayev's family or "*empire*" are said to have played a purported "*active role*." The best Claimants are able to allege is that two of the persons they mention, Mr. Kulibayev and his wife, might be participants of a Limited Partnership called Almex that was itself a shareholder of Investel/Telecom Invest, which were themselves participants in KaR-Tel.

458. Contrary to Claimants' allegations, Mr. Kulibayev had no role whatsoever in the negotiations with the Investment Committee and was at no time a director of Investel or Telecom Invest.

459. On that extraordinarily tenuous basis, Claimants seek to allege that the Republic bears responsibility for the dispute that arose between three private entities. However, there is no basis on which a State can bear legal responsibility for the actions of its President's son-in-law.

460. Claimants are alleging that the conspiracy was between all of:

- Mr. Kulibayev, Mrs. Kulibayeva, Mr. Abuov and President Nazarbayev;
- numerous members of the Investment Committee;
- two judges of the Almaty Court;
- numerous Court bailiffs;

- numerous members of the criminal prosecution office;
- all the members of the Working Group;
- Deloitte & Touche, PricewaterhouseCoopers and the other experts who produced reports before the Kazakh Courts;
- three judges of the Supreme Court of Kazakhstan;
- nine judges of the Presidium of the Supreme Court of Kazakhstan.

461. According to Respondent, when viewed in that context alone, Claimants' allegations seem extraordinary. When one realizes that these allegations are unsupported by evidence, Claimants' case becomes offensive.

462. In particular, Claimants' allegation that Respondent's Judiciary acted improperly because it was corrupted is wholly unparticularised. Moreover, Claimants fail to mention that they filed appeals that resulted in first instance decisions being reversed.

463. According to Respondent, Claimants' case theory was always flawed by one incontrovertible fact. After January 2003, Mr. Kulibayev, Mr. Abuov and Mr. Karijbanov had no role or interest in Telecom Invest or KaR-Tel. They had sold Telecom Invest to Mr. Seysembayev. Therefore, any tenuous connection that might have existed with Respondent prior to that sale extinguished six months before the first judgment in the legal proceedings.

2. The termination of the Investment Contract

464. Respondent points out that clause 13 of the Investment Contract required KaR-Tel to provide the Investment Committee with detailed information on the progress of the investment programme on a quarterly and annual basis. This was to allow the Committee, which does not have the power to carry out inspections or audits, to monitor KaR-Tel's compliance with the terms of the Investment Contract. In the period when it was under the control of Claimants, KaR-Tel conspicuously failed to comply with these obligations:

- no annual reports were filed at all during the entire period of the Investment Contract. Only one report was submitted, after the Investment Contract had been terminated and it related to the year 2000;
- the deadlines for filing the quarterly reports were repeatedly missed. By way of example, the reports for the first and second quarters of 2000 were filed together at the end of August 2000 and the report for the third quarter of 2000 was not filed until November 2000. The reports for the third and fourth quarters of 2001 were not filed until after the Investment Contract had been terminated.

465. According to Respondent, it subsequently became clear why KaR-Tel had failed to file any annual reports: the reports had to be certified by an auditor and Mr. Agilönü could not find an auditor who would certify them. For example, in July 2002, Deloitte & Touche provided KaR-Tel with the results of an audit in the course of which they had discovered material discrepancies between the information recorded on the partnership's balance sheet and its actual financial status. It is obvious that the reason why Claimants did not file reports was to prevent the Committee from seeing that in reality KaR-Tel was insolvent and heavily in default on the Motorola Loan.

466. The official notice dated September 10, 2001 sent by the Investment Committee set a deadline of November 1, 2001 for KaR-Tel to cure its breaches. KaR-Tel did not comply with this notice and asked for several extensions, which were granted. In any case, KaR-Tel failed to file either of the requested annual reports or any other information at all. The Committee then sent a letter dated February 21, 2002. There followed a meeting between Claimants' executives and members of the Investment Committee. These later accepted that if the reports were filed within 30 days, it would be possible to stop the cancellation of the Investment Contract. The formal order of cancellation was sent on March 27, 2002. Given the multiple breaches of the Investment Contract in terms of reporting, the Investment Committee clearly had the right to terminate the Contract.

467. According to Respondent, Mr. Agilönü's evidence on the cancellation of the Investment Contract was limited in scope and unreliable. The most incredible part of his evidence on

this issue turned on the new allegations he made at the hearing that the filing of the reports had always been the responsibility of Investel/Telecom and more specifically of Mr. Podporin. This, the latter denied. And, upon closer examination, Mr. Agilönü's new allegations disintegrated. He was asked how Mr. Podporin, who was only the logistics manager, could prepare the detailed financial reports required. Mr.Agilönü's response was telling. He replied that his team was responsible for preparing the reports, which Mr. Podporin was then responsible for filing. However, in view of the fact that Mr. Agilönü accepted that the 1999 and 2001 annual reports for KaR-Tel had never been prepared, it is difficult to see what blame could possibly attach to Mr. Podporin, even if Mr. Agilönü were correct. It is also to note that Mr. Agilönü's acceptance of the failure to file the reports for 1999 to 2000 is contrary to Claimants' position as set out in their Memorials.

468. Mr. Agilönü went even further in his evidence and stated that in September 2001, on receipt of the Investment Committee's warning letter, he had specifically asked Mr. Podporin to resolve the problem. This is clearly a further lie. Mr. Podporin denied this alleged conversation. Further, this allegation, together with Mr. Agilönü's admission that he spoke to Mr. Abuov in January 2002, contradicts the statement in Mr. Agilönü's witness statement that Mr. Abuov and Mr. Podporin disappeared after the letter of 10 September 2001 was received. In the same vein, Mr. Agilönü confirmed that he had not attempted to contact Mr. Kulibayev at any stage in relation to the problem KaR-Tel was facing with the Investment Committee, which contradicts Claimants' allegation that they knew that Mr. Kulibayev was a man of great influence in Kazakhstan.

469. According to Respondent, Claimants admitted that several extensions of time have been given to file the reports. And, in any case, no reports for 1999 or 2001 were ever filed. Therefore, even if the 2000 report was filed on time – which it was not – KaR-Tel would still have been in significant breach of its reporting obligations.

470. With respect to the timing, Mr. Agilönü's evidence was that he filed the 2000 annual report with the Investment Committee by facsimile on March 25, 2002. This conflicts

with Claimants' case in their Request for Arbitration which states that on March 25, 2002, they filed two quarterly reports and only on March 31, 2002 did they file the remaining documents. In any event, this was after the deadline of March 23, 2002, which was the end of the 30-day notice period granted by the letter of termination dated February 21, 2002.

471. On the allegation of collusion that would have led to the cancellation of the Investment Contract, Respondent points out that Ambassador Zverkov, Chairman of the Investment Committee, denies having been under any pressure to cancel the Contract. With respect to Mr. Abuov, who was accused of having failed to assist KaR-Tel when it needed him, he answered that he had never been asked to assist and that whenever he had given his advice to Claimants and their appointees, it had been routinely ignored.

472. Mr. Abuov further testified that it was nonsensical for Telecom Invest to cause the cancellation of the Investment Contract as it would have caused significant harm to KaR-Tel and thus to Telecom Invet's investment. In any case, Almex sold Telecom Invest in January 2003 and thereafter had nothing to do with it.

473. Respondent further submits that Claimants' complaint of unfair procedure, i.e., that the Investment Committee cancelled the Investment Contract on a statutory basis rather than on the contractual basis of clause 19, which would have required a prior suspension of the Contract, is unfounded.

474. Indeed, article 13 of the Investment Support Law gives the Investment Committee the right to cancel the Investment Contract without prior suspension. The evidence given by Mr. Sabirov, who was himself Chairman of the Investment Committee after Amabassador Zverkov, shows that during his tenure on the Committee, the Committee cancelled 30 to 40 investment contracts without prior suspension. Around a quarter of those cancellations were based on the investor's failure to file their reports.

475. Moreover, as confirmed by Professor Kaudyrov, article 13 of the Investment Support Law is mandatory. Consequently, the Investment Contract could not deviate from, or

condition, its application. Therefore, Claimants could not have had a "*legitimate expectation*" that suspension was a prerequisite.

476. In any event, Respondent alleges that Claimants' failure to challenge the cancellation of the Investment Contract debars them from bringing a claim that Respondent has denied them justice or fair and equitable treatment.

477. Respondent further alleges that:

- although the Investment Committee did not cancel the Investment Contract on the basis of clause 19 thereof, and did not formally suspend the Contract, it could have been validly cancelled pursuant to clause 19.3 on February 21 in any event. Indeed, the notice sent on September 10, 2001 constituted a suspension of the Contract in accordance with the spirit of clause 19. If that notice alone did not constitute a suspension, the repeated further extensions of time granted did. The only difference from the strict position under clause 19.2 is that the Investment Committee refrained from formally suspending the Investment Contract, as that would have obliged KaR-Tel to make ordinary payments of tax until the suspension was lifted: it therefore benefited KaR-Tel;
- the May 14, 2003 letters invoked by Claimants in support of their position have been written by junior administrators in Respondent's Ministry of Finance and Ministry of Economy. They are not based on a review of the events. They take as given the incorrect assertions made by Claimants in their April 2003 letters that they had fully complied with all of their reporting obligations. Moreover, Respondent points out that it is difficult to see how these letters match with Claimants' case theory of collusion;
- the cancellation was not abrupt since KaR-Tel had been granted 6 months of extensions from the initial demand to file the reports;
- Exhibit RM32 constitutes another example of a telecommunications company whose investment contract was terminated according to the same procedure;

- had the Investment Committee been presented at the time with the information it ought to have received from KaR-Tel, it would have been entitled to cancel the Investment Contract and would have done so for breach of KaR-Tel's obligations to make direct investments under clause 3.

478. Respondent finally points out that Claimants did not request KaR-Tel to challenge the termination of the Investment Contract.

3. On the purported collusion between Telecom Invest and Respondent to effect the compulsory sale of Claimants' interest in KaR-Tel

a) The KaR-Tel EGMs

479. According to Respondent, it is incorrect to allege, as Claimants do, that the April 2002 EGMs were invalidly held.

480. First, contrary to Claimants' allegation, they received notice of the EGMs. The default rule of Kazakh law is that extraordinary general meetings of LLPs are to be convened by the central executive body of an LLP, in the case of KaR-Tel the General Manager. However, article 45(2) also provides that if, despite a request, the executive body does not call an EGM, any shareholder with at least 10% of the equity may also do it.

481. By letters dated March 4 and March 20, 2002, Telecom Invest's Mr. Podporin requested KaR-Tel's General Manager to call an EGM as soon as possible to discuss the cancellation of the Investment Contract. Mr. Agilönü ignored these requests. He denied having received these letters. However, evidence from the Kazakh postal service and from two of KaR-Tel's secretaries proved this statement to be false. Therefore, on March 26, 2002, in view of Mr. Agilönü's failure to respond, Mr. Podporin sent to Rumeli and Telsim formal notices calling an EGM of KaR-Tel.

482. According to Respondent, the Turkish postal service confirmed that the EGM notices were delivered and signed for by named individuals at Rumeli and Telsim. Therefore,

unless Claimants also implicate the Turkish postal service in the alleged conspiracy to expropriate their investment, they cannot challenge this evidence.

483. Respondent further submits that contrary to Claimants' allegation, article 46 of the LLP Law does not state that it is not possible to provide notice of two EGMs in a single document. On the contrary:

- the Office of the Public Prosecutor stated that it was for the Court to decide;
- the Supreme Court, having heard the evidence of Professor Suleimenov for Claimants, rejected the view that it was impermissible to have notice for two EGMs in one document;
- the Civil Expert Report of Respondent concludes that the Court was correct;
- Professor Sergeev, Claimants' expert, accepted that this issue was not clear cut in Kazakh law.

484. It is also Respondent's allegation, supported by their legal experts, that pursuant to article 176 of the Kazakh Civil Code, notices sent by post before midnight on the last day of a period set by law are deemed to be made on time. In any case, this issue was not raised by Claimants before the Kazakh Courts. They cannot therefore be criticized for not having decided an issue that they were not submitted. Moreover, in these circumstances, it is not open to the Tribunal to find that the decision of the Almaty City Court was so egregiously wrong that no competent and honest judge could have determined the issues in that way

485. With respect to the issue of quorum, Respondent sets forth that, pursuant to article 47(5) of the LLP Law, an adjourned or reconvened EGM is quorate irrespective of the number of voting rights present. This is confirmed by their Civil Expert Report and even by Professor Didenko, Claimants' expert before the Kazakh Courts, who indeed changed his views in an article subsequent to his testimony.

486. Article 47(5) of the LLP Law provides that where fewer than half of the total votes are present at a reconvened EGM, it is not competent to adopt resolutions requiring a

qualified majority. Claimants allege that the decision on compulsory redemption is one requiring qualified majority voting and, thus, that as Telecom Invest held only 40% of the total votes, it could not legally adopt a decision on compulsory redemption at the April 15, 2002 EGM.

487. Article 48(2) of the LLP Law provides that a motion for the compulsory redemption of a participant's shareholding in a LLP requires: "*a qualified majority of three fourth of votes of the partnership present and represented at the meeting. When adopting a decision under sub-paragraph (9) of paragraph 2 of article 43 of this Law the participant whose participating interest is to be purchased into a forced procedure shall not take part in voting and the number of votes he has shall not be considered.*"

488. The Almaty City Court dismissed Claimants' contention holding that article 48(2) is clear that it is only the votes present or represented at the meeting that count for the purpose of assessing whether or not the 75% threshold has been achieved. The Court added that the final part of article 48(2) made the position even more clear: had Claimants been present at the meeting on April 15, 2002, they would not have been entitled to vote on the question of compulsory redemption, and Telecom Invest would still have held 100% of the votes eligible to be exercised in passing that resolution.

489. Professors Kaudyrov's and Klimkin's expert evidence, which was unchallenged, was that there is an ambiguity between article 47(5) and article 48(2): the former refers to "*qualified majority of vote*" and the latter to "*a qualified majority of three quarters of the votes present and represented at the meeting*." Respondent's experts opined that, faced with such ambiguity, the better approach is to adopt the narrower standard of article 48(2), which is also more directly relevant to the issue to be determined. In their view, the Almaty City Court's determination of this issue was correct. Moreover, one of Claimants' expert witnesses in the Kazakh proceedings, Professor Didenko, has subsequently revised his view and now considers that the Kazakh Courts determined this issue correctly.

490. In this framework, Respondent alleges that, pursuant to article 48(2) of the LLP Law, even if Claimants had been present at the meeting on April 15, 2002, they would not have been entitled to vote on the issue of compulsory redemption, and thus Telecom Invest would still have held 100% of the votes eligible to be exercised in passing that resolution. In this context, the Almaty City Court rightly held that Claimants were to be treated as a single entity in view of their mutual ownership and behavior. Professor Didenko confirmed this point of view.

491. With respect to the certification of the quorum, Claimants allege that article 47(9) of the LLP Law requires that the quorum be certified anew immediately prior to the vote. However, according to Respondent, whether or not it was done is irrelevant since there was only one shareholder present.

492. With respect to the minutes of the EGM, Respondent further points out that Claimants, which initially argued that the minutes of the meeting did not record the evidence which had been presented relating to the significant damage suffered by KaR-Tel, now appear to accept that the harm suffered by KaR-Tel as a result of the cancellation of the Investment Contract was discussed at the EGM.

493. Respondent finally submits that, as confirmed by its Procedural Expert Report, and now also by Professor Didenko, the LLP Law contains no formal limits on the size of the shareholding which may be the subject of an order for compulsory redemption. In any case, even if it were otherwise, this limit would have been inapplicable in the present case since there was no majority shareholder, unless Claimants' shareholdings are taken together, which they dispute in relation to the voting on compulsory redemption.

b) The Injunctive relief proceedings

494. According to Respondent, there were good reasons for Telecom Invest to seek an injunction in March 2002. Indeed, Claimants had not participated at all in the EGMs, and, in addition, Telecom Invest had recently discovered falsified minutes of a purported EGM at which it had been falsely recorded that Telecom Invest had consented to Rumeli

transferring a further 10% of its shares in KaR-Tel to Telsim. There was a risk that, once Claimants would have learned of KaR-Tel's resolution for compulsory redemption of their shareholding, they might have attempted to disrupt KaR-Tel's network and destroy critical documents.

495. Indeed, notwithstanding the injunction, Claimants managed to delete KaR-Tel's website. Claimants did not challenge that point. Nor do they dispute Mr. Yerimbetov's evidence that Claimants' representatives attempted to obtain the remote access details for KaR-Tel's switch, which would have permitted them to switch off the entire KaR-Tel network. Claimants, rather than deny this outright, simply suggested to Mr. Yerimbetov that there might be other reasons for them to have sought the switch remote access details, but Mr. Yerimbetov was clear in his recollection.

496. Respondent submits that the application for the injunction was, by necessity, filed *ex parte*. Article 158 of the Kazakh Civil Procedure Code provides that Courts may take steps to secure a claim on a motion by a participant in the relevant case. As explained by Respondent's Procedural Expert Report, applications for such injunctions are determined *ex parte*. The evidence of Professor Mukhamedshin that this *ex parte* procedure is normal and regularly used in Kazakhstan and that the Court acted entirely properly was unchallenged. Claimants did not adduce any expert evidence on this issue. Nor was there any challenge to Professor Mukhamedshin's evidence. The judge must simply evaluate whether the applicant has submitted a *prima facie* case that in the absence of an injunction the Court's orders may be difficult to enforce. According to Respondent, in view of the application, the Court's decision was sensible.

497. Respondent also submits that it is not true to say that the Court ratified the appointment of Mr. Yerimbetov and prejudged the merits of the pending claim. The appointment of the General Manager is for the General Meeting of the Shareholders to decide. During the meeting held in April 2002, it was decided to appoint Mr. Yerimbetov, in replacement of Mr. Agilönü. Therefore, the Court had no basis to doubt the validity of this

appointment and no legal basis to appoint a third party. Professor Mukhamedshin's evidence confirms that point.

498. Respondent further points out that Claimants filed an appeal against the injunction and the Supreme Court set aside the second part thereof (related to the limits of access to KaR-Tel's premises, etc.), which is hardly the conduct of a Judiciary that is said to be denying justice to Claimants.

499. Finally, it is not true that in fact Claimants continued to be denied access despite the Supreme Court decision and that their requests to the Courts remained unanswered. They made a single application on July 25, 2002 to challenge Mr. Yerimbetov's control over the access to KaR-Tel of employees engaged by Claimants. The decision on this point is at the discretion of the Court. The request was rejected. In fact, the Court found that as the only attempts made to access KaR-Tel were prior to the alteration of the injunction by the Court of Appeal decision of June 11, 2002, it could not be said at that stage that Claimants had been denied access to KaR-Tel, such as to justify a Court order. It was always open to Claimants to return to Court if they still were not given access. Respondent's Procedural Expert Report finds that the Court's decision was valid. His opinion was not challenged by Claimants.

500. In this context, Respondent finally points out that, when almost one year later, on May 22, 2003, Claimants attempted to access documents at KaR-Tel once more and were unable to contact Mr. Yerimbetov, they immediately went to the Almaty City Court which granted their application for an order.

4. The actions of Respondent's police authorities

501. According to Respondent, Claimants attempt to give the impression that the Kazakhstan armed police seized KaR-Tel's premises and evicted Claimants whereas, in fact, the Kazakh police was not present. During the enforcement of the injunction by Court bailiffs, there were guards from the Kuzet Security Service. Respondent does not know whether they were armed, but, in any event, they were not present to assist in the

enforcement of the injunction but rather to take over from the existing KaR-Tel security guards, who had been dismissed by Mr. Yerimbetov.

502. According to Respondent, in the course of the hearing, the allegations relating to the enforcement of the injunction were disavowed or undermined by Mr. Agilönü. Indeed, he admitted that:

- he did not know if it was in fact the Kazakh police, it could have been Kuzet security guards;
- he could not recall whether or not they were armed, let alone whether or not they had machine guns;
- he had a conversation with Mr. Karijbanov at the switch and agreed to meet Mr. Karijbanov in the following days to discuss the situation.

503. Mr. Karijbanov confirmed his evidence that he saw Kuzet security guards at the premises of KaR-Tel during the enforcement of the injunction, but no police and no-one armed. According to Respondent, this is a radically different picture than that previously painted by Claimants and casts significant doubt on the reliability of their case and evidence.

504. The police was thus not there but even if it had been otherwise, it is a matter within the discretion of the enforcing bailiff whether to call for assistance. Contrary to Claimants' suggestion, the bailiff is not required to attempt first to enforce the injunction without police assistance.

505. Respondent finally alleges that:

- KaR-Tel's premises were not simultaneously seized;
- Mr. Karibjanov was not present to lead the allegedly armed force but merely to protect Telecom Invest's interest;
- the Court's bailiffs did not bar Turkish executives from entering the premises. The Turkish executives simply failed to appear for work;

- there is no obligation in Kazakh law to notify the respondent to an ex parte procedure that the injunction has been obtained prior to enforcing its terms.

5. The attempt to sell Telecom Invest's participation in KaR-Tel

506. Respondent disputes Claimants' position on Telecom Invest's attempt to sell its participation in KaR-Tel. This was not at all a purported way of extracting money from the partnership. On the contrary, in late summer 2002, Almex and Telecom Invest took the position that it would be sensible for them to sell their interest in KaR-Tel as quickly as possible in view of the real danger of KaR-Tel being made insolvent and losing its principal valuable asset.

507. Their first option was to discuss with Claimants. Mr. Karibjanov, appointed by Telecom Invest, flew to Corfu and had a meeting with Hakan Uzan. Initially, Mr. Uzan offered to sell Claimants' shares to Telecom Invest for USD 20 million. Mr. Karibjanov refused. Mr. Uzan then offered to purchase Telecom Invest's shareholding for USD 12 million.

508. There followed further discussions. Claimants wanted to retain 30% of the purchase price on completion and that Telecom Invest obtain a new investment contract. A Stock Purchase Agreement was drafted but, ultimately, Rumeli did not transfer the funds and the agreement lapsed.

509. According to Respondent, the price offer made does not reveal anything. It is just the price that Mr. Uzan offered, which Respondent considered to be a considerable overvalue. In any case, the fact that Telecom Invest was ready to sell its stake for USD 12 million is irrelevant to the issue of its true value.

510. Moreover, Claimants' allegation that the Stock Purchase Agreement would demonstrate that the Investment Committee was under the influence of the local partner, is simply wrong. It is true that the Agreement provided that Telecom Invest had to procure either a new investment contract or to persuade the Investment Committee to overturn its cancellation of the previous Contract. However, this clause was simply a best endeavors clause and Mr. Karibjanov took the view that even if Telecom Invest were not successful

in securing the reinstatement of the Investment Contract, or in obtaining a new one, it would still have obtained USD 10.2 million for its 40% shareholding which he himself considered to be worthless.

511. Respondent finally submits that:

- the ultimate proof of the absence of influence of Telecom Invest on the Investment Committee is the fact that the Investment Contract was never reinstated;
- the Stock Purchase Agreement contained a contractual mechanism in the form of a retention of 15% of the purchase price to deal with the risk that KaR-Tel could have entered into transactions that were not in its interest during the time it was managed by Telecom Invest. Contrary to Claimants' allegation, this risk was not at the origin of the non execution of the Agreement. In reality, Claimants were unable to complete the transactions because external events left them without funds.

6. The actions of the Working Group

512. The next entity criticized by Claimants is the Working Group established by Respondent's Government. According to Respondent, the only evidence adduced by Claimants in relation to the Working Group was a short section of Professor Sergeev's report. The only question asked to Professor Sergeev – whether the Working Group could validate the cancellation of the Investment Contract – was not in issue between the parties, and so is irrelevant. On the other hand, Respondent provided a witness statement from Mr. Imin Sabirov, who as well as being a former Chairman of the Investment Committee, was the Chairman of the Working Group. Mr. Sabirov gave evidence to the Tribunal at the hearing.

513. Claimants were not *de facto* excluded by Respondent from the Working Group investigation. Instead:

- there was no legal obligation for Respondent to establish such a Working Group. It was an informal group before which there was no formal procedure. There was thus no requirement to hear representations from Claimants, nor to involve them in any way. However, the Working Group did offer Claimants the opportunity to participate;
- as evidenced by Mr. Sabirov, the Working Group wanted Claimants to participate as they were the complainants. Claimants were notified of the creation of the Group. On July 1, 2003, Claimants' attorney was informed by telephone of the new start date of the work on July 4, 2003;
- since the Group was to conduct an audit on KaR-Tel, including on its investment obligations, it was logical to hold the meetings of the Working Group at KaR-Tel's offices. In this respect, Respondent points out that, in the light of Mr. Agilönü's evidence that he sought access to KaR-Tel's premises, no credence can be given to the affirmation that those premises were hostile to Claimants;
- at no stage did Claimants display any interest in participating in the Working Group's investigation. There were no letters from Claimants indicating willingness to participate or seeking information on the process.

514. With respect to the criminal proceedings, Respondent disputes Claimants' allegation that they were wholly unfounded and begun at the same time as the Working Group's examination precisely to dissuade Claimants' appointees from participating in the Working Group's work:

- in 2002, Mr. Yerimbetov had discovered that approximately USD 200,000 had been taken from KaR-Tel by its senior management without appropriate paperwork. During the spring of 2003, Mr. Yerimbetov was warned by the tax authorities that if he did not report this as a criminal offence, he could render himself personally liable. After an audit of the relevant transactions, Mr. Yerimbetov and KaR-Tel's chief accountant made a report to the Almaty police on June 24, 2003. Mr. Yerimbetov confirmed that once he had discovered that the money was missing, he had contacted the individuals involved on a

number of occasions and asked them to repay the debt, but they had refused. He was not asked a single question at the hearing, so that his evidence is unchallenged;

- a criminal indictment was issued on July 1, 2003. However, on September 1, 2003, the Almaty police was forced to suspend the proceedings as they had been unable to interview any of the persons indicted, who had fled Kazakhstan;
- Claimants' appointees did not challenge the decision to indict them as it was their right to do so;
- on the contrary, Mr. Ozornek wrote to KaR-Tel, admitting having taken the sums alleged;
- one of the persons indicted is a Kazakh national, which undermines Claimants' suggestion that the criminal charges were brought only against Turkish executives and for an ulterior purpose;
- these indictments were far from being unfounded;
- Respondent's Expert on Criminal Procedure in Kazakhstan confirms that there was nothing unusual from a procedural point of view. Claimants did not adduce any expert on this issue and Respondent's expert evidence remained unchallenged;
- Claimants' continued reliance on the fact that Mr. Seysembayev knew of the criminal proceedings is misconceived. The indictment was a document of public record and Mr. Seysembayev was the ultimate beneficial owner of Telecom Invest at the time, and therefore the person to whom Mr. Yerimbetov was answerable. It was therefore perfectly legitimate to make him aware of the complaint filed by Mr. Yerimbetov.

515. According to Respondent, Mr. Agilönü's witness statement, which is the only evidence adduced by Claimants in relation to the criminal investigation says almost nothing. Furthermore, in cross-examination, Mr. Agilönü admitted that:

- none of Claimants' appointees had contested the criminal investigation;

- Mr. Ozornek admitted to having taken the sums alleged and Rumeli offered to offset the sums against its claims against KaR-Tel.

516. In re-examination, Mr. Agilönü alleged for the first time that he had in fact repaid the money it was alleged he took, implicitly accepting that he had taken the sums alleged.

517. Contrary to Claimants' allegation, the Working Group was not in any sense established to review the legality of the Investment Committee's decision to cancel the Investment Contract or to find alternative grounds for its cancellation. After the Government had received Claimants' complaints dated April 2 and 3, 2003, various Ministries suggested that, in the interest of preserving a good relationship with Claimants and to avoid the costs of an arbitration procedure they were threatening to initiate, an attempt should be made to settle the dispute amicably through negotiation. In this perspective, the Working Group was created by the Kazakh Government to provide information to the Government concerning whether or not KaR-Tel had fulfilled its obligations under the Investment Contract. The purpose was therefore not at all improper. This was confirmed by Mr. Sabirov.

518. The Working Group found that, contrary to Claimants' allegations, KaR-Tel had not complied either with its reporting obligations or with its investment obligations, and that, consequently, the Investment Committee was right in cancelling the Investment Contract. According to Respondent, it is crucial for the Tribunal to recognize that Claimants did not challenge in evidence any of the findings of the Working Group.

519. Mr. Sabirov was cross-examined on his views on the legitimacy of the cancellation of the Investment Contract. He confirmed his witness statement and provided further explanation:

- suspension was only the right, not the obligation of the Investment Committee;
- it was normal practice for the Investment Committee to cancel investment contracts unilaterally, without a Court decision, and without suspending first pursuant to article 13 of the Investment Law;

- he was in fact only surprised that the Investment Committee had granted KaR-Tel so long to remedy its breaches;
- the most common grounds for which investment contracts were cancelled under article 13 of the Investment Law were failure to file reports and non-compliance with the working program;
- no member of the Working Group had any idea that KaR-Tel was in any way related to the President's family or the Government.

520. Respondent finally alleges that, even if Claimants were correct about the Working Group process being procedurally or substantively wrongful, they failed to challenge that process, or its findings, in Kazakhstan, even by writing to the Working Group itself to protest its conclusions. Claimants thereby denied the Kazakh system the opportunity to correct the alleged errors on which they now seek to rely.

7. The actions of Respondent's Judiciary

521. According to Respondent, Claimants' position that Respondent's Judiciary grossly misapplied the law is totally unfounded. Respondent adduced expert evidence from Professors Kaudyrov and Klimkin and from Professor Mukhamedshin in relation to the principles of Kazakh law on each issue raised by Claimants.

522. Claimants submitted the testimony of Professor Sergeev, who admitted that he had not published on the areas of investment law, corporate law in Kazakhstan or Kazakh LLP Law, whereas Professors Kaudyrov and Mukhamedshin have a significant experience in those fields. In addition, in the course of his evidence, Professor Sergeev accepted that the issue of whether the notice for the EGMs was in compliance with Kazakh law was open to debate. He also accepted that the opinions of Professors Kaudyrov, Klimkin and Mukhamedshin submitted to the Tribunal, and which support the Almaty City Court's reasoning, were their honest opinions.

523. In this respect, it is Respondent's position that the Courts correctly applied the law by deciding that the April 2002 EGM was valid.

524. Respondent further submits that the delivery of the April 2002 injunction was perfectly legitimate and in accordance with Kazakh law with the consequence that the Court's decision to validate it was correct.

525. Respondent further disputes Claimants' allegation that the Court violated the law with respect to the issue of the harm to the partnership discussed at the EGMs, following the cancellation of the Investment Contract. Claimants indeed allege that the judge ignored the rule of article 34 of the LLP Law that only actual and incurred harm can justify a compulsory redemption, not purely potential harm.

526. According to Respondent, and as confirmed by their Civil Expert Report, there is no requirement in the LLP Law for evidence of "*harm*" or "*damage*" to be presented at the EGM. It cannot therefore be a requirement for a valid resolution of compulsory redemption.

527. Respondent further alleges that Claimants are unable to demonstrate that the Court decision on the compulsory redemption was incorrect. Indeed, the cancellation of the Investment Contract had caused KaR-Tel losses in two ways. First KaR-Tel had to pay back 34,500,000 Tenge, as well as fines and default interest bringing the total amount to be paid to approximately USD 389,000. Second, KaR-Tel lost the benefit of the Investment Contract for the future.

528. Respondent further alleges that Claimants caused KaR-Tel to purchase outdated equipment and mobile telephone handsets at inflated prices and that this also generated damage for KaR-Tel, as evidenced by the Court-appointed forensic merchandising experts. The only complaint that Claimants expressed on this report is that it only established probable prices, not certain prices. According to Respondent, it is notable in relation to the issue of the transactions with Telsim that Mr. Agilönü gave evidence to the Tribunal in which he accepted that he had not conducted any tenders for equipment whilst General Director of KaR-Tel.

529. In this framework, it is also Respondent's contention that the Court rightly rejected the argument put forward by Claimants that they could not be blamed for these transactions since they were entered into with Telsim and not Rumeli, at a time when Telsim was not a shareholder. Indeed, each of the transactions had been made conditional upon Rumeli's approval.

530. Respondent further points out that for its Procedural Law Expert, it is beyond dispute that the multi-million dollars of harm caused to KaR-Tel are to be qualified as significant.

531. Respondent finally disputes Claimants' allegation that the Court violated the law to the extent that the harm caused to KaR-Tel was not attributable to Claimants or could also have been attributed to the local partner. Claimants' position is indeed that they did not owe any obligations to the Investment Committee, such obligations being only owed by KaR-Tel; a member of an LLP is not responsible for the obligations of the LLP by virtue of article 44 of the LLP Law. Respondent disputes this and submits that the Kazakh Courts correctly decided that the obligations of KaR-Tel to make investments under the Investment Contract were directly related to Claimants' obligations to invest under the Foundation Agreement. The Courts held that the reason for the failure to file the reports was that the companies controlling KaR-Tel recognized that KaR-Tel had not complied with its obligations. Thus, the Investment Contract could validly be cancelled for failure to invest.

532. The Courts further found that KaR-Tel's General Manager was at all times a person controlled by Rumeli and Telsim. Therefore, the failure to file the reports was attributable to Claimants. This is confirmed by Respondent's Procedural Expert Report.

533. On the other hand, Telecom Invest being a silent partner, it could not be considered equally responsible for the failure of KaR-Tel to comply with its obligations.

534. With respect to the issue of the reasons to buy out a participant, Respondent submits that their Civil Law Expert dismissed as being without any basis in the LLP Law, Claimants' contention that any allegation of harm or damage caused to the LLP, which was not

explicitly discussed at the EGM at which the resolution was passed, is *ultra vires* and may not be entertained by the Court. Indeed, as the compulsory redemption is a judicial procedure, the proper place to bring and consider evidence of harm or damage caused to the partnership is before the Court.

535. Respondent further contends that the Court's approach to the expert evidence was appropriate. It is correct that Judge Begaliev said that opinions of Professor Suleimenov and the other professors were not accepted, and that "*the indicated individuals do not have the right to interpret the law*." This is conform to Kazakh law, according to which legal opinions are considered as evidence, which judges are entitled to reject.

536. According to Respondent, the only real allegation of denial of justice by Claimants precisely concerns Judge Begaliev who would have been corrupted. The allegation against Judge Begaliev is based only on the evidence of Mr. Agilönü. Respondent makes the following submissions on this issue:

- this is a very serious allegation, which requires the Tribunal to look at the matter very carefully. In addition, Mr. Agilönü is the leading factual witness for Claimants. If the Tribunal concludes that he lied to the Tribunal with respect to Judge Begaliev, then this should have an adverse effect on the remainder of his evidence;
- the allegations were raised very late in the proceedings;
- there is not a single contemporary document supporting the allegations. Mr. Agilönü reported back to Claimants' management located in Turkey. It is reasonable to suppose, if his evidence was truthful, that the discussions would have been documented particularly since he says he was following management's instructions;
- had Judge Begaliev done any of the acts complained of, Claimants would have asked for his removal from the case or raised his conduct by way of an appeal from the decision of June 6 , 2003. None of this happened;
- Mr. Agilönü was an unsatisfactory witness. Indeed, his evidence was incredible:

- for the first time he introduced the suggestion that another judge had asked for a bribe but he was not prepared to name him;
- for the first time, once he had admitted he spoke limited Russian at the time, he alleged that all his dealings with Judge Begaliev had been through an interpreter, whom he also refused to name;
- it is inconsistent for Judge Begaliev to have told Mr. Agilönü on one day that he would decide the case in Claimants' favor for money, and the next to have told Mr. Agilönü that he had been ordered by the highest authorities to decide in the other way;
- although his witness statement speaks of Judge Begaliev receiving instructions from the highest authorities, implying the Presidential family, in cross-examination, Mr. Agilönü admitted that he had understood merely that it was someone more senior than Judge Begaliev at Almaty City Court;

- Judge Begaliev gave his evidence in a calm and measured manner;
- Judge Begaliev's evidence was entirely consistent with the expert evidence given on Kazakhstan law. Claimants did not identify a single aspect of Judge Begaliev's judgment that was only explicable on the basis that he was corrupt and rendered a dishonest judgment;
- finally, the pantomime with the non-existent photograph of Judge Begaliev wearing a dark suit and sitting behind a table with sandwiches on it did no more than highlight the hopelessness of Claimants' case and the inappropriate lack of seriousness with which they treat making such grave allegations against a serving judge.

537. Respondent further notes that, in their Memorials, Claimants did not make any direct criticism of the Supreme Court's judgment, though it was to be inferred that they applied the same criticisms to it as those they applied to the judgment of the Almaty City Court.

538. In the course of his evidence before the Tribunal, however, Mr. Agilönü, for the first time in this arbitration, alleged that a Justice of the Supreme Court had also solicited a bribe from him in order to determine the appeal in Claimants' favor. However, Mr. Agilönü refused to give the name of the judge and further details. Therefore, the Tribunal is invited to draw the inference that Mr. Agilönü is not telling the truth on this issue. The nature of the allegation makes it inherently improbable, the circumstances and timing in which it was first raised and the conduct of Claimants' counsel in respect of it only heighten the sense that it is a further lie.

539. Respondent finally alleges that none of the critics made by Claimants against the decision of the Presidium of the Supreme Court has any merit:

- Claimants were notified of the hearing. It is notable that they made no attempt to protest against this alleged further failure of the Kazakh postal service;
- pursuant to article 82 of the Kazakh Civil Code, it was within the Presidium's power to determine the price for the compulsory redemption since there had been no agreement between the parties. Claimants have not adduced any expert evidence on this issue and the expert evidence of Professor Mukhamedshin and Professors Kaudyrov and Klimkin was unchallenged in cross-examination;
- the valuation of the Presidium was correct. It based its valuation decision on several expert reports prepared by a number of different entities, including international audit firms and the independent and Court-appointed Forensic Examination Center of the Ministry of Justice of the Republic. Moreover, the Expert Valuation prepared by Navigant Consulting also confirms the valuation provided to the Kazakh Courts. He demonstrated also that, despite the superficial attraction of Claimants' attempts to draw a comparison between the Presidium's valuation and the price paid by VimpelCom, the two are reconcilable.

540. Respondent finally alleges that, even if the Presidium's decision could be potentially expropriatory, which is denied, it is plain that Claimants received fair compensation for

their shareholdings, such that one of the key requirements for expropriation is not present, or they would not have suffered any loss as a result.

8. The alleged attempts to pay Claimants to go away

541. It is true that in April 2003, Mr. Seysembayev attempted to purchase Claimants' 60% interest in KaR-Tel for USD 12 to 15 million. Claimants refused the offer. However, Claimants misstate the chronological sequence of the events. The offer made by KaR-Tel in the amount of USD 3,000 was not made before but after Mr. Seysembayev. Indeed, KaR-Tel's offer was after the judgment of the Almaty City Court and Claimants failed to appeal to the Supreme Court. KaR-Tel's offer was thus made at a time when Telecom Invest knew that KaR-Tel was insolvent.

542. Respondent further points out that both these offers were made considerably after the sale of Telecom Invest to Mr. Seysembayev. There is therefore no basis for alleging that these offers were in any way made by either Respondent or "*members of President Nazarbayev's empire*."

543. According to Respondent, a final link to the President's family, and supposedly therefore, to Respondent's liability, was the alleged offer by Arlan/Altel in August 2004 to purchase Claimants' shares in KaR-Tel for USD 20 million. Claimants allege that this was made on behalf of Respondent since one of the President's daughters has an interest in Altel and that Kazakhtelecom does too.

544. Respondent disputes that allegation :

- Altel is only partially owned by Kazakhtelecom;
- the documents invoked by Claimants in support of their allegation are irrelevant;
- even if Claimants were correct that an offer was made at the meeting held on August 24, 2004, it is a significant step to further allege that it was in some way made on behalf of Respondent and that it would constitute an admission of a violation of Respondent's obligations under international law.

545. According to Respondent, it was alleged that Mr. Orazbekov had made this offer at a meeting with Mr. Akgün in Kazakhstan. However, Mr. Akgün's evidence before the Tribunal on this issue was riddled with inconsistencies:

- he accepted that there was no mention in the letter from Mr. Umirzhanov, the President of Altel, to Mr. Tasalin, to anything relating to KaR-Tel, only to opportunities for collaboration in the telecommunications sector;
- his explanation of the letter was not credible. Mr. Akgün stated that the first contact had been by telephone. He said" This letter just makes for us possible to visit" but he then accepted that he did not need a visa to travel to Kazakhstan;
- he accepted that his own letter in response equally made no mention of KaR-Tel, though his explanation for it being written in English was that this was company policy;
- in contrast to this, Mr. Akgün then suggested that the memorandum from him to TSDIF was originally in Turkish, not English. No Turkish version of this document has ever been provided by Claimants, unlike in relation to all other Turkish documents in this arbitration, and it is curious that the supposed translation is radically different from all other translations provided by Claimants;
- he accepted that the offer he alleges he received from Mr. Orazbekov was never put into writing;
- Mr. Akgün then alleged for the first time that Mr. Umirzhanov had also made the same offer to purchase Claimants' shareholding for USD 20 million. This was not alleged in Claimants' Memorials or in Mr. Akgün's witness statement.

546. On the contrary, Mr. Orazbekov gave evidence to the Tribunal that he had been asked to have a meeting with some Turkish people to discuss investment opportunities, but that they had not wanted to discuss this at all and had instead just complained of the problems they were having in Kazakhstan. He was also clear that he did not have the authority to commit Arlan to pay USD 20 million on any contract.

547. According to Respondent, the Arbitral Tribunal should accept Mr. Orazbekov's evidence as being inherently more credible than Mr. Akgün's inconsistent and shifting account. The Tribunal is also invited by Respondent to find that Claimants have not established how any such offer, even if made, could possibly be attributable to Respondent as a matter of international law.

9. The sale of KaR-Tel to VimpelCom

548. According to Respondent, Claimants' attempt to contrast the figure paid by VimpelCom with the valuation of the Presidium is not proper for the following reasons:

- no account can be taken of what a private company wishes to pay to acquire an asset in an open tender process;
- VimpelCom was bidding in an open tender for a business that might well have a significant specific value for VimpelCom, but which could not be realized by any other entity;
- the Presidium's valuation was for 60% of KaR-Tel in April 2002. VimpelCom's bid was for 100% of KaR-Tel in late August 2004;
- VimpelCom bid for a completely different entity than the insolvent KaR-Tel of April 2002. Indeed, KaR-Tel had been operated and restructured by Mr. Yerimbetov.

549. According to Respondent, thanks to the efforts of Mr. Yerimbetov:

- KaR-Tel overall debt had been reduced by over USD 101 million, whilst at the same time significant investments had been made in new technology;
- the network had been expanded considerably;
- KaR-Tel had over 600,000 real subscribers, as opposed to 150,000 alleged subscribers;
- KaR-Tel had a market share in Kazakhstan of 31%, compared to less than 20% in 2002;
- KaR-Tel had a fast growing and very successful prepay product;

- KaR-Tel had a modern billing platform.

550. With respect to KaR-Tel's debt, Respondent alleges that Mr. Yerimbetov was able to negotiate very hard with Motorola and to obtain a restructuring deal whereby the Loan would be discounted to USD 35 million because:

    - he could demonstrate to Motorola that the Uzans had nothing to do any more with KaR-Tel;
    - he had realized that the 3-year limitation period for bringing a claim would expire; and
    - he had seen that Motorola had already written off from its accounts the debt owed by KaR-Tel.

551. Mr. Yerimbetov further persuaded KazKommertz Bank to lend KaR-Tel the USD 35 million required to repay Motorola.

552. Respondent finally points out that KaR-Tel filed a claim for the losses suffered as a result of Claimants' actions related to the un-commercial transactions with Telsim. On 6 July 2004, the Almaty City Court awarded KaR-Tel damages of USD 41.8 million. Claimants did not appeal the judgment but have so far failed to pay any part of the sum. However, this enabled Mr. Yerimbetov to set-off the alleged debts towards Rumeli and Telsim.

10. The conspiracy theory

553. According to Respondent, the first element of Claimants' case was a conspiracy to expropriate their investments in Kazakhstan. However, this conspiracy case was, and remains, a fiction.

554. In this respect, Respondent points out that it presented a number of witnesses who, on Claimants' case, either knew of the purported conspiracy or even participated in it. It was pointed out in Respondent's opening submissions and twice subsequently, that fairness required that the conspiracy case be put to any witness who, it was said, was involved in the alleged wrongful acts. However, Claimants studiously declined to put

their allegations, or the facts underlying those allegations to Respondent's witness. The reason for this failure is clear: there is no discernible factual basis for any of the allegations made by Claimants.

555. According to Respondent, faced with the prospect that their case was lost, Claimants resorted to bizarre tactics:

- they concocted a dishonesty case against a serving judge, Jugde Begaliev, without any ground;
- they alleged that Respondent had taken steps to prevent Claimants from obtaining legal advice on Kazakhstan law, whereas the truth was that Claimants were unable to find anyone who was prepared to support their case;
- they alleged that Professor Didenko had been forced to write his academic article "*contradicting in violation of the most fundamental rules of ethics, his own position in the previous litigation against the local partner in Kazakhstan*," whereas this article is a balanced opinion in which Professor Didenko alters some, but by no means all, of his views. He still stands by certain of his criticisms of the approach taken by the Almaty City Court. Moreover, his article was published in 2003, over two years before these arbitral proceedings were commenced;
- they allege that Respondent was seeking to "intimidate" Claimants by copying correspondence to someone in Salans' offices in Kazakhstan: again this was a groundless allegation.

556. With respect to Claimants' allegation that an adverse inference should be drawn by the fact that Respondent did not call Mr. Kulibayev, Respondent points out that there is nothing in this point:

- no prima facie case has been disclosed which requires a response from Mr. Kulibayev;
- Respondent does not have the power to compel Mr. Kulibayev; he holds no position in the Republic of Kazakhstan Government;

- Respondent did call as witnesses a number of persons who had contact with Mr. Kulibayev. In particular, they called Mr. Abuov, who was alleged by Claimants to be the "right hand man" of Mr. Kulibayev. He testified that Mr. Kulibayev did not cause the Investment Committee to cancel the Investment Contract.

III. ON THE PURPORTED BREACHES BY RESPONDENT OF ITS OBLIGATIONS

A. The legal framework

1. Claimants' position

557. According to Claimants, their investment is protected by the BIT between Turkey and the Republic, more specifically by virtue of its Articles II and III.

558. Article II provides that:

> *"(1) Each Party shall permit in its territory investments, and activities associated therewith, on a basis no less favorable than that accorded in similar situations to investments of investors of any third country, within the framework of its laws and regulations.*
>
> *(2) Each Party shall accord to these investments, once established, treatment no less favorable than that accorded in similar situations to investments of its investors ('National Treatment clause') or to investments of investors of any third country, whichever is the most favorable ('MFN clause')."*

559. Article III provides that:

> *"(1) Investments shall not be expropriated, nationalized or subject directly or indirectly, to measures of similar effect except for a public purpose, in a non-discriminatory manner, upon payment of prompt, adequate and effective compensation, and in accordance with due process of law and the general principles of treatment provided for in Article II of this Agreement.*
>
> *(2) Compensation shall be equivalent to the real value of the expropriated investment before the expropriatory action was taken or became known. Compensation shall be paid without delay and be freely transferable."*

560. According to Claimants, in view of the MFN clause contained in the BIT, Respondent's international obligations assumed in other bilateral treaties are applicable to the instant case. Such obligations include:

- the obligation to ensure the fair and equitable treatment of the investments of investors of the other Contracting Party;
- the obligation to accord full protection and security to such investments;
- the obligation not to impair by unreasonable, arbitrary, or discriminatory measures the management, maintenance, use, enjoyment, or disposal of such investments.

561. Claimants also consider that their investment is protected by the FIL, and more specifically its Articles 7 and 9.

562. Article 7 provides that:

> *"1. Foreign investments may not be nationalized, expropriated or subjected to any measures which have the same consequences as nationalization and expropriation (henceforth, expropriation), except for the cases where such expropriation is carried out for public interests in compliance with the appropriate legal procedures and carried out without discrimination with the payment of immediate, adequate and efficient compensation.*
>
> *2. The compensation must be equal to the fair market value of the expropriated investments at the moment when the investor learnt of the expropriation."*

563. Article 9(2) provides that:

> *"[l]osses inflicted by any illegal suspension, restriction or termination of the business activities of a foreign investor by the actions of the bodies and persons named in Article 8 of this Law, shall be compensated to the foreign investor." The persons named in article 8 include, inter alia, state executive bodies, law enforcement bodies, and state officials at any level.*

564. Finally, according to Claimants, Respondent is also obliged to act in accordance with "*such rules of international law as may be applicable*," which includes customary international law.

565. Given the foregoing, it is Claimants' position that the acts and omissions of Respondent, individually and collectively, constitute breaches of its obligations:

- to afford fair and equitable treatment;
- not to deny justice;
- to ensure full protection and security;
- not to impose unreasonable, arbitrary and/or discriminatory measures;
- not to expropriate absent certain specific conditions.

2. Respondent's position

566. Respondent submits that pursuant to Article 42(1) of the ICSID Convention, the law applicable to this arbitration is Kazakh law, supplemented by certain principles of international law.

567. Referring to the five international standards invoked by Claimants in their memorial (fair and equitable treatment, denial of justice, full protection and security, no unreasonable, arbitrary or discriminatory measures and expropriation), Respondent submits that there is very little substantive dispute between the parties on the test for each of them, except that these standards are probably less onerous than Claimants suggest.

568. More precisely, Respondent does not dispute that its actions are to be measured against international standards and broadly accepts the applicability of the particular standards set out by Claimants. Rather, it is Respondent's case that, when applied to the real facts, none of the above legal grounds for complaint is even close to being made out.

569. Respondent accepts that it owed Claimants a duty to accord them fair and equitable treatment with respect to their investments and a duty not to unlawfully expropriate such investments. It denies that it breached either of those duties.

570. Respondent considers that, on a proper interpretation, the duty to accord fair and equitable treatment includes the other duties set out by Claimants. According to Respondent, in dividing the various duties, Claimants have unreasonably sought to create the impression that Respondent owed Claimants substantially greater duties than did it in fact. Therefore, Respondent does not accept that each such duty is a separate obligation.

571. Respondent further accepts that under customary international law, Claimants were entitled to the minimum customary standard, and that this includes the denial of justice. However, according to Respondent, the obligations stated by Claimants exceed that minimum international standard.

572. Respondent also accepts that the Turkey-Kazakhstan BIT imposes certain obligations upon it and that the provisions this case is concerned with are Articles II and III. It also accepts that, under the MFN clause, it was obliged to treat Claimants in accordance with any more favourable treatment afforded to nationals of other countries.

573. However, for Claimants to be afforded that treatment, they had to meet the conditions required of those other nationals. In this respect, Respondent alleges that Claimants have not identified the specific BITs upon which they rely to found their claims to the various obligations. The BITs to which Kazakhstan is not a party are not relevant.

574. Finally, each of the obligations asserted by Claimants must be interpreted by reference to the specific terms, context and aims of each individual BIT. To interpret the obligations claimed by Claimants that are not in the Turkey-Kazakhstan itself, Respondent will refer only to the United Kingdom-Kazakhstan BIT. This contains all of the obligations Claimants allege they were owed and Respondent accepts that, were Claimants United Kingdom companies, the standards of that treaty would be applicable to them.

3. The applicable standards: Decision of the Arbitral Tribunal

575. The parties agree that in view of the MFN clause contained in the BIT, Respondent's international obligations assumed in other bilateral treaties, and in particular the United Kingdom-Kazakhstan BIT, are applicable to this case, such obligations including:

- the obligation to ensure the fair and equitable treatment of the investments of investors of the other Contracting Party;
- the duty not to deny justice;
- the obligation to accord full protection and security to such investments; and
- the obligation not to impair by unreasonable, arbitrary, or discriminatory measures the management, maintenance, use, enjoyment, or disposal of such investments.

The parties also agree to a large extent on the test applicable for each of these obligations, as we will see below.

576. Whether a breach of one of the above standards can be attributed to the State will be determined on the basis of the principles laid down in the ILC Articles. According to Article 2 of the ILC Articles:

> *"there is an internationally wrongful act of a State when conduct consisting of an action or omission : a) is attributable to the State under international law; and b) constitutes a breach of an international obligation of that State."*

577. According to Article 4:

> *"1. The conduct of any State organ shall be considered an act of that State under international law, whether the organ exercises legislative, executive, judicial or any other functions, whatever position it holds in the organization of the State, and whatever its character as an organ of the central government or of a territorial unit of the State.*
>
> *2. An organ includes any person or entity which has that status in accordance with the internal law of the State."*

578. Article 5 further provides that:

> *"[t]he conduct of a person or entity which is not an organ of the State under Article 4 but which is empowered by the law of that State to exercise elements of the governmental authority shall be considered an act of the State under international law, provided the person or entity is acting in that capacity in the particular instance."*

579. According to Article 12:

> *"[t]here is a breach of an international obligation by a State when an act of that State is not in conformity with what is required of it by that obligation, regardless of its origin or character."*

580. Finally, according to Article 13:

> *"[a]n act of State does not constitute a breach of an international obligation unless the State is bound by the obligation in question at the time the act occurs."*

B. Fair and equitable treatment

1. Claimants' position

a) The Standard

581. According to Claimants, Respondent's obligation to afford "*fair and equitable treatment*" is imposed not only by customary international law but also by virtue of the MFN clause of the BIT.

582. The standard can indeed have two meanings. It can be given its plain meaning, i.e., fairness and equity of treatment as these terms are generally understood in non-technical terms. Accordingly, tribunals would determine whether "*in all the circumstances [of the case] the conduct in issue is fair and equitable or unfair and inequitable*."[31] Alternatively, this standard can mean that beneficiaries are assured treatment commensurate to the international minimum standard for investors.

583. The standard is intentionally vague in order to give arbitrators the possibility to articulate the range of principles to achieve the treaty's purpose in particular disputes. As it emerges from the arbitral case law, the principle encompasses, *inter alia*, the following concrete principles:

- the State must act in a transparent manner (Metalclad, Tecmed);
- the State is obliged to act in good faith (Tecmed, Waste Management);

---

[31] F.A. Mann, *British Treaties for the Promotion and Protection of Investment*, 52 British Y.B. Int'l L, 1981, pp. 241, 244 [hereinafter F.A. Mann, *British Treaties*].

- State conduct cannot be arbitrary, grossly unfair, unjust, idiosyncratic, discriminatory, or lacking in due process (Waste Management);
- the State must respect procedural propriety and due process (Amco, Azinian, Fabiani, Brown).

584. Fair and equitable treatment thus requires that the State act in a transparent manner, namely that there is no ambiguity in the legal framework relating to the investor's operations and that the decision affecting the latter be traceable to that legal framework.

585. As confirmed by *Metalclad*,[32] transparency requires that the investor be informed about the laws and administrative or other binding decisions before they are imposed. In the same vein, the tribunal in *Tecmed*[33] stated that the fair and equitable treatment provision requires that the investor's basic expectations should not be affected by a State's conduct, which must be consistent, free from ambiguity, and completely transparent in its relation to the foreign investor. According to the tribunal in *Tecmed*, the foreign investor "*also expects the host State to act consistently, i.e. without arbitrarily revoking any preexisting decisions or permits issued by the State that were relied upon by the investor to assume its commitments as well as to plan and launch its commercial and business activities*."[34]

586. According to Claimants, arbitral tribunals – including *Tecmed* and *Waste Management* – also have confirmed that good faith is inherent in fair and equitable treatment.

587. Taking together the arbitral jurisprudence, Claimants allege that the *Waste Management*[35] tribunal best summarized the standard requiring that a State act in a manner affording fair and equitable treatment to foreign investment:

---

[32] *Metalclad Corporation v. United Mexican States* (ICSID Case No. ARB (AF)/97/1), Award of August 30, 2000 [hereinafter *Metalclad*].

[33] *Técnicas Medioambientales Tecmed S.A. v. United Mexican States* (ICSID Case No. ARB(AF)/00/2), Award of May 29, 2003, para. 154 [hereinafter *Tecmed*].

[34] *Id*., para. 154.

[35] *Waste Management, Inc. v. United Mexican States* (ICSID Case No. ARB(AF)/00/3), Award of April 30, 2004, para. 98 [hereinafter *Waste Management v. Mexico*].

"[the] minimum standard of treatment of fair and equitable treatment is infringed by conduct attributable to the State and harmful to the claimant if the conduct is arbitrary, grossly unfair, unjust or idiosyncratic, is discriminatory and exposes the claimant to sectional or racial prejudice, or involves a lack of due process leading to an outcome which offends judicial propriety – as might be the case with a manifest failure of natural justice in judicial proceedings or a complete lack of transparency and candor in an administrative process. In applying this standard it is relevant that the treatment is in breach of representations made by the host State which were reasonably relied on by the Claimant."

b) Application to the facts of the case

588. According to Claimants, the facts of the case clearly demonstrate that Respondent has not treated Claimants' investment fairly or equitably:

- the Investment Committee did not even wait until its own extended deadline for the filing of the reports before terminating the Investment Contract on March 25, 2002;
- the Investment Contract was terminated despite the fact that Claimants submitted the requested reports on March 25, 2002;
- the Investment Committee had the obligation to first suspend the Investment Contract;
- the Investment Committee terminated the Investment Contract with the utmost lack of good faith and in clear violation of the international obligations of Respondent contained in the Bilateral Investment Treaty. The termination was unreasonable, arbitrary, grossly unfair, unjust, idiosyncratic and violated the legitimate expectation of Claimants.

589. According to Claimants, the above undisputable breaches of the Bilateral Investment Treaty are alone sufficient to justify a ruling against Respondent, irrespective of the subsequent breaches committed by Respondent and irrespective of the collusion between Respondent and powerful local partner.

590. Claimants further point out the following breaches of the Bilateral Investment Treaty by Respondent:

- the process that led to the termination of the Investment Contract and to the decision of the Working Group was anything but transparent;
- Claimants were not granted an opportunity to present their position either before the Investment Committee or the Working Group;
- Respondent's Courts and enforcement authorities ousted Claimants from KaR-Tel prior to a determination of the merits of the dispute;
- Respondent's Courts favored the local partner by confirming the appointment of the new General Manager;
- the decision ordering the compulsory sale of Claimants' shareholding for USD 3,000 is particularly outrageous;
- Respondent initiated criminal proceedings in total bad faith;
- Respondent recognized that it had treated Claimants unfairly and inequitably when it offered Claimants, through a controlled entity, USD 20 million to acquire its interest in KaR-Tel.

2. Respondent's position

a) The standard

591. Respondent accepts that the duty of fair and equitable treatment was owed to Claimants under the most favored nation clause of the Turkey-Kazakhstan BIT in conjunction with the UK-Kazakhstan BIT. The substance of that obligation, however, is different from that stated by Claimants.

592. Respondent accepts that in accordance with this principle, it was required to act in good faith and in a transparent manner, and that its conduct could not be arbitrary, grossly unfair, unjust, idiosyncratic, discriminatory or lacking in due process. However, Respondent does not accept Claimants' standard, which is too high. For Respondent, the fair and equitable treatment standard is a minimal one and moreover, for a breach of the standard to occur, Respondent's conduct should have fallen below that minimal standard in a manner that "*shocks, or at least surprises, a sense of juridical propriety*" (*ELSI*).

593. In this respect, Respondent alleges that the interpretation must follow the standard rules. Awards based on NAFTA are in principle inapplicable since not only is the wording of Article 1105 NAFTA different to Article II of the UK-Kazakhstan BIT but moreover, as Schreuer stated, it does not follow that the result reached in the NAFTA context should also necessarily be applied to other treaties, notably to BIT's because of the special features of Article 1105(1). Respondent will therefore rely upon elements of awards under NAFTA only insofar as they are also applicable to the relevant BIT.

594. Respondent further alleges that to determine the extent of the fair and equitable treatment obligation in this case, it is necessary to construe the specific part of Article II(2) of the UK-Kazakhstan BIT. This should be done in accordance with the accepted rules of treaty interpretation, as applied in the *Saluka* decision.

595. As stated in *Saluka*, the ordinary meaning of fair and equitable treatment "*can only be defined by terms of almost equal vagueness.*" It includes "*just, even-handed, unbiased, legitimate.*"[36]

596. Moreover, its context in an international legal instrument must indicate that it refers to international standards. In order for the standard to be breached, the investor must therefore have been "*treated in such an unjust or arbitrary manner that [it] rises to the level that is unacceptable from the international perspective" (S.D. Meyers*[37]). Its context in an international legal instrument also indicates that it should not, without express indication, overrule fundamental principles of international law. Any determination of breach of the provision "*must be made in the light of the high measure of deference that international law generally extends to the right of domestic authorities to regulate matters within their own borders*."[38]

---

36 *Saluka v. Czech Republic,* Partial Award of March 17, 2006, paras. 296 to 309.

37 *S.D. Myers v. Canada* (UNCITRAL), First Partial Award of November 13, 2000, para. 263 [hereinafter *S.D. Myers v. Canada*].

38 *Id.,* para. 263.

597. The context of the fair and equitable treatment provision does not, therefore, raise the obligation upon Respondent beyond the international minimum standard of protection.

598. As in *Saluka*, one of the principal aims of BITs is to encourage international investment. There is therefore a need for a balanced approach: if the protection of the foreign investors were exaggerated, the host State might be dissuaded from admitting all foreign investors.

599. Furthermore, the stated goals of the UK-Kazakhstan BIT are not to ensure extending and intensifying economic relations like in *Saluka*. Its object and purpose is therefore relevant only to the extent that Respondent is required to do no more than that which does not deter foreign capital by providing disincentives to investment. It therefore only sets a floor of minimum treatment that must be accorded to foreign investors, regardless of the treatment accorded to nationals.

600. Respondent also alleges that a fair and equitable treatment standard that does no more than not to deter foreign investment is related to the expectations of the investors. For Respondent to be bound to respect those expectations, they must be legitimate and reasonable in the light of the circumstances. They should be limited to a base level and should not in any case include an expectation to be able to act contrary to public interest.

601. According to Respondent, the reasonable and legitimate expectations of an investor, determined in accordance with the above interpretation, would always include that the State "*implements its policies bona fide by conduct that is, as far as it affects the investors' investment, reasonably justifiable by public policies and that such conduct does not manifestly violate requirements of consistency, transparency, even-handedness and non-discrimination. In particular, any differential treatment of a foreign investor must not be based on unreasonable distinctions and demands, and must be justified by*

showing that it bears reasonable relationship to rational policies not motivated by a preference for other investments over the foreign-owned investment."[39]

602. They will also include that the State will not commit the delict of denial of justice by disregarding the principles of procedural propriety and due process. The State must not, therefore, act in an arbitrary or discriminatory manner. In this respect, Respondent submits that it accepts the definitions of arbitrary, unreasonable and discriminatory conduct as set out in the authorities cited by Claimants.

603. Respondent concludes that in accordance with the above, in order to succeed that Respondent breached its obligations of fair and equitable treatment, Claimants must demonstrate that its actions were "*evidently arbitrary, unjust or idiosyncratic"* or prove that they were directly or indirectly discriminated against on the grounds of their nationality. The burden of proof is on Claimants and is a high one.

604. In this context, the Tribunal should not engage in a complex review of the decisions of the State's Courts. The conduct and decisions of Respondent's Courts should only be held to fall below the minimum standard if their conduct amounted to a denial of justice.

605. Finally, Respondent alleges that:

- the various requirements of the standard are closely interrelated. For example, if the State acts in good faith and in a non-discriminatory manner, without any procedural impropriety, it follows that it is exceptionally unlikely to have acted arbitrarily;
- if the actions of the State complained of were justified, and proportionate to that justification, it cannot have acted in an unfair and inequitable manner. The only exception would be if the justification was in fact a sham.

[39] *Saluka v. Czech Republic,* Partial Award of March 17, 2006, para. 307.

b) Application to the facts of the case

606. According to Respondent, when viewed against the facts of the case, it is clear that the Republic has not in any way breached its obligations under the fair and equitable treatment principle.

607. Claimants' allegation that the Kazakhstan Supreme Court exceeded its jurisdiction and thereby breached international law is denied by Respondent. Moreover, even if there had been a misapplication of Kazakh law by the Kazakh Courts, that would not automatically rise to the level of an international wrong.

608. With respect to the criminal proceedings, Respondent alleges that they were not initiated by the Republic, that they were justified, they were not arbitrary and that in any case, they have not prevented Claimants from pursuing their rights.

3. Decision of the Arbitral Tribunal

a) The Standard

609. The parties rightly agree that the fair and equitable treatment standard encompasses *inter alia* the following concrete principles:

- the State must act in a transparent manner;
- the State is obliged to act in good faith;
- the State's conduct cannot be arbitrary, grossly unfair, unjust, idiosyncratic, discriminatory, or lacking in due process;
- the State must respect procedural propriety and due process.

The case law also confirms that to comply with the standard, the State must respect the investor's reasonable and legitimate expectations.

610. The concept "fair and equitable treatment" is not precisely defined. *"It offers a general point of departure in formulating an argument that the foreign investor has not been well treated by reason of discriminatory or other unfair measures being taken against its interest. It is therefore a concept that depends on the interpretation of specific facts for*

its content."[40] The precise scope of the standard is therefore left to the determination of the Tribunal which "*will have to decide whether in all the circumstances the conduct in issue is fair and equitable or unfair and inequitable*."[41]

611. The only aspect on which the parties differ is that for Respondent, the concept does not raise the obligation upon Respondent beyond the international minimum standard of protection. The Arbitral Tribunal considers that this precision is more theoretical than real. It shares the view of several ICSID tribunals that the treaty standard of fair and equitable treatment is not materially different from the minimum standard of treatment in customary international law.[42]

b) Application to the facts of the case

612. Claimants complain that the Investment Committee did not even wait until its own extended deadline for the filing of the reports before terminating the Investment Contract on March 25, 2002. The initial deadline of one month mentioned in the Committee's letter of February 21, 2002 was indeed extended until March 23, 2002, as was confirmed by Mr. Zverkov during his testimony. Claimants point out that March 23 was a Saturday and that since the 22nd of March was Noruz, a public holiday in Kazakhstan, the Investment Committee was certainly closed on the 23rd; and in any case, since the 23rd was a Saturday, the extension extended automatically until Monday, March 25, 2002, the first following working day. The record confirms that the reports on the implementation of the investment project for the third and fourth quarters of 2001 were faxed by Claimants on the 25th of March and subsequently delivered to the Committee on March 27.

---

[40] Peter Muchlinski, *Multinational enterprises and the law*, 1995, p. 625 [hereinafter *Muchlinski*].

[41] F.A. Mann, *British Treaties*, pp. 241-244.

[42] *Azurix Corp. v. Argentine Republic* (ICSID Case No. ARB/01/12), Award of July 14, 2006, para. 361 [hereinafter *Azurix*]; and *CMS Gas Transmission Company v. Argentine Republic* (ICSID Case No. ARB/01/8), Award of May 12, 2005, para. 284 [hereinafter *CMS*].

613. The Arbitral Tribunal notes however that even if Claimants are right that the deadline for the delivery of the reports was March 25, it remains that the filing by Claimants was only partial in that it only concerned the report for the third and fourth quarters of 2001. Claimants did not therefore comply with the requirement of the Investment Committee.

614. On the other hand, in accordance with Article 19.3 of the Investment Contract, the Investment Committee had the right to terminate the Contract in case of "*[r]efusal of the Investor to cure the reasons which have caused the decision on suspension of the Contract, or a failure to cure these reasons during the term established by Agency*." This presupposes that there had been a suspension of the Contract in accordance with the terms of Article 19.2 and the reasons for such suspension were notified.

615. The Arbitral Tribunal considers that in deciding to terminate the Contract without prior suspension, the Republic breached the Investment Contract. This was admitted by the Republic in two letters sent to the Ministry of Industry and Trade on May 14, 2003 by officials of the Ministry of Finance and the Ministry of Economy and Budget planning. Since the Investment Committee is an organ of the State, and in the particular circumstances of this case discussed above, this breach amounts to a breach of the BIT by the Republic. The decision was arbitrary, unfair, unjust, lacked in due process and did not respect the investor's reasonable and legitimate expectations.

616. Respondent's attempt to justify its failure to suspend the Contract by relying on Article 13 of the Investment Support Law is unconvincing. Although the Law grants the Investment Committee the right to terminate a Contract without first suspending the same, this provision can be supplemented by the express terms of each individual contract. Moreover, it is a general principle of international law that a State cannot rely on its internal law to invalidate its own undertakings.

617. The Arbitral Tribunal is also of the opinion that the process that led to the decision of the Working Group appointed by the Ministry of Industry and Trade on June 9, 2003 lacked transparency and due process. The Working Group was appointed in relation to the

termination of the Investment Contract, to perform the verification of the fulfillment by Kar-Tel of the terms and conditions of the Contract, including investment obligations, "*for the purpose of settlement of this issue prior to the arbitration*." The Working Group issued a three and a half pages decision, summarily reasoned, and concluded that the Contract was lawfully terminated and that there were no grounds for its restauration. The Working Group founded its decision of validation not only on Kar-Tel's non-compliance with its reporting obligations but also on various entirely different grounds than those forming the basis for the initial decision. The decision was made without Claimants having a real possibility to present their position. They were only verbally invited to a meeting just two days before the meeting of the Working Group. The meeting was to take place at Kar-Tel's offices which were under the control of Telecom Invest and from which Claimants had been previously ousted. Moreover, Claimants had been informed that criminal proceedings against Claimants' executives had been initiated on July 1, 2003, the very same day that the invitation had been extended.

618. The Arbitral Tribunal therefore considers that the process that led to the decision of the Working Group lacked transparency and due process and was unfair, in contradiction with the requirements of the fair and equitable treatment principle. Since the Working Group acted as an organ of the State, the violation amounts to a breach of the BIT by the Republic.

619. On the other hand, the Arbitral Tribunal considers that it does not have any clear evidence that the decisions of the various Kazakh Courts which have been reviewed above were wrong procedurally or substantially, or were so egregiously wrong as to be inexplicable other than by a denial of justice. As was evidenced by the legal experts who testified during the hearing, the issues that the Courts had to decide were sometimes highly disputed issues. The Tribunal has also noted that when the decisions were appealed, they were carefully reviewed by the appellate courts and sometimes partially reversed by them.

C. Denial of justice

1. Claimants' position

a) The standard

620. According to Claimants, the duty not to deny justice arises from customary international law and is a subset of the international minimum standard of treatment, *i.e.* the standard below which a nation could not fall without violating international law. It can also be considered to fall within the scope of treaty provisions providing for "*fair and equitable treatment.*"

621. It is Claimants' position that although denial of justice is "*always procedural*," it encompasses instances of politically-dictated judgments, corruption, and intimidation. Moreover, it includes cases where "*the proof of the failed process is that the substance of a decision is so egregiously wrong that no honest or competent court could possibly have given it.*"[43]

622. Tribunals have identified four types of factual circumstances where a State's conduct amounted or could amount to a denial of justice.

623. First, Courts are not the only State organs the conduct of which can amount to a denial of justice. Administrative organs can also engage the State's international responsibility by denying justice. This was confirmed in the *Amco I*[44] decision where the tribunal found that "*the mere lack of due process would have been an insuperable obstacle to the lawfulness of the revocation.*" The *Amco II* tribunal also found that "*the whole approach to the issue of revocation of the license was tainted by bad faith, reflected in events and procedures*"[45] and that therefore, even if substantive grounds existed for the revocation of the licence, the circumstances surrounding the decision made it unlawful.[46] It pointed out

---

[43] Citing Don Wallace Jr., *Fair and Equitable Treatment and Denial of Justice*, International Investment Law and Arbitration, 2005, pp. 669, 672 [hereinafter Wallace, *Fair and Equitable Treatment*].

[44] *Amco I v. Indonesia*, Award of November 20, 1984, para. 242.

[45] *Amco II v. Indonesia*, Award in the Resubmitted Case of June 5, 1990, para. 98.

[46] *Id.,* para. 99.

that there is "*no provision of international law that makes impossible a denial of justice by an administrative body.*"[47]

624. Second, as the *Azinian* tribunal stated, a denial of justice can be pleaded "*if the relevant courts refuse to entertain a suit, if they subject it to undue delay, or if they administer justice in a seriously inadequate way*"or if there is a "*clear and malicious misapplication of the law.*"[48] The latter form of denial of justice likely overlaps with the notion of "*pretense of form*" to mask an international law violation or cloak the pursuit of hidden wrongful objectives.

625. Third, tribunals have found that collusion between the State judicial authorities, and the local party-in-interest can amount to a denial of justice. In *France v. Venezuela*,[49] Mr. Fabiani was unable to enforce an arbitral award in Venezuela due to a number of judicial and political obstacles resulting from collusion between a private citizen and governmental authorities. The tribunal found that the government of Venezuela was under an obligation to "*ensure the administration of justice*" and adopted the view that a State is "*liable for the denial of justice committed by the judiciary, at least when, duly informed of the denial, the state has not undertaken any action to prevent its effect.*"

626. Fourth, tribunals have also found that collusion among branches of government can result in a denial of justice. Specifically, in *U.S. v. Great Britain*,[50] the tribunal concluded that "*[a]ll three branches of the Government conspired to ruin [an] enterprise*"; that based on the whole case, the cumulative steps taken by the State amounted to a denial of justice.

---

47 *Id.,* para. 137.

48 *Robert Azinian and others v. United Mexican States* (ICSID Case No. ARB(AF)/97/2), Award of November 1, 1999, paras.102-103 [hereinafter *Azinian*].

49 *France v. Venezuela* (Antoine Fabiani case No. 1), Award of 1898, V Moore's International Arbitrations, p. 4878 [hereinafter *Fabiani*].

50 *U.S. v. Great Britain* (*Robert E. Brown* case), Award of November 23, 1923, VI Reports of International Arbitral Awards (United Nations), p. 120 [hereinafter *Robert E. Brown*].

b) Application to the facts of the case

627. According to Claimants, the following elements constitute a denial of justice:

- the Investment Committee did not even wait until its own extended deadline for the filing of the reports before terminating the Investment Contract on March 25, 2002;
- the Investment Contract was terminated despite the fact that Claimants submitted the required reports on March 25, 2002;
- the Investment Committee had the obligation to first suspend the Investment Contract;
- the Investment Committee terminated the Investment Contract with the utmost lack of good faith and in clear violation of the international obligations of Respondent contained in the Bilateral Investment Treaty. The termination was unreasonable, arbitrary, grossly unfair, unjust, idiosyncratic and violated the legitimate expectation of Claimants.

628. According to Claimants, the above undisputable breaches of the Bilateral Investment Treaty are alone sufficient to justify a ruling against Respondent, irrespective of the subsequent breaches committed by Respondent and irrespective of the collusion between Respondent and powerful local partner.

629. Claimants further allege that, in the present case, the Investment Committee's termination of the Investment Contract was unlawful and improper for the same reasons as those enumerated by the *Amco* tribunals. Indeed, the Committee unilaterally terminated the Contract abruptly and without warning and in breach of the suspension mechanism. Furthermore, the Working Group confirmed the termination on completely different grounds without an input from Claimants who were *de facto* excluded from the process. Consequently, irrespective of whether there may have been legitimate grounds for the revocation of the Contract – which Claimants deny – the whole approach leading to its termination lacked in due process. Moreover, in light of Respondent's collusion among

its various organs and with the various shareholders of the local partner, Respondent's unlawful termination of the Contract is tainted by bad faith.

630. Claimants also allege that even if Respondent's Courts decisions could be deemed to have been proper procedurally and substantially – which Claimants vigorously deny – such decisions only served to cloak Respondent's violation of international law. The substance of the Courts' decisions is so egregiously wrong as to be inexplicable other than by a denial of justice.

631. Moreover, the real parties in interest behind Claimants' local partner were various Kazakhstan officials and/or members of President Nazarbayev's family and empire. Clearly, Telecom Invest and the Investment Committee were working in tandem so as to put in place the mechanism by which Telecom Invest's parties-in-interest would maximize their financial interest, *i.e.* by forcing out Claimants.

632. Subsequently, Respondent continued to give Telecom Invest and its shareholders the necessary active support to accomplish their objectives. Respondent's Judiciary rubber stamped the improperly-convened general meeting of KaR-Tel shareholders and sanctioned the resolutions adopted thereat, notwithstanding the clear *prima facie* evidence to the contrary. Respondent's police authorities and public prosecutor's office then assisted Telecom Invest in physically ousting Claimants and their executives from KaR-Tel and eventually from Kazakhstan. Finally, by putting a USD 3,000 price tag on Claimants' 60% stake in KaR-Tel, the Kazakhstan Supreme Court assisted Telecom Invest in acquiring 100% of KaR-Tel for a derisory price, which Telecom Invest's shareholders subsequently sold to VimpelCom for the sum of USD 350 million.

633. Finally, Claimants allege that Respondent's various organs acted in concert to achieve the same end (the expropriation of Claimant's investment), in collusion with the shareholders of the local partner. Indeed, Respondent offered Telecom Invest a package of coordinated State actions, from the termination of the Investment Contract to the fixing of the price for the compulsory redemption of Claimants' stake in KaR-Tel. In a nutshell,

the investment committee terminated the Contract unlawfully, which gave Telecom Invest a pretext to adopt illegal shareholder resolutions. In turn, Respondent's Judiciary not only ratified these illegal resolutions but also the Kazakhstan Courts even went a step further by ascribing a value of a mere USD 3,000 to Claimants' multi-million dollar investment, thereby sealing the expropriation. Moreover, Respondent initiated criminal proceedings against Claimants' executives with a view to intimidate them and to force them to flee Kazakhstan and thereby abandon the defense of Claimants' interests.

2. Respondent's position

a) The standard

634. According to Respondent, denial of justice is an element of the overarching fair and equitable treatment standard of the BIT. It does not extend or further the legal basis for Claimants' claims.

635. Contrary to Claimants' allegation, Respondent points out that '*denial of justice*' has only one meaning: it refers to the failure of the administration of justice in a State to meet a certain procedural standard. It is always procedural and the substantive outcome of a proceeding is only of relevance when it demonstrates irregularities in the procedure.

636. Respondent further alleges that the four types of factual circumstances raised by Claimants are no more than examples of attribution of various actions to a State that were in denial of justice. However, for each of the methods of attribution, Claimants must meet a high standard of proof. Simply stating that it is possible that a conspiracy between the State and others can, in certain circumstances, lead to a denial of justice is not probative of that denial.

637. Respondent also alleges that Claimants' claim is based to a large extent upon a substantive denial of justice in the sense that Claimants submit that the outcome of the decisions was unfair. However, there is no concept of substantive denial of justice: "*the mere violation of internal law may never justify an international claim based on denial of*

justice."[51] The substance is only relevant where there have been "*exceptionally outrageous or monstrously grave breaches of municipal law. In such cases, ... it must be shown that "one can no longer explain the sentence rendered by any factual consideration or valid legal reason."*[52]

638. Respondent further alleges that a claim in denial of justice does not relate to a single Court, but to a Court system. It also submits that litigants are required to give the Court system every opportunity to correct a challenged decision before resorting to international tribunals. Therefore, even if Claimants were correct about the cancellation of the Investment Contract, the Working Group process, or the decisions of the Kazakh Courts, their failure to challenge at all or to exhaust the system bars them from succeeding on their claims because they have denied the Kazakh legal system the opportunity to correct the alleged errors on which they now seek to rely.

b) Application to the facts of the case

639. Denial of justice is thus only concerned with procedure. However, Claimants do not allege that they were prevented from access to the Kazakh legal system, nor that the determination of the Kazakh legal system was subject to ruinous delay amounting in effect to an exclusion from its use. Claimants could not allege this, as they have, and for the most part made use of access to all three instances of the Kazakh civil Courts.

640. Instead, what Claimants allege is that the decisions of the Kazakh Courts were wrong as a matter of Kazakh law. However, substantive outcomes are not generally relevant. In any case, it is Respondent's position that Claimants have not even demonstrated that the decisions of the Kazakh Courts misapplied Kazakh law.

641. With respect to the cancellation of the Investment Contract, it was substantially justified on the grounds given as a matter of Kazakh law. But even if Claimants were able to

[51] Charles de Visscher, *Le déni de justice en droit international*, (1935), 54 Recueil des cours 370 at 376.

[52] Jan Paulsson, *Denial of Justice in International Law*, 2005, p. 83.

establish that the termination breached Kazakh law, this would not be sufficient to amount to a denial of justice. Indeed, in order to amount to such a breach, Claimants would have to demonstrate that the Investment Committee's misapplication of Kazakh law was patently arbitrary, unjust or idiosyncratic such that it would demonstrate bad faith, which they have not done.

642. According to Respondent, Claimants must prove a procedural denial of justice and Claimants do not provide this proof. They have not even begun to establish any misapplication of Kazakh law. Their sole evidence in relation to Kazakh law comes from one of the reports submitted in the proceedings in Kazakhstan in 2003, which were all rejected by the Courts. In any case, those reports have no status in this arbitration.

643. Moreover, Professor Didenko, on whose expert report (produced before the Kazakh Courts) Claimants rely, published an article a short time after the end of the Courts' proceedings in which he expressed a different view on a number of matters at issue in this case.

644. Respondent further alleges that:

- Claimants' allegation that the Republic Judiciary was bribed is not particularized;
- with respect to the decision of the Presidium, Respondent disputes that Claimants were not notified of the hearing.

645. Moreover, it is Respondent's position that, even if Claimants would be correct about the cancellation of the Investment Contract, the Working Group process, or decisions of the Kazakh Courts being procedurally or substantively wrong, they failed to challenge those decisions in Kazakhstan, which debars them from bringing a claim for denial of justice.

646. In particular, between the cancellation of the Contract and the registration of this arbitration, Claimants made no serious attempt to challenge the cancellation, with the exception of two letters of protest. These are not sufficient to comply with the preconditions of a claim for denial of justice.

647. Respondent disputes Claimants' allegation that they were prevented from contesting the termination of the Contract by the injunction restricting access to KaR-Tel's premises and documents. This restriction was amended by the Supreme Court. It is not true that Claimants were thereafter *de facto* denied access to the premises or documents. In any case, even if they were, that did not prevent them from challenging the cancellation of the Investment Contract.

648. Likewise, Respondent points out that Claimants never challenged the findings of the Working Group.

649. In the same vein, Respondent submits that with respect to the validation of the deliberation of the April 2002 EGM, Claimants did not appeal their case to the Presidium of the Supreme Court, as was their right. Moreover, several of the contentions now advanced by Claimants were not even put in issue before the Kazakh Courts.

650. According to Respondent, the result of Claimants' failures to pursue their right to challenge the disputed decisions before the appropriate Kazakh authorities and Courts is that Claimants denied the Kazakh system the opportunity to correct any errors that there may have been. Therefore, their claim for denial of justice, and thus for breach of fair and equitable treatment, is inadmissible before this Tribunal and alternatively fails.

3. Decision of the Arbitral Tribunal

a) The Standard

651. The parties agree that the duty not to deny justice arises from customary international law and can also be considered to fall within the scope of treaty provisions provided for "*fair and equitable treatment*."

652. The parties also agree that denial of justice is always procedural. However, for Claimants, it also encompasses instances of politically-dictated judgments, corruption and intimidation and extends to cases where there is a "*clear and malicious*

misapplication of the law."[53] On the other hand, Respondent considers that denial of justice only refers to the failure of the administration of justice in a State to meet a certain procedural standard. The substantive outcome is only of relevance when it demonstrates irregularities in the procedure. In other words, a court decision will be considered a denial of justice if it was patently arbitrary, unjust or idiosyncratic such that it would demonstrate bad faith.

653. The Arbitral Tribunal does not think that there is a major difference in the parties' understanding of the concept. The standard is indeed of a procedural nature. In that sense, a court procedure which does not comply with due process is in breach of the duty. On the other hand, as pointed out by Respondent, the substance of a decision may be relevant in the sense that a breach of the standard can also be found when the decision is so patently arbitrary, unjust or idiosyncratic that it demonstrates bad faith.

b) Application to the facts of the case

654. The Arbitral Tribunal notes that the violations alleged by Claimants and allegedly constituting a denial of justice, have also been invoked by Claimants as constituting a violation of the fair and equitable treatment principle. The Arbitral Tribunal considers that these violations are better qualified and dealt with as issues falling under the fair and equitable treatment standard which also includes in its generality the standard of denial of justice. Reference is therefore made to the Tribunal's decisions at paragraphs 609 to 619, above. Consequently, the alleged violations will not be separately dealt with under the denial of justice standard.

655. The Arbitral Tribunal would like however to add that Claimants' allegation of an attempt at bribery by Judge Begaliev has been contradicted by Respondent and Judge Begaliev himself and is not supported by the record.

656. On the other hand, Respondent's allegation that Claimants have made no serious attempt to challenge the cancellation of the Investment Contract or the decision of the Working

[53] *Azinian*, Award of November 1, 1999, paras. 102-103.

Group, is unfounded as these procedures could only have been initiated by Kar-Tel. Claimants filed appeals of the court decisions each time they could, at the sole exception of the decision relating to the validation of the deliberation of the April 2002 EGM which they could have further appealed to the Presidium of the Supreme Court.

657. Claimants have argued that they were not given notice of the Presidium hearing which took place on October 30, 2003, upon Kar-Tel's appeal of September 15, 2003, to determine the sum to be paid on the compulsory redemption. Respondent challenges that statement and has produced copies of the notice of appeal, apparently also addressed to Claimants, as well as copies of notices allegedly sent by Mr. D. Shamshiev, the Manager, Secretariat of the Presidium, to counsel for Rumeli and Telsim, on October 17, 2003, advising them that a meeting of the supervisory collegium was scheduled for October 30, 2003 in connection with the court orders in the civil case on the claim by Telekom Invest and KaR-Tel against Rumeli and Telsim. No evidence of actual delivery has been submitted to the Tribunal but the Tribunal does not conclude from this that it did not take place. The Arbitral Tribunal notes in this respect that Claimants disputed for the first time in their Reply Memorial (page 52) the fact that they were given notice. There was no mention of this important and obvious point in their first memorial.

D. Full protection and security

1. Claimants' position

a) The standard

658. According to Claimants, a treatment that is not fair and equitable "*automatically entails an absence of full protection and security.*" The obligation to accord full protection and security requires the host State to exercise due diligence in the protection of foreign investments. It imposes an objective standard of vigilance and thus requires the State to afford the degree of protection and security that should be legitimately expected from a reasonably well-organized modern State.

659. According to the United Nations Conference on Trade and Development, the full protection and security standard:

> *"connotes the assurance of full protection and security for foreign investors as contemplated or required by customary international law. At the same time, the clause on full protection and security is unusual in that it contemplates protecting investment against private as well as public action, that is, the clause requires that the host country should exercise reasonable care to protect investment against injury by private parties."*

660. It is inconsequential whether the damage is caused by a member of the State forces or by a private party. In either case, the State has a "*primary obligation"* to exercise due diligence to provide adequate protection. The State's failure to comply with this objective obligation due to the mere lack of diligence is sufficient, without any need to establish malice or negligence.[54]

661. The question was addressed in the *Wena Hotels*[55] arbitration where a dispute arose out of agreements concluded between Wena Hotels and Egyptian Hotels Company ("EHC"), a State-owned Egyptian company. The tribunal found that, although it was unclear whether Egyptian officials directly participated in the seizure of the hotel, Egypt was aware of EHC's intentions in this connection and took no actions to prevent EHC from doing so. Egypt did nothing to protect Wena Hotels' investment after the illegal seizures, made no attempts to return the hotel, refused to compensate the claimant and failed to prosecute the EHC or its senior officials.

b) Application to the facts of the case

662. It is Claimants' allegation that in the present case, Respondent failed to afford Claimants' investment full protection and security. Rather, Respondent colluded with and actively supported Telecom Invest, to the detriment of Claimants. Among other actions:

---

[54] *American Manufacturing & Trading, Inc. v. Republic of Zaire* (ICSID Case No. ARB/93/1), Award of February 21, 1997, 36 ILM 1534, paras. 6.05 – 6.06 and 6.13 [hereinafter *AMT*]; and *Asian Agricultural Products Ltd. v. Republic of Sri Lanka* (ICSID Case No ARB/87/3), Final Award of June 27, 1990, paras. 76-77 [hereinafter *AAP*].

[55] *Wena Hotels Limited v. Arab Republic of Egypt* (ICSID Case No. ARB/98/4), Award of December 8, 2000, para. 84 [hereinafter *Wena*].

- Respondent's Courts ratified Telecom Invest's illegitimate resolutions adopted at an improperly-convened meeting granting its request for injunctive relief;
- the Almaty City Court validated Mr. Yerimbetov's illegitimate appointment as General Manager pending a decision on the merits;
- with the help of the Kuzet security service, Respondent enjoined Claimants from accessing the premises or data of KaR-Tel without Mr. Yerimbetov's permission;
- Claimants were not able to enforce the judgment ruling that Claimants should have access to KaR-Tel documents;
- Respondent instituted criminal proceedings against Claimants' executives as a means of exerting pressure on such individuals.

2. Respondent's position

a) The standard

663. According to Respondent, the full protection and security standard in Article II(2) of the UK-Kazakhstan BIT must be construed in accordance with the accepted rules of treaty interpretation. It is closely related to the fair and equitable standard. Previous tribunals have held that it obliges the State to provide a certain level of protection to foreign investments from physical damage and even not all physical damage. Arbitral tribunals have also held that the full protection and security obligation is one of due diligence and no more. The key criterion is that the State knows of the unlawful act and takes no action to prevent or remedy it, according to the case.

664. In *Lauder v. Czech Republic*,[56] the tribunal stated that it considered this principle to oblige the parties to:

> *"exercise such due diligence in the protection of foreign investment as reasonable under the circumstances. However, the treaty does not oblige the parties to protect foreign investment against any possible loss of value caused by persons whose acts could not be attributed to the State. Such*

[56] *Ronald S. Lauder v. Czech Republic* (UNCITRAL), Final Award of September 3, 2001, paras. 318 et seq. [hereinafter *Lauder*].

protection would amount to strict liability, which cannot be imposed to a State absent any specific provision in the Treaty."

665. The tribunal went on to state that:

> *"the investment treaty created no duty of due diligence on the part of the Czech Republic to intervene in the dispute between the two companies over the nature of their legal relationships. The Respondent's only duty under the treaty was to keep its judicial system available for the Claimant and any entities he controls to bring their claims, and for such claims to be properly examined and decided in accordance with domestic and international law…."*

b) Application to the facts of the case

666. According to Respondent, Claimants have not alleged any physical damage and have not therefore alleged a breach of the obligation of full protection and security. The allegation of favoring one shareholder over another is an allegation of unfair and inequitable treatment; and the allegation that "*in effect, Respondent took KaR-Tel away from Claimants"* is an allegation of expropriation. Claimants therefore have no proper claim that Respondent did not accord their investment full protection and security.

667. With respect to the criminal proceedings, Respondent alleges that they were not initiated by Respondent, that they were justified, that they were not arbitrary and in any case, that they have not prevented Claimants from pursuing their rights.

3. Decision of the Arbitral Tribunal

a) The Standard

668. The Arbitral Tribunal agrees with Respondent that the full protection and security standard in Article II(2) of the UK-Kazakhstan BIT must be construed in accordance with the accepted rules of treaty interpretation. It obliges the State to provide a certain level of protection to foreign investment from physical damage. In *AMT v. Zaire*[57] and in the *Wena* case,[58] ICSID tribunals have recognized that in international law, the full protection

[57] *AMT v. Zaire,* Award of February 21, 1997, 36 ILM p. 1534.

[58] *Wena v. Egypt*, Award of December 8, 2000.

and security obligation is one of "due diligence" and no more. More recently, in *Saluka*,[59] the Tribunal also decided that "*the "full security and protection" clause is not meant to cover just any kind of impairment of an investor's investment, but to protect more specifically the physical integrity of an investment against interference by use of force*."

b) Application to the facts of the case

669. Given the limited scope of the full security and protection standard, the Arbitral Tribunal considers that the violations alleged by Claimants cannot fall under it, except in respect of the allegation that with the help of the Kuzet Security Services, Respondent enjoined Claimants from accessing the premises or data of Kar-Tel without Mr. Yerimbetov's permission. The Tribunal considers however that given the factual circumstances of the case, there was no such violation.

670. Indeed, at the hearing, Respondent's witnesses confirmed that Kuzet Security Services were not acting upon instructions of the State authorities but pursuant to a contract they had concluded with Telecom Invest and therefore, upon instructions of the latter. Moreover, the record does not support Claimants' allegation that police officers were present during the enforcement procedure conducted by a bailiff.

E. <u>Unreasonable, arbitrary, or discriminatory measures</u>

1. Claimants' position

a) The standard

671. According to Claimants, Respondent also violated the BIT by impairing the operation of Claimants' investment by unreasonable, arbitrary, and/or discriminatory measures. The standard of "*reasonableness*" has no different meaning than the "*fair and equitable treatment"* standard with which it is associated. Therefore, it requires that the State's conduct bears a reasonable relationship to some rational policy, whereas the standard of

[59] *Saluka v. Czech Republic,* Partial Award of March 17, 2006, para. 483.

non discriminatory measures requires a rational justification of any differential treatment of a foreign investor.

672. Arbitrariness is a willful disregard of due process of law, an act which shocks, or at least surprises, a sense of judicial propriety.[60] A measure is discriminatory when it provides the foreign investment with a treatment less favorable than the domestic investment or than other foreign investment.

673. According to Claimants, the award rendered in *CME*[61] is highly persuasive for the purpose of this arbitration.

b) Application to the facts of the case

674. According to Claimants, Respondent violated its obligations by unreasonable, arbitrary, and/or discriminatory measures in that:

- the Investment Committee did not even wait until its own extended deadline for the filing of the reports before terminating the Investment Contract on March 25, 2002;
- the Investment Contract was terminated despite the fact that Claimants submitted the required reports on March 25, 2002;
- the Investment Committee had the obligation to first suspend the Investment Contract;
- the Investment Committee terminated the Investment Contract with the utmost lack of good faith and in clear violation of the international obligations of Respondent contained in the Bilateral Investment Treaty. The termination was unreasonable, arbitrary, grossly unfair, unjust, idiosyncratic and violated the legitimate expectation of Claimants.

---

60 *Elettronica Sicula S.p.A. (ELSI) (United States of America v. Italy)*, Judgment of July 20, 1989, 1989 ICJ Reports 15, para. 128 [hereinafter *ELSI*].

61 *CME Czech Republic B.V. v. The Czech Republic* (UNCITRAL), Partial Award of September 13, 2001, para. 612 [hereinafter *CME*].

675. According to Claimants, the above undisputable breaches of the Bilateral Investment Treaty are alone sufficient to justify a ruling against Respondent, irrespective of the subsequent breaches committed by Respondent and irrespective of the collusion between Respondent and powerful local partner.

676. Claimants further invoke the following elements as unreasonable, arbitrary, and/or discriminatory measures:

- Respondent's judiciary took decisions and actions in support of Telecom Invest's expulsion of Claimants from KaR-Tel, depriving Claimants of all the benefits and enjoyment of their investments as well as access to documents to defend themselves;
- the Working Group's treatment of Claimants' investment was also in breach of Respondent's same obligation since it was unreasonable, arbitrary, grossly unfair, unjust;
- the decisions of Respondent's judiciary were unreasonable, arbitrary and grossly unfair;
- the sole purpose of the Investment Committee's purported termination of the Investment Contract was to give Telecom Invest a basis to undermine the legal foundation of Claimants' investment;
- all following actions of Respondent were clearly intended to collude with the foreign investor's local partner. Respondent's actions were discriminatory. They were even more so discriminatory on the part of the judiciary and other organs to have evicted Claimants and then deprived Claimants of their shares on this basis as it is the local partner that had the lobbying obligations with respect to the Investment Committee, and irrespective of these obligations had the duty of assistance as shareholder;
- moreover, Respondent took such actions in favor of Claimants' local partner and to the detriment of Claimants as foreign investors despite Telecom Invest's own failure to fulfill its obligations in KaR-Tel. Indeed, pursuant to the Foundation Agreement, Telecom Invest assumed the obligation of assuring relations with the

Investment Committee; it shared the responsibility of the operations and management of KaR-Tel. Yet, Respondent's Investment Committee and Judiciary failed equally to take all of those elements into consideration;

- the fact that Claimants had no access to documents at KaR-Tel after their eviction is also plainly discriminatory;
- finally, the institution of criminal proceedings against only Turkish employees (save for one local secretary who was the secretary of Mr. Agilönü) for the alleged theft of petty cash worth a few hundred euros is discriminatory, particularly since a few thousand dollars were paid for years to employees forced on KaR-Tel by the local partner who did not even show up for work but were paid anyway upon Mr. Kulibayev's instructions.

2. Respondent's position

a) The standard

677. Respondent accepts the definition of unreasonable, arbitrary and discriminatory treatment stated by the authorities cited by Claimants. According to Respondent, in accordance with the proper interpretation of the fair and equitable treatment obligation, the standard of protection to be afforded is low. Further, any purportedly unreasonable, arbitrary or discriminatory conduct is capable of justification if it is proportionate and for a public purpose.

b) Application to the facts of the case

678. According to Respondent, Claimants have not demonstrated a *prima facie* case of any arbitrary or unreasonable or discriminatory conduct by any person or entity whose actions are attributable to Respondent.

3. Decision of the Arbitral Tribunal

a) The Standard

679. As we have noted, the parties agree with the interpretation of the standard. As the Arbitral Tribunal appropriately determined in *Saluka*, the standard of "reasonableness"

has no different meaning than the "fair and equitable treatment" standard "*with which it is associated*."[62] Reasonableness therefore requires that the State's conduct *"bears a reasonable relationship to some rational policy, whereas the standard of "non-discrimination" requires a rational justification of any differential treatment of a foreign investor*."[63]

680. Similarly, the Arbitral Tribunal in the *CMS* award stated that the standard of protection against discrimination "*is related to that of fair and equitable treatment. Any measure that might involve ... discrimination is in itself contrary to fair and equitable treatment.*[64] *The standard is next related to impairment*."[65] A measure is discriminatory when it provides "*the foreign investment with a treatment less favorable than domestic investment*."[66]

b) Application to the facts of the case

681. The Arbitral Tribunal notes that the violations alleged by Claimants and allegedly constituting unreasonable, arbitrary or discriminatory measures, have also been invoked by Claimants as constituting a violation of the fair and equitable treatment principle. The Arbitral Tribunal considers that these violations are better qualified and dealt with as issues falling under the fair and equitable treatment standard, which also includes in its generality the principle of no-unreasonable, arbitrary or discriminatory measures. Reference is therefore made to the Tribunal's decision at paragraphs 609 to 619, above.

---

62 *Saluka v. Czech Republic,* Partial Award of March 17, 2006, para. 460.

63 *Ibidem*.

64 *CMS*, Award of 12 May 2005, para. 290. See also *Saluka,* Partial Award of March 17, 2006, para. 460.

65 *CMS*, Award of May 12, 2005, para. 290.

66 *ELSI,* Judgment of July 20, 1989, para. 128.

F. Expropriation

1. Claimants' position

a) The standard

682. Both the BIT and the FIL prohibit the host State from expropriating directly or indirectly, or subjecting to measures of similar effect, any foreign investment, if certain specific conditions are not met. The circumstances under which a State may lawfully expropriate a foreign investment are limited to expropriations that are done:

- for a public purpose;
- in a non-discriminatory manner;
- in accordance with due process of law;
- upon payment of prompt, adequate, and effective compensation.

683. Moreover, it is generally accepted that a State can expropriate an investment in a number of ways, including through acts of harassment. One of the methods is when a State forces an alien to dispose of his property at a price representing only a fraction of what it would have been had not the alien's use of its property been subjected to interference by the State.

684. An expropriation may also be '*creeping*', *i.e.* a form of indirect expropriation with a distinctive temporal quality in the sense that it encapsulates the situation whereby a series of acts which are attributable to the State over a period of time culminate in the expropriatory taking of such property.[67]

685. A distinction is indeed made in public international law between two types of expropriation: either a direct and deliberate formal act of taking, such as an outright nationalization, or an indirect taking that substantially deprives the investor of the use or enjoyment of its investment, including deprivation of the whole or a significant part of the economic benefit of property.

---

[67] *Generation Ukraine, Inc. v. Ukraine* (ICSID Case No. ARB/00/9), Award of September 16, 2003, para. 20.22 [hereinafter *Generation Ukraine*].

686. Claimants further allege that although the intent of the State may play a role, such intention is not decisive. In essence, the standard for determining whether a State's conduct amounts to an expropriation is the actual effect of the measures on the investor's property.

687. Claimants finally allege that an expropriation does not have to be for the benefit of the host State for it to be unlawful. Indeed, as confirmed in *Metalclad* and *Tecmed*,[68] a State can expropriate an investment, or take measures equivalent to an expropriation in connection with an investment, for the benefit of a third party. Similarly, the *Tecmed* tribunal[69] commented that the term "expropriation" covered situations where the State actions *"transfer assets to third parties different from the expropriating State*."

b) Application to the facts of the case

688. According to Claimants, in the present case, there can be no doubt that Respondent has expropriated Claimants' investment. Each of the acts and omissions described above, individually and collectively, constitute an expropriation:

- the termination of the Investment Contract in violation of its terms was the triggering event;
- subsequently, the decision of Respondent's Courts to rubber stamp, without more, Telecom Invest's request for injunctive relief, and to replace KaR-Tel's General Manager by Mr. Yerimbetov, amounted to a de facto expropriation;
- Claimants were thus physically ousted from KaR-Tel's premises but were also excluded from the management, enjoyment, and use of their investment as such;
- Respondent's Courts subsequently expropriated Claimants' title for the further benefit of Telecom Invest, ordering the compulsory redemption of Claimants' shares in KaR-Tel;

---

[68] *Metalclad*, Award of August 30, 2000, para. 103; and *Tecmed*, Award of May 29, 2003.

[69] *Id.,* para. 113.

- Respondent's unlawful expropriation culminated in the October 2003 decision of the Kazakhstan Supreme Court, in which the compulsory redemption decision was affirmed and Claimants' 60% combined stake in KaR-Tel was valued at a mere USD 3,000.

689. In reality, according to Claimants, the parties do not dispute that Claimants' investment was expropriated. Respondent's objection that Claimant's expropriation was justified is irrelevant as Claimants are not seeking restitution or specific performance but adequate compensation. In this respect, Claimants allege that the USD 3,000 valuation of KaR-Tel by Respondent's judiciary is a defiant mockery of justice. Respondent itself recognized this fact as is evidenced by its offer, via Altel, to purchase Claimants' shares for USD 20 million.

690. Given the foregoing, Claimants submit that none of the elements of lawful expropriation has been satisfied.

2. Respondent's position

a) The standard

691. Respondent accepts that the conditions for lawful expropriation are:

- that it should take place for a public purpose;
- in a non-discriminatory manner;
- in accordance with due process of law;
- upon payment of prompt, adequate and effective compensation.

692. Respondent also accepts that expropriation can be direct or indirect and take place in a single action or a series of actions. However, Respondent submits that the intention of the State is highly relevant, although admittedly not determinative of whether or not there has in fact been an expropriation.

693. Respondent further accepts that expropriation can exist despite there being no obvious benefit to the State concerned, albeit this kind of case is exceptional.

694. Respondent finally points out that in order for an act to be an unlawful expropriation, it must have had a significant impact upon the enjoyment of the investment and must have been initiated by an act attributable to Respondent.

b) Application to the facts of the case

695. Respondent denies that it has expropriated Claimants' investment. In any case, the difficulty in which Claimants find themselves is that expropriation requires the taking of an asset belonging to the person making the claim. Claimants did not in fact make any investment, therefore, there was nothing to expropriate.

696. Additionally, the real Claimant is the Turkish State. The sums that Claimants are in fact seeking to recover are the losses that the Turkish State itself, and not Rumeli or Telsim, have suffered as a result of the collapse of the Uzan family's bank and the settlement of the ICSID claim brought against the Turkish State by Motorola.

697. Respondent further sets forth that a transfer to a third party is only an expropriation if that transfer was instigated by the State. In this respect, it is Respondent's position that Claimants have not adduced any evidence to suggest that Respondent instigated the compulsory redemption of their shares in KaR-Tel. The plain truth is that it was Telecom Invest, a private Kazakh entity, the actions of which are not attributable to Respondent, which in fact instigated that process.

3. Decision of the Arbitral Tribunal

a) The Standard

698. Article III of the BIT provides that -

> *"1. Investment shall not be expropriated, nationalized or subject directly or indirectly, to measures of similar effect expect for a public purpose, in a non-discriminatory manner, upon payment of prompt, adequate and effective compensation, and in accordance with due process of law and the general principles of treatment provided for in Article II of this Agreement.*

2. Compensation shall be equivalent to the real value of the expropriated investment before the expropriatory action was taken or became known. Compensation shall be paid without delay and be freely transferable as described in para. 2 Article 4."

699. The FIL provides that -

> *"1. Foreign investments may not be nationalised, expropriated or subjected to any measures which have the same consequences as nationalization and expropriation (henceforth, expropriation), except for the cases where such expropriation is carried out for public interests in compliance with the appropriate legal procedures and carried out without discrimination with the payment of immediate, adequate and efficient compensation.*
>
> *2. The compensation must be equal to the fair market value of the expropriated investments at the moment when the investor learnt of the expropriation."*

700. The parties agree that expropriation can be direct, that is, resulting from a deliberate formal act of taking, or indirect, that is, resulting from a series of acts which are attributable to the State over a period of time and culminate in the expropriatory taking of the relevant property.[70] The intention or purpose of the State organ is not mentioned in Article III of the BIT and the parties agree that the intent of the State is relevant to, but is not decisive of the question whether there has been an expropriation:

> *"The intent of the government is less important than the effects of the measures on the owner, and the form of the measures of control or interference is less important than the reality of their impact.... Therefore, the Tribunal need not determine the intent of the Government of Iran...."*[71]

701. The parties also agree that expropriation can exist despite there being no obvious benefit to the State concerned:

---

[70] *Generation Ukraine v. Ukraine*, Award of September 16, 2003, paras. 20-22.

[71] Georges H. Aldrich, *What Constitutes a Compensable Taking of Property? The Decisions of the Iran-United States Claims Tribunal,* 1994, 88 American Journal of International Law, p. 603; and *Phillips Petroleum Co. Iran v. The Islamic Republic of Iran*, Case No. 39, Chamber Two, Award No. 425-39-2 of June 29, 1989, 1989 WL663903, para. 97.

"Although formally an expropriation means a forcible taking by the Government of tangible or intangible property by means of administrative or legislative action to that effect, the term also covers a number of situations described as de facto expropriation, where such actions or laws transfer assets to third parties different from the expropriating State or where such laws or actions deprive persons of their ownership over such assets, without allocating such assets to third parties or to the Government." [72]

This is supported by a footnote referring to the following passage in *Metalclad*:

"Thus, expropriation... includes not only open, deliberate and acknowledged takings of property, such as outright seizure or formal or obligatory transfer of title in favour of the host State, but also covert or incidental interference with the use of property which has the effect of depriving the owner, in whole or significant part, of the use or reasonably to be expected economic benefit of property even if not necessarily to the obvious benefit of the host State."[73]

702. Whereas most cases of expropriation result from action by the executive or legislative arm of a State, a taking by the judicial arm of the State may also amount to an expropriation. In the *Oil Field of Texas* case the Tribunal held that:

"It is well established in international law that the decision of a court in fact depriving an owner of the use and benefit of his property may amount to an expropriation of such property that is attributable to the state of that court. As the French-Italian Commission held in its decision No. 136 of 25 June 1952, concerning a dispute over Italian property in Tunisia:

'La sentence rendue par l'autorité judiciaire est une émanation d'un organe de l'Etat, tout comme la loi promulguée par l'autorité législative, ou la décision prise par l'autorité exécutive. La non-observance d'une règle internationale, de la part d'un tribunal, crée la responsabilité internationale de la collective dont le tribunal est un organe, même si le tribunal a appliqué un droit interne conforme au droit international.'"[74]

---

[72] *Tecmed*, Award of May 29, 2003, para. 113.

[73] *Metalclad*, Award of August 30, 2000, para. 103.

[74] *Oil Field of Texas Inc. v. The Government of the Islamic Republic of Iran*, Iran-US Claims Tribunal, Award in Case No. 43 (258-43-1) of October 8, 1986, Yearbook of Commercial Arbitration, Vol. XII

703. The Tribunal notes also the provisions of Article 4(1) of the ILC Articles (see paragraph 577 above).[75]

704. It is a characteristic of judicial expropriation that it is usually instigated by a private party for his own benefit, and not that of the State. This is no doubt a relevant consideration, although not in itself decisive, as has already been observed. The Tribunal considers however, and Respondent indeed accepted in paragraph 259 of its Rejoinder, that a transfer to a third party may amount to an expropriation attributable to the State if the judicial process was instigated by the State.

b) Application to the facts of this case.

705. The final act of 'taking' as regards Claimants' investment (i.e. their shares in Kar-Tel) was the decision of the Presidium of the Supreme Court affirming the compulsory redemption of those shares. The Tribunal is satisfied that this decision was made "for a public purpose," namely the administration of justice and the execution of the laws of the host State. Moreover, despite the fact that the valuation of the shares was, unusually, made by the Presidium rather than by either of the inferior tribunals, there was no evidence that it was not made "in accordance with due process of law."

706. Nevertheless, for reasons which the Tribunal will discuss under the heading "Calculation Of Damages And Quantum," the valuation placed on Claimants' shares was manifestly and grossly inadequate compared to the compensation which the Tribunal there holds to be necessary in order to afford adequate compensation under the BIT and the FIL. The Tribunal accordingly holds that the expropriation by the Presidium was unlawful.

(1987), at pp. 287-291 [hereinafter *Oil Field of Texas v. Iran*]. *See* also *CCL v. Republic of Kazakhstan, SCC Case 122/2001,* Stockholm International Arbitration Review 2005:1, pp. 174-5 [hereinafter *CCL v. Kazakhstan*].

[75] *See also* the observation of Professor Christopher J. Greenwood, *State Responsibility for the Decisions of National Courts,* in *Issues of State Responsibility before International Juridical Institutions*, ed. Fitzmaurice and Sarooshi 2004, p. 57, that "the decisions of a court - at whatever level of the judicial hierarchy - are plainly imputable to the State."

707. The Tribunal further holds that the fact that the expropriation was not directly for the benefit of the State but for the benefit of Telecom Invest does not affect this conclusion, since, as the parties agree, expropriation can exist despite there being no obvious benefit to the State concerned. In this connection the Tribunal does however consider that it is relevant that the court process which culminated in the expropriation was instigated by the decision of the State, acting through the Investment Committee, to terminate the Investment Contract. This decision was taken on March 25, 2002: the following day Telcom Invest sent its notice to Kar-Tel and to Claimants calling for an Extraordinary General Meeting of shareholders of Kar-Tel to consider the harm to Kar-Tel and the compulsory redemption of Claimants' shares. This notice was sent without the decision of the Investment Committee having been communicated to Kar-Tel. In the judgment of the Tribunal, the only possible conclusion from these circumstances is that Telcom Invest and its shareholders were privy to the decision and that Kar-Tel and Claimants were not, and that this was the result of collusion between the Investment Committee on the one hand and Telcom Invest and its shareholders on the other. The Tribunal is unable to conclude with confidence that the Investment Committee foresaw or intended the court proceedings which resulted from this, although such court proceedings were, if not actually foreseen, at least reasonably foreseeable. The Tribunal is left in no doubt, however, that the court process which resulted in the expropriation of Claimants' shares was brought about through improper collusion between the State, acting through the Investment Committee, and Telcom Invest. The fact that the result may not have been intended by the Investment Committee is not decisive of the issue of expropriation. Moreover, it is beyond doubt that expropriation *was* the intended consequence of the court orders for compulsory redemption of Claimants' shares.

708. In summary, the conclusion of the Tribunal is that this was a case of 'creeping' expropriation, instigated by the decision of the Investment Committee which was then collusively and improperly communicated to Telcom Invest and its shareholders before Claimants were made aware of it, and which proceeded via a series of court decisions, culminating in the final decision of the Presidium of the Supreme Court. The decision of

the Investment Committee was moreover unfair and inequitable in itself, as the Tribunal has found.

709. Claimants, however, advanced a very much broader case than this, founded on an allegation that the entire process leading to the expropriation of their shares in Kar-Tel was brought about by a conspiracy between the shareholders of Telcom Invest, the Investment Committee, and the judges of the courts who heard the various stages of the legal proceedings, to bring about a result which benefited members of the family of the President of the Republic of Kazakhstan, and thereby indirectly the President himself. The evidence for this was mainly, if not wholly circumstantial, but it is in the nature of such an allegation that direct evidence of a conspiracy is unlikely to be available. The Tribunal has therefore considered the evidence with particular care, reminding itself that an allegation such as this must, if it is to be supported only by circumstantial evidence, be proved by evidence which leads clearly and convincingly to the inference that a conspiracy has occurred.

710. The Tribunal has before it a number of documents, mostly in the form of press reports, which tend to establish that the whole country, the whole political system and the whole economy of Kazakhstan are controlled by President Nurabayev and his family, including an article by the International Eurasian Institute for Economic and Political Research. The Tribunal was also shown a report by the UN Economic and Social Council which indicates that the judiciary is not independent and is prone to allegations of bribery, and another by the Bureau of Democracy noting that human rights are not respected and that "the constitution concentrates power in the hands of the presidency, permitting the president to control regional and local governments and to exercise significant influence over the legislature and judiciary ..."

711. It is also clear that the President's family played a role, at least behind the scenes, in relation to Kar-Tel. Investel, the first partner of Claimants in Kar-Tel, was owned to the extent of 51% by Almex. The majority owners of Almex were Timur Kulibaev and his wife Dina Kulibaeva, the President's second daughter. Almex is a major company: it is

also the major shareholder of Halik Bank, with a participation of 80.92%. Investel was later replaced by Telecom Invest whose founders were Almex (87.5%) and Mrs. Helena Goutova (12.5%).

712. The Tribunal notes that the role of the local partner was to "obtain necessary permissions and licenses from official bodies of Kazakhstan Republic (Government Investment Committee, Kazakhtelcom, etc.)." In this connection, the Tribunal recalls that in August 2002, Mr. Hakin Uzan offered to sell Claimants' shares to Telecom Invest for USD 20 million. That offer was rejected by Mr. Karibjanov, who represented Telecom Invest, and Mr. Uzan then offered to buy Telecom Invest's shares for USD 12 million. Subsequently, Telecom Invest accepted the offer and a Share Purchase Agreement was negotiated and the parties initialled it on October 13, 2002. Claimants however never proceeded to transfer the required funds. The draft Stock Purchase Agreement provided in its Article 6.2 that "the seller shall either obtain on behalf of the Company a valid investment incentive certificate, which was previously cancelled by the Investment Committee on 19 April 2002, or shall procure that the Investment Committee will have rescinded its cancellation of 19 April 2002. It is the full responsibility of the seller that the Company will have obtained the new and valid investment incentive certificate or the Investment Committee will have rescinded its cancellation of 19 April 202. The seller shall obtain the new investment incentive certificate or shall procure the rescission of the cancellation of 19 April 2002 to the full satisfaction of the Buyer within four months after the closing. The seller shall ensure in the new investment incentive certificate or in the rescission of the cancellation of 19 April 2002 that the Company and the Buyer shall enjoy exactly the same benefits as originally granted by the Investment Committee when the Company was established as if there had been no cancellation on 19 April 2002." The Stock Purchase Agreement further provided that if the seller failed to obtain the certificate or the rescission of the cancellation, Claimants would obtain a reduction of price. This clearly indicates that Telecom Invest had grounds for believing that it was able to influence the decisions of the Investment Committee. Mr. Kulibaev was indeed a former member of the Investment Committee.

713. According to Claimants, in August 2004 Altel (together with Orlon) indicated to Claimants that they were willing to purchase their 60% share for USD 20 million. Respondent disputes this and states that the meeting had another purpose. The Tribunal is unable to say which version of events is correct. One of the founders of Altel was represented by Ms. A. N. Nazarbayeva, apparently the youngest daughter of the President. Claimants also allege, but without any concrete evidence, that Orlon is owned by another daughter of the President.

714. The Tribunal further takes into account the fact that once the Investment Contract was terminated the local partner took no steps - and nor did Kar-Tel - to challenge the decision of the Investment Committee or to reinstate the Contract.

715. In these circumstances it is not in the least surprising that Claimants harbour the gravest suspicions that they are the victims of a conspiracy for the benefit of the President and his family. Indeed the material summarised above is consistent with and positively supports the Tribunal's finding that there was improper collusion between the Investment Committee and Telcom Invest with regard to the decision to terminate the Contract, although it is not necessary to decide whether this involved Mr. Kulibaev directly, which he denied, or some other means. Despite this, the Tribunal is unable on this material to conclude with the necessary degree of conviction that there was a wider conspiracy involving the President, or for his direct or indirect benefit. Nor is the Tribunal able to conclude that any of the other participants in the investment acted in such a way as to engage the international responsibility of the Republic of Kazakhstan. In particular, the Tribunal observes that in January 2003 Telcom Invest was sold to Mr. Seysembayev, who was not alleged to have any family relationship to the President, and that a number of key elements in the process leading to the expropriation took place after this date.

CHAPTER VI. COMPENSATION AND DAMAGES

I. PRELIMINARY REMARKS ON CLAIMANTS' CLAIM FOR DAMAGES

A. Respondent's position

716. According to Respondent, in the light of the foregoing, it is unnecessary for the Tribunal to consider the issue of damages. Claimants have failed to establish any breach by Respondent of its international law obligations. In any case, if it is found that the cancellation of the Investment Contract constituted a breach of Respondent's international obligation, no compensation can be awarded to Claimants because:

- first, Claimants did not make investments in the amount or the nature alleged so that they cannot claim damages for the alleged expropriation of non-existent investments;
- second, for reasons of public policy, the Tribunal should not allow Claimants to recover alleged losses connected with their fraud on KaR-Tel;
- third, in any case, it is obvious that Claimants' fraud would have been detected and used to justify the acts complained of by Claimants. Accordingly, Claimants are unable to show any damages flowing from the acts complained of against Respondent;
- finally, the reports filed in the Kazakh proceedings indicate that KaR-Tel was insolvent. Any valuation must take this fact into consideration.

B. Claimants' position

717. According to Claimants, none of these arguments is convincing:

- Claimants made a substantial multi-million dollar financial investment and contributed know-how and training so as to build a successful and growing KaR-Tel as the second GSM licensed operator in Kazakhstan;
- the manner in which the Uzan family may or may not have conducted the business of its companies in Turkey is irrelevant;

- even if Claimants' alleged fraud in Turkey "would have been detected," this does not in any way justify or somehow change anything in Respondent's wrongful conduct in breach of international law. Respondent's obligation is independent of any conduct that Respondent might seek to attribute to Claimants;
- Claimants dispute that KaR-Tel, with the only second-issued GSM license in Kazakhstan, was in any way an insolvent entity. The report filed before the Kazakhstan Courts and the Courts' conclusion in this regard form part of the denial of justice that Claimants suffered due to the Courts' blatant misapplication of Kazakhstan law. In any event, this argument cannot be sustained in the light of the fact that a year after the valuation of Claimants' shares by the Courts, Respondent offered – through Altel – to purchase Claimants' rights for USD 20 million and Vimpelcom purchased KaR-Tel for more than USD 350 million.

II. General Principles

A. The compensation in international law

1. Claimants' position

718. According to Claimants, with respect to expropriation, the BIT and the FIL both require that the investor be compensated for its expropriated investment. The Bilateral Investment Treaty establishes that "*Compensation shall be equivalent to the real value of the expropriated investment before the expropriatory action was taken or became known.*" Beside the case of expropriation, the BIT does not define the manner in which damages should be calculated in case of treaty violations other than expropriation. Therefore, it is Claimants' position that reparation should be determined in accordance with general principles of international law. Such principles are set forth in the ILC Articles. Article 31 of the ILC Articles enunciates the principle of full reparation, a principle which is confirmed by the *Chorzow Factory* decision.[76]

[76] *Case Concerning Certain German Interests in Polish Upper Silesia (Germany v Poland),* 1928 P.C.I.J. (Ser. A) No. 17, at 40 [hereinafter *Chorzów Factory*].

719. This principle of full reparation is equally applicable to calculate damages for non-expropriation breaches of treaty obligations when there has been no finding of expropriation. Since the Bilateral Investment Treaty does not define the manner in which damages should be calculated in case of treaty violations other than expropriation, an arbitral tribunal "*must accordingly exercise its discretion to identify the standard best attending to the nature of the breaches found*."[77]

2. Respondent's position

720. Respondent points out that the *Chorzow Factory* decision requires the restoration of the *status quo ante*, or compensation of the same effect. The *status quo ante* in this case would be for Claimants to hold 60% of the equity of a heavily insolvent partnership whose major creditor was actively pursuing repayment of over USD 100 million.

721. According to Respondent, if the Tribunal is minded to award damages to Claimants, it is Respondent's case that:

- the proper valuation standard is the fair market value of Claimants' investment in April 2002;
- the Analysys Report is so seriously flawed as to be worthless to the Tribunal in assessing the proper measure of compensation;
- the Navigant Report is eminently preferable to the Analysys Report, and provides clear and compelling evidence that the fair market value of Claimants' investment in April 2002 was zero.

B. <u>Valuation standards</u>

1. Claimants' position

722. According to Claimants, when assessing the compensation due following an expropriation, the Tribunal should determine the fair market value of the foreign investment so as to give full effect to the principle of full reparation set forth in *Chorzow*

[77] *CMS*, Award of May 12, 2005, para. 409.

Factory. This principle of full reparation is equally applicable to calculate damages for non-expropriatory breaches of treaty obligations. In this respect, Claimants point out that, while some tribunals have favored the guiding principle set forth in *Chorzow Factory*, other tribunals, such as in *CMS*, have preferred the fair market value approach.

723. According to Claimants, in the instant case, the "*cumulative nature*" of Respondent's breaches of its treaty obligations (other than expropriation) have resulted in the irreversible deprivation of Claimants' entire investment for which Claimants should be compensated at full market value.

724. Claimants submit that in determining the value of KaR-Tel, its expert, Analysys, rightly applied a discounted cash flow ("*DCF*") approach as this is the most "*widely accepted and highly regarded methodology used to calculate the value of cashflows being generated by a business.*" Analysys dismissed the net book value approach ("*NBV*") as "*particularly inappropriate in the case of a mobile operator, where the business model is one of heavy investment to establish an asset base (network) that can be used to generate returns over an extended period of time.*"

725. Therefore, Mr. Wright of Analysys used the DCF to determine the value of KaR-Tel as of two alternative valuation dates, namely April 23, 2002 (the date of expulsion of Claimants from KaR-Tel) and October 30, 2003 (the date of the unappealable decision of Respondent's Supreme Court ordering the compulsory redemption of Claimants' shares).

726. Respondent's damage expert, Mr. Kaczmarek of Navigant Consulting, did not dispute that the DCF approach is a traditional method for valuing companies. He argued only that the DCF approach was inapplicable in the instant case because, in his view, KaR-Tel was insolvent and could thus not be treated as a going concern as of April 2002. However, Mr. Kaczmarek did not address the question of solvency of KaR-Tel as of October 2003.

727. Claimants further point out that, contrary to Mr. Kaczmarek's opinion, Mr. Wright rightly explained that "*[T]his was never in doubt, that it was a going concern…This was a fully*

operational company…They couldn't fund the financing, or they couldn't repay the Motorola Loan, that is balance sheet insolvent, but they were an ongoing business…."

728. According to Claimants, the facts and circumstances clearly support Mr. Wright's view:

- KaR-Tel was and is a going concern; it continues in active existence today and is a highly profitable company. It would be contrary to the principles of full restitution to reject use of the DCF method on grounds of insolvency when KaR-Tel has not been liquidated, had valuable assets, including one of the two GSM licenses in a large and emerging oil-rich country;
- Motorola could not push KaR-Tel into bankruptcy for so long as the Telsim guarantee remained in place;
- as evidenced in the PWC report, KaR-Tel generated positive EBITDA margins in both 2001 and early 2002;
- although Mr. Wright acknowledged that the restructuring of the debt would restore solvency, he rightly argued that "*it's valuable even before you solved it [the restructuring of the debt], just the knowledge that it can be solved means the thing is valuable, and it is demonstrated when you solve it*;"
- the Vimpelcom transaction for USD 350 million, less than a year following the Supreme Court's valuation of Claimants' shares, gives the Tribunal the benefit of an objective and fully independent valuation. As noted by Analysys, it is simply inconceivable that in a short period of time KaR-Tel's value could increase to that extraordinary extent.

2. Respondent's position

729. According to Respondent, the only loss for which Claimants claim is the *de facto* or indirect expropriation of their shareholding in KaR-Tel. A number of ICSID awards have accepted a measure of compensation based upon fair market value as appropriate for treaty breaches not amounting to expropriation. Moreover:

- the BIT provides that "*compensation shall be equivalent to the real value of the expropriated investment*;"
- Article 7(2) of the FIL, on which Claimants rely, provides that compensation shall be equivalent to the fair market value of the asset expropriated;
- the Kuwait-Kazakhstan BIT specifies that compensation shall be assessed "*in accordance with internationally recognized principles of valuation on the basis of the fair market value*."

730. Therefore, according to Respondent, the standard of compensation should be assessed by reference to internationally recognized principles of valuation on the basis of the fair market value. The best statement of the internationally recognized principles referred to are the World Bank Guidelines of 1992. These provide that "*without implying the exclusive validity of a single standard for the fairness by which compensation is to be determined and as an illustration of the reasonable determination by a State of the market value of the investment…, such determination will be deemed reasonable if conducted as follows: for a going concern with a proven record of profitability on the basis of the discounted cash flow value (DCF); for an enterprise which, not being a proven going concern demonstrates lack of profitability, on the basis of the liquidation value.*"

731. According to Respondent, there can be no doubt that KaR-Tel was heavily insolvent in April 2002. The Navigant Report is clear that KaR-Tel satisfied each of the possible tests for insolvency. In addition:

- KaR-Tel had missed nearly all of the targets in its own business plan;
- the total equity investment made had only been USD 10,000;
- KaR-Tel had dramatically underinvested in capital equipment in particular;
- KaR-Tel had never made a profit;
- KaR-Tel was increasingly underperforming its only rival, K-Cell;
- KaR-Tel had been capitalized using short-term debt, on which it was in default.

732. Deloitte & Touche's auditor's statement dated July 15, 2002 was unambiguous: "*there is substantial doubt that the Company will be able to continue as a going concern.*" Even Mr. Wright from Analysys accepted in cross-examination that KaR-Tel was balance sheet insolvent.

733. The best Claimants can do is say that it is not correct to say that KaR-Tel was insolvent since it did in fact continue to survive and eventually prosper. That, however, only serves to highlight precisely why using hindsight is inappropriate. No one looking at KaR-Tel as it stood in April 2002 would have thought that it had a realistic chance of survival.

734. Accordingly, Respondent alleges that, in the present case, as confirmed by the Navigant Consulting Report, the best approach is liquidation value. However, even if KaR-Tel is valued as a going concern, the Navigant Report confirms that KaR-Tel's shares were worthless in April 2002.

735. Respondent further alleges that damages reflecting lost profits or future earnings are only recoverable where the entity is a going concern with a history of actual operations. In April 2002, KaR-Tel was not a going concern in any sense of the word. It was clearly insolvent.

736. In the same vein, it is Respondent's position that arbitral tribunals do not accept claims for speculative, uncertain or contingent damages. Indeed, in cases where lost profits have been awarded, this measure has been based upon a long history of operations. In the present circumstances, KaR-Tel's financial status in April 2002 was such that any assessment of lost profits would be speculative and uncertain in the extreme.

C. The valuation date

1. Claimants' position

737. Claimants point out that with respect to unlawful expropriation, the relevant date for purposes of assessing damages is respectively defined by the BIT and the FIL as the moment "*before the expropriatory action was taken or became known*" and "*the moment when the investor learnt of the expropriation*." However, neither provides any guidelines

as to how such date of expropriation should be ascertained. In case of creeping expropriation such as this one, the precise date of expropriation is difficult to ascertain since various events can be deemed expropriatory in nature. Arbitral tribunals have considered that, in cases of creeping expropriation, the date of expropriation is not necessarily the date of the first or of the last expropriatory event, but can be any point in time within that range when the owner has been irreversibly deprived of its property. The exact date on which this moment is deemed to have occurred is left to the discretion of the Arbitral Tribunal.

738. According to Claimants, the moment of valuation should be, as pointed out by Messrs. Reisman and Sloane, "*the date on which assessing the fair market value of a foreign investment for purposes of calculating compensation will enable a tribunal to give full effect to the principle of full reparation.*"[78] This is the approach that was retained in the *ADC* case, where the tribunal, confronted to a case where the value of the investment after the date of expropriation had risen considerably held that the application of the *Chorzow Factory* standard required that the "*date of valuation should be the date of the Award and not the date of expropriation, since this is what is necessary to put the Claimants in the same position as if the expropriation had not been committed*."[79]

739. Moreover, arbitral tribunals, as in *Amco II,* have held that, since the purpose of the compensation is full restitution, it is neither necessary nor appropriate to exclude from consideration in value calculations information which became available after the date of expropriation.[80]

740. Claimants point out that the same approach is applicable to calculate damages for non-expropriatory breaches.

---

[78] Michael Reisman and Robert Sloane, *Indirect Expropriation and Its Valuation in the BIT Generation*, 74 the British Yearbook of International Law, 115, 150.

[79] *ADC*, Award of October 2, 2006, paras. 484-494.

[80] *Amco II*, Award in the Resubmitted Case of June 5, 1990.

741. Claimants therefore instructed Analysys to determine the value of Claimants' investment at two different moments in the timeline of Respondent's creeping expropriation: (1) on April 23, 2002, when Claimants were physically ousted from KaR-Tel by Respondent's enforcement authorities and on the basis of an injunction issued by Respondent's Courts and were never permitted to return, such that their investment was *de facto* expropriated on such date; and (2) on October 30, 2003, when the final and unappealable decision of Kazakhstan Supreme Court effectuated the compulsory sale of Claimants' shares for a price of only USD 3,000, thereby irreversibly depriving Claimants of their investment.

2. Respondent's position

742. According to Respondent, the only possible relevant date for valuation should be 23 April 2002. As decided in the *Chorzow Factory* case, the reparations should, insofar as possible, place claimant in the position in which it would have been had the expropriation not occurred. The appropriate date for valuation of Claimants' shareholding in KaR-Tel would, therefore, be as at April 2002. Indeed, April 2002 was the last time that Claimants or their appointees played any role in KaR-Tel. From that point onwards, Claimants did not invest or otherwise provide any funding to KaR-Tel, nor did they or their appointees participate in any way in the operations of KaR-Tel. If, therefore, as Claimants allege, the injunction marked the beginning of the continuum of expropriation, this makes April 23, 2002 the most appropriate date for valuation purposes.

743. Respondent notes that Claimants refer to the approach taken by the *ADC* tribunal which adopted the date of the award as the valuation date. However, Respondent draws the Tribunal's attention to the very different circumstances leading to the adoption of that approach:

- the ADC tribunal itself referred to the unique nature of the case;
- the claimant in the ADC case had a contract with the host government itself for the provision of airport management services;
- by the time of the expropriation, that contract had been in operation for six years and had been very successful financially;

- had the benefit of the contract not been expropriated, the claimant would not have had to implement significant changes to its operations;
- the claim for lost profits was therefore reasonably certain;
- the only way in which the claimant could be put into the position it would have been without the expropriation, was to award the lost profits.

744. According to Respondent, *ADC* was therefore a case concerning the award of lost profits and it relied upon the same principles, especially that of a "*going concern*." Respondent alleges that the contrast with the facts of this arbitration could not be more pronounced since KaR-Tel failed to make any profit in its first four years, was insolvent and it is only as a result of Mr. Yerimbetov's management skills and change of direction that KaR-Tel eventually became successful.

D. <u>Causation</u>

745. According to Claimants, Respondent's wrongful conduct in breach of the Bilateral Investment Treaty and of international law has resulted in the total loss of Claimants' considerable investment. The causal nexus between the wrongful acts and the damage is obvious. This is because it is the unlawful termination of the Investment Contract that triggered and served as the justification for the process that ultimately led to the expropriation of Claimants' 60% shares in KaR-Tel by Respondent as it is on the termination of the Investment Contract that the local partner and Respondent's judiciary relied to evict Claimants.

746. According to Respondent, the principles governing international law require the wrongdoer to compensate the victim for the loss it has suffered which was directly caused by the wrongful acts. In other words, if the Tribunal finds Respondent liable to make reparations to Claimants, such reparations may only extend to that which is necessary to compensate Claimants for losses directly caused by the international wrong attributed to Respondent.

747. In this respect, Respondent submits that if the Tribunal were to find that the cancellation of the Investment Contract was procedurally unlawful, or even substantively unlawful, this would not have caused any loss to Claimants.

748. Indeed, even if there had been no procedural irregularities – and Respondent alleges that there were none – the Investment Committee would still have cancelled the Investment Contract. Even if some procedural irregularities were established, they could not have had any effect on the termination of the Investment Contract. It is the cancellation of the Contract, not the alleged procedural irregularities, which is the proximate cause of Claimants' loss.

749. Even if the Tribunal were to find that the Investment Contract ought to have been suspended prior to its cancellation, that did not cause Claimants any loss. Indeed, it would not have been possible for KaR-Tel, under Claimants' control, to remedy the multiple breaches of the Investment Contract's terms even if there had been a suspension.

750. Claimants' reliance upon the *Amco II* award as support for its position that procedural defects can make a substantively valid cancellation unlawful in international law, is unjustified. According to Respondent:

- the facts of both cases are different;
- the Amco award is not binding upon the Tribunal;
- it conflicts on this issue with all the leading authorities including the International Court of Justice.

751. Consequently, it is Respondent's position that if the Tribunal finds either that the cancellation of the Investment Contract was substantively valid or that other valid substantive grounds for its cancellation existed, the causal nexus between the alleged procedural defects and the losses allegedly suffered would not be present. From the moment the cancellation was the ultimate cause of the compulsory redemption of Claimants' shares, the loss suffered by Claimants has not been caused by a wrongful act of Respondent, which, therefore, does not have to make any reparation.

III. CALCULATION OF DAMAGES AND QUANTUM

1. Claimants' position

a) The position developed in Claimants' Memorials

752. According to Claimants, the market value upon which the compensation should be based should be ascertained against the background of the existing contemporaneous evidence, namely the sale by Telecom Invest in September 2004 of 100% of KaR-Tel to VimpelCom for the sum of USD 350 million.

753. In this regard, Claimants dispute Respondent's allegation that this sale price was achieved only as a result of two years of Mr. Yerimbetov's "*considerable efforts*" and that KaR-Tel was allegedly insolvent at the time that Claimants were ousted in April 2002.

754. Claimants submit that:

- KaR-Tel was not insolvent. It was not generating large profits in the short term, like most telecommunications companies, but this fact alone cannot serve as a basis to conclude that KaR-Tel was insolvent, particularly with KaR-Tel holding the second GSM license ever issued in Kazakhstan, with over 138,000 subscribers and a national network;
- rather, at the time Claimants were ousted, KaR-Tel was worth several hundreds of millions of dollars;
- in any event, no evidence is – or can be – adduced that KaR-Tel's management at the time would not have undertaken its own restructuring of KaR-Tel and further increased the value of the company. In fact, any other investor to which Claimants could have sold their investment at the time would have provided similar, if not more, considerable "*efforts*." Had the company not been expropriated nor consequently been subject to Rumeli's and Telsim's claims, there is no reason why KaR-Tel could not have been sold for more than USD 350 million in 2003.

755. According to Claimants, based on the elements identified and detailed in its report, Analysys first established a "*Base Case*" evaluation of KaR-Tel as of April 23, 2002, which consisted of two elements: (1) the Net Present Value ("*NPV*") of KaR-Tel over the period of 2002-2013 equal to over USD 345 million; and (2) the Terminal Value ("*TV*") of KaR-Tel – which takes into account revenues and costs generated upon the renewal of the License – equal to over USD 221 million. The Base Case value of 100% of KaR-Tel is thus approximately USD 567 million, with Claimants' combined 60% stake in KaR-Tel being valued at USD 340 million.

756. Claimants further note that Analysys took into account "*certain market data…that would not have been available in 2002, namely the actual penetration rates for mobile telephony in Kazakhstan between 2002 and 2006"* so as to ensure the "*maximum accuracy of the model in establishing a valuation that reflects the likely impact of actual market developments and market events."*

757. According to Claimants, to ensure the comprehensiveness of its Report, Analysys made an alternative calculation, on the basis of information that was known and predicted in 2002. The effect of this scenario is to reduce the NPV by USD 151 million and the TV by USD 85 million, resulting in a total valuation of USD 331 million, and of approximately USD 199 million for Claimants' combined 60% stake in KaR-Tel. However, it is Claimants' position that the Tribunal should not rely on this more conservative approach to the detriment of a more accurate approach based on actual market developments and relevant market events.

758. Taking into consideration the date of October 30, 2003 for the valuation, Analysys has estimated that the NPV would have increased by USD 131 million and the TV by USD 66 million, for a total valuation of KaR-Tel of USD 763 million. Claimants' stake therein is thus valued at approximately USD 458 million.

759. Consequently, Claimants consider that they are entitled to USD 458 million, corresponding to the value of their stake on October 30, 2003, and alternatively, that they

are entitled to an amount of USD 340 million, corresponding to the value of their stake on April 23, 2002.

b) The position developed in Claimants' Post-Hearing Memorial

760. In their Post-Hearing Memorial, Claimants point out that, as discussed at the hearing, Analysys had to revise its initial model. In developing its "*Base Case*" DCF Model, Analysys collected and verified public forecasts of mobile subscribers in Kazakhstan to forecast the addressable market. It then developed forecasts of Average Revenue Per User (ARPU) based on income distribution, GDP growth, and reported market ARPU's.

761. According to Claimants, Analysys had to revise its initial model because a key input relating to ARPU in the model had been misleadingly identified by Vimpelcom in its 2005 Annual Report. Upon reading Vimpelcom's 2006 Annual Report, which was not available at the time Analysys'model was first constructed, Analysys realized that Vimpelcom was including interconnect revenues in what was defined as "*services revenues*," although this had not been identified in Vimpelcom's earlier definition of "*service revenues*." Analysys thus reran its model to take this difference into account.

762. Analysys' methodology is described in more detail in Analysys' quantum opinion of February 26, 2007 and in Analysys' PowerPoint presentation of October 26, 2007. In this respect, Claimants point out that the entire amount of the outstanding Motorola Loan was fully accounted for in Analysys' model, and was deducted from the value of KaR-Tel and by consequence from the value of Claimants' 60% shares in KaR-Tel.

763. On the basis of this DCF methodology, Analysys concluded that the real value of Claimants' 60% stake in KaR-Tel under the "*Base Case*" scenario was USD 162,000,000 on April 23, 2002 and was USD 227,000,000 on October 30, 2003.

764. Contrary to Respondent's allegation, it is Claimants' position that, in this valuation, it is legitimate to take into account the development occurring in the market and the business after the date of the expropriation. Indeed, Claimants' investments could have benefited

from the expanding Kazakhstan telecom market. To ignore what actually happened in the Kazakhstan telecom market would not reestablish the situation which would have existed, had Respondent's expropriation not been committed.

765. Nevertheless, for the benefit of the Tribunal, if it were to rule that no data subsequent to Respondent's expropriation should be used to calculate the "*real value*" of Claimants' losses, Analysys has run further scenarios based on forecasts from 2002/2003, *i.e.*, contemporary forecasts that underestimated actual growth in the Kazakh mobile communications market. Without using any hindsight, and ignoring the actual growth in the Kazakh mobile communications market, Analysys has determined that Claimants' 60% stake in KaR-Tel should be valued at USD 111,000,000 (without 3G investments) or USD 54,600,000 (with 3G investments), respectively, on April 23, 2002.

766. On the final day of the hearing, the Tribunal requested that Analysys provide further valuations of KaR-Tel based on the assumption that the licenses would terminate in 2013 and not be extended (so that no terminal value should be accounted for in the model). Analysys' expert immediately noted that "*I don't know any cases where there hasn't been continuity beyond the end of a license.*" The presumption used in valuating telecom companies is that there would be a renewal of the license. This is further confirmed by the fact that there are renewal provisions contained in KaR-Tel's GSM license. Claimants thus strongly object to the valuation of KaR-Tel based on the assumption that the license would not be renewed.

767. Nevertheless, on October 30, 2007, Analysys provided the breakdown requested by the Tribunal of the valuation of KaR-Tel based on the non-renewal of the license.[81] Analysys noted that, in reality, there would always be a terminal value since "*we would expect KaR-Tel to derive some value from the assets and from selling the subscriber contracts to another operator.*" Analysys added that in this scenario, the cost item for the purchase of a 3G spectrum in 2010 should be removed from the model, since the company would have bought a 3G spectrum only if it knew it had continuity.

---

[81] *See* Exhibit 30 to the Analysys' Quantum Opinion.

768. In any case, Claimants allege that Analysys' original "*Base Case*" scenario most accurately reflects the real value as specified in Article III of the Bilateral Investment Treaty. Based on the foregoing, Claimants are entitled to compensation of USD 227,000,000 corresponding to the real value of their 60% stake in KaR-Tel as of October 30, 2003. Alternatively, Claimants take the position that they are entitled to the amount of USD 162,000,000 corresponding to the real value of their 60% stake in KaR-Tel as of April 23, 2002.

769. As for the interest, the most appropriate standard which will satisfactorily compensate Claimants is the 6 month average LIBOR plus 2 per cent per year for each year during which amounts are owed. Interest should be compounded semi-annually as reflected by the recent practice of ICSID tribunals. Finally, interest should start running at the date of the expropriation until payment of the award.

2. Respondent's position

770. For their valuation, Claimants rely on the difference between the compensation awarded to them by the Presidium of the Supreme Court and the price paid by VimpelCom. However, the difference between the two numbers is easy to explain:

- the Presidium was valuing 60% and not 100% of the shares;
- the Presidium was valuing KaR-Tel as of April 2002 whereas Vimpelcom did bid for KaR-Tel in August 2004;
- the Presidium was bound by the formula agreed by Claimants and Telecom Invest in KaR-Tel's Foundation Agreement;
- the Presidium made its valuation on the basis of a number of independent expert audit reports, all but one of which concluded that KaR-Tel was insolvent, whereas VimpelCom was bidding for a company with significantly lower debt levels, profitable operations, four times the number of subscribers and a great deal of new equipment;
- the Navigant Report demonstrates that the Presidium's valuation of KaR-Tel and VimpelCom's implicit valuation are in fact entirely compatible.

771. According to Respondent, it is untenable to suggest, as Claimants do, that no evidence is adduced that KaR-Tel's management at the time would not have undertaken its own restructuring of KaR-Tel and further increased the value of the company. Indeed, by April 2002, Claimants had been in control of KaR-Tel's management for four years and during that period:

- they had saddled KaR-Tel with over USD 100 million of debt to Motorola alone;
- KaR-Tel did not make a single payment towards the Motorola Loan;
- Motorola had begun to threaten KaR-Tel with legal proceedings;
- between 1999 and 2001, KaR-Tel had been unprofitable;
- notwithstanding this situation, Claimants did not show any willingness to inject any equity into KaR-Tel;
- Motorola had filed fraud and racketeering claims in the New York Courts against Claimants' owners;
- there was no possibility open to Claimants to renegotiate the Motorola Loan since Motorola would not accept to discuss any settlement of its claim until the Uzans were no longer involved in KaR-Tel;
- ultimately, whether or not some other party could have achieved the same results is irrelevant from a valuation standpoint since, as Mr. Kaczmarek of Navigant pointed out in his testimony, it does not alter the fact that no external investor would have paid more than an extremely token amount for the equity in KaR-Tel at that time. Any investor proposing to come into the business would have had to either pay off Motorola or put sufficient funds into KaR-Tel to enable it to do it itself. No rational investor would do either of those things without demanding the issue of new shares for that equity, which would have left the existing shareholders diluted so that they owned less than 1% of the company.

772. Claimants also miss the point when they allege that KaR-Tel was not insolvent in April 2002 because it is not uncommon for mobile telecom operators to generate losses during the early years of operations. Indeed, KaR-Tel's insolvency was not directly tied to its

ability to generate profits. It was insolvent because it had failed to make a single payment of interest or principal on the Motorola Loan.

773. Moreover, according to Respondent, Claimants' statement that "*it is not uncommon for mobile telecom operators to generate losses during the early years of operations*" must be compared against the performance of KaR-Tel's only competitor in the Kazakh market, K-Cell. They received their licenses within a month of each other. However, as early as 2001, K-Cell was generating short-term profits. The comparison with K-Cell is illustrative of the fact that Claimants appear to have viewed KaR-Tel simply as another vehicle for their worldwide fraud.

774. Respondent further considers that the Report prepared by Analysys and submitted on behalf of Claimants is unreliable. There are two indicators which reveal immediately that the Analysys valuation is incorrect:

- Analysys' s April 2002 valuation gives an enterprise value per subscriber (EVPS) of over USD 4,450, whereas the enterprise value per subscriber for comparable companies at the same time was between USD 500 and USD 600;
- Analysys's valuation of KaR-Tel as of September 2004 (USD 928 million) is almost three times the value paid by VimpelCom at the time (USD 350 million).

775. Claimants' counsel opened the hearing before the Tribunal on the basis of the figures in the Analysys Report. It was extraordinary, therefore, when, in the middle of the hearing, Analysys informed Respondent that they had got it dramatically wrong. In fact, Analysys provided new figures which reduced their valuations by 50%. If, as is its usual role, Analysys had been advising a company on the purchase of KaR-Tel, that company would have paid more than the double of what Analysys now believes the company to have been worth.

776. Further, Respondent alleges that what is particularly troubling is the lateness of this admission. Analysys has had Navigant's Report since May 2007, which made clear that there must have been a significant error by Analysys.

777. Moreover, the new valuation by Analysys is still hopelessly overstated. It continues to fail to treat KaR-Tel as insolvent, which means its entire report adopts the wrong methodology, applying a valuation method for solvent companies to an insolvent company.

778. Respondent further submits that it is unacceptable as a matter of valuation theory, to use historical data when producing a fair market valuation. Only knowledge and expectations at the time are relevant. And in this context, in 2002, no analyst or investor appears to have foreseen the exponential growth that would occur in the Kazakh mobile telephony market between 2002 and 2006.

779. According to Respondent, the reason why Claimants have sought to rely on a different basis than fair market value is that fair market valuations are not permitted to rely on hindsight and must value the investment on the basis of the information that was known to the market at the relevant time. In April 2002, which is the appropriate time for valuation, it is quite clear that the market did not expect the growth in Kazakhstan mobile telephony which in fact occurred. Analysys acknowledged contemporaneous forecasts were not available for Kazakhstan in 2002. Moreover, a review of Analysys' own exhibit containing contemporaneous forecasts of mobile penetration for comparable countries in Central Asia and East Europe confirms that there is compelling evidence that the mobile markets in all these countries grew much faster than was forecast in 2002.

780. According to Respondent, the Tribunal should take into account the following:

- the BIT itself provides that "*compensation shall be equivalent to the real value of the expropriated investment before the expropriatory action was taken.*" This implicitly recognizes that what is to be valuated is the investment as it stood in April 2002, not what somenone in 2007 would pay for it if they could go back in time with subsequent knowledge;
- Analysys have not disclosed any authority for the proposition that real value means something different from fair market value and that it permits the use of hindsight in valuation. Navigant have, on the contrary, provided the Tribunal

with a wide range of ICSID awards demonstrating that fair market value is the appropriate standard and that it is not permissible to use hindsight in arriving at a fair market valuation.

781. Respondent finally alleges that further evidence that even Analysys' second attempt at a valuation is inaccurate is provided by a comparison of the actual data we now know for KaR-Tel with the figures that their model generates. As Navigant Slide 60 demonstrates, Analysys' net income figures for KaR-Tel for 2005 and 2006 are, respectively, 12 times and almost 5 times higher than the actual results posted by KaR-Tel – differences of over USD 25 million and over USD 70 million respectively.

782. The clearest way to see the absurdity of Analysys' figures is to do the arithmetic. In the course of his evidence to the Tribunal, Mr. Wright was asked about the fact that even his revised calculations led to a notional enterprise value per subscriber for KaR-Tel of USD 2,554.4 which looked rather high compared with the average actual enterprise value per subscriber of USD 746 achieved on the sale of KaR-Tel's only rival K-Cell in February 2002. Mr. Wright maintained that his figures were correct and were unsurprising. He stated that the disparity was explained by the fact that less developed mobile phone operators with smaller subscriber numbers were "*earlier in the curve*" so attracted a greater EVPS than more established operators like K-Cell. According to Respondent, these arguments are hopeless. The effect of Mr. Wright's evidence is that an informed buyer in April 2002 would have paid more for KaR-Tel than for K-Cell.

783. According to Respondent, its Navigant Report is to be preferred. It concludes that the fair market value of KaR-Tel was zero, even if it is evaluated on a going concern perspective.

784. Therefore, Claimants are not able to make out their case for the damages they claim. Respondent submits that the Tribunal should not award them a different or lesser sum.

IV. DECISION OF THE ARBITRAL TRIBUNAL

A. The principles of compensation

785. For expropriation, Article III of the BIT provides that "(c)ompensation shall be equivalent to the real value of the expropriated investment before the expropriatory action was taken or became known." Article 7(2) of the FIL provides that "(t)he compensation must be equal to the fair market value of the expropriated investments at the moment when the investor learnt of the expropriation."

786. The expression "fair market value" may in certain contexts have a specific technical meaning for the valuation of assets. In the context of the FIL, however, the expression must be taken to have a non-technical meaning and to convey a measure of value which can be applied whether or not a "fair market value" in a technical sense can be ascertained in the particular case. For present purposes, the Tribunal considers that no relevant distinction can be drawn between the expressions "real value" and "fair market value." The Tribunal should apply the method or methods of valuation which will most closely reflect the value of the expropriated investment to the investor at the relevant time.

787. Under Article 7(2) of the FIL the relevant time, i.e. the moment when the investor learnt of the expropriation, must necessarily be later than the expropriation itself. Article III of the BIT, on the other hand, does not indicate whether the Tribunal should apply the moment before the expropriatory action was taken, or the moment when it became known. For present purposes, the Tribunal considers that it can treat both moments as having occurred at the same time, since every step in the events leading up to the decision of the Presidium of the Supreme Court was known at once or almost at once to Claimants.

788. The moment at which the expropriation took place is not to be determined by any principle of international law, but is a question of fact to be determined by the Tribunal in the particular circumstances of the case. In some cases the moment of expropriation may be clearly established by a single expropriatory act. In other cases, such as the present

case, the expropriation may be gradual or "creeping," or it may be indirect rather than direct, so that to determine the moment of expropriation may be a matter of judgment rather than of direct and clear evidence. Given that both the BIT and the FIL refer, in similar language, to the moment when the expropriation became known to the investor, the Tribunal may legitimately have regard to the question whether any initial expropriatory act was known to be irrevocable, or whether there remained any possibility that it might be reversed.

789. For claims for breaches other than expropriation, neither the BIT nor the FIL offer any guidance for evaluating the damages arising from such breaches. Under Article 1 of the ILC Articles, every 'internationally wrongful act' of a State entails the 'international responsibility' of that State. An 'internationally wrongful act' is defined under Article 2 as an act which is (i) attributable to the State under international law and (ii) a breach of an international obligation of the State.

790. Under Article 28 of the ILC Articles, the international responsibility of a State which is entailed by an internationally wrongful act involves the legal consequences set out in part II of the ILC Articles. These include, under Article 32 (Reparation), an obligation to make "*full reparation for the injury caused by the internationally wrongful act.*" Injury is defined as including "*any damage, whether material or moral, caused by the internationally wrongful act*." Article 34 sets out the three forms of reparation which may be claimed individually or in combination: (i) restitution; (ii) compensation; (iii) satisfaction.

791. Under Article 36, when restitution cannot be made, as in the present case, the State is under an obligation to compensate for the damage caused. Such compensation is to cover "*any financially assessable damage including the loss of profits insofar as it is established*."

792. In assessing compensation for internationally wrongful acts other than expropriation, the Tribunal considers that it should apply the principle of the *Factory at Chorzow* case, according to which any award should "as far as possible wipe out all the consequences of

the illegal act and reestablish the situation which would in all probability have existed if that act had not been committed."[82]

793. In the present case, the loss which Claimants maintain that they have suffered is in fact the expropriation of their shares in Kar-Tel, whether or not this is characterised as an expropriation calling for compensation under the BIT, or merely as the consequence of some other internationally wrongful act, such as a breach of the obligation of fair and equitable treatment. In either case, the Tribunal considers that the correct approach is to award such compensation as will give back to Claimants the value to them of their shares at the time when the expropriation took place. This requires the Tribunal to take account only of the value which the shares would probably have had in the hands of Claimants if the shares had not been expropriated, and therefore to leave out of account any increase (or decrease) in the value of the shares which Claimants would probably not have enjoyed (or suffered) if the shares had remained in their hands.

B. <u>The calculation of the compensation and its amount</u>

794. As the Tribunal has just stated, it considers that, regardless of the nature of the breach which has been established, the correct approach in this case is to award such compensation as will give back to Claimants the value to them of their shares at the time when the expropriation took place.

795. The valuation date was a matter of controversy between the parties. Respondent maintained that the expropriation took place on April 23, 2002, which was the date of the injunction which excluded Claimants from the premises of Kar-Tel and was the last date on which Claimants played any part in the operations of Kar-Tel. Claimants on the other hand maintain that the expropriation did not take place until October 30, 2003, the date of the decision of the Presidium ordering the compulsory redemption of Claimants' shares. Having regard to what is said in paragraph 768, the Tribunal considers that it is appropriate to take into account the fact that until the unappealable decision of the Presidium on October 30, 2003 it could not reasonably be known by Claimants that their

[82] *Chorzów Factory,* 1928 PCIJ, Series A No. 17, p. 47.

exclusion from the premises of Kar-Tel would irrevocably lead to the loss of their shares. The injunction was challenged by Claimants, and did not become irrevocable until the decision of the Presidium in August 2002. Even then, the shares themselves remained in the ownership of Claimants, and the injunction could and would have been reversed if Claimants had succeeded on the merits by defeating the claim for compulsory redemption. It was not until June 6, 2003 that an order was made by the Almaty City Court for the compulsory redemption of the shares. That decision was also challenged on appeal, and it did not become irreversible until the decision of the Presidium on October 30, 2003.

796. The Tribunal considers that at no time until that date could it be said that there had been, to the knowledge of Claimants, an expropriation which had taken definite and irrevocable effect. The fact that successive decisions of the lower court were appealed to the Supreme Court is cogent evidence that Claimants considered that there was at least some prospect that they might retain their shares and resume control of the operations of Kar-Tel. For these reasons the Tribunal considers that it should assess the value of the shares to Claimants at October 30, 2003, and not at any earlier date.

797. The Tribunal has given consideration to the question whether the valuation of the shares by the Presidium is relevant or even conclusive as to the value of the shares to the Claimant. In the Tribunal's opinion, this valuation is neither relevant nor conclusive, for two reasons. First, to the extent that the decision of the courts that the shares should be compulsorily redeemed resulted from the internationally wrongful acts of the Investment Committee, the task of the Tribunal is to make an award which will restore Claimants to the position which would probably have prevailed if those wrongful acts had not taken place. That involves assuming a hypothetical state of affairs, in which the train of events which led to the valuation by the Presidium would not have taken place. That valuation is irrelevant to the hypothesis on which the Tribunal must make its own award, because on that hypothesis the valuation would not have occurred, and should not have occurred. Second, to the extent that the Tribunal determines that this was a case of expropriation requiring compensation under the BIT, it is axiomatic that such compensation must be

assessed by the Tribunal seized of the question whether, *under international law*, the compensation is "prompt, adequate and effective." That is a question which cannot be foreclosed by a decision of the State, including its courts, even if the decision is unimpeachable under the law of the host State. That is clearly so where as here, the decision of the court of the host State was a decision under the law of that State, and not under international law or under the BIT. In principle, however, the position would be the same even if the Presidium had purported to make its decision as if it were a valuation for the purpose of the BIT and under international law.

798. On the assessment of compensation itself, the discussion above of the respective positions of the parties discloses fundamental disagreements both as to the method of valuation and as to the result. In summary form the differences can be stated as follows.

799. Claimants for their part invite the Tribunal to adopt the DCF method of valuation, which on adjusted figures produces a valuation of Claimants' 60% shareholding, as at October 30, 2003, of USD 227 million. This valuation was based on forecasts of future growth which would have been available at that date (although not on April 23, 2002), so it does not rely on hindsight, which was a criticism made by Respondent of the figures for the earlier date, but only of those figures. Claimants maintain that the figure of USD 227 million compares well with the price paid by Vimpelcom in August 2004, of USD 350 million (of which 60% would have been USD 210 million).

800. Respondent on the other hand maintains that it is wrong in principle to use the DCF method to value a company which is not solvent and is therefore not a going concern, as they maintain was true of Kar-Tel in April 2002 and would have remained true in October 2003 if Claimants had remained in control. They maintain that the DCF method, as applied by Claimants' expert, leads to a valuation which is grossly out of line with the price paid in comparable transactions involving mobile phone licences, and that if the values implicit in those transactions are taken into account, the value of Kar-Tel's licence was insufficient to repay Kar-Tel's indebtedness to Motorola. In other words, Claimants' shares were valueless.

801. The Tribunal has considered in this connection the World Bank Guidelines on the Treatment of Foreign Direct Investment, 1992. Guideline IV contains the following remarks:

> *"3. Compensation will be deemed "adequate" if it is based on the full market value of the taken asset ...*
>
> *5. ... the fair market value will be deemed acceptable if determined by the State according to reasonable criteria related to the market value of the investment, i.e., in an amount that a willing buyer would normally pay to a willing seller after taking into account the nature of the investment, the circumstances in which it would operate in the future and its specific characteristics, including the period in which it would operate in the future and its specific characteristics, including the period in which it has been in existence, the proportion of tangible assets in the total investment and other relevant factors pertinent to the specific circumstances of each case."*

802. The Tribunal notes that this attaches to "fair market value" a meaning which does not presuppose the existence of a market in which investments of the class in question can be freely traded (there being no such market in the present case) but assumes a transaction between a willing buyer and a willing seller. The Tribunal also notes that the Guidelines do not state that there is no other way of arriving at a "fair market value." Nevertheless the Tribunal considers that these sections of the Guidelines set out concisely and accurately the approach to valuation of Claimants' shares which is appropriate in the circumstances of the present case, and that this is so even though the BIT refers to "real value" rather than "fair market value."

803. Section 6 of Guideline IV sets out the following guidelines for determining the market value of an investment:

> *"6. Without implying the exclusive validity of a single standard for the fairness by which compensation is to be determined as an illustration of the reasonable determination by a State of the market value of the investment under Section 5 above, such determination will be deemed reasonable if conducted as follows:*
>
> > *(i) for a going concern with a proven record of profitability, on the basis of the discounted cash flow value;*

> *(ii) for an enterprise which, not being a proven going concern, demonstrates lack of profitability, on the basis of the liquidation value;*
>
> *(iii) for other assets .... [Omitted as not relevant to the present case.]*
>
> *For the purposes of this provision:*
>
> *-a 'going concern' means an enterprise consisting of income producing assets which has been in operation for a sufficient period of time to generate the data required for the calculation of future income and which could have been expected with reasonable certainty, if the taking had not occurred, to continue producing legitimate income over the course of its economic life in the general circumstances following the taking by the State;*
>
> *-'discounted cash flow value' means the cash receipts realistically expected from the enterprise in each future year of its economic life as reasonably projected minus that year's expected cash expenditure, after discounting this net cash flow for each year by a factor which reflects the time value of money, expected inflation, and the risk associated with such cash flow under reasonable circumstances. Such discount may be measured by examining the rate of return available in the same market on alternative investments of comparable risk on the basis of their present value;*
>
> *-'liquidation value' means the amounts at which individual assets comprising the enterprise or the entire assets of the enterprise could be sold under conditions of liquidation to a willing buyer less any liabilities which the enterprise has to meet;*
>
> *[The definitions of 'replacement value' and 'book value' are omitted as not relevant to the present case.]*

804. The Tribunal adopts these provisions of Guideline IV as a valuable starting point for assessing compensation in the present case, while reminding itself (a) that they do not imply the exclusive validity of a single standard, (b) that the guidelines are described as "an illustration" and (c) that the overriding object is to ascertain the "fair market value" as defined in section 5. There is, as the Tribunal is aware, an extensive body of awards and other writings concerning the proper approach to the assessment of compensation for expropriation. In other cases it might be necessary to refer to such writings to resolve

particular issues, but the parties have not invited the Tribunal to embark on such an exercise, and the Tribunal considers that these sections of Guideline IV represent a widely recognised and well respected statement of the modern practice in such matters, which the Tribunal should follow so far as they are appropriate to the circumstances of this case.

805. With these observations in mind the Tribunal turns to consider the fair market value to Claimants of their shares on October 30, 2003. For this purpose the assumption must be made that Claimants had not been removed from the premises of Kar-Tel in April 2002 and that they had remained in continuous control of the operations of Kar-Tel from then until October 30, 2003, and indeed thereafter. On this assumption Respondent maintains that Kar-Tel was not a 'going concern' in April 2002, and that it would not have been a 'going concern' at October 30, 2003 if Claimants had remained in control of its operations.

806. In support of this Respondent relies on the facts set out in paragraph 731, above, as showing that Kar-Tel was insolvent in April 2002. The Tribunal accepts that on the basis of these matters Kar-Tel was probably insolvent at that date, at least as regards its balance sheet. Whether it would likewise have been insolvent as at October 30, 2003 if it had remained in the hands of Claimants is a matter of speculation. No doubt, given the financial strength of Rumeli's affiliate Telsim, funds could have been found to keep Kar-Tel in being and even, if it had proved absolutely unavoidable, to repay the Motorola Loan. Nevertheless the past history of the company under Claimants' management indicates that it would have continued to be starved of funds to make the necessary capital investment to turn the fortunes of the company around, particularly if it had become necessary to repay the Motorola loan. No doubt the fact that Claimants would have provided 100% of the capital but held only 60% of the shares (of which only 15% were held by Telsim) would have been a disincentive to any large scale investment. There is moreover no evidence to suggest the likelihood of any improvement in the quality of the management of Kar-Tel under Claimants' control. The strong likelihood is that its market share would at best have remained static and might even have continued to

shrink, that it would have remained chronically undercapitalised, and that it would have continued to miss its performance targets. It would also have remained under threat from the bankruptcy proceedings begun in Kazakhstan in August 2002.

807. According to Respondent the fact that Kar-Tel did not cease to carry on business was due to the new management brought in after Claimants were removed in April 2002, in the person of Mr. Yerimbetov, who gave evidence at the hearing. Mr. Yerimbetov was able to renegotiate the Motorola Loan down from over USD 100 million to USD 35 million and to borrow the funds necessary to repay the renegotiated amount. But this was not until after October 2003 (in fact in April 2004), and it had no impact on the availability of capital for day to day operations. That was achieved by Mr. Yerimbetov negotiating an allowance of credit from two large banks in the Kazakhstan market in the form of bank guarantees in the amount of USD 25 million. This enabled to buy new up-to date top of the range equipment from Alcatel, and thereby substantially to improve Kar-Tel's network coverage. Mr. Yerimbetov also purchased a new billing platform and re-branded the prepay card system, and he attributed the fact that subscribers increased to over 600,000 people and sales to over USD 100 million a year, to the activities which he described.

808. For the present it is sufficient for the Tribunal to find that if Kar-Tel had remained in the hands of Claimants it is likely that there would have been little or no improvement in its management or its financial position between April 2002 and October 2003, and that the impressive improvement in the fortunes of Kar-Tel after April 2002 would not have taken place.

809. Respondent's expert, as has been mentioned, considered that the DCF value is entirely inappropriate for Kar-Tel, because at October 30, 2003 it would still not have been a going concern. That is perhaps correct if one has regard to the definition of 'going concern' in the World Bank Guideline IV, section 6, which assumes predictable future profits based on historical data. It is also no doubt correct that in those circumstances the Guideline would allow the use of 'liquidation value' as a reasonable method for assessing

the fair market value of the investment. The Guideline does not however require the use of either the DCF or the liquidation value as the only correct method for assessing value. The overriding objective, as the Tribunal has already observed, to establish the "market value" of the investment, i.e. the amount that a willing buyer would normally pay to a willing seller, taking into account the matters referred to in section 5 of Guideline IV.

810. In the opinion of the Tribunal a DCF valuation would likely have formed one of the measures which would have informed a discussion between a willing seller and a willing buyer in October 2003, and it would have been equally appropriate to use the DCF method as a basis for discussion, whether the transaction was to involve a sale of the shares or a sale of the licence and other assets on their own. But the discussion would certainly not have ended there. It is well known that DCF values are to a greater or lesser extent sensitive to the validity of the data on which they are based, such as the inflation rate, the discount rate, the assumptions underlying the predicted cash flows. Claimants' expert's report contains a number of sensitivity analyses which demonstrate that quite small changes in input can materially affect the outcome. For example, the expert's original value of USD 567 million could, depending on various alternative assumptions which might reasonably have been made, have been as much as USD 753 million or as little as USD 451 million. The Tribunal is aware that the sensitivity analyses are used as a cross check on the figure adopted by the expert, and not to invalidate the figure. Nevertheless, they demonstrate that the method must be understood as an approximation which is dependent on the validity of the assumptions, and not as a mechanical calculation which will yield a value whose validity is not open to question.

811. This is particularly relevant in a case such as this, where even in October 2003 the enterprise had not been in existence for long enough to have generated the data required for the calculation of future income. This would mean that the enterprise would not be treated as a going concern under the World Bank Guidelines, and would therefore be more suitable for the 'liquidation value' rather than the DCF method of valuation. Kar-Tel would in October 2003 still have been in a relatively immature stage of development, with no established and stable track record of past income from which to predict future

income. This would have given rise to considerable doubt about the reliability of the DCF method. Despite this, the application of the 'liquidation value' still makes it necessary to ascribe a value to Kar-Tel's only asset of real value, namely its licence to operate the mobile telecommunication network. On any view that clearly had a value in October 2003 far in excess of its book value. Since the value of that asset was directly linked to its potential to produce future income, there is no realistic alternative to using the DCF method to ascribe a value to it. It is however necessary to recognise the limitations of the DCF method, including the limited reliability of the method without adequate historical data. This is strikingly illustrated by the fact that the DCF valuation by Claimants' expert as at April 2002 produced a revised valuation which implied an enterprise value ('EV') per subscriber of USD 2,500, whereas, according to Respondent's expert the EV for a sale and purchase of a 40% stake in Kar-Tel's competitor KCell in February 2002 resulted in an EV between USD 722 and USD 770: analysts at the time produced their own EV's of between USD 500 and USD 600, from which they concluded that the price was on the high side. The discrepancy between the DCF valuation and the EV values is very striking.

812. A potential buyer in October 2003 would for its part have been likely to take account of other matters which tended to increase the risk of purchasing the shares or the licence. These would have included the fact that, assuming continued control by Claimants until October 2003, Kar-Tel would not have regained market share lost to its principal competitor, that it would not have benefited from any substantial injection of capital, and that there would have been doubts about the quality of the equipment which Kar-Tel had acquired. On the other hand, these matters might be said to have afforded opportunities for new managers with access to adequate capital resources to turn Kar-Tel around.

813. In the absence of any more reliable method of valuation, the Tribunal takes as its starting point the base case DCF valuation by Claimants' expert as at October 30, 2003 of USD 227 million for Claimants' 60% stake in Kar-Tel, after repaying the Motorola Loan. This figure assumes historical data derived in part from the period between April 2002 and October 2003, when Kar-Tel was under new management and adequately capitalised.

During this period, Kar-Tel had improved its technical base, introduced new billing systems and begun to recover market share. It is not obvious to the Tribunal that Claimants would have undertaken such initiatives had they retained control of Kar-Tel. Moreover, the figure of USD 227 is to be compared with the price paid by Vimpelcom in August 2004, of which 60% is USD 210 million. This is substantially lower than the valuation of USD 227 as at October 30, 2003, despite the fact that the growth in mobile phone usage in Kazakhstan had continued in the intervening period, and had in fact accelerated.

814. Taking into account all the circumstances described above, the Tribunal concludes that an award of USD 125 million will adequately compensate Claimants for the expropriation of their shares and will give them full reparation for the injury caused by the internationally wrongful acts which the Tribunal has found to have been committed by Respondent. The Tribunal therefore orders Respondent to pay this amount of USD 125 million to Claimants.

815. In reaching this conclusion, the Tribunal has taken note of the evidence (some of which was contested) as to various negotiations which are said to have taken place with regard to the shares in Kar-Tel.

816. Two of these negotiations are said to have involved offers to buy Claimants' shares which were rejected: see paragraphs 138, and 541-547. Since these took place at a time when Claimants had been or were likely to be deprived of the shares, and the offers were rejected by Claimants, the Tribunal does not regard them as relevant to the market value of the shares in October 2003.

817. The third negotiation concerned the sale by Telcom Invest of its 40% stake in Kar-Tel to Claimants in the autumn of 2002: see paragraphs 134-135, 401-403, and 506-510. This reached the stage of a draft agreement for the sale of Telcom Invest's 40% shareholding for USD 12 million. In the end the transaction fell through, but if Telcom Invest was willing to sell its 40% stake for USD 12 million, it can certainly be asked why Claimants' 60% stake should have been worth more than USD 18 million. A number of explanations

are possible, the most likely of which is that Telcom Invest and its backers had at that time little or no real knowledge of the mobile telecommunications business and had failed to appreciate the potential value of the licence. The Tribunal does not consider that this evidence can be used as a safe guide to the fair market value of Claimants' shareholding, beyond indicating that the true value of the licence was less obvious in 2002 than it later became: at that time the very rapid growth in the market which began in 2003 had not become established.

818. As far as interest is concerned, the Arbitral Tribunal orders Respondent to pay Claimants compound interest at the rate of 6-month average Libor plus 2 percent per year, compounded semi-annually, on the amount of USD 125 million from October 30, 2003 until the date of the payment of the Award.

V. COSTS

819. Finally, the Tribunal turns to costs. To obtain justice, Claimants had no option but to bring this arbitration forward and to incur the related costs. Although they have prevailed on the substance of the dispute, they have failed on a number of their allegations and the amount of damages awarded is less than the one claimed. On this basis, the Tribunal considers fair that each party bear 50% of the costs of the arbitration proceeding (advances to ICSID) and that Respondent be condemned to pay 50% of Claimants' legal costs and fees as detailed in Claimants' letter of January 25, 2008 (with appendices under tab 1 to 5), with the exception of the costs of the arbitration (lodging fee and advances to ICSID).

AWARD

1. Respondent breached its obligation to accord the investor the fair and equitable treatment imposed on Respondent by virtue of the Most Favourable Nation Clause contained in Article II(1) of the Bilateral Investment Treaty;

2. Respondent has expropriated Claimants' investment without complying with the conditions set forth in Article III(1) of the Bilateral Investment Treaty;

3. Respondent shall pay Claimants compensation in the amount of USD 125 million;

4. Respondent shall pay Claimants compound interest at a rate of 6-month average Libor plus 2 percent per year, compounded semi-annually, on the amount of USD 125 million from 30 October 2003 until the date of the payment of the Award;

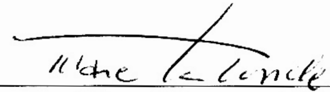
5. Respondent shall pay 50% of Claimants' legal fees and costs as detailed in Claimants' letter of January 25, 2008 with details under tab 1 to 6;

6. Respondent shall pay Claimants compound interest on the Claimants' legal fees and as awarded under No. 5 at the rate indicated above at No. 4, from the date of this Award until the date of full payment;

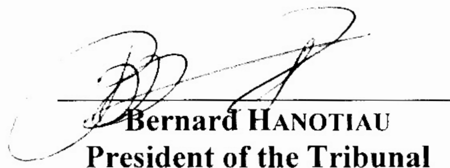
7. All other claims are dismissed.

THE ARBITRAL TRIBUNAL

Stewart BOYD
Arbitrator
Date: 2/7/08



Marc LALONDE
Arbitrator
Date:



Bernard HANOTIAU
President of the Tribunal
Date: 17 July 2008

CLA-000064

(English Translation from Spanish Original)

INTERNATIONAL CENTRE FOR SETTLEMENT
OF INVESTMENT DISPUTES
WASHINGTON, D.C.

IN THE PROCEEDING BETWEEN

EMILIO AGUSTÍN MAFFEZINI
(CLAIMANT)

and

THE KINGDOM OF SPAIN
(RESPONDENT)

CASE NO. ARB/97/7

A W A R D

Members of the Tribunal

Professor Francisco Orrego Vicuña, President
Judge Thomas Buergenthal, Arbitrator
Mr. Maurice Wolf, Arbitrator

Secretary of the Tribunal

Mr. Gonzalo Flores

Representing the Claimant

Dr. Raúl Emilio Vinuesa
Dra. María Cristina Brea
Dra. Silvina González Napolitano
Dra. Gisela Makowski
Estudio Vinuesa y Asociados
Buenos Aires
Argentina

Representing the Respondent

Mr. Rafael Andrés León Cavero
Abogado del Estado
Subdirección General de los Servicios Contenciosos del Ministerio de Justicia
Madrid
Spain

Date of dispatch to the parties: **November 13, 2000**

THE TRIBUNAL

Composed as above,

After deliberation,

Makes the following Award:

A. Introduction

1. The Claimant, Mr. Emilio Agustín Maffezini, is a national of the Argentine Republic (Argentina), with his domicile in Buenos Aires, Argentina. He is represented in this arbitration proceeding by:

Dr. Raúl Emilio Vinuesa,
Dra. María Cristina Brea,
Dra. Silvina González Napolitano, and
Dra. Gisela Makowski
Estudio Vinuesa y Asociados
Alsina 2360
San Isidro (1642)
Buenos Aires, Argentina

2. The Respondent is the Kingdom of Spain (Spain), represented in this proceeding by:

Mr. Rafael León Cavero
Abogado del Estado
Subdirección General de los Servicios Contenciosos del Ministerio de Justicia
Ayala 5
28001, Madrid
Spain

3. This Award contains the Tribunal's declaration of closure of the proceeding issued pursuant to Rule 38 of the ICSID Rules of Procedure for

Arbitration Proceedings (Arbitration Rules) as well as the Award on the merits in accordance with Arbitration Rule 47. The Tribunal has taken into account all pleadings, documents and testimony in this case insofar as it considered them relevant.

B. Summary of the Procedure

1. Procedure Leading to the Decision on Jurisdiction

4. On July 18, 1997, the International Centre for Settlement of Investment Disputes (ICSID or the Centre) received from Mr. Emilio Agustín Maffezini a Request for Arbitration against the Kingdom of Spain. The request concerned a dispute arising from treatment allegedly received by Mr. Maffezini from Spanish entities, in connection with his investment in an enterprise for the production and distribution of chemical products in the Spanish region of Galicia. In his request the Claimant invoked the provisions of the 1991 "Agreement for the Reciprocal Promotion and Protection of Investments between the Kingdom of Spain and the Argentine Republic" (the Argentine-Spain Bilateral Investment Treaty or BIT).[1] The request also invoked, by way of a most-favored-nation (MFN) clause in the Argentine-Spain BIT, the provisions of a 1991 bilateral investment treaty between the Republic of Chile (Chile) and Spain.[2]

5. On August 8, 1997, the Centre, in accordance with Rule 5 of the ICSID Rules of Procedure for the Institution of Conciliation and Arbitration Proceedings (Institution Rules), acknowledged receipt of the request and on the same day transmitted a copy to the Kingdom of Spain and to the Spanish Embassy in Washington, D.C. At the same time, the Centre asked Mr. Maffezini to provide (i) specific information concerning the issues in dispute and the character of the underlying investment; (ii) information as to the complete terms of Spain's consent to submit the dispute to arbitration under the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (the ICSID Convention); (iii) information as to the basis of his claim that the MFN clause in the Argentine-Spain BIT would allow him to invoke Spain's

---

[1] Agreement between Argentina and Spain of October 3, 1991. Hereinafter cited as the Argentine-Spain BIT.

[2] Agreement between Chile and Spain of October 2, 1991. Hereinafter cited as the Chile-Spain BIT.

consent contained in the Chile-Spain BIT; and (iv) documentation concerning the entry into force of the bilateral investment treaties invoked in the request. Mr. Maffezini provided this information in two letters of September 10 and September 29, 1997.

6. On October 30, 1997, the Secretary-General of the Centre registered the request, pursuant to Article 36(3) of the ICSID Convention. On this same date, the Secretary-General, in accordance with Institution Rule 7, notified the parties of the registration of the request and invited them to proceed to constitute an Arbitral Tribunal as soon as possible.

7. On December 22, 1997, the Claimant proposed to the Respondent that the Arbitral Tribunal consist of a sole arbitrator, to be appointed by agreement of the parties. The Claimant further proposed that, if the parties fail to agree in the name of the sole arbitrator by January 31, 1998, the sole arbitrator shall be appointed by ICSID's Secretary-General.

8. On March 5, 1998, Spain having failed to respond to the Claimant's proposal and more that 60 days having elapsed since the registration of the request, the Claimant informed the Secretary-General that he was choosing the formula set forth in Article 37(2)(b) of the ICSID Convention. The Tribunal, therefore, would consist of three arbitrators, one appointed by Mr. Maffezini, one appointed by Spain, and the third, presiding arbitrator, appointed by agreement of the parties.

9. On March 18, 1998, the Centre received a communication from the Spanish Ministry of Economy and Finance, whereby Spain anticipated having objections to the jurisdiction of the Centre and to the competence of the Tribunal, providing the Centre with a summary of the grounds on which such objections were based. The Centre promptly informed the Respondent that a copy of this communication, as well as copies of the request for arbitration and its accompanying documentation, of the notice of registration and of the correspondence exchanged between the parties and the Centre would be transmitted, in due course, to each of the Members of the Tribunal, noting that the question of jurisdiction was one for the Tribunal to decide.

10. On April 24, 1998, Mr. Maffezini appointed Professor Thomas Buergenthal, a national of the United States of America, as an arbitrator. On May 4, 1998, Spain appointed Mr. Maurice Wolf, also a national of the

United States of America, as an arbitrator. The parties, however, failed to agree on the appointment of the third, presiding, arbitrator. In these circumstances, by means of a further communication of May 14, 1998, the Claimant requested that the third, presiding, arbitrator in the proceeding be appointed by the Chairman of ICSID's Administrative Council in accordance with Article 38 of the ICSID Convention and Rule 4 of the Arbitration Rules.[3]

11. Having consulted with the parties, the Chairman of ICSID's Administrative Council appointed Professor Francisco Orrego Vicuña, a Chilean national, as the President of the Arbitral Tribunal. On June 24, 1998, ICSID's Legal Adviser, on behalf of the Centre's Secretary-General, and in accordance with Rule 6(1) of the Arbitration Rules, notified the parties that all three arbitrators had accepted their appointments and that the Tribunal was therefore deemed to have been constituted on that date. On the same date, pursuant to ICSID Administrative and Financial Regulation 25, the parties were informed that Mr. Gonzalo Flores, Counsel, ICSID, would serve as Secretary of the Arbitral Tribunal.

12. On July 3, 1998, the Respondent filed an application for provisional measures, requiring the Claimant to post a guaranty in the amount of the costs expected to be incurred by Spain in defending against this action. By further filing of August 7, 1998, the Claimant requested the Tribunal to dismiss such application.

13. After consulting with the parties, the Tribunal scheduled a first session for August 21, 1998. On August 20, 1998, counsel for the Respondent hand-delivered a document containing Spain's objections to the jurisdiction of the Centre. A copy of Spain's filing was distributed by the Centre to the Members of the Tribunal on that same date. A copy of Spain's filing was later handed by the Secretary of the Tribunal to the Claimant's representative in the course of the Tribunal's first session with the parties.

[3] Under Article 38 of the ICSID Convention and Rule 4 of the Arbitration Rules, if the Tribunal is not yet constituted within 90 days after the notice of registration of the request has been dispatched, the Chairman of ICSID's Administrative Council shall, at the request of either party, and after consulting both parties as far as possible, appoint the arbitrator or arbitrators not yet appointed and designate an arbitrator to be the President of the Tribunal.

14. The first session of the Tribunal with the parties was held, as scheduled, on August 21, 1998, at the seat of ICSID in Washington, D.C. At the session, the parties expressed their agreement that the Tribunal had been properly constituted, in accordance with the relevant provisions of the ICSID Convention and the Arbitration Rules, and that they did not have any objections in this respect. The Tribunal hereby states that it was therefore established under the Convention.

15. During the course of the first session the parties agreed on a number of procedural matters reflected in written minutes signed by the President and the Secretary of the Tribunal. Spanish was chosen by the parties as the procedural language and Washington, D.C., the seat of the Centre, was selected as the formal place of proceedings. The Respondent, represented at the session by Mr. Rafael Andrés León Cavero, drew the Tribunal's attention to its objections to the jurisdiction of the Centre. The Tribunal, after briefly ascertaining the views of the parties on this matter, fixed the following time limits for the written phase of the proceedings: the Claimant would file a memorial, with all of his arguments on the question of jurisdiction and on the merits within 90 days from the date of the first session; the Respondent would then file a counter-memorial, with all of its arguments on the question of jurisdiction and on the merits within 90 days from its reception of the Claimant's memorial. The Tribunal left open the possibility of requiring the submission of a reply and a rejoinder to the parties. The Tribunal also left open the possibility of holding a hearing on the issue of jurisdiction.

16. In accordance with the above-described schedule, the Claimant submitted to the Centre his memorial on the merits and on the question of jurisdiction on November 19, 1998. On April 9, 1999, after a request for an extension of the time limit for the filing of its counter-memorial was granted by the Tribunal, the Respondent submitted its written pleadings on the merits and on the question of jurisdiction.

17. On May 14, 1999, the Tribunal invited the parties to submit any further observations they may had on the question of jurisdiction, calling for a hearing on jurisdiction to be held on July 7, 1999, at the seat of the Centre in Washington, D.C. The parties filed their final observations on the question of jurisdiction on June 3, 1999 (the Claimant) and June 18, 1999 (the Respondent). Due to consecutive requests filed first by counsel

for the Respondent, and later by counsel for the Claimant, the hearing on jurisdiction was postponed until August 9, 1999.

18. At the August 9, 1999 hearing, Dr. Raúl Emilio Vinuesa addressed the Tribunal on behalf of the Claimant, referring to the arguments put forward in his written pleadings. Mr. Rafael Andrés León Cavero addressed the Tribunal on behalf of the Kingdom of Spain. The Tribunal then posed questions to the representatives of the parties, as provided in Rule 32(3) of the Arbitration Rules.

19. Having heard the views of the parties, the Tribunal rendered, on August 26, 1999, Procedural Order No 1, deciding that, in accordance with Article 41(2) of the ICSID Convention and Rule 41(3) of the Arbitration Rules, it would deal with the question of jurisdiction as a preliminary matter, therefore suspending the proceedings on the merits.

20. On October 28, 1999, the Tribunal issued Procedural Order No. 2, addressing Spain's request for provisional measures. The Tribunal, pointing out that the recommendation of provisional measures seeking to protect mere expectations of success on the side of the Respondent would amount to a prejudgement of the Claimant's case, unanimously dismissed Spain's request. Certified copies of the Tribunal's Procedural Order No. 2 were distributed to the parties by the Secretary of the Tribunal. A copy of Procedural Order No. 2 is attached to the present Award as an integral part of such.

21. On January 25, 2000 the Tribunal, having deliberated by correspondence, issued its unanimous Decision on the Objections to Jurisdiction raised by the Kingdom of Spain. In its Decision, the Tribunal rejected the Respondent's contention that the Claimant failed to comply with an exhaustion of local remedies requirement set forth in Article X of the Argentine-Spain BIT. Also, in light of the application of the most favored nation clause included in the Argentine-Spain BIT, and therefore relying on the more favorable arrangements contained in the Chile-Spain BIT, the Tribunal rejected Spain's contention that the Claimant should have submitted the case to Spanish courts before referring it to international arbitration under Article X(2) of the BIT, and concluded that the Claimant had the right to submit the instant dispute to arbitration without first accessing the Spanish courts. Finally, the Tribunal, addressing the other objections to jurisdiction raised by Spain, concluded that the Claimant had

made out a *prima facie* case that he had standing to file this case, that the *Sociedad para el Desarrollo Industrial de Galicia Sociedad Anonima* (SODIGA S.A. or SODIGA) was a State entity acting on behalf of the Kingdom of Spain and that the dispute came into being after both the Argentine-Spain and the Chile-Spain BITs had entered into force. On these basis, the Tribunal concluded that the Centre had jurisdiction and that the Tribunal was competent to consider the dispute between the parties in accordance with the provisions of the Argentine-Spain BIT.

22. Certified copies of the Tribunal's decision were distributed to the parties by the Secretary of the Tribunal. A copy of the Tribunal's Decision on Jurisdiction is attached to the present Award as an integral part of such.

2. Procedure leading to the Award on the Merits

23. On January 25, 2000, the Tribunal, following its Decision on Jurisdiction, issued, in accordance with Rules 19 and 41(4) of the Arbitration Rules of the Centre, Procedural Order No. 3 for the continuation of the proceedings on the merits. In that Procedural Order the Tribunal fixed the following schedule for the further procedures: having the parties filed their principal written pleadings, the Claimant would file a reply on the merits within forty five days from his receipt of the Tribunal's Decision on Jurisdiction and the Respondent would file a rejoinder on the merits forty-five days from its receipt of the Claimant's reply. Once the Tribunal has received these memorials it would fix a date for a hearing.

24. Pursuant to that schedule, the Claimant submitted to the Centre, on March 21, 2000, his reply on the merits. On May 3, 2000, the Respondent submitted its rejoinder on the merits.

25. By letter of May 10, 2000, the Tribunal, having previously consulted with counsel for both parties, called for a hearing on the merits to be held during the week of July 10, 2000, in London, England.

26. By letter of June 2, 2000, the Tribunal, in accordance with Arbitration Rule 34(2)(a), call upon the Claimant to produce the following witnesses to be available for examination at the hearing on the merits: Mr. Emilio Agustín Maffezini, Mr. Silverio Bouzas Piñeiro and Mr. Héctor Rodríguez Molnar.

27. By same letter of June 2, 2000, the Tribunal, in accordance with Arbitration Rule 34(2)(a), call upon the Respondent to produce the following witnesses to be available for examination at the hearing on the merits: Mr. Ricardo Méndez Rey, Mr. Manuel Mucientes Iglesias, Mr. Luis Fernández García and Mr. Luis Soto Baños. Additionally, the Tribunal requested that the Respondent make available for examination the following expert: Mr. José Ramón Álvarez Arnau.

28. In accordance with the Tribunal's directions of June 2, 2000, the hearing on the merits would follow this order:

> The Tribunal would deliberate privately on Monday, July 10, 2000.
>
> The Hearing on the merits would commence on Tuesday, July 11, 2000 at 10 a.m.
>
> Counsel for the Claimant would open with a 30-minute oral presentation, followed by a 30-minute presentation by counsel for the Respondent. Each party may then present, by way of rebuttal and surrebuttal, any further remarks it may have for 15 minutes each.
>
> The Claimant would then be entitled to a 30-minute examination of each of its witnesses, followed by a 30-minute examination of each of the Claimant's witnesses by counsel for the Respondent. The Respondent would thereafter be entitled to a 30-minute examination of each of its witnesses and of the expert, followed by a 30-minute examination of each of such witnesses and expert by counsel for the Claimant.
>
> Finally the Claimant would close with a statement of no more than 30 minutes, followed by a 30-minute closing statement by the Respondent.
>
> The members of the Tribunal may put questions to the witnesses and to the expert witness, and ask them for explanations at any moment during the hearings, but such questions would not be chargeable to the parties' time.

29. By letter of July 5, 2000, counsel for the Claimant submitted the written deposition of the witness requested from that party, Mr. Silverio

Bouzas Piñeiro, and an additional deposition made by Mr. Emilio Agustín Maffezini.

30. The hearing on the merits was held, as scheduled, the week of July 10, 2000, in London, at the seat of the International Dispute Resolution Centre (IDRC). Present at the hearing were:

Members of the Tribunal:
Professor Francisco Orrego Vicuña, President, Judge Thomas Buergenthal, Arbitrator and Mr. Maurice Wolf, Arbitrator

ICSID Secretariat:
Mr. Gonzalo Flores, Secretary of the Tribunal

On behalf of the Claimant:
Dr. Raúl Emilio Vinuesa, Dra. Silvina González Napolitano and Dra. Gisela Makowski

On behalf of the Respondent:
Mr. Rafael León Cavero, Abogado del Estado

Also attending on behalf of the Respondent:
Ms. Pilar Morán Reyero, Subdirectora General de Inversiones Exteriores del Ministerio de Economía del Reino de España and Mr. Félix Martínez Burgos, Consejero Comercial Jefe de la oficina Comercial de España en Gran Bretaña

31. The hearing commenced, as scheduled, on July 11, 2000 at 10 a.m. After a brief introduction by the President of the Tribunal, Dr. Raúl Emilio Vinuesa addressed the Tribunal on behalf of the Claimant, referring to the arguments put forward in his written pleadings. Mr. Rafael Andrés León Cavero then addressed the Tribunal on behalf of the Kingdom of Spain.

32. Of the witnesses requested by the Tribunal from the Claimant only Mr. Rodriguez Molnar appeared at the hearing. As noted in paragraph 29 above, Messrs. Maffezini and Bouzas Piñeiro submitted written deposition to the Centre on July 5, 2000. Of the witnesses requested by the Tribunal from the Respondent, Mr. Mendez Rey, Mr. Mucientes Iglesias, Mr. Fernández García and Mr. Soto Baños appeared at the hearing. So did the expert requested by the Tribunal from the Respondent, Mr. Álvarez Arnau.

33. The hearing was suspended on the afternoon of July 11, 2000, during the Claimant's interrogation of the expert, due to a health emergency suffered by Mr. Wolf. The parties having agreed during the August 21, 1998 session of the Tribunal with the parties, that only the presence of the majority of the members of the Tribunal would be required at its sittings, the other members of the Tribunal, with the agreement of the parties, decided to continue with the hearing. The hearing continued thus, in the absence of Mr. Wolf and the Secretary of the Tribunal, who left the hearing to help Mr. Wolf. Even though part of the witnesses' depositions of the afternoon of July 11, 2000 were not recorded due to a technical mishap, which was made known to both of the parties, the recordings were subsequently made available to Mr. Wolf and the other arbitrators, so that all members of the Tribunal had access to most of the testimony presented by the witnesses and the expert. All of the witnesses and the expert that attend the hearing were examined by the presenting party, cross examined by the other party and questioned by the Tribunal. The examination, cross-examination and questioning of all of the witnesses took place during the session of July 11, 2000.

34. The hearing continued on the morning of July 12, 2000. Mr. Wolf could not attend this session due to ill health. During this session, counsel for both parties made their closing presentations, as scheduled. The hearing concluded with some final remarks by the President of the Tribunal concerning the efficient and professional presentation of their cases made by counsel for both parties.

35. On November 9, 2000, the members of the Tribunal met for the last time at the seat of the Centre, in Washington, D.C., for final deliberations.

3. Declaration of Closure of the Proceeding

36. ICSID Arbitration Rule 38 (1) requires that when the presentation of the case by the Parties is complete, the proceeding shall be declared closed.

37. Having reviewed all of the presentations by the parties, the Tribunal, came to the conclusion that there is no request by a Party or any reason to reopen the proceeding, as is possible under ICSID Arbitration Rule 38(2).

38. Accordingly, by letter dated November 2, 2000, the Tribunal declared the proceeding closed, in accordance with ICSID Arbitration Rule 38(1).

C. Summary of Facts and Contentions

39. In 1989, Mr. Emilio Agustín Maffezini decided to embark on the production of various chemical products in Galicia, Spain, by establishing and investing in a corporation named Emilio A. Maffezini S. A. (EAMSA). EAMSA was incorporated under the laws of Spain on November 15, 1989. Mr. Maffezini subscribed to 70% of the capital for 35 million Spanish Pesetas, paying 66.36% thereof at the time of incorporation, with the balance to be paid at a later time. The *Sociedad para el Desarrollo Industrial de Galicia*, a Spanish entity whose legal status will be discussed below, subscribed to 30% of the capital or 15 million Spanish Pesetas. A third nominal shareholder was included to comply with the legal requirements relating to the incorporation, but that share was immediately repurchased by Mr. Maffezini. A contract was also made for the repurchase of SODIGA's shares by Mr. Maffezini. This contract provided for an interest rate of 12%. That rate was lower than the current market rate of 16.6% and reflected a preferential arrangement. SODIGA also granted a loan of 40 million Spanish Pesetas to the newly incorporated company, at a preferential interest rate, to be applicable at least for the first year. Various subsidies were requested from and approved by the Spanish Ministry of Finance and the *Xunta de Galicia*.

40. Information on prospective markets was requested from various Spanish government agencies. At the same time, EAMSA proceeded to hire a private consulting firm in order to identify the appropriate plot of land to buy and to undertake a study on the costs of construction and whatever other requirements the new company might have to begin production. On the basis of this study the land was purchased and contracts concluded with various firms and suppliers. SODIGA, for its part, had also undertaken an economic evaluation of the project in order to decide whether to participate in it.

41. On June 24, 1991, an environmental impact assessment (EIA) study was filed with the *Xunta de Galicia*, the government of the Autonomous Region of Galicia. Additional information was requested and provided,

and the EIA was finally cleared on January 15, 1992. Before such clearance was obtained, work commenced on readying the land for construction. Construction of the plant itself was also begun.

42. While these preparations for the implementation of the project were in progress, EAMSA began to experience financial difficulties. A capital increase was agreed to, new loans were requested and applications for additional subsidies were made. Some of these efforts did not succeed, however. A transfer of 30 million Spanish Pesetas was made from a personal account of Mr. Maffezini to EAMSA, under circumstances that will be considered below.

43. In early March 1992, Mr. Maffezini ordered the construction to stop and the dismissal of EAMSA employees. In June 1994 an attorney working for Mr. Maffezini approached SODIGA with an offer inviting it to cancel all outstanding debts owed it by EAMSA and Mr. Maffezini in exchange for EAMSA's assets. SODIGA indicated that it would accept this offer provided Mr. Maffezini was willing to add 2 million Spanish Pesetas. This proposal was rejected by Mr. Maffezini. The Argentine embassy in Madrid was then asked by Mr. Maffezini to intervene. After an exchange of more correspondence, SODIGA indicated, on June 13, 1996, that it was willing to accept the original proposal made by Mr. Maffezini's attorney. Mr. Maffezini did not follow up on SODIGA's latest proposal. Not long thereafter he instituted the ICSID proceedings described above.

44. Based on the foregoing facts, Mr. Maffezini has submitted four main contentions to this Tribunal. First, that because of SODIGA's status as a public entity, all of its acts and omissions are attributable to the Kingdom of Spain. Second, that the project failed because of the wrong advice given by SODIGA with regard to the costs of the project, which turned out to be significantly higher than originally estimated. Third, that SODIGA was also responsible for the additional costs resulting from the EIA since EAMSA was pressured to make the investment before the EIA process was finalized and before its implications were known. Fourth, that Mr. Maffezini had not agreed to a loan to EAMSA for 30 million Spanish Pesetas and that the transfer of this amount from his personal account to EAMSA was irregular.

45. The Kingdom of Spain has contested these allegations. It considers that SODIGA is a private company whose acts are not attributable to the

State. In any event, the Kingdom contends that the one year statute of limitation applicable under Spanish law to such claims against public entities bars the instant action even if SODIGA were to be considered a public entity. Spain also argues that Mr. Maffezini was responsible for the feasibility study of the project, including availability of markets for its products and costs, and that SODIGA's studies and estimates were intended purely for its own purposes in order to enable it to decide whether to participate in the venture. The Kingdom of Spain further argues that Mr. Maffezini was fully aware of the requirements of the EIA and that he decided to acquire the land and proceed with the construction before receiving EIA approval and did so against the advice of his own employees and consultants. According to Spain, the transfer of funds to EAMSA was fully authorized by Mr. Maffezini and was carried out by an official of SODIGA acting in his personal capacity on instructions of Mr. Maffezini. The Kingdom also considers that, as a matter of law, Mr. Maffezini's 1994 settlement proposal was an offer to conclude a contract. That offer was never withdrawn and, therefore, became a binding contract when SODIGA accepted it in 1996.

D. Considerations

SODIGA's status in the Kingdom of Spain.

46. The status of SODIGA in the Kingdom of Spain was considered by the Tribunal at the jurisdictional stage of these proceedings from two points of view. The Tribunal first considered whether or not SODIGA was a State entity for the purpose of determining the jurisdiction of the Centre and the competence of the Tribunal. Here the Tribunal found that the Claimant had made out a *prima facie* case that SODIGA was a State entity acting on behalf of the Kingdom of Spain. Both a structural and a functional test were applied to reach this conclusion.

47. This *prima facie* determination can now be confirmed by the Tribunal since no convincing evidence has been produced to rebut it. The Kingdom of Spain has continuously relied on the structure of the Spanish public administration to argue that SODIGA did not fall in this category and that it is merely a financial company created as a private corporation. Among other arguments in support of this position, the Kingdom of Spain invoked Article 2 of Law 30/92, dated November 27, 1992, which establishes the legal regime of Public Administrations and Common Adminis-

trative Procedure.[4] This provision identifies as public administrations the General Administration of the State, the Administration of Autonomous Communities and the entities belonging to local administrations. It further identifies in this category the entities created under public law and that have a legal personality associated with any of the entities mentioned. This listing is consistent with the structural test employed by the Spanish Administration.

48. But even if the structural test is applied, it is clear that financial companies such as SODIGA could not at the period relevant to the present dispute be held to fall entirely outside the overall scheme of public administration. In fact, there existed a variety of public entities that were governed by private law but which would occasionally exercise public functions that were governed by public law.[5] Thus, the *Instituto Nacional de Industria*, established in 1941, followed in 1992 by the Group *TENEO S. A.,* both with close institutional and financial relations to SODIGA, as well as the creation in 1995 of the State Corporation for Industrial Participation ("Sociedad Estatal de Participaciones Industriales"), were all in this mixed category of public entities with private law regimes.[6] Their status always gave rise to great confusion.[7]

49. The enactment of Law 30/92 clarified this situation in part. It must be noted, however, that this law is of a date subsequent to the here relevant period—November 27, 1992. Gradually the distinction came to be made between Public Business Entities ("Entidades públicas empresariales") which, although governed by private law, could eventually exercise some public functions under public law,[8] and State commercial corporations ("Sociedades mercantiles estatales"). The latter, although considered public entities from an economic point of view, are as a matter of law governed by private law, and not administrative law.[9] But even here some activities of

[4] Law No. 30/1992, November 26, 1992, as amended, text in Luis Martín Rebollo: *Leyes Administrativas*, 1999, at 369.

[5] Luis Martín Rebollo: "Estudio Preliminar y Esquema de la Organización de la Administración General del Estado y de la Estructura Orgánica Básica de los diferentes Ministerios", in op. cit., supra note 4, 636, 639.

[6] Ibid., at 639-640.

[7] Ibid., at 679.

[8] See in particular Article 2.2 of Law No. 30/1992, and the notes to this Article by Martín Rebollo, op. cit. supra note 4, at 385.

[9] Martín Rebollo, op. cit., supra note 4, at 679.

these commercial corporations, such as contracting for example, were governed by administrative law.[10] It was not until the adoption of Law 6/1997 of April 14, 1997 that state commercial corporations were clearly forbidden to "perform functions that imply the exercise of public authority."[11] The regime only came to be completed recently with the enactment of Law 1/1999, dated January 5, 1999, which governs capital venture entities and the corporations established to manage such entities, including "XesGALICIA S.G.E.C.R., S.A," established in 1999, the present corporation that now controls SODIGA.[12]

50. The structural test, however, is but one element to be taken into account. Other elements to which international law looks are, in particular, the control of the company by the State or State entities and the objectives and functions for which the company was created. As the Tribunal emphasized in its Decision on jurisdiction, many of these elements point in the instant case to its public nature.

51. The second issue the Tribunal considered at the jurisdictional stage was whether the actions and omissions complained of by the Claimant were attributable to the State. In dealing with this question, the Tribunal concluded that whether SODIGA was responsible for those acts, whether they were wrongful, whether all these acts and omissions always were governmental rather than commercial in nature, and, hence, whether they can be attributed to the Spanish State, were all issues that could only be decided at the merits stage of the case.

52. In dealing with these questions, the Tribunal must again rely on the functional test, that is, it must establish whether specific acts or omissions are essentially commercial rather than governmental in nature or, conversely, whether their nature is essentially governmental rather than commercial. Commercial acts cannot be attributed to the Spanish State, while governmental acts should be so attributed.

---

[10] Ibid., at 679.

[11] Law No. 6/1997, April 14, 1997, in Martín Rebollo, op. cit., supra note 4, at 677, Disposición Adicional Duodécima, at 713.

[12] José Martí Pellón: *El capital inversión en España1999*, Asociación Española de Capital Inversión, 1999, at 24. For a description of "XesGalicia S. G. E. C. R., S. A.", see Ibid., at 197.

53. SODIGA was incorporated in 1972 at a time when the Spanish State pursued an active policy of industrial promotion, particularly in depressed areas of the country. This policy was specifically designed by the public sector to encourage the industrial development of Spain. To this end not less than twenty-two such entities were created in different regions of the country. Only four such entities were related to the private sector. All others, including SODIGA, were closely related to the *Instituto Nacional de Industria* and to the respective *Comunidades Autonomas* which, in the case of SODIGA, was the *Xunta de Galicia*.[13]

54. Just as in the case of EAMSA, the policy pursued by these entities was implemented by investing in newly created companies, by the grant of loans and the conclusion of contracts for the repurchase of shares, which in a sense also amounted to a deferred loan. Most of these ventures were not quite successful from a financial point of view, although they contributed to the development of the industrial and business base of the region concerned. Important shortcomings that have been identified in this policy were the lack of a specific legal and fiscal framework, difficulties in recovering the investments made and the lack of professional expertise. These shortcomings were aggravated by political pressures to support investments of doubtful viability.[14]

55. Because of the problems that were encountered under the original approach, the entities here in question embarked on a reorientation of their functions. Beginning in the late 1980's, they started to adopt a more business-oriented approach, particularly in order to be able to confront the growing competition from European financial institutions that came to Spain following its incorporation into the European Economic Community. As a result of this new orientation, investments in newly formed companies diminished significantly. Later the number of companies in which investments were made also diminished, and capital was invested in consolidated companies, generally by means of leveraged buy-outs, management buy-outs or management buy-ins.[15] At the same time, small investments gradually diminished. They were replaced by larger volume investments in each operation and company.

---

[13] Ibid., at 39-40.

[14] Ibid., at 40.

[15] Ibid., at 45-46.

56. The end result of this reorientation was that in the 1990's these entities became active participants in a flourishing market economy. A number of investment projects were discontinued and some recovery of capital took place, either directly or by means of the sale of shares in the stock market.[16] A Spanish Association of Investment Capital, formerly the Spanish Association of Capital-Risk Entities, was created in 1986. It and the corresponding association of comparable European entities, in which SODIGA also participated, have been instrumental in bringing about this transformation. Some of the changes and resulting developments were most helpfully explained to the Tribunal by the President of SODIGA and now President of "XesGALICIA S.G.E.C.R., S.A.", Mr. Luis Fernández García, during the oral hearings in these proceedings.

57. At the time EAMSA was established, SODIGA was in the process of transforming itself from a State-oriented to a market-oriented entity. While originally a number of SODIGA's functions were closer to being governmental in nature, they must today be considered commercial in nature. But at the time of transition, there was in fact a combination of both, some to be regarded as functions essentially governmental in nature and others essentially commercial in character. As mentioned above, this is the dividing line between those acts or omissions that can be attributed to the Spanish State and those that cannot. The Tribunal must accordingly categorize the various acts or omissions giving rise to the instant dispute.

Responsibility for mistaken advice.

58. The second main contention by the Claimant, as noted above, is that the project failed because SODIGA provided faulty advice regarding the cost of the project, which turned out to be significantly higher than originally estimated. According to the Claimant, the first draft investment project was based on a report by SODIGA, dated May 1989, which was made in order to determine the viability of the project. Claimant submits that the final cost of the investment would have been 300% higher had the project been completed.

59. The Tribunal has already noted that Spain rejected this contention. It argued that Mr. Maffezini was responsible for the commissioning of a

[16] Ibid., at 30-31.

feasibility study for the project, and that SODIGA's estimates were designed solely for its own internal purposes to enable it to decide whether to participate in the new company. Spain also submitted that the investor was an experienced businessman and that he and his team of professionals prepared the project. SODIGA's advice was never requested and EAMSA was not induced to invest. Furthermore, the technical study regarding costs was prepared at the request of EAMSA by a consulting firm—COTECNO. Spain contended, furthermore, that the increased cost amounted to no more than 21% and that it was due to specification changes ordered by Mr. Maffezini. According to Spain, once the increase in cost attributable to the changed specifications is deducted from the original estimate, the cost per square meter constructed does not differ significantly from the estimated figure.

60. According to Spain, what really went wrong was that the project was ill conceived. No market studies were undertaken, Spain's public services provided free information but were not supposed to provide professional advice, the plot of land was not appropriately examined and required additional work, and the specifications were changed with regard to both the quality and quantity of the construction that had been envisaged. Mr. Maffezini was responsible for all these problems, and it was he who eventually decided to stop the work and dismiss all EAMSA's employees.

61. The Tribunal has carefully examined all of these contentions. In doing so, it has taken account of the fact that one of the functions of SODIGA and her sister institutions in Spain was to provide information to investors and businessmen in order to promote the industrialization of the region concerned. In this connection, it is apparent that SODIGA did more than merely provide EAMSA with information. It made available to EAMSA a number of other services. SODIGA provided EAMSA with office space during the start-up period and accounting services that included assistance with the disbursement for the payment of bills and other expenditures. There was, as a result, considerable interaction between SODIGA's officials and EAMSA employees, in the course of which the project, its costs and returns, and the viability and prospects of the proposed investment were explored by them at some length.

62. The Tribunal is satisfied, however, that SODIGA was not discharging any public functions in providing the aforesaid information assistance to EAMSA. This type of activity does not ordinarily go beyond

the commercial assistance that many financial and commercial entities provide to their prospective customers. Some of the other services provided, however, do have a connection with other aspects of the claim.

63. The Tribunal is also satisfied, after hearing expert and witness testimony on these issues, that the feasibility study made by SODIGA, whether faulty or not, was intended solely for SODIGA's internal purposes of deciding on its own participation in the capital of EAMSA and that it was not intended to serve as a substitute for the study the investor commissioned by hiring COTECNO. Hence, SODIGA cannot be held responsible for cost overruns, whatever their real amount might have been. Moreover, SODIGA's membership on the board of EAMSA, an aspect that has also been raised by the claimant so as to justify an attribution of responsibility in this connection, was also consistent with normal business arrangements. Subsidies were granted by the Spanish State and the *Xunta de Galicia* at the request of EAMSA and not by SODIGA, thus neither providing a link to potential attribution of responsibility to the latter. Even the preferential rates applied to SODIGA's loans were paid for by the *Xunta de Galicia* by way of reimbursement.

64. In this connection, the Tribunal must emphasize that Bilateral Investment Treaties are not insurance policies against bad business judgments. While it is probably true that there were shortcomings in the policies and practices that SODIGA and its sister entities pursued in the here relevant period in Spain, they cannot be deemed to relieve investors of the business risks inherent in any investment. To that extent, it is clear that Spain cannot be held responsible for the losses Mr. Maffezini may have sustained any more than would any private entity under similar circumstances.

Responsibility for Environmental Impact Assessment.

65. The Claimant also contends that SODIGA is responsible for the additional costs resulting from the EIA because EAMSA was pressured to go ahead with the investment before that process was finalized and its implications were known. This pressure, according to Claimant, was exercised for political reasons by the authorities of the *Xunta de Galicia* and the local municipality. Claimant's decision to stop the construction work was directly related to this additional increase in the costs of the project.

66. The Kingdom of Spain is of the view that Mr. Maffezini was fully aware of the requirements of the EIA and decided to acquire the land and proceed with the construction before its approval, and that he did so against the advice of his own employees and consultants. The Claimant was specifically informed of the applicable legal requirements in Spain and under the European Economic Community, particularly as the project involved the highly toxic chemical industry. The initial EIA study prepared by EAMSA was insufficient and the *Xunta de Galicia* had to request supplemental information. Once this information was submitted, the approval of the EIA proceeded expeditiously. No pressure was applied on EAMSA and the decision to discontinue the project was entirely unrelated to the EIA.

67. The Tribunal has carefully examined these contentions, since the Environmental Impact Assessment procedure is basic for the adequate protection of the environment and the application of appropriate preventive measures. This is true, not only under Spanish and EEC law, but also increasingly so under international law.[17]

68. The Tribunal notes that in Spain there is a Constitutional mandate relating to the protection of the environment, which finds expression in Article 45 of the Constitution of 1978.[18] Paragraph 2 of this Article states that "[t]he public authorities, relying on the necessary public solidarity, shall ensure that all natural resources are used rationally, with a view to safeguarding and improving the quality of life and protecting and restoring the environment."[19] This mandate applies not only to the General Administration of the State but also to the Autonomous Communities and Municipalities.[20] Specific legislation has been enacted to fulfill this

[17] See for example the Convention on Environmental Impact Assessment in a Transboundary Context, Espoo, February 25, 1991, and see generally Philippe Sands: *Principles of International Environmental Law*, Vol. 1, 1995, Chapter 15: "Environmental Impact Assessment", 579-595.

[18] Constitución Española, December 27, 1978, *Boletín Oficial del Estado*, No. 311. December 29, 1978, Article 45.

[19] As translated in European Court of Human Rights, Case *López Ostra v. Spain*, Case No. 41/1993/436/515, December 9, 1994, paragraph 23.

[20] Ramón Martín Mateo: "The Environmental Law System", in N. S. J. Koeman: *Environmental Law in Europe*, 1999, Chapter 15: "Environmental Law in Spain", 497, at 497-499.

mandate, including the Law on Toxic and Hazardous Waste[21] and other instruments.[22]

69. Particularly noteworthy is the legislation on EIA. Strict procedures in this respect are provided in EEC Directive 85/337 of June 27, 1985[23] and in Spain's Royal Legislative Decree No. 1302/1986 of June 28, 1986.[24] Chemical industries are specifically required under both measures to undertake an EIA. Public information, consultation with pertinent authorities, licensing and other procedures are also a part thereof.[25] The EEC Directive, like the one that later came to amend it,[26] requires "that an EIA is undertaken before consent is given to certain public and private projects considered to have significant environmental implications."[27] Suspension of projects can be ordered under Spanish law, particularly if work thereon is begun before the EIA is approved.[28]

70. There can be no doubt that EAMSA's project required an EIA and that both Mr. Maffezini and his employees were aware that this was so. The record is abundantly clear with regard to the exchange of correspondence and other communications on the issue of environmental requirements. Apart from the general principle that ignorance of the law is no defense, there is evidence in this case that the Claimant was informed of these requirements. That was why COTECNO was also asked to prepare the initial EIA study as part of its broader study on costs. It appears to the Tribunal that the investor, as happens so often, tried to minimize this requirement so as to avoid additional costs or technical difficulties. Moreover, the Claimant has also not

[21] Law No. 20, May 14, 1986, as discussed in Martín Mateo, loc. cit., supra note 20, at 504.

[22] On the Spanish environmental legislation see generally Martín Mateo, loc. cit., supra note 20, and Carlos de Miguel Perales: "Practical Questions of Environmental Law", in Koeman, op. cit. and chapter cit., supra note 20, 508.

[23] EEC Directive 85/337, June 27, 1985, *Official Journal of the European Community,* No. L175/40, July 5, 1985.

[24] Real Decreto Legislativo No. 1302/1986, June 28, 1986, *Boletín Oficial del Estado,* No. 155, June 30, 1986, 23733.

[25] De Miguel Perales, loc. cit., supra note 22, at 508-511.

[26] EEC Directive 97/11, *Official Journal of the European Community,* L73/5, 1997.

[27] Laurens Jan Brinkhorst: "European Environmental Law: an Introduction", in Koeman, op. cit., supra note 20, 1, at 15.

[28] Decree No. 1302, cit., supra note 24, Article 9. 1.

substantiated, much less proved, the costs or damages attributable to the handling of the EIA by the Spanish authorities.

71. The Kingdom of Spain and SODIGA have done no more in this respect than insist on the strict observance of the EEC and Spanish law applicable to the industry in question. It follows that Spain cannot be held responsible for the decisions taken by the Claimant with regard to the EIA. Furthermore, the Kingdom of Spain's action is fully consistent with Article 2(1) of the Argentine-Spain Bilateral Investment Treaty, which calls for the promotion of investment in compliance with national legislation. The Tribunal accordingly also dismisses this contention by the Claimant.

The transfer of funds.

72. The Claimant also contends that 30 million Spanish Pesetas were transferred from his personal account as a loan to EAMSA, despite the fact that he had not consented to the loan. The Claimant also complains of a number of irregularities attributable to the private banks that managed his accounts, and that these acts also engage the responsibility of the *Banco de España*, Spain's Central Bank.

73. The Kingdom of Spain denies these allegations on the grounds that Mr. Maffezini had consented to the loan, had authorized the transfer of funds and had mandated Mr. Luis Soto Baños, SODIGA's representative in EAMSA, to undertake these operations. Since Mr. Soto Baños was for these purposes acting as the personal representative of Mr. Maffezini, Spain submits that his acts cannot be attributed to SODIGA. Moreover, according to Spain, alleged irregularities on the part of private banks are not the responsibility of the *Banco de España* nor of the Spanish State. Besides, Spanish courts are open to decide on any complaints Mr. Maffezini might have against these banks.

74. In late 1991, when EAMSA was experiencing financial difficulties, discussions were held on how to overcome these problems. In that context, it appears that Mr. Maffezini offered to make available the amount of 30 million pesetas. It is an established fact that on November 14, 1991, Mr. Maffezini authorized his bank to transfer such an amount to the account of EAMSA whenever requested to do so by Mr. Soto Baños. While it is true that the order was not conditioned on other events, it is clear that at that time neither the terms of the financial arrangements nor the details relating

to the eventual loan had been fully negotiated. The specific cash requirements of EAMSA were also not known at the time.

75. The order to transfer was given by Mr. Soto Baños on February 4, 1992. The underlying financial commitment, however, never came to be formalized in a contract binding on Mr. Maffezini, nor was the loan approved by the board of EAMSA, either before or after the transfer of the funds. In this respect the Claimant has convincingly made a distinction between the authorization to the transfer of funds, which was indeed given by him, and the translation of that transaction into a contract, which was never concluded or consented by Mr. Maffezini. The transfer authorization was apparently given on the assumption that it would be preceded by a contract, but no such contract was concluded. Mr. Soto Baños' testimony at the oral hearing confirmed that the loan was never formalized. While this kind of financial arrangement is not uncommon in emergency situations, the lack of a prior or later legally binding contract formalizing the transaction compels the conclusion that this *de facto* arrangement cannot be opposed to the Claimant against his consent.

76. The Tribunal also finds that Mr. Soto Baños was not acting in this operation as the personal representative of Mr. Maffezini but as an official of SODIGA. The oral hearings confirmed that Mr. Soto Baños discussed the transfer of these funds with the President of SODIGA and that the latter authorized him to proceed as he thought best. Similar authorization was not sought from Mr. Maffezini, even though there was time to do so. This further authorization was necessary since, although Mr. Soto Baños was authorized to transfer the funds, no agreement had been reached on the use to which the funds were to be put and on the terms of the loan. The fact that Mr. Soto Baños failed to consult with Mr. Maffezini, but sought and obtained authorization to act from the President of SODIGA, compels the conclusion that Mr. Soto Baños' action, whether within the terms of the mandate or *ultra vires*, is attributable to SODIGA.

77. It must therefore be asked whether that action is purely commercial in nature or whether it was performed in the exercise of SODIGA's public or government functions. In the latter case, it would be attributable to the Spanish State.

78. It is here that the public functions of SODIGA, discussed above, acquire special relevance. Because SODIGA was an entity charged with the

implementation of governmental policies relating to industrial promotion, it performed a number of functions not normally open to ordinary commercial companies. Handling the accounts of EAMSA as a participating company, managing its payments and finances and generally intervening on its behalf before the Spanish authorities without being paid for these services, are all elements that responded to SODIGA's public nature and responsibility. Moreover, the manner in which the private banks conducted themselves in this case with regard to the loan, can be explained in large measure only because of their recognition that SODIGA's orders and instructions were entitled to be honored because of the public functions it performed in Galicia.

79. In addition, it must be noted that although the transfer was labeled a loan, in fact it amounted to an increase of the investment. This explains the inquiries made with the Ministry of Economics about whether the loan should be registered as a part of the investment. The rejoinder by the Kingdom of Spain also describes the investments made by the Claimant as comprising 35 million pesetas as a capital subscription and 30 million as a loan to EAMSA, both being submitted for registration with the Ministry of Economy.[29] A decision to increase the investment taken not by Mr. Maffezini but by the entity entrusted by the State to promote the industrialization of Galicia, cannot be considered a commercial activity. Rather, it grew out of the public functions of SODIGA.

80. While it has been argued by Spain that the transfer resulted in the protection of the investment and thus ultimately benefited Mr. Maffezini by strengthening the financial condition of EAMSA, this is not a tenable proposition in view of the fact that the investor himself did not think that these steps were appropriate. Neither the fact that a credit was entered in favor of Mr. Maffezini on EAMSA's accounts, nor the argument that he could at any time recover the 30 million pesetas that had been transferred change the situation since the funds were largely spent and, hence, not really available to Mr. Maffezini.

81. The Kingdom of Spain has convincingly argued that neither the Spanish State nor the *Banco de España* is responsible for the alleged irregu-

[29] Memorial de Dúplica del Reino de España, May 3, 2000, at 36-37.

larities attributed to the private banks since the Central Bank only has supervising authority over general financial and monetary operation of private banks and not over their relations with clients.

82. In accordance with Article 1214 of the Spanish Civil Code the burden of proof of the existence of an obligation rests with him who claims its fulfillment.[30] In this case, no written or other proof has been offered regarding the existence of a loan binding on Mr. Maffezini. On the contrary, the evidence presented to the Tribunal indicates that no legal obligation existed with regard to the loan.

83. Because the acts of SODIGA relating to the loan cannot be considered commercial in nature and involve its public functions, responsibility for them should be attributed to the Kingdom of Spain. In particular, these acts amounted to a breach by Spain of its obligation to protect the investment as provided for in Article 3(1) of the Argentine-Spain Bilateral Investment Treaty. Moreover, the lack of transparency with which this loan transaction was conducted is incompatible with Spain's commitment to ensure the investor a fair and equitable treatment in accordance with Article 4(1) of the same treaty. Accordingly, the Tribunal finds that, with regard to this contention, the Claimant has substantiated his claim and is entitled to compensation in the manner spelled out below.

Desinvestment negotiations.

84. The Tribunal must now examine the question of the desinvestment negotiations that took place in the period 1994-1996 and their meaning. The Tribunal is mindful of the fact that one of the difficult issues arising from the experience of industrial promotion in Spain relates to the desinvestment and recovery of the capital contributions and loans made by the risk-capital entities to the newly created companies.

85. On June 13, 1994, a meeting was held between Mr. Héctor Rodríguez Molnar, an attorney working for Mr. Maffezini, and officials of SODIGA. The meeting was specifically requested by the attorney in order to discuss a final settlement of the obligations that both EAMSA and Mr. Maffezini had with SODIGA. As it was later summarized in a letter by

[30] Código Civil, Article 1214, and notes by Francisco Javier Fernández-Urzainqui, 1999, at 318.

SODIGA's President dated June 23, 1994, Mr. Rodríguez Molnar proposed an arrangement at this meeting that would have had the effect of cancelling all EAMSA's and Mr. Maffezini's obligations in exchange for the assets of EAMSA, amounting to 23,604,168 pesetas. This discussion was confirmed by Mr. Rodríguez Molnar at the oral hearings of this Tribunal at which he appeared as a witness for the Claimant.

86. It has also been demonstrated that SODIGA countered this offer by demanding an additional 2 million pesetas from Mr. Maffezini. This proposal was rejected by Mr. Maffezini. After the first demarches by the Argentine embassy in Madrid, SODIGA's President wrote to Mr. Maffezini on June 13, 1996, stating that in the spirit of reaching an amicable solution SODIGA was prepared to accept the settlement discussed two years earlier with Mr. Rodriguez Molnar, that is, SODIGA waived payment of the additional 2 million pesetas. At this time, however, Mr. Maffezini was already embarked on preparations to submit the matter to ICSID, and the settlement negotiations were not pursued further.

87. The Kingdom of Spain has argued that the proposal made by Mr. Rodríguez Molnar in 1994 constitutes an offer that was never withdrawn, and that its acceptance by SODIGA two years later resulted in a legally binding contract which the Claimant could not now ignore. In Spain's view, this desinvestment settlement was the only question that could be brought before this Tribunal.

88. The Tribunal considers that at the time these negotiations were taking place, the parties did not believe that they were concluding a contract. Instead, the evidence suggests that they assumed that they were engaging in negotiations that might produce an eventual settlement. Negotiation with banks and financial entities are commonly resorted to in order to resolve questions concerning the payment of loans, capital contributions and other aspects of a business; in essence, these are negotiations designed to reach agreement on the amounts involved. The President of SODIGA confirmed this understanding in his letter of June 13, 1996, when he stated that SODIGA was prepared to settle "in terms similar to the negotiations undertaken at its time with Mr. Rodríguez Molnar." There is no reference to any contract or its finalization by this acceptance.

89. The Tribunal has also examined this matter from the point of view of Spanish law. Article 1262 of the Spanish Civil Code simply provides that

"Consent is expressed by the concurrence of the offer on the object and cause that will constitute the contract and its acceptance."[31] Article 54 of the Spanish Commercial Code elaborates the point further by providing that "Contracts made by correspondence shall be perfected when there is a reply accepting the offer or the conditions with which the offer was modified."[32] These provisions assume that there was an intention to make an offer with a view to concluding a contract, which was not true of the negotiations described above. Here it is not relevant that the original "offer" was not withdrawn.

90. Even if the offer was likely to lead to the conclusion of the contract, its acceptance would have to be unconditional. A conditional acceptance amounts to a counter-offer that must be accepted by the original offeror.[33] SODIGA's acceptance was conditioned on the payment of an additional 2 million pesetas and was thus a counter-offer. It was expressly rejected by Mr. Maffezini. From a legal point of view then the original offer lapsed and there was no consent, no contract and no liability. Moreover, the letter from SODIGA's President of June 13, 1996 cannot consequently be considered an acceptance of the original offer. It was a new offer in similar terms that would require Mr. Maffezini's acceptance, which he did not give. It is well established under the Spanish Civil Code and the writing of eminent commentators that courts may treat an offer as withdrawn or lapsed if acceptance is not timely, that is, when it does not take place within a reasonable period of time.[34] Hence, even if one were to assume, *arguendo,*

[31] Código Civil, Article 1262, and notes by Fernández-Urzainqui, cit., supra note 30, at 327. See in particular Manuel Albaladejo: *Derecho Civil*, II, Vol. 1, Tenth edition, 1997, at 374-375, with reference to a judicial decision of December 14, 1964, relating the offer and acceptance to the intention of producing legal effects.

[32] Código de Comercio, Article 54.

[33] Albaladejo, op. cit., supra note 31, at 385, describing the counter-offer as a second offer that follows the rejection of the first and with reference to a judicial decision of March 14, 1973.

[34] See, for example, Calixto Valverde y Valverde: *Tratado de Derecho Civil Español*, 1926, at 241, with reference to a judicial decision of October 2, 1867. This author comments in particular: "Estimamos también, que de si las circunstancias se dedujere que ha transcurrido con exceso un plazo prudencial para que el aceptante haya podido recoger la oferta, los tribunales podrán considerar en ese caso retirada, o mejor dicho, caducada la oferta", at 241. See also Federico Puig Peña: *Tratado de Derecho Civil Español*, Tomo IV, Vol. II, 1951, at 53 and Albaladejo, op. cit., supra note 31, at 390 with reference to the circumstances of the case and the nature of the matter.

that there had been offer, its acceptance two years later would certainly not be timely.

91. It follows from what has been said above that no contract was concluded regarding the desinvestment and that neither party had assumed a legally binding commitment with regard thereto.

Limitation period.

92. The Kingdom of Spain has also argued that even if it were found to have incurred some liability in this case, the claim against it was barred by a one-year statute of limitation that applies to claims for compensatory damages against the State, as provided in Article 142.2 of Law 30/92.

93. Although it is true that this statute of limitation exists, it cannot apply to claims filed under the ICSID Convention.

Compensation and interest.

94. The Tribunal now turns to the question of compensation for the claim that has been upheld.

95. The parties have not disputed the sum that was transferred, which amounts to 30 million Spanish Pesetas.

96. This sum is subject to the payment of interest. Since the funds were withdrawn from a time-deposit account of Mr. Maffezini, it is appropriate in this case to order the payment of interest compounded on an annual basis from February 4, 1992 until the date of the Award. The Tribunal considers reasonable to fix as interest rate the LIBOR rate for the Spanish peseta for each annual period since February 4, 1992 and for the proportion that corresponds to the period between February 4, 2000 and the date of the Award.[35] The interests therefore amount to ESP 27,641,265.28 (twenty-seven million six hundred forty one thousand two hundred and sixty-five Spanish pesetas and 28 cents).

[35] In accordance with British Bankers Association Financial Data.

97. Accordingly, the Tribunal finds that the total amount of compensation, including interest, that the Kingdom of Spain is to pay the Claimant is ESP 57,641,265.28 (fifty-seven million six hundred forty one thousand two hundred and sixty-five Spanish pesetas and 28 cents). The Kingdom of Spain shall make such payment within a period of 60 days as of the date of this Award. Should the payment of this amount not be made within the period specified above, the amount shall accrue interests at a rate of 6% per annum, compounded monthly, as of the date of the Award to the date of payment.

98. As for the expenses incurred in these proceedings, including the charges for the use of the facilities of the Centre and the fees and expenses of the Tribunal, it holds that these institutional expenses shall be borne equally by the parties.

99. As for the expenses and legal costs of counsel for the parties, the Tribunal decides that each party shall bear the entirety of its own expenses and legal fees for its own counsel, considering that each party has been successful on the key points of their respective positions.

100. The Tribunal expresses its appreciation to counsel for both parties, distinguished Argentine and Spanish lawyers, for the outstanding professionalism and cooperation which they demonstrated in this case.

E. Decisions

For the reasons stated above the Tribunal unanimously decides that:

(1) The Kingdom of Spain shall pay the Claimant the amount of ESP 57,641,265.28 (fifty-seven million six hundred forty one thousand two hundred and sixty-five Spanish pesetas and 28 cents).

(2) Each of the parties shall bear the entirety of its own expenses and legal fees for its own counsel.

(3) All other claims are dismissed.

So Decided.

Signed in Washington D. C. on November 9, 2000

[signature and date]
Francisco Orrego Vicuña
President of the Tribunal

[signature and date]
Thomas Buergenthal
Arbitrator

[signature and date]
Maurice Wolf
Arbitrator

CLA-000066

International Centre for
Settlement of Investment Disputes
(ICSID)

ICSID Case No. ARB/06/1

SPYRIDON ROUSSALIS

V.

ROMANIA

AWARD

Rendered by an Arbitral Tribunal composed of:

Andrea Giardina, ***Arbitrator***
Michael Reisman, ***Arbitrator***
Bernard Hanotiau, ***President***

Date of Dispatch to the Parties: December 7, 2011

TABLE OF CONTENTS

CHAPTER I. THE PARTIES AND THE BACKGROUND OF THE DISPUTE 1

CHAPTER II. THE PROCEDURE 2
I. INSTITUTION OF THE PROCEEDINGS AND THE TRIBUNAL.....................................2
II. PROCEDURAL RULES AND AGENDA: MINUTES OF THE FIRST SESSION 3
III. RESPONDENT'S FIRST REQUEST FOR PRODUCTION OF DOCUMENTS 3
IV. RESPONDENT'S FIRST REQUEST FOR PROVISIONAL MEASURES 3
V. RESPONDENT'S SECOND REQUEST FOR PRODUCTION OF DOCUMENTS................4
VI. RESPONDENT'S SECOND REQUEST FOR PROVISIONAL MEASURES 4
VII. PROCEDURAL RULES AND AGENDA: PRE-HEARING TELEPHONE CONFERENCE AND ADDITIONAL REQUESTS 4
VIII. EXCHANGE OF WRITTEN PLEADINGS 5
IX. ORAL PLEADINGS 5
X. POST HEARING SUBMISSIONS..6

CHAPTER III. JURISDICTION 6
SECTION I. CLAIMANT'S POSITION ON JURISDICTION 6
SECTION II. RESPONDENT'S POSITION ON JURISDICTION..8
SECTION III. DECISION OF THE ARBITRAL TRIBUNAL...8

CHAPTER IV. THE CLAIMANT'S CLAIMS 9
SECTION I. THE INVESTMENT CLAIM 10
SUB-SECTION I. CLAIMANT'S POSITION ON THE INVESTMENT CLAIM 10
§1. THE FACTS 10
I. AVAS'S JUDICIAL PROCEEDINGS FOR THE ENFORCEMENT OF THE SHARE PLEDGE 10
A. Claimant fulfilled his contractual obligations 10
B. Despite Claimant's fulfilment of his contractual obligations, AVAS filed judicial proceedings for the enforcement of the pledge................................15
C. Despite the existence of an irrevocable judgment, AVAS requested that the General Prosecutor take steps to seek supervisory review by the Supreme Court and an order vacating the judgment..16
D. Subsequent Decisions 17
II. AVAS'S JUDICIAL PROCEEDINGS FOR THE ANNULMENT OF THE SHAREHOLDERS' RESOLUTION DATED DECEMBER 15, 2000 17
III. CONFIRMATION BY DOMESTIC COURTS OF THE PROPER PERFORMANCE OF THE PRIVATIZATION AGREEMENT...18
§2. THE LAW 18
I. VIOLATION OF ARTICLE 4, PARAGRAPH 1 OF THE TREATY AND OF ARTICLE 1 OF THE FIRST ADDITIONAL PROTOCOL TO THE EUROPEAN CONVENTION ON HUMAN RIGHTS...18
A. Introduction...18
B. AVAS's attempt to enforce the share pledge is a measure equivalent to expropriation 19
1. The lawsuit filed by AVAS is groundless since Claimant had fulfilled his contractual obligation 20
2. The lawsuit filed by AVAS is illegal because the Trade Registry decision has *res judicata* effect 21

C. The "absolute nullity" claim filed by AVAS in August 2007 to annul the increase in share capital is groundless and illegal, and has effects equivalent to an expropriation 21
D. The Proceedings initiated by Romania, through the Intervention of the General Prosecutor and the Decision of the Supreme Court, have effects equivalent to an expropriation 22
II. VIOLATION OF ARTICLE 2, PARAGRAPH 2 OF THE TREATY: FAIR AND EQUITABLE TREATMENT 23
III. VIOLATION OF ARTICLE 2, PARAGRAPH 2 OF THE TREATY: FULL PROTECTION AND SECURITY 24
§3. DAMAGES 26
SUB-SECTION II. RESPONDENT'S POSITION ON THE INVESTMENT CLAIM 28
§1. THE FACTS 28
A. The Privatization Agreement 28
B. Continent SRL failed to perform its capital contribution obligation 29
1. Claimant's fraudulent scheme 29
2. The Expert Proiect Report does not establish that the investment was made in compliance with the Privatization Agreement 32
a) The valuation is baseless and not reliable according to Romanian law 32
b) The required capital contribution was not made by Continent SRL 32
3. Claimant's criminal conviction for tax evasion 33
4. Claimant's misuse of Continent SA's funds 34
C. AVAS reasonably investigated Continent SRL's failure to fulfill its investment obligation and thereafter sought enforcement of the pledge 34
D. The General Prosecutor's intervention and the Supreme Court's Decision quashing previous court decisions were necessary 35
E. AVAS's proceedings to annul the shareholders' resolution dated December 15, 2000 seek to redress serious improprieties committed by Claimant 37
F. Claimant continues to be the majority owner and continues to exercise control over Continent SA 37
G. Conclusion 38
§2. THE LAW 39
A. On the facts, there is no basis for claiming that Claimant's shareholding interest was expropriated, either directly or indirectly 39
1. The law on indirect or creeping expropriation does not support the claim 40
2. The alleged interference with Claimant's management and control of his investment does not amount to an expropriation 40
3. There is no permanent and irreversible interference with Claimant's property rights 41
4. Claimant's allegations demonstrate that the complained-of actions by AVAS and the Supreme Court have not ripened into an expropriation 41
5. There is no basis for bringing this claim under Article 4(1) of the Treaty 42
B. The failure to negotiate and the denial of a stay of litigation do not support claims under Article 2(2) of the Treaty 42
C. There is no basis under the Treaty for the "Full Protection and Safety" claims 43

1. The Supreme Court's decision to vacate the AVAS judgment was appropriate under Romanian law and international law....................43
a) The General Prosecutor's motion to vacate was a settled procedure under Romanian law at the time it was filed and granted in this case..43
b) No violation of the principle of legal certainty arises from the Supreme Court's decision..44
c) The reasons stated for the Supreme Court's decision are reasonable, justify the relief granted, and do not interfere with Claimant's right of ownership..45
d) The principle of proportionality is not violated by the Supreme Court's order vacating the judgment..46
2. Claimant's other arguments under Romanian law are equally unavailing...47
a) Claimant's argument – that the Trade Registry decision has *res judicata* effect – is contrary to Romanian law...........................47
b) Claimant's argument that AVAS had 15 days to challenge the Trade Registry ruling is incorrect 48
c) Romanian law authorized AVAS to file an "absolute nullity" claim against Continent SA to set aside the shareholders' resolution...48
§3. DAMAGES 49
1. There is no basis for the award of Claimant's primary demand for moral damages...50
2. Claimant has a heavy burden of proof, which he has failed to meet 52
SUB-SECTION III. DECISION OF THE ARBITRAL TRIBUNAL 52
§1. THE LEGAL FRAMEWORK APPLICABLE TO THE 52
I. The applicable law 52
II. The Fair and Equitable Treatment Standard...53
III. The Full Protection and Security Standard..55
IV. The Non-Impairment Standard: Unjustifiable or Discriminatory Measures 55
V. The Expropriation Standard 56
§2. APPLICATION OF THE STANDARDS TO THE FACTS OF THIS CASE.........................57
I. Claimant's allegations 57
II. Refusal to negotiate an amicable settlement 58
III. AVAS's attempt to execute the Share Pledge Agreement, the proceedings initiated by the General Prosecutor and the subsequent Supreme Court decision 58
IV. Filing of the request to annul the increase in share capital......................62
V. The cumulative effect of the various court proceedings 62
SECTION II. THE FISCAL CLAIM 62
SUB-SECTION III. CLAIMANT'S POSITION ON THE FISCAL CLAIM.....................................62
§1. THE FACTS...62
I. The Financial Guard Minutes n°11238 and the DGFPMB Minutes n°191624..62
II. The Financial Guard - Bucharest Department Minutes n°11275/297/13.02.2001..64
III. The DGFPMB Minutes of December 17, 2003......................................65

IV. The Ministry of Public Finances' civil action within criminal proceedings: claim for a prejudice not related to the criminal litigation .67
§2. THE LAW 68
§3. DAMAGES 69
SUB-SECTION II. RESPONDENT'S POSITION ON THE FISCAL CLAIM 69
§1. THE FACTS 69
I. Continent SA was subject to a Tax Audit during 2003 69
II. Rights and obligations of taxpayers and Tax Authorities during a Tax Audit 70
III. Continent SA failed to cooperate with the Tax Authorities during the 2003 Audit 70
IV. The tax liabilities covered numerous Tax Code violations 71
V. The Tax Audit report reassessed penalties for unpaid taxes owed by Continent SA for free storage provided to Continent SRL 71
VI. The Tax Authorities ordered sequestration of certain assets of Continent SA as security for the additional tax liabilities, but enforcement of the tax audit report was suspended (The Tax Agency's 2004 sequestration order) 72
VII. The criminal authorities issued proper orders restraining Claimant and Continent SA from disposing of their assets 72
VIII. ANAF claimed civil damages in the criminal prosecution 73
A. Victims of criminal offenses may join their civil damages claim to the criminal prosecution of the indicted persons 73
B. ANAF claimed civil damages liabilities identified in the December 17, 2003 tax audit 74
C. Claimant did not deny committing tax evasion, and Continent SA had the opportunity to challenge the damages claimed 74
D. The Financial Guard imposed additional tax liabilities and penalties against Continent SRL based on a February 13, 2001 audit for the year 2000 75
IX. The taxes and penalties were assessed against Continent SA and included in the criminal judgment 75
X. The criminal court's judgment requiring Continent SA to pay damages has not been enforced 75
XI. The criminal case was not a pretense 76
§2. THE LAW 76
I. ICSID tribunals have no jurisdiction to resolve tax disputes 76
II. Claimant failed to establish that the Fiscal Claim has merit 78
A. The expropriation claim has not been proved 78
B. Continent SA has not been deprived of any right to an equitable judgment by an independent and fair court 79
C. No "unjustifiable measures" result from the sequestration orders 79
Respondent did not prevent Continent SA from either challenging the Tax Assessment or from enjoying or disposing of his investment 80
§3. DAMAGES 80
SUB-SECTION III. DECISION OF THE ARBITRAL TRIBUNAL 81
§1. JURISDICTION OVER THE FISCAL CLAIM 81
§2. MERITS 83
I. Was there a breach of the Fair and Equitable Treatment requirement? ..83
1. The control actions carried out by the Tax Authorities and the tax liabilities 83

2. Prevention from having the tax litigation resolved because of the criminal proceedings 84
3. The allegedly disproportionate sequestration orders 85
II. Was there a breach of the non-impairment requirement? 87
III. Was there an expropriation or a measure the effects of which would be tantamount to expropriation? 87
SECTION III. THE INTERDICTION CLAIM 87
SUB-SECTION I. CLAIMANT'S POSITION ON THE INTERDICTION CLAIM 87
§1. THE FACTS 87
A. The criminal proceedings 87
B. The prohibition on leaving the country 89
§2. THE LAW 90
§3. DAMAGES 91
SUB-SECTION II. RESPONDENT'S POSITION ON THE INTERDICTION CLAIM 91
§1. THE FACTS 91
§2. THE LAW 93
I. The Treaty does not confer subject matter jurisdiction for this claim 93
II. The alleged wrongful conduct does not violate the "unjustifiable measures" clause 94
A. The burden of proof 94
B. The interdiction order does not constitute an "unjustifiable measure" 94
1. Preventing flight to avoid criminal prosecution promotes a rational public policy 94
2. The measure does not shock the conscience; it is defensible and can be justified in view of the unsettled and confusing state of the law at the time it was issued 95
3. There is no violation of any international standard of justice that would trigger state responsibility 96
§3. DAMAGES 96
I. Claimant has failed to prove both the existence and quantum of material damages 96
II. Moral damages are not appropriate for this claim 96
SUB-SECTION III. DECISION OF THE TRIBUNAL 97
§1. JURISDICTION OVER THE INTERDICTION CLAIM 97
§2. MERITS 99
I. Length of the criminal proceedings 99
II. Severity of the interdiction measures 99
SECTION IV. THE FOOD AND SAFETY CLAIM 100
SUB-SECTION I. CLAIMANT'S POSITION ON THE FOOD AND SAFETY CLAIM 100
§1. THE FACTS 100
I. The FSD Order regarding the interdiction to carry out the activities, n°57/06.05.2005 100
II. The FSD Order regarding the provisional cancellation of activity n°45/06.03.2006 101
III. Continent SA did not require a permit in order to operate its refrigerated warehouse facility after the abrogation of Order 139/2004 103
§2. THE LAW 103
§3. DAMAGES 103
SUB-SECTION II. RESPONDENT'S POSITION ON THE FOOD SAFETY CLAIM 104
§1. THE FACTS 104

I. Prior to Romania's accession to the EU (January 1, 2007), Romania's Food Safety Regulations were updated to conform to EU standards..................104
II. Continent SA did not comply with Romania's updated food safety standards and its permit to operate a refrigerated warehouse was revoked 105
§2. THE LAW 108
I. The Tribunal lacks subject matter jurisdiction to decide this claim, as matters of purely domestic law fall outside ICSID's jurisdiction 108
II. The claim does not assert any Treaty violation 109
A. Romania did not take any "unjustifiable or discriminatory measures" against Claimant...109
B. The Bucharest Court's decision does not establish that the FSD's actions violate the Treaty..110
§3. DAMAGES 110
I. Claimant has demonstrated no compensable damages incurred by Continent SA as a result of the May 2005 order 110
II. Claimant's allegations of damages caused by the March 2006 order are unproven 111
III. The alleged damages fall short of what is required for compensable moral damages 111
SUB-SECTION III. DECISION OF THE TRIBUNAL...111
§1. JURISDICTION OVER THE FOOD SAFETY CLAIM 111
§2. MERITS 112
SECTION V. THE OZIAS TAX CLAIM 113
SUB-SECTION I. CLAIMANT'S POSITION ON THE OZIAS TAX CLAIM 113
§1. THE FACTS..113
§2. THE LAW 114
§3. DAMAGES 114
SUB-SECTION II. RESPONDENT'S POSITION ON THE OZIAS TAX CLAIM 115
§ 1. THE FACTS...115
I. Continent SA allegedly contracted with Ozias for Consulting Services......115
II. Ozias was formed to be a shipping company...115
III. Continent SA has not substantiated Ozias's work product.........................116
IV. Claimant took tax deductions on payments made to Ozias 116
A. The Tax Agency disallowed Continent SA's profit tax deductions for the Ozias fees 116
B. The Tax Agency also assessed VAT liabilities that Continent SA had failed to pay 116
C. Continent SA objected to the profit tax and VAT assessments...........117
§2. THE LAW 117
I. The Tribunal lacks subject matter jurisdiction over the Ozias Tax Claim...117
II. Claimant has neither alleged nor proved a Treaty violation 117
A. Claimant was not subjected to any "unjustifiable or discriminatory measures" 117
B. There are reasonable grounds to question the legitimacy of the claimed consulting fees...118
1. The absence of an arm's-length agreement raises reasonable doubts as to whether any services were ever provided 118
2. The contracts raise serious questions that have not been answered118
C. Claimant's complaint about the Tax Agency's inconsistent positions is baseless..119
§3. DAMAGES 119

A. Continent SA has not paid the assessed tax liability and there is no evidence to prove that this issue affected Continent SA's reputation, business planning, management, or employee morale......................120
B. The USD 1 million sought by Claimant does not qualify as compensable moral damages 120
SUB-SECTION III. DECISION OF THE TRIBUNAL 120
§1. JURISDICTION OVER THE OZIAS TAX CLAIM 120
§2. MERITS 121

OVERALL CONCLUSION 121

CHAPTER V. THE RESPONDENT'S COUNTERCLAIM 122
SECTION I. RESPONDENT'S POSITION ON ITS COUNTERCLAIM 122
I. THE COUNTERCLAIM 122
A. Counterclaim against Claimant 122
B. Counterclaim against Continent SRL 123
C. Counterclaim against Continent SA 123
II. JURISDICTION 123
A. The Tribunal has jurisdiction to decide Respondent's Counterclaim.................123
1. In General 123
2. The Counterclaim's contractual basis does not negate the Tribunal's jurisdiction to decide this closely related counterclaim 126
B. Claimant consented to arbitrate Respondent's Counterclaim............................126
C. The Tribunal has jurisdiction over Respondent's Counterclaim by virtue of the umbrella clause in Article 2(6) of the Treaty 127
D. Romania is under no obligation to exhaust local remedies before submitting its Counterclaim 128
E. Romania's claim for losses incurred in the period from November 1998 to December 1999 is not time-barred...128
F. Romania was not required to annul the Ozias contracts before filing its Counterclaim 129
III. BASIS OF COUNTERCLAIM 129
A. Enforcement of share pledge against Continent SRL and damages for misappropriated funds...129
B. Declaration that the shareholders' resolution is not properly grounded............131
C. Counterclaim against Claimant for each of these foregoing claims...................131
D. Amendment of Respondent's Counterclaim 131
IV. Request for Relief...132
SECTION II. CLAIMANT'S POSITION ON RESPONDENT'S COUNTERCLAIM 135
I. THE INADMISSIBILITY OF THE COUNTERCLAIM ON JURISDICTIONAL AND PROCEDURAL GROUNDS 135
A. In general 135
B. Lack of Claimant's consent 136
C. The Tribunal has no jurisdiction to decide counterclaims against Roussalis 137
D. The Tribunal has no jurisdiction to decide counterclaims against Continent SRL and Continent SA...138
E. Romania failed to exhaust local remedies before submitting its Counterclaim .138
F. The Counterclaim is time barred under the Romanian statute of limitations.....139
G. Romania lacks standing to bring a counterclaim for damages 139

H. The Counterclaim for damages arising out of the Ozias contracts is inadmissible because Romania must seek the annulment of those contracts as a condition precedent to bringing a damages claim 140
II. THE AMENDMENT OF THE COUNTERCLAIM IS INADMISSIBLE 140
III. THE COUNTERCLAIM IS MERITLESS 140
SECTION III. DECISION OF THE TRIBUNAL 141

CHAPTER VI. COSTS 143

AWARD 144

CHAPTER I. THE PARTIES AND THE BACKGROUND OF THE DISPUTE

1. The Claimant in this arbitration is Spyridon Roussalis (hereinafter "Claimant" or "Roussalis"), a Greek citizen. Claimant's address is Mavrokordatou Street, 11, Pireu, Greece. Claimant is represented in this arbitration by Ms. Nina Hall of Global Arbitration Litigation Services Ltd., Mr. Doru Costea of Doru Costea Law Office and Mr. Doru Băjan.

2. The Respondent in this arbitration is the State of Romania (hereinafter "Respondent," "Romania" or the "State"). It is represented in this arbitration by Mr. Mark N. Bravin of Morgan Lewis & Bockius LLP and Messrs. Gabriel Sidere and John Fitzpatrick of CMS Cameron McKenna SCA.

3. The Authority for State Assets Recovery ("AVAS" or the "State Property Fund") is a government agency created to, *inter alia*, manage the privatization of state-owned enterprises.

4. S.C. CONTINENT MARINE ENTERPRISE IMPORT EXPORT S.R.L. ("Continent SRL") is a Romanian legal entity, 100 percent owned by Claimant, having its registered office in Bucharest, 82 Timişoara Av., sector 6, registered to O.R.C.M.B. with n°J 40/4719/1997.

5. Until 1998, S.C. Malimp S.A. was a State-owned company. It had been partly privatized in 1991. Thirty percent of its shares were being held privately. AVAS owned the remaining 70 percent.

6. On September 4, 1998, AVAS issued an invitation to tender for its shares in S.C. Malimp S.A. Continent SRL won the tender process with an offer of ROL 32,591 per share and a proposed capital contribution of USD 1.4 million.

7. On October 23, 1998, Claimant entered into a Share Purchase Agreement n°732/23.10.1998 (the "Privatization Agreement" or the "SPA") with AVAS to purchase, through Continent SRL, AVAS's 70 percent interest in S.C. Malinp S.A., consisting of 372,523 shares. Following the acquisition, the company name was changed to S.C. CONTINENT MARINE ENTERPRISE S.A. ("Continent SA").

8. Continent SRL agreed to make an additional post-purchase investment of USD 1.4 million from its own funds over a two-year period starting on January 1, 1999 and ending on December 31, 2000. As security for this post-purchase investment, Continent SRL agreed to grant and register a pledge of the 372,523 shares in Continent SA in favor of AVAS.

9. Claimant contends that Continent SRL complied with its post-purchase investment obligation. The shareholders of Continent SA approved a resolution declaring a share capital increase. This share capital increase was the basis for issuing 1,418,648 new shares in Continent SA to Continent SRL. The shareholders' decision to issue the shares was duly approved by Romania's Trade Registry. However, Respondent disputes that Continent SRL made the post-purchase investment.

10. Claimant asserts that his investments were subject to a series of malicious and unjustifiable acts taken by various agencies of the Romanian government. He alleges, *inter alia*, that the State agents' actions taken collectively or individually amount to an indirect expropriation, or at least substantial impairment, of his investments, in violation of the Agreement between the Government of Romania and the Government of the Hellenic Republic on the Promotion and Reciprocal Protection of Investments, which entered into force on May 23, 1997 (the "Treaty" or the "BIT"); that they also constitute violations of the fair and equitable treatment, the full protection and security and the non-impairment standards of the Treaty as well as of Article 6 of the European Convention on Human Rights and of Article 1 of the First Additional Protocol to the European Convention.

11. Claimant's allegations are strongly denied and disputed by Respondent.

CHAPTER II. THE PROCEDURE

I. INSTITUTION OF THE PROCEEDINGS AND THE TRIBUNAL

12. On May 13, 2004, ICSID received a Request from Roussalis for the institution of arbitration proceedings under the ICSID Convention (the "Request"), with accompanying documentation comprising 16 annexes.

13. On June 9, 2004, the ICSID Secretariat (the "Secretariat") transmitted copies of the Request and of its accompanying documentation to Romania in accordance with Rule 5(2) of the ICSID Institution Rules.

14. After a prolonged period during which Claimant supplemented his Request, on January 10, 2006, the Request was registered pursuant to Article 36(3) of the ICSID Convention.

15. On March 14, 2007, an Arbitral Tribunal was constituted in accordance with Articles 37(2)(b) and 38 of the ICSID Convention. The Tribunal consisted of Dr. Robert Briner (President, appointed by ICSID), Prof. Andrea Giardina (also appointed by ICSID), and Prof. W. Michael Reisman (appointed by Respondent). The ICSID Secretariat informed the Parties on the same date that Ms. Martina Polasek (Senior Counsel, ICSID), would serve as Secretary of the Tribunal (the "Secretary").

16. On July 29, 2009, Dr. Briner resigned as arbitrator from this case. Consequently, the Chairman of the ICSID Administrative Council appointed Prof. Bernard Hanotiau in order to fill the vacancy in accordance with Articles 38 and 40(1) of the ICSID Convention and Arbitration Rule 11(1). On September 3, 2009, Prof. Hanotiau accepted the appointment as President of the Tribunal and the Tribunal was thus reconstituted and the proceedings resumed on that date.

17. On January 18, 2010, the Parties approved the appointment of Ms. Erica Stein, associate of the President's firm, as assistant to the Tribunal in this case. Subsequently, on February 4, 2011, Ms. Stein was replaced by Ms. Alexandra De Roose, also associate of the President's firm.

II. PROCEDURAL RULES AND AGENDA: MINUTES OF THE FIRST SESSION

18. By agreement of the Parties, the first session of the Arbitral Tribunal concerning the procedural rules and the agenda of the arbitration was held at the World Bank offices in Paris on May 4, 2007.

19. This first session addressed various procedural matters listed on the agenda circulated to the Parties by the Secretary on April 9, 2007 (attached to the Minutes as Annex 1). It also addressed matters contained in the Parties' Joint Proposal of May 3, 2007 (attached to the Minutes as Annex 2), which enumerated various points of agreement between the Parties regarding the procedure to be followed. The minutes of the first session, signed by the arbitrators and the Secretary of the Tribunal, were transmitted to the Parties on July 11, 2007.

20. Among other matters, it was agreed that the applicable arbitration rules would be the ICSID Arbitration Rules in force as of April 10, 2006, that the place of proceedings would be Paris and that the procedural language would be English. It was further agreed that substantive Romanian law would govern the arbitration, and that the BIT would be treated as part of Romanian law.

III. RESPONDENT'S FIRST REQUEST FOR PRODUCTION OF DOCUMENTS

21. On March 7, 2008, Respondent submitted its Request for an Order Compelling the Production of Certain Documents by Claimant, comprising twenty-six Requests and two Supplemental Requests. Claimant submitted his reply on March 17, 2008.

22. On March 27, 2008, the Tribunal took note of Claimant's commitment to produce certain specified documents by March 31, 2008. The Tribunal also expressed its satisfaction regarding the explanations given by Claimant regarding the other Requests, noting that this would be sufficient for Respondent to draft its Counter-Memorial.

IV. RESPONDENT'S FIRST REQUEST FOR PROVISIONAL MEASURES

23. On May 28, 2008, Respondent submitted a First Request for Provisional Measures requesting that Claimant refrain from selling certain properties until the conclusion of the arbitration proceedings. Pursuant to the Tribunal's invitation in accordance with ICSID Arbitration Rule 39(4), Claimant submitted his observations on the Request on June 13, 2008. Respondent filed its Reply on June 23, 2008, and Claimant filed his Rejoinder on June 30, 2008. On July 8, 2008, Respondent sent a letter to the Tribunal challenging a new allegation raised by Claimant in his Rejoinder. By letter dated July 10, 2008, Claimant replied to Respondent's letter of July 8, 2008.

24. On July 22, 2008, the Tribunal rendered its Decision on Provisional Measures, directing that Claimant does not sell or alienate any property belonging to Continent SA, without prejudice to all substantive issues in dispute.

V. Respondent's Second Request for Production of Documents

25. On March 27, 2009, Respondent submitted a "Request for Documents" to Claimant. On April 27, 2009, Claimant objected to Respondent's Request.

26. On April 29, 2009, Respondent filed a Request for an order compelling Claimant to produce documents and preserve evidence for later production. Claimant submitted his Response to the request on May 19, 2009. Respondent submitted its Reply on July 24, 2009 and Claimant submitted his Response on October 7, 2009.

27. On October 14, 2009, the Tribunal issued its Decision on Document Production and Preservation of Evidence, rejecting Respondent's Request for Production and Preservation in its entirety.

VI. Respondent's Second Request for Provisional Measures

28. On May 12, 2009, Respondent submitted a Request for provisional measures seeking an order requiring the parties to refrain from pursuing non-ICSID remedies, namely a stay of pending Romanian court proceedings until such time as the Tribunal would issue an award. Claimant submitted his observations on May 19, 2009. Respondent then submitted its Reply on May 29, 2009 and Claimant a Rejoinder on June 23, 2009.

29. On July 2, 2009, the Tribunal issued a Decision on Provisional Measures ordering that Roussalis cause Continent SRL and Continent SA to take all necessary actions to seek, together with Romania and AVAS, a stay of two pending Romanian court proceedings until the rending of this Award.

VII. Procedural Rules and Agenda: Pre-Hearing Telephone Conference and Additional Requests

30. On January 27, 2010, a pre-hearing telephone conference was held between the Parties and the Tribunal in order to determine various procedural matters. Prior to the telephone conference, the Parties had submitted a written statement enumerating various points of agreement. On January 28, 2010, the Tribunal confirmed that it had no objection to the agreed points, and communicated its decisions regarding various outstanding issues. These included: (i) the availability of witnesses for examination and cross-examination at the hearing; (ii) the oral presentation of opening and closing statements; (iii) the order in which the various heads of claim were to be heard at the hearing; and (iv) the submission of post-hearing briefs. The Tribunal invited the Parties to submit a detailed schedule for the five-day hearing by mid-February.

31. On March 1, 2011, Claimant made a request to: (i) submit evidence from two witnesses at the hearing who had not previously submitted a witness statement or expert report; (ii) submit new rebuttal evidence; (iii) file certain new authorities relating to Romanian law; and (iv) amend the procedural schedule of the hearing. By letter of March 4, 2011,

Respondent stated its objections to the request. On March 8, 2011, the Tribunal rendered its directions in respect of Claimant's requests, by which it: (i) denied the Claimant's first request in accordance with the Parties' agreement set out in the Minutes of the First Session; (ii) allowed the submission of late rebuttal evidence in respect of one exhibit, but denied it in respect of five others, inviting limited rebuttal evidence from Respondent; (iii) approved the third request regarding the filing of the authorities relating to Romanian law; (iv) confirmed the sequence of arguments set out in its directions of January 28, 2010, but approved the Parties' agreement to hear the Ozias Tax Claim jointly with the Fiscal Claim.

VIII. EXCHANGE OF WRITTEN PLEADINGS

32. The time limits contained in the Minutes of the first session of the Arbitral Tribunal were extended several times by the Tribunal upon the Parties' requests. Each party filed its written submissions pursuant to the Tribunal's amended directions.

33. On October 2, 2007, Claimant filed his Memorial on the merits together with exhibits and legal authorities.

34. On June 2, 2008, Respondent filed its Counter-Memorial, including objections to jurisdiction and a Counterclaim, together with supporting documentation and five witness statements.

35. Claimant filed his Reply on jurisdiction and the merits on December 21, 2008, together with exhibits and legal authorities. On the same date, Claimant also submitted his Counter-Memorial to Respondent's Counterclaim.

36. On March 31, 2009, having considered the Parties' respective submissions on the issue, the Tribunal granted Respondent's request for bifurcation of the proceedings, directing that any damages concerning Respondent's Counterclaim be assessed in a second stage of the proceedings, should the Tribunal find for Respondent with respect to jurisdiction and liability.

37. On July 13, 2009, Respondent filed its Rejoinder on jurisdiction and the merits, including a Reply on the Counterclaim.

38. On November 13, 2009, the Claimant filed a Rejoinder on the Counterclaim.

IX. ORAL PLEADINGS

39. An oral Hearing on Jurisdiction and the Merits was held between March 14, 2011 and March 18, 2011 at the World Bank's offices, 66 Avenue d'Iéna, Paris. The hearing was audio recorded and transcribed by a court reporter, Ms. Emma White.

40. During the Hearing, the following witnesses of fact were heard in accordance with the agreed method (namely – direct, cross and re-direct examination, and questions from the Tribunal):

- Ms. Mariana Predescu (regarding the Investment Claim);
- Ms. Ana Lucia Chivu (regarding the Fiscal Claim and Ozias Claim);
- Ms. Oana Scrobota (regarding the Fiscal Claim and Ozias Claim);
- Mrs. Alexandra Stocia (regarding the Food Safety Claim);
- Mrs. Maria Dulgheriu (regarding the Food Safety Claim).

X. POST HEARING SUBMISSIONS

41. The Parties submitted their Post-Hearing Briefs on June 7, 2011. On the same date, the Parties submitted their Statements of Costs. On June 21, 2011, Claimant submitted a supplementary submission on Costs.

42. On September 7, 2011, Respondent requested the admission of an additional exhibit. Following the Tribunal's invitation, on September 22, 2011, Claimant objected to Respondent's request, submitting a witness statement of Roussalis with approximately 90 pages of appendices in support of his objection. On September 28, 2011, the Arbitral Tribunal rejected the admissibility of the new documentary evidence.

CHAPTER III. JURISDICTION

SECTION I. CLAIMANT'S POSITION ON JURISDICTION

43. Claimant submits that the Arbitral Tribunal has jurisdiction over this case in accordance with the Treaty. Article 9 of the Treaty provides :

Settlement of Disputes between an Investor and a Contracting Party

1. *Disputes between an investor of a Contracting Party and the other Contracting Party concerning an obligation of the latter under this Agreement, in relation to an investment of the former, shall, if possible, be settled by the disputing parties in an amicable way.*

2. *If such disputes cannot be settled within six months from the date either party requested amicable settlement, the investor concerned may submit the dispute either to the competent courts of the Contracting Party in the territory of which the investment has been made or to international arbitration.*

   Each Contracting Party hereby consents to the submission of such dispute to international arbitration.

3. *Where the dispute is referred to international arbitration the investor concerned may submit the dispute either to:*

   a) *the International Centre for the Settlement of Investment Disputes, established under the Convention on the Settlement of Investment Disputes*

between States and Nationals of Other States, opened for signature at Washington D.C. on 18 March 1965, for arbitration or conciliation, or

b) *an ad hoc arbitral tribunal to be established under the arbitration rules of the United Nations Commission on International Trade Law (U.N.C.I.T.R.A.L).*

4. *The arbitral tribunal shall decide the dispute in accordance with the provisions of this Agreement and the applicable rules and principles of international law. The awards of arbitration shall be final and binding on both parties to the dispute. Each Contracting Party shall carry out without delay any such award and such award shall he enforced in accordance with domestic law.*

44. Article 1(3) of the Treaty provides that: *"'Investor' shall comprise, in respect of either Contracting Party, nationals and legal persons or other legal entities constituted or otherwise duly organised in accordance with the laws of that Contracting Party and having their effective economic activities in the territory of that same Contracting Party. "*

45. Article 1(4) of the Treaty provides that: *"'national' means: b) In respect of the Hellenic Republic, any natural person having or acquiring Greek nationality in accordance with the Greek nationality code".*

46. Spyridon Roussalis is a Greek citizen with Passport series „O" n°3107555. Greece signed the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (the "ICSID Convention") on March 16, 1966 and became an ICSID Member State on May 21, 1969.

47. Respondent, Romania, signed the ICSID Convention on September 6, 1974 and became an ICSID Member State on October 12, 1975.

48. Claimant made an investment in Romania when Roussalis entered, through Continent SRL, into the Privatization Agreement with AVAS and purchased a 70 percent interest in S.C. Malimp SA (now Continent SA).

49. In light of the foregoing, Spyridon Roussalis, a Greek citizen and the sole shareholder of Continent SRL, is an investor within the meaning of Article 1(3) of the Treaty.

50. Claimant further states that he fulfilled the "amicable settlement" preliminary procedure. Indeed, by registered letter dated December 9, 2003 (Claimant Exhibit n°3), he wrote to Romania's Government seeking amicable settlement of the dispute. Romania's Government did not reply.

51. Therefore, in accordance with Article 9 of the Treaty, Claimant, after the expiry of the six-month "amicable settlement term," submitted the dispute to arbitration under the auspices of ICSID.

SECTION II. RESPONDENT'S POSITION ON JURISDICTION

52. In its written pleadings, Respondent submitted that the Arbitral Tribunal does not have jurisdiction to hear this case since Claimant did not make an investment within the meaning of Article 9(1) of the Treaty.

53. Respondent argued that bilateral investment treaties do not offer protection to investments, such as Claimant's, that are fraudulent or otherwise illegal. Recognizing the existence of rights under BITs arising from illegal acts would violate "respect for the law," a fundamental principle of such treaties (*Inceysa Vallisoletana S.L. v. Republic of El Salvador*, ICSID Case No. ARB/03/26). Moreover, in the case at hand, Article 2(1) of the Treaty expressly provides that each Contracting Party admits investments by investors of the other Contracting Party *in accordance with its legislation*. Consequently, Claimant cannot rely on the Treaty as a basis for a claim that is premised on purported financial transactions which, under Romanian law, are void.

54. Respondent further submitted that Roussalis bears the burden of proving that his claimed investment was made, and that it was made in accordance with Romanian law; that he has proved neither and that accordingly, the Treaty provides no basis for Claimant's Investment Claim.

55. However, in its oral pleadings, counsel for Respondent amended their position and stated that: *"The only dispute is on the facts. So, for the purposes of jurisdiction, we believe that once you decide, as I think you must, because there is no dispute here, that you have jurisdiction to decide the investment claim, that will a fair and appropriate application of the convention, and the limited amount of case law that is out there, and the limited amount of commentary that is available to you*" (Transcript, Day 4, p.132, line 5).

56. Counsel for Respondent indicated that their contention as regards Claimant's unfulfilled post-purchase obligations under the SPA was on the merits, *inter alia* in support of Respondent's Counterclaim. Professor Reisman asked Respondent: *"So reference has been made from the first day to the investment not being made, I am to understand that that means [that] the post-investment portion?"* Counsel for Respondent answered: *"Yes, and I apologize, it is sloppiness on our side, but all of those references, if I can correct them by a global correction, are all meant to say, "The post-privatisation investment of US$1.4 million was not made."*

SECTION III. DECISION OF THE ARBITRAL TRIBUNAL

57. The Tribunal's jurisdiction is contingent upon the provisions of the BIT and the ICSID Convention.

58. The relevant provision of the ICSID Convention is Article 25(1), which reads as follows:

"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."

59. The relevant provision of the BIT is its Article 9 (see above ¶43).

60. An analysis of the arguments raised by the Parties in connection with the jurisdiction of the Tribunal over the claims indicates that it is not disputed that Claimant made an investment in Romania when Roussalis entered, through Continent SRL, into the Privatization Agreement with AVAS and purchased a 70 percent interest in S.C. Malimp SA.

61. Respondent's counsel recognised during the hearing that *"The Investor put in the money necessary to have the shares transferred into his possession, but then the Investor did not comply with the second half of the investment, so yes, there was an investment, you do have jurisdiction to decide the investment claim"* (Transcript, Day 3, p.129, line 12 *et seq*.). In particular, upon Professor Reisman's question: *"(...) if I may restate it, it is the position of Respondent that the Claimant did make an investment and that investment comes under the protection of the BIT?"* Respondent's counsel answered: *"Correct"* (Transcript, Day 3, p.131, line 23 *et seq*.). The following day, the Respondent confirmed once again its position: "*Obviously, there was an investment. This investor put up an initial 1-2 million dollars, more or less to acquire the shares and they were transferred to him.*" (Transcript, Day 4, page 128, lines 7 and 8).

62. In light of the foregoing, the Tribunal decides that the present dispute constitutes an investment within the jurisdiction of the tribunal. The other objections to the subject matter jurisdiction of four of the five claims will be addressed hereafter in the discussion of each of those respective claims.

CHAPTER IV. THE CLAIMANT'S CLAIMS

63. Claimant invokes the violation by Respondent of the of the BIT, of the European Convention on Human Rights and of the First Additional Protocol to the European Convention in relation to five claims:

- The Investment Claim
- The Fiscal Claim
- The Interdiction Claim
- The Food and Safety Claim
- The Ozias Claim.

64. Claimant submits that a series of measures taken by the Romanian authorities in relation to Roussalis's investment amount to a violation of Articles 2(2) and 4(4) of the Treaty, of Article 6 of the European Convention on Human Rights and of Article 1 of the First Additional Protocol to the European Convention.

65. The five claims are analyzed below. They are strongly disputed by Respondent.

66. In a nutshell, Claimant submits that in breach of the BIT – and of the European Convention on Human Rights and of its Additional Protocol – Romania failed to create a safe environment for the investor and the investment; it failed to protect the investor and his investment from arbitrary State measures and failed to treat the investor and the investment equitably and fairly. In particular, the lack of recognition given to the Claimant's contractual rights and legitimate expectations to sell and/or dispose of his assets amounted to an expropriation.

SECTION I. THE INVESTMENT CLAIM

SUB-SECTION I. CLAIMANT'S POSITION ON THE INVESTMENT CLAIM

§1. THE FACTS

I. AVAS'S JUDICIAL PROCEEDINGS FOR THE ENFORCEMENT OF THE SHARE PLEDGE

A. Claimant fulfilled his Contractual Obligations

67. In accordance with the Privatization Agreement, Continent SRL agreed to make an additional post-purchase investment of USD 1.4 million over a two-year period from January 1, 1999 to December 31, 2000. Annex 4 to the Privatization Agreement specified that a capital contribution of USD 1.1 million must be made in 1999, with the remainder (USD 300,000) to be contributed in 2000.

68. This investment had to be carried out by the buyer *"from personal sources or sources attracted on its behalf"* (Claimant's Memorial, ¶24).

69. The Privatization Agreement and Annex 4 thereto did not further stipulate the method by which the post purchase investments should be made. That decision was left to the buyer. The sole obligation was the financial result, namely that the investments should amount to USD 1,400,000.

70. As security for the post-purchase investment, Continent SRL also agreed to pledge in favor of AVAS the 372,523 shares that it had purchased.

71. Article 8.10.2 of the Privatization Agreement states that the capital contribution "is deemed to be performed on the date of the registration at the Trade Registry of the increase of [Continent SA's] capital by the subscribed contribution and fully paid by [Continent SRL]". In other words, in order for the capital investment to be "*deemed to be performed*," Continent SRL had to demonstrate that Continent SA's capital increase had been registered at the Trade Registry.

72. Claimant contends that Continent SRL complied with its post-purchase investment obligation by means of (i) undertaking construction works; (ii) making installations in buildings; and (iii) purchasing fixed assets.

73. An extraordinary general meeting of the shareholders of Continent SA was held on October 27, 2000. The items on the agenda included both the share capital increase by way of contribution in kind for a value of USD 1,400,000, and the appointment of an expert to draft the assessment report on the contribution in kind. The meeting also provided an opportunity for other shareholders, where applicable, to exercise their rights of pre-emption.

74. Claimant hired SC Expert Proiect L.B. S.R.L. ("Expert Proiect") as the consulting firm to draft a technical expertise and an expert report assessing the value of the investment made under the Privatization Agreement. In particular, Expert Proiect had to determine (a) the value of the in kind contribution, as it has physically been presented to it, (b) the assets purchased and the manual labor for which invoices had been submitted, and (c) the updating of the amounts. The expert was not asked to establish the financing sources of the post-purchase investment.

75. Claimant points out that, contrary to Respondent's contention, Expert Proiect's registered office was not located in the same building as Continent SRL's registered office. Its registered office is at 5, N. Balcescu Av., the Dunarea Block, staircase B, flat No. 42, Bucharest – 1st District.

76. Expert Proiect used legal assessment methods and confirmed that an investment was made amounting to lei 35,571,648,325, representing the equivalent amount of USD 1,404,162. The report concludes as follows (see Claimant's Memorial, p. 19):

"- lei 27,690,960,312– USD 1,093,079– investment realized for constructions and installations;

- lei 4,370,272,799– USD 172,513– investment engaged for works in process [sic] *on constructions and installations;*

- lei 3,510,415,214– USD 138,571– purchased fixed assets.

____

lei 35,571,648,325 = USD 1,404,162 – the value effectively ascertained as invested by the Claimant so as to fulfill the obligation undertaken with respect to AVAS (former FPS)".

77. Claimant contests Respondent's allegations that Expert Proiect had previously performed a preliminary valuation of the post-purchase investment and that it had not reached the value of USD 1,400,000. Claimant further denies that, subsequently, in order to reach this value, Claimant requested his personnel to forge invoices and other documents that would serve as basis for the issuing of the final valuation report. He submits that Respondent does not offer any proof of these serious allegations.

78. Moreover, Respondent's allegations are based on a written statement given to the police in April 2001 by Continent SA and Continent SRL's chief accountant, Ms. Angela Doanta. Claimant argues that Ms. Doanta's statement should be excluded from the record as unreliable on the ground that, following a complaint made by Roussalis, Ms. Doanta was investigated, convicted, and sentenced to five years' imprisonment for embezzlement

(Claimant's Reply Exhibit n°1). According to Claimant, Ms. Doanta's statement is obviously tendentious, untrue and motivated by revenge.

79. Claimant submits that the invoices on which Expert Proiect based its report show the material (physical) reality of the invoiced services and assets purchased. Respondent's allegation that some irregularities have been discovered in the invoice forms is not relevant as long as the invoiced assets and services have been effectively provided to Continent SA.

80. On November 29, 2000, Continent SA sent a notice to the Official Gazette announcing that a shareholders' meeting would be convened to approve the Expert Proiect report and to pass a resolution increasing Continent SA's share capital by USD 1,404,162**.**

81. On December 15, 2000, during an extraordinary general meeting, Continent SA's shareholders approved the Expert Proiect report. The share capital increase was also approved, increasing the number of shares by 1.418.648, with a face value amounting to ROL[1] 25,000 for each share and a total value amounting to ROL 35,466,200,000 (Claimant's Exhibit n°16).

82. The additional Act n°4933/15.12.2000, issued by the Mircia Elena Public Notary's Office, modified the company's Deed of Incorporation and mentioned the share capital increase by way of the buyer's contribution in kind.

83. The amendment of the company's Deed of Incorporation was registered with the National Trade Register Office ("O.R.C." or the "Trade Registry")[2] of the Bucharest Municipality (the "O.R.C.M.B") under n°146699/15.12.2000 (Claimant's Exhibit n°5). The shareholders' resolution and the expert report were presented to the judge at the Trade Registry. Claimant obtained approval for the increase in Continent SA's share capital by a judgment handed down by the designated Trade Registry judge (see Conclusion n°6962/20.12.2000, Claimant's Exhibit n°5).

84. On December 21, 2000, the day after the Trade Registry judge rendered a decision, Continent SRL informed AVAS that it had fulfilled its post-purchase investment obligation, in accordance with Article 8.10.1 of the Privatization Agreement, by way of a contribution in kind for a value of USD 1,400,000.

85. According to Article 6 of Law 26/1990 on the Trade Register Office, the Trade Registry approval of the capital increase could only be appealed within 15 days of the decision being rendered. Neither AVAS nor any state authority had any objection to the Trade Registry approval decision since they did not challenge it within the applicable time limit.

---

[1] ROL is the currency abbreviation for the Old Romanian lei, the official Romanian currency until July 1, 2005.

[2] The Trade Registry is the Government agency tasked with registering and managing incorporations and modifications to a commercial entity's status. It is part of the Justice Ministry, with each of its 42 territorial offices attached to a tribunal whose judges take turns in reviewing registrations.

Therefore, the Trade Registry judge's decision became irrevocable. Even if the Tribunal would accept Respondent's contention that the 15-day period began to run upon publication of the approval of the capital increase in the Official Gazette, it remains that Article 5(2) of Law n°26/1990 provides that: *"(2) The person whose responsibility is to request a registration cannot oppose to third parties the not-registered acts or facts, unless he has fulfilled the burden of proof that they were familiar with these ones"* (*sic*., Claimant's Reply Memorial, ¶182). Therefore, since Claimant immediately informed AVAS that the registration had taken place, AVAS could have challenged the decision within the required time limit.

86. Claimant denies Respondent's allegation that Continent SA's letter of May 21, 2001 contradicts the allegation that Continent SRL had fulfilled its investment obligation by stating that *"a part of the investment has been made by Continent SA and not by Continent SRL"* (Respondent's Exhibit n°12). Indeed, the portion of the letter quoted by Respondent actually indicates that, due to chaotic keeping of accounts and aberrant economic management (by Ms. Doanta), regularization needed to be made. Such regularization was made, and as a consequence, *"all the amounts that were used to achieve the investment belong to* [Continent SRL] *or have been attracted by this one*" (Claimant's Reply, ¶140).

87. Claimant refutes Respondent's allegation that Continent SA's accounts were manipulated to make Continent SA's capital expenditures appear as if they should be credited to Continent SRL as qualifying investments. It denies that Roussalis used two companies that he owned, SC Continent Marine Trading SRL and SC Continent Construction SRL, to that end. Indeed, the assignment agreements entered into in June 2001 by these two companies (as assignors) and Continent SRL (as assignees) have actually been recorded in the accounting registers of the respective companies. These agreements have extinguished the debt for construction works that Continent SA had towards the two companies. The debt was transferred to Continent SRL and Continent SA never paid the invoices for construction works that the two companies had issued.

88. According to Claimant, it is only several months after the Trade Registry judge's decision became irrevocable that AVAS began to request the submission of supporting documents concerning the fulfillment of the obligations stipulated in the Privatization Agreement. AVAS was obviously trying to find reasons to pretend that Claimant had not fulfilled his contractual obligations.

89. Claimant asserts that, at the date it purchased S.C. Malimp SA, the price it paid for the shares was "sensibly lower" than the actual value of the acquired assets. Indeed, during the privatization process in Romania, acquisitions of marginally profitable state-owned companies were customarily made undervalue. For Claimant, the value of Continent SA's assets is the reason underlying the long history of aggression and application of abusive measures by the Government towards Claimant's investment. Such aggression began when the new government took office after the November 2000 election. The new Romanian government tried to recover land, covering as much as 40,000 sq. m., where the assets were located (warehouses, refrigerating warehouses, including 5 floored

buildings, platforms, etc) because the value of these assets, and more specifically of the land, had exponentially increased in Romania.

90. The existence of the post-purchase investment has been confirmed in the decision of 8 October 2007 of the 6th Commercial Section of the Bucharest Court of Appeal which Claimant reproduces *in extenso* in its Reply Memorial (¶174), and which states that: "*As it resulted from the technical expertise and from the accounting one that have been carried out on the occasion of the trial of the cause in the first instance court, real investments have been made at the privatized company, investments that consisted in construction and installation works, as well as in the acquisition of fixed assets, investments whose total value amounted to 1,400,000 USD, and the Annex contains the estimations of the works to be done and the list with the invoices that have been checked by the accounting expert, invoices that certify the achievement of the investment.*

As concerns the nominal share capital increase, at the Trade Register, there has been written down the notification related to it that was subsequent to the ruling no. 6962 /20.12.2000 that has been rendered by the mandatory judge from the Court of Law from Bucharest at O.R.C.T.B. Given the above mentioned, it is considered that there have been observed and fulfilled the conditions from Art. 8.10.12 from the privatization contract, that there have been observed and fulfilled the registration conditions at the Trade Register, as capital increase, of the investment made by [Continent SA].

The decision of the Shareholders' Extraordinary General Meeting (AGEA) no. 6 / 2000 reflects the reality as concerns the effective increase of the nominal share capital by the amount of 1,400,000 USD; (…).

(…), as concerns the investment financing sources, these ones comply with the issues stipulated in the Shares Sale – Purchase Contract, and in the own sources / attracted sources contract, respectively, on the name of [Continent SRL].

(…), the own sources to achieve the investments were transformed into re-investing the profit obtained by [Continent SA] *during the years of 1998, 1999 and 2000. The re-investing of the profit was possible as a consequence of the decision, reached to this purpose, by* [Continent SRL]*, the controlling shareholder, who has, thus, given up the idea of cashing dividends for the respective years, his target being to make investments into the privatized company.*

At the same time, there have also been amounts that have been attracted on the name of [Continent SRL]. *The above refers to the acquisition of some fixed assets and to the carrying out of construction works for* [Continent SA] *by S.C. CONTINENT MARINE CONSTRUCTION S.R.L. and by S.C. CONTINENT MARINE TRADING S.R.L. These companies have assigned, subsequently to having made the investments, their debts amounting to 9,250,087,000 LEI (ROL) and 3,985,471,852 LEI (ROL), respectively, in favor of the assignee* [Continent SRL] *by means of transfer of debts contracts signed and concluded on the 15-th of June 2001 and on the 30-th of June 2001.*

At the same time, Roussalis Spyridon, who is the representative of [Continent SRL]*, has credited, on his own name* [Continent SA] *with the amount of 3,237,146,146 LEI (ROL) in view of purchasing fixed assets. After this acquisition, a contract called "novation contract" was signed and concluded on the 30-th of June 2001, which stands for a*

perfect deputation. This way, Roussalis Spyridon, the creditor, has agreed to the replacement of the initial debtor, [Continent SA] *by the new debtor,* [Continent SRL]. *As previously indicated by the accounting expert, both the transfer of debts contracts, and the novation contract have been registered in accounting (…).*

Based on the analysis made to the previously presented facts in the accounting expertise minutes, there results that the financing sources of the investment are either own sources, or sources attracted on the name of the controlling shareholder [Continent SRL] *(…).*

The irregularities that have been found by the Financial Guard's representatives (…) cannot annul the reality of the achieved investments, reality that has been noticed by the technical experts who have concretely valuated these investments, and, more than that, they can represent only civil penalties with reference to the way in which the accounting registration are made, as, the Financial Guard has stipulated, as a matter of fact.

Given the above stipulated, it is contended the reality of the effective achievement, out of own or attracted sources, on the name of [Continent SRL]*, of the investments brought as contribution to the nominal share capital of the privatized company, and, therefore, the achievement, by the plaintiff in appeal – defendant, of the liability assumed at Art. 8.10.1 and at Art. 8.10.2 from the Shares Sale – Purchase Contract. As the investment that represents a contribution to the share nominal capital of* [Continent SA] *has been integrally achieved at the end of 2000, and as Art. 8.10.3 from the Shares Sale – Purchase Contract stipulates that "the shares that represent a collateral shall be withdrawn from the collateral within 30 days since the date of the integral achievement of the capital investment /contribution by the Purchaser, under the conditions stipulated at Art. 8.10.1 and Art. 8.10.2 from the present Contract"* (*sic.*, Claimant's Reply Exhibit n°3).

B. Despite Claimant's fulfilment of his contractual obligations, AVAS filed judicial proceedings for the enforcement of the pledge

91. Claimant submits that despite the fulfilment of Continent SRL's contractual obligations, on April 23, 2001, AVAS filed a breach of contract claim in the Bucharest Commercial Court (Claimant's Exhibit n°7). AVAS also sought to enforce its rights under Article 8.10 of the Privatization Agreement with respect to the share pledge as security for the investment obligation. It requested the *registration* of the pledge, as well as the payment of "comminatory damages" (*i.e. per diem* delay penalties) if the execution of the court's decision was delayed.

92. On June 22, 2001, AVAS amended the claim to seek *enforcement* of the share pledge and requested to have the property of the pledged asset, i.e. the 372,532 shares, returned to the State.

93. AVAS contended during the proceedings that Continent SRL had not fulfilled its obligations arising out of Article 8 of the Privatization Agreement and had not made the investments under the contract to the value of 1.4 million USD. It mainly based its allegation on the fact that:

- the documentation submitted by Continent SRL contained estimates of the investments that were based on works managed and executed by Continent SA and on invoices pertaining to fixed assets purchased by Continent SA; that
- accordingly, the financing sources of the investments were not the buyer's (Continent SRL) or "attracted on its behalf."

94. The first instance court and the appeal court ruled in favor of Continent SRL and rejected AVAS's requests as groundless (See Claimant's Exhibits n° 9 to 11). According to Claimant, the civil judge's decision n°7886/19.10.2001 in favor of Continent SRL became therefore irrevocable.

C. Despite the existence of an irrevocable judgment, AVAS requested that the General Prosecutor take steps to seek supervisory review by the Supreme Court and an order vacating the judgment

95. Notwithstanding the above, AVAS requested that the General Prosecutor take steps to seek supervisory review by the Romanian Supreme Court (the "Supreme Court") and an order vacating the judgment. On November 21, 2002, AVAS requested the General Prosecutor to file a motion to vacate the judgments rendered by the lower courts.

96. On March 11, 2002, the Public Ministry, through the General Prosecutor, filed a motion to vacate the lower court judgments (Claimant's Exhibit n°12). On July 9, 2003, the Supreme Court accepted the motion, cancelled the two judgments and remanded the case to the Bucharest Commercial Court for a full re-trial (Judgment n°3397/09.07.2003, Claimant's Exhibit n°13).

97. Claimant submits that this procedure of submitting motions to vacate irrevocable judgments is a reminiscence of the communist procedural system, which was subsequently abrogated. Indeed, such procedure does not compare to regular "annulment" proceedings since the right to file a motion to vacate a final judgment is left to the discretion of the General Prosecutor, an instrument of the State. According to Claimant, it infringes the principle of legal certainty.

98. The Supreme Court's decision reads as follows: "[r]*egarding the criticism brought by the General Prosecutor to the mode how the debt concession contracts were signed and also the novation contract, they will be examined by the main instance after it would be established if the material contribution was real or fictive, in the conditions presented above and after checking the operations performed between the companies belonging to the same group"* (*sic.,* Claimant's Exhibit n°13). The Supreme Court remanded the case to the trial court for further proceedings without any substantiated reasons. The decision led to an unreasonable new delay in the final settlement of the case. Indeed, it ordered a full retrial more than four years after the execution of the SPA.

D. Subsequent Decisions

99. On remand, the 6th Commercial Department within the Bucharest Court ruled on 5 May 2006 in favor of Continent SRL, deciding that it had fulfilled its investment obligations (Claimant's Exhibit n°14).

100. AVAS, once again, filed an appeal against the judgment. Following a further full trial, the Court of Appeal ruled in favour of Continent SRL on August 10, 2007 (Judgment no. 430/08.10.2007, Claimant's Exhibit n°3, C. Reply).

101. AVAS appealed the Court of Appeal's decision. On June 30, 2009, the Supreme Court ruled in favour of Continent SRL (Judgment no. 2090, Claimant's Exhibit n°1, C. Rejoinder).

102. It results from the above that for nearly ten years, the ownership of the shares has been challenged by the State on grounds which were ultimately found to be without merit.

II. AVAS'S JUDICIAL PROCEEDINGS FOR THE ANNULMENT OF THE SHAREHOLDERS' RESOLUTION DATED DECEMBER 15, 2000

103. Claimant asserts that notwithstanding the Supreme Court's decision, AVAS resorted to a new subterfuge lacking any legal ground. On August 17, 2007, it filed a request for:

- the annulment of the shareholders' resolution dated December 15, 2000 approving the share capital increase (Claimant's Exhibits n°15 and 16), and

- the registration of the annulment decision with the Trade Registry and thereby the deletion of the registration of Continent SA's share capital increase.

104. AVAS's aim was to establish that Continent SRL had not fulfilled its investment obligations.

105. Claimant argues that AVAS was not entitled to a set aside ruling declaring the Continent SA shareholders' resolution null. Indeed, the "absolute nullity sanction" was introduced in Romanian law in 2005, *i.e.* after the extraordinary general shareholders' meeting took place. Therefore it was not in force when the general meeting approved the capital increase.

106. Prior to 2005, the "absolute nullity sanction" was a remedy provided exclusively to shareholders who had not attended the meeting or who voted against the resolution. The shareholders had the right to contest the general meeting resolution within 15 days following the decision's publication in the Romanian Official Gazette.

107. In any case, the legal grounds that Respondent invoked to justify the filing of its "absolute nullity" claim were spurious. *First*, Article 966 of the Civil Code, invoked by Respondent, which provides that "[a]*n obligation without cause or grounded on a false or illicit cause, cannot have any* [legally-enforceable] *effect*", only applies to contracts, not to shareholder resolutions. Therefore it cannot be called upon to justify the filing of

the nullity claim. *Second*, there was no violation of mandatory provisions of the Company Law concerning decisions made with the vote of directors. Indeed, Claimant asserts that he participated in the meeting as the sole shareholder and representative of the controlling shareholder, not as Continent SA's director. The report shows that the directors participated only as guests in the extraordinary general meeting.

108. According to Claimant, Respondent's actions amount to a *"permanent juridical procedural harassment creating a state of juridical insecurity over the ownership (the investment)."* It led to deprive the investor of the exercise of its right of ownership over the investment (Claimant's Memorial, ¶48).

109. The Commercial Court ruled against AVAS and refused to nullify the shareholders' resolution (Claimant's Exhibit n°2, C. Rejoinder). The Court declared that the meeting had been convened and conducted with due process of law and without any conflict because of Roussalis's status as majority shareholder/owner and director of Continent SA.

III. CONFIRMATION BY DOMESTIC COURTS OF THE PROPER PERFORMANCE OF THE PRIVATIZATION AGREEMENT

110. In light of the foregoing, it is clear that the Romanian courts, where AVAS was adequately represented, have always ruled in favour of Claimant concerning the proper performance of the SPA. Their rulings are binding upon both Continent SA and Continent SRL. They confirm that the post purchase investment was duly made and that the SPA was duly and lawfully performed.

§ 2. THE LAW

I. VIOLATION OF ARTICLE 4, PARAGRAPH 1 OF THE TREATY AND OF ARTICLE 1 OF THE FIRST ADDITIONAL PROTOCOL TO THE EUROPEAN CONVENTION ON HUMAN RIGHTS

A. Introduction

111. Claimant submits that the facts summarized above demonstrate that:

- he made the initially required investment, and subsequently performed the SPA in accordance with Romanian law.
- Romania, from 2001 to date, attempted to reclaim the privatized company's shares via lengthy and unjustified court proceedings.

112. It is Claimant's position that AVAS has acted in a manner that is inconsistent with its international obligations, without due regard to its own legal process and in breach of the BIT and the First Additional Protocol to the European Convention on Human Rights (the "European Convention").

113. This persistent refusal to recognize the valid performance of the investment obligations has, *inter alia*, caused Roussalis to be deprived of his right to sell and/or dispose of the

assets forming part of its investment and forced him to manage the investment in a *sub optimum* way. Indeed, even where a potential buyer agreed to a price and/or the fair market value of the assets, as occurred at a point during this arbitration, it would not go ahead with the deal upon completion of its due diligence, in light of Romania's extant claims.

114. Claimant notes the irrelevance of Respondent's observation that Roussalis withdrew funds from Continent SA over the years. He points out that: (i) Continent SA consisted predominantly of tangible assets when it was privatized, the cash that was allegedly made available later would therefore necessarily have come about due to Continent SA's activities or Claimant's investment in Continent SA through Continent SRL; (ii) Continent SA's income could be diverted by its owner in any direction, including reinvestments back into the company; (iii) the domestic courts admitted that such reinvestment of funds took place (Judgment no. 2090, para. 2, page 4, Claimant's Exhibit n°1, C. Rejoinder). Moreover, in light of his near 100% ownership of Continent SA, the manner in which Roussalis withdrew funds was within his business discretion.

B. AVAS's attempt to enforce the share pledge is a measure equivalent to expropriation

115. Claimant contends that AVAS's attempt to enforce the share pledge through the Romanian courts is groundless and illegal and amounts to a seizure of Continent SRL's shares in Continent and, together with the other lawsuit filed by AVAS, is tantamount to an expropriation in violation of Article 4(1) of the Treaty and Article 1 of the First Additional Protocol to the European Convention.

116. Article 4(1) of the Treaty provides that :

"Investments by investors of either Contracting Party in the territory of the other Contracting Party shall not be expropriated, nationalized or subjected to any other measure the effects of which would be tantamount to expropriation or nationalization (hereinafter referred to as " expropriation"), except under the following conditions:

a) the measures are taken in the public interest and under due process of law;

b) the measures are clear and on a non discriminatory basis;

c) the measures are taken against payment of prompt, adequate and effective compensation. Such compensation shall amount to the market value of the investment affected immediately before the measures referred to above in this paragraph were taken or became public knowledge, whichever is the earlier, it shall include interest from the date of expropriation until the date of payment at a normal commercial rate and shall be freely transferable, without delay, in a freely convertible currency. The amount of the compensation shall be subject to review by due process of law, within the framework of the legislation of the Contracting Party, in the territory of which the investment has been made,"

117. In this regard, Article 10 of the Treaty provides that "[i]*f the provisions of law of either Contracting Party or obligations under international law existing at present or*

established hereafter between the Contracting Parties in addition to this Agreement, contain a regulation, whether general or specific, entitling investments by investors of the other Contracting Party to a treatment more favourable than is provided for by this Agreement, such regulation shall to the extent that it is more favourable, prevail over this Agreement." Since Article 1 of the First Additional Protocol to the European Convention creates far better treatment than Article 4 of the Treaty, Article 1 of the First Additional Protocol comes within the jurisdiction of the Tribunal.

118. Article 1 of the First Additional Protocol to the European Convention provides that *"[e]very natural or legal person is entitled to the peaceful enjoyment of his possessions. No one shall be deprived of his possessions except in the public interest and subject to the conditions provided for by law and by the general principles of international law."*

<u>1. The lawsuit filed by AVAS is groundless since Claimant had fulfilled his contractual obligations</u>

119. According to Article 8.10.2 of the Privatization Agreement, in order for the capital investment to be "*deemed to be performed*," Continent SRL had to carry out Continent SA's capital increase and such capital increase had to be registered at the Trade Registry. Claimant submits that it took all the necessary steps to register the capital increase. It obtained the Trade Registry approval and the Trade Registry judge's decision became irrevocable.

120. Moreover, all of the numerous other experts who submitted reports in connection with the AVAS litigation confirmed that Continent SRL had fulfilled its contractual obligations and invested the amount it had undertaken to invest.

121. Within the commercial litigation, during the proceedings initiated on remand before the 6th Commercial Department of the Bucharest Court, Popescu Silvia drafted a technical expertise report (Claimant's Exhibit n°18). The report stated that the technical expertise and the assessment report drafted by Expert Proiect were correct and valid. Beside the technical expertise report, a judiciary accounting expertise report was drafted by Nicolae Gheorghe (Claimant's Exhibit n°21). This latter report also confirms the financial description of the investment contained in the Expert Proiect report.

122. In addition to the commercial litigation initiated by AVAS for the enforcement of the pledge on the 372,523 shares**,** the Financial Guard, Romania's fiscal control agency, allegedly discovered illegalities which resulted in the filing of a criminal case against Roussalis. During the criminal investigation, technical expertise was also carried out. The expert report drafted by Isuf Eliade and by Mihăilă Dumitru (Claimant's Exhibit n°19) stated that an investment had been made by December 31st 2000, amounting to USD 1,454,443. This report therefore also confirmed the fulfillment of the investor's obligation.

123. As a supplement to the aforementioned technical expertise, Velicu Viorel also drafted a judiciary technical expert report (Claimant's Exhibit n°20). This report establishes that the value of the investment performed by December 31st 2000 amounted to USD

2,062,143. It further states that, together with the additional investments performed by October 3, 2002, the total value of the investment amounted to USD 2,338,928.

124. Claimant submits that, since the reality of the post-purchase investment and the fact that it exceeds USD 1,400,000 have been established by numerous expertise reports, the only issue that remains concerns the financial means used for the performance of Continent SRL's contractual obligation.

125. In this respect, the Privatization Agreement stipulated the obligation for the seller to perform the investment, using *"private or attracted financial means"* (Claimant's Memorial, para. 67). Both the Nicolae Gheorghe judiciary accounting expertise and the Glăvan Maria report (prepared to assist Claimant in defending criminal charges brought against him and Ms. Doanta (Claimant's Exhibit n°22) confirm that the investment was made through the personal financial resources of Roussalis. In particular, the Gheorghe expert report concludes that the re-valuation methods were accurate and that the three assignment agreements were confirmed as financing sources.

<u>2. The lawsuit filed by AVAS is illegal because the Trade Registry decision has *res judicata* effect</u>

126. Claimant submits that the decision rendered by the Trade Registry judge, who approved the resolution passed at the December 15, 2000 extraordinary general meeting of the shareholders of Continent SA, has, according to Romanian law, the nature of a court decision ascertaining the fulfillment of the obligation. Accordingly, since this court decision was not challenged within the 15 days time limit (see above, ¶85), it became irrevocable in January 2001. It is *res judicata*.

127. Accordingly, the lawsuit filed by AVAS to enforce the Privatization Agreement is "illegal" under Romanian Law. The Trade Registry decision barred AVAS from bringing the action.

<u>**C. The "absolute nullity" claim filed by AVAS in August 2007 to annul the increase in share capital is groundless and illegal, and has effects equivalent to an expropriation**</u>

128. Claimant submits that the purpose of the "absolute nullity" claim filed by AVAS in August 2007 was the cancellation of the effective investment realized by the company, and implicitly, the denial of the investor's right of ownership over such investment as a result of the cancellation of the issued 1,418,648 shares. AVAS filed this claim to create new "arguments", *inter alia*, to support the proceedings regarding the enforcement of the share pledge.

129. Moreover, Claimant points out that the present proceedings initially referred only to the 372,521 shares initially purchased. Through the subsequent filing of the internal "absolute nullity" procedure, Romania ensured that the 1,418,648 shares held by Continent SA, be cancelled, without any kind of compensation. This action is obviously an abusive interference with the investor's right of ownership over such investment.

130. Such course of action amounts to expropriation as established in *Metalclad v. United Mexican States* (ICSID Case No. ARB AF/97/1): *"Expropriation can take various forms. Direct expropriation involves the seizure of the investor's property. But expropriation may also be indirect, as where, without the taking of property, the measures of which complaint is made substantially deprive the investment of economic value. Moreover, it is not necessary to show a single act or group of acts committed at one time. As stated earlier, there may be "creeping" expropriation involving a series of acts over a period of time none of which is itself of sufficient gravity to constitute an expropriatory act but all of which taken together produce the effects of expropriation"*.

D. The proceedings initiated by Romania, through the intervention of the General Prosecutor and the Decision of the Supreme Court, have effects equivalent to an expropriation

131. Claimant rather submits that the proceedings initiated by Respondent's institutions, namely through the intervention of the General Prosecutor and the decision of the Supreme Court to quash the previous courts' decisions in favor of AVAS are also a violation of Article 4(1)(a) of the Treaty which provides that no investor may be deprived of his property unless the measures are taken in the public interest and in accordance with due process of law.

132. Claimant alleges in the first place that the General Prosecutor's intervention, the Supreme Court's acceptance of the motion to vacate the lower courts judgments and the remanding of the case to the Commercial Court represent *"an unwarranted interference with the right of ownership of [Continent] S.R.L., the decision having the same value as the depriving of the investor company of its good"* (Claimant's Memorial, ¶78).

133. Claimant further submits that the proceedings initiated by Respondent have deprived the investor of the use of his ownership by creating juridical insecurity through a breach of the principle of legal certainty. The principle of legal certainty means, *inter alia*, that a final judgment delivered by a court may not be put on trial again.

134. Indeed, the European Court of Human Rights ("ECHR") decided on December 1, 2005, in the *Maşinexportimport Industrial Group S.A. v. Romania* case (*Case n°22.687/ 03-ECHR*) that: *"32. (…). En vertu de ce principe* [de sécurité des rapports juridiques], *aucune partie n'est habilitée à solliciter la supervision d'un jugement définitif et exécutoire à la seule fin d'obtenir un réexamen de l'affaire et une nouvelle décision à son sujet. Les juridictions supérieures ne doivent utiliser leur pouvoir de supervision que pour corriger les erreurs de fait ou de droit et les erreurs judiciaires et non pour procéder à un nouvel examen. La supervision ne doit pas devenir un appel déguisé et le simple fait qu'il puisse exister deux points de vue sur le sujet n'est pas un motif suffisant pour rejuger une affaire*[3]*."*

[3] Free translation: "*By virtue of this principle, no party shall be entitled to request the supervision of a final and enforceable decision, with the sole purpose of obtaining a re-examination of the case and a new decision. The Supreme Courts should only use their power to review errors of fact or law and miscarriages of justices, and they should not use it to re-examine the entire case. The supervision should not be treated*

135. In the *Riabykh v. Russia* case (n°52854/99, § 52, CEDH 2003-IX, §52), the ECHR also decided that *"[l]egal certainty presupposes respect of the principle of res judicata (…), that is the principle of finality of judgments. This principle insists that no party is entitled to seek a review of a final and binding judgment merely for the purpose of a rehearing and a fresh decision of the case. Higher courts' power of review should be exercised for correction of judicial mistakes, miscarriages of justice, and not to substitute a review. The review cannot be treated as an appeal in disguise, and the mere possibility of two views on the subject is not a ground for re-examination."*

136. The principle of legal certainty has therefore been clearly breached. The "error of law," invoked by the Supreme Court in order to justify its decision to hinder Continent SRL's right to ownership, is not sufficient to legitimately deprive Claimant of his legally acquired property.

137. And even if it could be proven that the above actions were taken in the public interest, Claimant asserts that, by vacating the lower court judgment, the Supreme Court's decision interfered with Claimant's rights of ownership. Such interference was not justified as being disproportionate.

II. VIOLATION OF ARTICLE 2, PARAGRAPH 2 OF THE TREATY: FAIR AND EQUITABLE TREATMENT

138. Claimant also alleges that through its conduct, Respondent has violated the fair and equitable treatment provision embodied in Article 2(2) of the Treaty.

139. Article 2(2) provides that "[i]*nvestments by investors of a Contracting Party shall, at all times, be accorded fair and equitable treatment and shall enjoy full protection and security in the territory of the other Contracting Party. Each Contracting Party shall ensure that the management, maintenance, use, enjoyment or disposal, in its territory, of investments by investors of the other Contracting Party, is not in any ways impaired by unjustifiable or discriminatory measures"*.

140. When the Supreme Court rendered its decision vacating the judgment and remanding the case to the Bucharest Commercial Court, Claimant sought protection of his investment by referring the case to an ICSID Tribunal.

141. He first contacted Romania in order to try to reach an amicable settlement (Claimant's Exhibit n°3). However, Respondent did not respond.

142. According to Claimant, by ignoring his offer to negotiate an amicable settlement, Respondent has violated the Fair and Equitable Treatment Clause of Article 2(2).

143. Moreover, the Romanian institutions were uncooperative:

---

as an appeal in disguise, and the mere possibility of there being two views on the subject does not justify the review of the entire case."

- AVAS (Claimant's Exhibit n°23) and the Ministry of Public Finances (Claimant's Exhibit n°24) both stated that the disputes at stake were civil commercial litigation matters, which concerned the breach of a commercial agreement and did not implicate a breach of the Treaty. Both institutions refused to dismiss or stay AVAS's litigation to enforce the share pledge. The General Secretariat of the Romanian Government acknowledged AVAS and the Ministry of Public Finances' positions and adopted the same view in its letter of April 26, 2004 (Claimant's Exhibit n°25).

- After these arbitral proceedings were instituted, on August 17, 2007, Respondent filed a new request before a domestic court (Claimant's Exhibit n°15: absolute nullity of the resolution n°6 of the ordinary general meeting of shareholders of Continent SA). According to Claimant, Respondent knew that the nullification of resolution n°6 dated December 15, 2000 would have allowed AVAS to have the Trade Registry delete the registration of the share capital increase (Clause 8.10.2 of the SPA; *see* Transcript, Day 1, page 164, lines 11-25).

144. Claimant submits that, even if Respondent later asked for the stay of certain proceedings that were pending before domestic courts, a mere stay of proceedings would not have fulfilled the requirements of Article 26 of the ICSID Convention, which provides that *"consent of the parties to arbitration under this Convention shall, unless otherwise stated, be deemed consent to such arbitration to the exclusion of any other remedy."* Respondent should have dropped the domestic litigation. It did not. It ostensibly wished to maintain a backup option in the event of an unfavorable arbitral award.

145. Romania has constantly failed both to recognize the rights of the investor and to protect its legitimate expectations, as granted by and crystallized in the SPA. The numerous court proceedings and challenges brought by AVAS were not in the public interest, but were instead aimed at harassing Claimant and regaining Continent SA's shares and assets. The two sets of proceedings were highly disruptive, their ultimate aim being the return of the Claimant's property to the State.

146. Respondent's repeated refutation of its own courts' rulings must be seen by the Tribunal as an unjustifiable measure, having the effect of depriving the foreign investor of its right to sell Continent SA's assets and causing a loss in value of those assets. It violates Claimant's Treaty right to fair and equitable treatment in the administration of his investment.

III. VIOLATION OF ARTICLE 2, PARAGRAPH 2 OF THE TREATY: FULL PROTECTION AND SECURITY

147. Article 2(2) of the Treaty also provides that "[i]*nvestments by investors, of a Contracting Party shall, at all times … enjoy full protection and security in the territory of the other Contracting Party"*.

148. Article 6 of the European Convention, ratified by Romanian Law n°30/1994, further provides that: "[i]*n the determination of his civil rights and obligations or of any criminal*

charge against him, everyone is entitled to a fair and public hearing within a reasonable time by an independent and impartial tribunal established by law. (...)"

149. Claimant invokes a violation by Respondent of the Full Protection and Security Clause of Article 2(2) and of Article 6 of the European Convention. It alleges that Romania's General Prosecutor violated the principles of legal certainty and *res judicata* when he intervened, at AVAS' request, in the AVAS share pledge enforcement litigation and asked the Supreme Court to set aside a lower court decision which was in favor of Continent SRL.

150. It further alleges that the Supreme Court also violated the principle of legal certainty when it vacated the judgment and sent the case back to the court of first instance for further consideration of the facts.

151. Moreover, Claimant submits that the Supreme Court lacked independence and impartiality in contravention of Article 6(1) of the European Convention.

152. More specifically, Claimant points out that he had opposed a defense of inadmissibility before the Bucharest Commercial Court to which the case was remanded in 2001. Indeed, whereas the Privatization Agreement had been concluded on October 22, 1998, AVAS founded its request before the Commercial Court on a law which had been modified by Law n°99/1999, which only came into force on July 24, 1999. This new law cancelled the provisions from the Commercial Code regarding the pledge on which AVAS had grounded its request.

153. Claimant alleges that, subsequently, in order to be able to vacate and remand the case, the Supreme Court modified, on its own initiative, the legal grounds on which AVAS had founded its action, by including a new legal basis as ground for AVAS' request, namely Law n°99/1999. According to Claimant, the Supreme Court thus showed a lack of independence and impartiality.

154. In light of the foregoing, Claimant submits that the Supreme Court exceeded the boundaries of objectivity and decided to subscribe to the abusive position of the Romanian State.

155. Claimant states that this malicious attitude of the Supreme Court is not an isolated case in Romania. Indeed, the ECHR has heard dozens of cases against the Romanian State and has frequently identified serious and essential violations of ownership rights, by the Romanian courts.

156. For example, in the *Brumarescu vs. Romania* case (n°28342/95, ECHR 1999-VII, §§61 *et seq.*), the ECHR decided that: *"the right to a fair hearing before a tribunal as guaranteed by Article 6 § 1 of the Convention must be interpreted in the light of the Preamble to the Convention, which declares, among other things, the rule of law to be part of the common heritage of the Contracting States. One of the fundamental aspects of the rule of law is the principle of legal certainty, which requires inter alia that where the courts have finally determined an issue, their ruling should not be called into question. In the present case the Court notes that at the material time the Procurator-General of*

Romania – who was not a party to the proceedings – had a power under Article 330 of the Code of Civil Procedure to apply for a final judgment to be quashed. The Court notes that the exercise of that power by the Procurator-General was not subject to any time-limit, so that judgments were liable to challenge indefinitely. The Court observes that, by allowing the application lodged under that power, the Supreme Court of Justice set at naught an entire judicial process which had ended in – to use the Supreme Court of Justice's words – a judicial decision that was "irreversible" and thus res judicata – and which had, moreover, been executed. In applying the provisions of Article 330 in that manner, the Supreme Court of Justice infringed the principle of legal certainty. On the facts of the present case, that action breached the applicant's right to a fair hearing under Article 6 § 1 of the Convention. There has thus been a violation of that Article."

157. Claimant contends that in the *Brumarescu* case the ECHR *"established as a principle, that the annulment appeal in the hands of the general prosecutor as official representative was a breach of the principle of the security of legal relationships"* (Claimant's Reply, ¶252).

§3. DAMAGES

158. Claimant submits that where a government has taken action which is contrary to and damages the economic interests of a foreign investor, the investor is entitled to full reparation of the harm suffered.

159. Roussalis further contends that the permanent non-recognition by AVAS of his investment and the related rights deprived him from selling Continent SA's assets at fair market value.

160. In *Chorzow Factory* [1927 PCIJ series A no. 17, p.47] the tribunal decided that *"reparation must as far as possible, wipe out all the consequences of the illegalact and reestablish the situation which would, in all probability, have existed if that act had not been committed. Restitution in kind, or, if this is not possible, payment of a sum corresponding to the value which a restitution in kind would bear; the award if need be, of damages for loss sustained which would not be covered by restitution in kind or payment in place of it - such are the principles which should serve to determine the amount of compensation due for an act contrary to international law."*

161. Claimant submits that "*the gravity of the facts"* has to be *"acknowledged pro-rata with the values they affected and with their negative consequences, either caused or potential, with the used means, with the author of the fact and last, but not least, with its subjective attitude, with the purpose for which it had committed the fact"* (Claimant's Memorial, §99). Claimant refers in this respect to the fact that the Respondent's actions prevented the functioning of the trade company. They denied or restrained the investor's rights, or had similar effects.

162. Claimant determines the amount of his damages by reference to the official exchange rate on July 3, 2007, of lei/USD 2.3920, or of lei/EUR 3.2627, the EUR/USD exchange rate being 1.3640.

163. Continent SA held share capital amounting to ROL 13,304,400,000, divided into 532,176 shares of face value ROL 25,000 per share, out of which 464,199 shares (representing 87.227%) belonged to Continent SRL, and 67,977 shares (representing 12,773%) belonged to other shareholders.

164. When the post-purchase investment was performed, the share capital increased by 1,418,648 nominative shares, of face value ROL 25,000 per share, the new value of the share capital rising to ROL 48,770,600,000.

165. Claimant points out that Continent SA's assets included real estate located in Bucharest, 82, Timişoara Boulevard, 6th District, comprising land of surface area 36,003.75 sq. m. and a construction with a total built surface of 29,260 sq. m. (Claimant's exhibit n°30). The constructions were functional, being used as ice plants, refrigerating warehouses, food outlets, warehouses for non-commercial goods, and sections for riping bananas. They were equipped with all necessary machinery. According to market prices, the total current value of the real estate amounts to EUR 65,263,750.

166. In light of the above, Claimant requests that the Tribunal order the cessation of the two Romanian legal proceedings to enforce the share pledge and nullify the share capital increase. It further seeks USD 25 million in moral damages for the violation of his Treaty rights.

167. Claimant also asserts a contingent claim: if, at the time of the Tribunal's decision, Continent SRL has lost its majority ownership in Continent SA as a result of adverse rulings by the Romanian courts, Claimant requests USD 85,252,032.34 as compensatory damages for the expropriation of his *pro rata* ownership interest based on his original share purchase, the additional shares he acquired as a result of the share capital increase and those shares that he acquired from minority shareholders. In this case, Claimant also seeks USD 25 million in moral damages for the violation of his Treaty rights.

168. Claimant refutes Respondent's argument that Roussalis has not proved his loss because no expert report was submitted. According to Claimant, no expert report is needed since: (i) at the Hearing, Respondent repeatedly asserted that the property was very valuable (see: Transcript, Day 1, page 90, lines 56); (ii) Respondent never contested the amount put forward by Claimant and equally never produced any expert report(s) to rebut such amount; (iii) Respondent relied on the amount of EUR 65 million or USD 89 million as the fair market value of Continent SA's assets in its application to stop the sale of the assets (*see*: page 6 of Respondent's Reply to Claimant's Observations on Respondent's Request for Provisional Measures dated 23 June 2008); (iv) Respondent made an interim application to prevent the sale of the assets for EUR 40 million, which it agreed in its application before the Tribunal was an undervaluation.

169. On the basis of the above, Claimant formulates the following request (Claimant's Memorial ¶¶107-108):

"Mainly

1. *The cease of the judiciary actions [sic] carried out by AVAS, Romanian State institution, actions having as object the execution of the pledge formed by the 372,523 shares and the cancellation of the decision made by the Extraordinary General Shareholders' Meeting on 15.12.2000, of increasing the investment by another 1,418,648 shares.*

   and

2. *To oblige the Respondent - Romanian State to pay 25,000,000 USD as moral damages.*

<u>In subsidiary,</u>

1. *We hereby request to oblige the Romanian State to pay compensations [sic] amounting to USD 81,168,212.60, for a number of 1,791,171 shares and a compensation amounting to USD 4,083,819.74, corresponding to the balance for a number of 91.586 shares.*

   The amount of compensations was calculated corresponding to a patrimony amounting to USD 89,019,755.

   Compensations are requested if, upon the termination of the arbitration litigation [sic], the judicial actions performed by AVAS, representing unjustified measures whose effects are the equivalent of an expropriation, which took place despite the existence of the arbitration litigation [sic], had been completed and the investor had been dispossessed of the 1,791,171 shares and the balance of 91,586 shares has a decreased value by the transformation from a majority shareholder, to a minority shareholder.

   and

2. *To oblige the Romanian State to pay 25,000,000. USD as moral damages.*

<u>SUB-SECTION II. RESPONDENT'S POSITION ON THE INVESTMENT CLAIM</u>

<u>§ 1. THE FACTS</u>

<u>**A.** The Privatization Agreement</u>

170. On October 23, 1998, Claimant entered into a Privatization Agreement with AVAS to purchase, through Continent SRL, the AVAS 70 percent interest in S.C. Malimp SA for ROL 12,140,897,000.

171. Article 8.10.1 of the Privatization Agreement provided that Continent SRL also agreed *"to contribute to [Continent SA]* ***from its own sources*** *or sources gained over its name, over a period of 2 years, starting with the date 1.01.1999, an investment/capital contribution for the total amount of 1.4 million (USD), according to Annex no. 4"* (emphasis added).

172. Annex 4 specified that USD 1.1 million of the capital contribution was to be provided in 1999, with the remainder (USD 300,000) to be provided in 2000. Article 8.10.2 of the

Privatization Agreement confirmed that the capital contribution *"is deemed to be performed on the date of the registration at the Trade Registry of the increase of* [Malimp SA's] *capital by the subscribed contribution and fully paid by* [Continent SRL]*"*. Claimant asserts that it is clear from the inclusion of the words *"and fully paid by* [Continent SRL]" that, in order for the capital investment to be *"deemed to be performed*", Continent SRL had to demonstrate not only that Continent SA's capital increase had been registered at the Trade Registry, but also that the capital investment (a) had in fact been fully paid at the date of the registration of the capital increase at the Trade Registry and (b) had been contributed by Continent SRL (as specified in Article 8.10.1).

173. As security for the performance of the post-privatization capital contribution obligation, Continent SRL agreed at Article 8.10.3 of the Privatization Agreement (a) to grant and register a pledge of the 372,523 shares purchased under the Privatization Agreement and (b) that, *"in case* [Continent SRL] *does not fulfill its obligations stipulated at Article 8.10.1 and 8.10.2, then* [AVAS] ***will*** *execute the pledge over the shares"* (emphasis added).

<u>B. Continent SRL failed to perform its capital contribution obligation</u>

<u>1. Claimant's fraudulent scheme</u>

174. Respondent submits that Continent SRL did not fulfill its obligation to make capital contributions of USD 1.4 million to Continent SA. Respondent asserts that: (a) the value of the claimed investment was fraudulently inflated; and (b) the claimed investment was not made by Continent SRL's "own sources", as required under the terms of the Privatization Agreement.

175. Angela Doanta gave a written statement to the police in April 2001 during a criminal investigation against her and Claimant for fraud. Claimant asserts that Ms. Doanta's testimony is accurate and informative. Her statements are corroborated by the statements of Mr. Herisanu, the former General Manager of Continent Marine Construction SRL, of Ms. Tencu, Assistant Manager of Continent Marine Construction SRL (Respondent's Exhibit n°28-30), and of Ms. Mina Cornaciu's expert report. According to Respondent, the Tribunal should consider Ms. Doanta's Statement in light of the evidentiary record as a whole and decide what weight to give it.

176. According to Ms. Doanta's statement, on September 30, 2000 – three months prior to the deadline for completing the USD 1.4 million capital contribution – she told Claimant that only ROL 14 billion (approx. USD 553,000) had been invested in Continent SA. However, this "investment" related primarily to converting some of Continent SA's premises into a personal residence for Roussalis, a swimming pool, and private apartments for sale to third parties. Moreover, the source of this investment was Continent SA (A. Doanta's statement of 19 April 2001 given to the criminal investigative authorities, Respondent's Exhibit n°4).

177. After Ms. Doanta informed Claimant of the insufficient investment, Claimant hired Expert Proiect, a company whose office was in the same building as Continent SRL, to value the in-kind investment allegedly made in Continent SA. Expert Proiect conducted a preliminary review of the capital investments and informed Claimant, in October 2000, of its preliminary finding that the value of the works performed at Continent SA was substantially less than USD 1.4 million (Doanta's Statement, Respondent's Exhibit n°4).

178. Claimant then presented false invoices to Expert Proiect. Without conducting an independent review of Continent SA's records or any review of Continent SRL's accounting books, Expert Proiect issued a report dated "December 2000" in which it concluded that an investment of USD 1,404,162 had been accomplished – not by Continent SRL but by Continent SA (Respondent's Exhibit n°5).

179. Claimant published a notice in the Official Gazette on November 29, 2000, *i.e.* before Expert Proiect had even completed the valuation report, announcing that a shareholders' meeting would be convened to approve the Expert Proiect report and to pass a resolution increasing Continent SA's share capital by USD 1,404,162.

180. On December 15, 2000, the shareholders' meeting gathered at Continent SA and a resolution was passed, approving the Expert Proiect report and the capital increase (Respondent's Exhibit n°8).

181. Respondent contends that the shareholders' resolution was invalid as a matter of Romanian law, and, therefore, the share capital increase was a nullity.

182. First, Claimant participated in the shareholder's meeting both as a shareholder (*i.e.,* representing Continent SRL) and as a member of Continent SA's Board of Directors. However, Article 124(5) of the Company Law provides that the directors and officers of the company may not represent shareholders in shareholders' meetings and that any resolution passed in violation of this prohibition will be null and void if, without their votes, the requisite majority would not have been attained**.** According to Respondent, it is irrelevant that Claimant is mentioned in the Minutes as a director with no right to vote. Indeed, directors are prohibited not only from voting, but also from attending meetings as representatives of other shareholders, in order to avoid the fraudulent formation of a quorum (St. D. Carpenaru et al., *Legea societatilor comerciale - Comentariu pe articole,* 3rd Edition, C.H.Beck Publisher, 2006, 379). Claimant's lack of impartiality, overlapping capacities, and decisive influence on the deliberations of the meeting are revealed in the official Minutes of the shareholders' meeting (Respondent's Exhibit n°3) and render the resolution invalid as a matter of law.

183. Second, none of the minority shareholders attended the meeting or consented to the resolution. There is no list of shareholders in attendance attached to the minutes of the shareholders' meeting as required by Article 130(2) of the Company Law n°31/19903 and the resolution is signed only by Continent SA's Board of Directors**.** Respondent alleges that Claimant created an invalid paper record of a share capital increase to give a veneer of legitimacy to an investment that Continent SRL in fact never made.

184. Subsequently, on December 15, 2000, Claimant presented to a judge at the Trade Registry a submission consisting of the invalid shareholders' resolution together with the deficient report from Expert Proiect. Solely on the basis of this fraudulent evidence, Claimant obtained approval for the increase in Continent SA's share capital. The process before the Trade Registry judge was *ex parte* and AVAS had no opportunity to bring these obvious shortcomings to the judge's attention before judgment was handed down.

185. Claimant reported to AVAS on December 19, 2000 that Continent SRL had fulfilled its investment obligation. This was contradicted by a letter to AVAS, dated May 10, 2001, in which Continent SA admitted that *"a part of the investment has been made by Continent SA and not by Continent SRL"* (Respondent's Exhibit n°12, see below ¶211).

186. Respondent puts forward that Continent SA's accounts were manipulated to make Continent SA's capital expenditures appear as if they should be credited to Continent SRL as qualifying investments (*see* Judicial Accounting Expert's Report by Floarea Patrusca, Respondent's Exhibit n°13).

187. In June 2001, Claimant used two other companies that he owned, SC Continent Marine Trading SRL and SC Continent Construction SRL, to enter into bogus assignment agreements:

- SC Continent Marine Trading SRL, as assignor, and Continent SRL as assignee, entered into an assignment agreement concerning a receivable of ROL 3.98 Billion (approx. USD 157,000) purportedly owed by Continent SA for refrigeration equipment, a refrigeration chamber, a vacuum packaging machine, and meat chamber refurbishment (Respondent's Exhibit n°15);

- SC Continent Construction SRL, as assignor, and Continent SRL as assignee, entered into an assignment agreement concerning a receivable of ROL 9.25 billion ROL (approx. USD 365,000) purportedly owed by Continent SA for aluminum kiosks, the refurbishment of aluminum furniture, the refurbishment of Berth 8 in Constanta Harbor, the PVC production line, and the refurbishment of the administrative offices (Respondent's Exhibit n°16); and

- Continent SA as original debtor, Continent SRL as new debtor, and Claimant, as creditor, entered into a novation agreement concerning receivables amounting to ROL 3.2 Billion (approx. USD 126,000), purportedly for goods acquired by Continent SA and for works performed as part of the investment supposedly financed by Claimant. (Respondent's Exhibit n°17).

188. These agreements created the false impression that expenditures made by Continent SA were investments made by Continent SRL. However, the accounting documentation for these assignment agreements *"is not supported by documents evidencing that those payments would have been effectively made. Therefore, the assignment agreements ... in amount of ROL 13,235,504,852 do not have a real basis"* (Vladimir Popovici's Accounting Expert Report, January 29, 2002, Respondent's Exhibit n°18). Moreover, the

invoice Continent SA issued to Continent SRL, presumably to create the appearance of a reimbursement by Continent SRL, was never paid and was cancelled at the end of 2001.

2. The Expert Proiect Report does not establish that the investment was made in compliance with the Privatization Agreement

a) The valuation is baseless and not reliable according to Romanian law

189. Respondent asserts that almost half of the purported USD 1,404,162 investment reported by Expert Proiect is based on false invoices. In particular, Expert Proiect included in its calculation of the value of the capital investment: (i) invoices for goods and services allegedly supplied by companies that do not exist; (ii) invoices issued by a Claimant-owned company that falsely claimed to be the manufacturer of the invoiced goods but, in fact, had no legitimate role in the purchase or sale of the goods; (iii) invoices for services that were never performed and assets that were never acquired by Continent SRL; (iv) invoices recorded as having been paid personally by Claimant but for which there is no legitimate evidence of payment; and (v) invoices for goods and services, the value of which was fraudulently inflated based on illegitimate and unauthorized adjustments (see Accounting Expertise Report by Mina Cornaciu and Lidia Balanescu, Respondent's Exhibit n°24; technical expertise report by Isuf and Mihaila Respondent's Exhibit n°33; A. Doanta Statement, Respondent's Exhibit n°4; Statements of Continent Marine Construction's executive manager, Bogdan Herisanu, Respondent's Exhibits n°28 and 29; Statement of Continent Marine Construction assistant manager, Raluca Tencu, Respondent's Exhibit n°30).

190. Moreover, Expert Proiect further inflated the value of the alleged capital investment by adjusting the resulting values for inflation. Respondent alleges that such an adjustment contradicts the clear intention of the parties that Continent SRL should contribute USD 1.1 million in 1999 and USD 300,000 in 2000 (Articles 8.10.1 and Annex 4 of the Privatization Agreement). Adjusting such investments *a posteriori* for inflation would eviscerate this obligation by enabling Continent SRL to invest a few hundred thousand dollars in early 1999 and then rely on inflation to argue that the value of that sum has increased to USD 1.4 million as at the end of 2000.

191. Respondent points out that the reliability of the Expert Proiect report was first challenged on February 13, 2001 by the findings of the Financial Guard, which concluded that certain invoices relied on were false. The subsequent criminal proceedings against Claimant likewise confirmed that "*the conclusions of the technical accounting expert show that by the registration in the accounting of primary accounting documents that were not based upon real operations* […] *the income and the expenses of SC Continent Marine Enterprise SA were distorted which provoked a prejudice to the state budget of RON 1,410,997 profit tax and RON 1,828,190 VAT*" (Respondent's Exhibit n°42).

b) The required capital contribution was not made by Continent SRL

192. Expert Proiect proceeded to value a contribution that they concluded was made by Continent SA (Respondent's Exhibit n°5, p.7). Respondent points out in this regard that

Expert Proiect failed to review any of Continent SRL's accounting documentation to verify that any of the alleged capital contributions were made by Continent SRL.

193. Moreover, the valuation of Continent SA's expenditure is inflated. The Expert Proiect report cites, as part of Continent SA's investment, ROL 5.29 billion (approximately USD 209,000) in respect of labor costs (and related social security obligations) arising out of various construction and plumbing works. Ms. Doanta explains in her statement given to the criminal investigative authorities that none of these labor works were performed and that no related social security obligations were ever paid.

3. Claimant's criminal conviction for tax evasion

194. The false invoices were uncovered during an inspection carried out in January 2001 by the Financial Guard. Subsequently, on May 18, 2001, the police initiated a prosecution against Claimant for fraud, tax evasion, use of false documents, and instigation to commit forgery. On May 14, 2003, the Public Prosecutor filed an indictment against Claimant.

195. Respondent points out that in the ensuing criminal proceedings, Claimant did not deny that he had committed the offense of tax evasion, choosing instead to rely exclusively on a statute of limitations defense (see Continent SA's written submission to the District Court of Sector 6 in Bucharest, dated April 23, 2007, which was "*formulate*[d]" by "[t]*he undersigned attorney, Doru Costea, representative of defendant Spyridon Roussalis ..*".., Respondent's Exhibit n°46).

196. The expert evidence before the criminal court demonstrated that *"the financing was not raised and paid integrally by* [Continent SRL]. *Therefore, the agreement cannot be deemed as fulfilled"* and *"the investment was not made and supported by financing from* [Continent SRL] *(only in proportion of approximately 5 percent)"* (Respondent's Exhibit n°48).

197. Claimant refused to appear for trial on the criminal charges, avoiding service of process for more than three years, although he was summoned nine times in Romania and nine times in Greece. Eventually, service of process was made, and Claimant was tried *in absentia*. On May 28, 2007, he was sentenced to a two-year prison term for tax evasion based on forgery and the use of false documents. Respondent points out that the court found that: "*the purpose of these registrations* [i.e. the registration of the fake invoices in Continent SA's accounts] *being that of reporting the performance of* [falsely] *reporting the investment stipulated in the* [Privatization Agreement]" (Respondent's Exhibit n° 42).

198. Respondent points out that although Claimant correctly notes that his criminal conviction was subsequently overturned on appeal and remanded for re-trial, the decision was based on purely procedural grounds regarding summoning. None of the conclusions of the first instance court on the merits were contradicted by the findings of the Bucharest Tribunal.

4. Claimant's misuse of Continent SA's funds

199. On July 15, 1998, Continent SRL concluded a Services Agreement with Continent SA (Respondent's Exhibit n°47). Under that agreement, Continent SA agreed to provide food handling and storage services to Continent SRL in consideration for a monthly rent.

200. After execution of the Privatization Agreement, Continent SRL and Continent SA amended the Services Agreement by executing an *Addendum* purportedly dated November 19, 1998 (Respondent's Exhibit n°49). Continent SA agreed to provide food handling and cold storage services to Continent SRL free of charge until the end of 1999.

201. Respondent submits that both Continent SRL and Expert Proiect failed to take this net outflow of resources from Continent SA into account when calculating the value of Continent SRL's purported capital investment in Continent SA.

202. The 6th District Tax Administration estimated that Continent SA lost income of over USD 900,000 during the period from November 1998 through December 1999.

203. According to Respondent, this should be considered as having increased Continent SRL's investment obligation by the amount of the rent abatement. Therefore, even if the Expert Proiect report had documented a USD 1.4 million post-privatization investment by Continent SRL, approximately USD 900,000 of that investment was financed using funds that Continent SRL was legally obliged to pay to Continent SA.

C. AVAS reasonably investigated Continent SRL's failure to fulfill its investment obligation and thereafter sought enforcement of the pledge

204. As mentioned above (see ¶173), Continent SRL was required to register a pledge in favor of AVAS over the shares purchased pursuant to the Privatization Agreement as security for its obligation to make a post-purchase investment.

205. By letters dated July 6, 1999, December 10, 1999, March 6, 2000, and June 9, 2000 (Respondent's Exhibit n°2), AVAS sought confirmation from Continent SRL that the share pledge had been registered. Continent SRL did not answer. Respondent points out that Claimant never presented any evidence to show that Continent SRL ever registered the share pledge or that it should be released from the pledge.

206. In light of Continent SRL's failure to confirm its compliance with the obligations stipulated in the Privatization Agreement and its repeated failures even to respond to requests for information, AVAS issued a Notice of Default on September 20, 2000 recording (i) Continent SRL's failure to make the USD 1.1 million capital contribution by December 31, 1999; (ii) Continent SRL's failure to register the pledge; and (iii) AVAS's intention to commence legal proceedings if Continent SRL did not provide documents proving compliance with its contractual obligations.

207. On December 19, 2000, Claimant responded in a letter attaching the Expert Proiect report and falsely stating that Continent SRL had fulfilled its USD 1.4 million investment obligation (Claimant's Exhibit n°6).

208. After reviewing the Expert Proiect report, AVAS ascertained that Continent SRL had failed to prove the company's compliance with its investment obligations. Moreover, on February 13, 2001, AVAS received a letter from the Financial Guard highlighting various accounting and financial irregularities in the documentation on which the Expert Proiect report was based.

209. AVAS wrote several times to Continent SRL to request additional documents that might enable AVAS to independently assess the facts surrounding the irregularities reported by the Financial Guard. Continent SRL repeatedly delayed its answer and never fully complied with the request.

210. Respondent submits that, in light of the many concerns that had come to light, AVAS commenced legal action against Continent SRL on April 23, 2001 (Claimant's Exhibit n°7). AVAS requested the court to order Continent SRL to register the share pledge as required by Article 8.10.3(a) of the Privatization Agreement and pay *per diem* delay penalties until the pledge was registered.

211. On May 10, 2001, the General Manager of both Continent SRL and Continent SA, together with Continent SA's Economic Director, sent a letter to AVAS, on behalf of Continent SA, admitting that 90 percent of the investment constituted routine expenditures and *"has been made by Continent SA and not by Continent SRL"* (Respondent's Exhibit n°12). He promised that *"Continent SRL will transfer to the account of Continent SA the owed amounts"*. Respondent sets forth that the letter constitutes an admission that the previous claim that Continent SRL had fulfilled the capital investment obligation – on the basis of which it had obtained the Trade Registry judge's approval for the share capital increase – was false. AVAS received no further correspondence stating that the promised "transfer" ever took place.

212. Consequently, on June 22, 2001, AVAS amended its share pledge claim in the pending court proceedings to request enforcement of the share pledge (Claimant's Exhibit n°8).

D. The General Prosecutor's intervention and the Supreme Court's Decision quashing previous court decisions were necessary

213. As regard the AVAS share pledge claim, the first instance court and the appeal court ruled in favor of Continent SRL, but solely on the basis of a narrow and flawed interpretation of the requirements in Article 8.10.2 of the Privatization Agreement. The first instance and appeal courts held that the mere fact of the registration at the Trade Registry of the alleged capital increase was sufficient to show that the investment obligation had been fulfilled.

214. Respondent points out that the courts failed to establish that the capital contribution had, in fact, been "fully paid" and that the source of the capital contribution was Continent SRL. In addition, no attempt was made by either court to examine the numerous shortcomings of the Expert Proiect report or the serious allegations of fraud for which Claimant was being investigated.

215. In light of the above, on November 21, 2002, AVAS requested the General Prosecutor to submit a motion to vacate the judgments rendered by the lower courts, because the lower courts had (a) misconstrued the terms of the Privatization Agreement, (b) denied the request of AVAS to commission a judicial accounting expert report, and (c) ignored evidence showing Continent SRL's breach of the investment obligation through perpetration of a fraud (Respondent's Exhibit n°55).

216. At the time, the General Prosecutor was permitted under Article 330 of the Romanian Code of Civil Procedure to challenge final and irrevocable judgments within one year of their date of entry. The purpose of such a motion was to avoid a miscarriage of justice arising either from a fundamental error of law that prevented a valid finding on the merits, or from a judgment that was manifestly groundless.

217. On March 11, 2002, after considering the request by AVAS, the General Prosecutor filed a motion to vacate the lower court judgments (Claimant's Exhibit n°12). On July 9, 2003, the Supreme Court accepted the motion and remanded the case to the Bucharest Commercial Court with instructions to (a) investigate the challenged transactions, (b) commission a judicial expert report to determine whether the investment complied with the terms of the Privatization Agreement, and (c) consider the criminal charges that had been brought against Claimant and Ms. Doanta (Respondent's Exhibit n°43). The Supreme Court ordered that a new technical and evaluation report be completed to determine the source and value of the investment made by Continent SRL.

218. Respondent points out that the motion to vacate is heard by the Supreme Court in an adversarial hearing. In this case, Claimant's counsel was present when the Supreme Court heard AVAS's motion to vacate.

219. Inexplicably, on remand, the first instance court ignored these instructions of the Supreme Court and, among other things, failed to verify the source of the investment alleged to have been made by Continent SRL. There was no investigation into the accounting and financial documentation of Continent SRL to determine the source of the investment. Moreover, the court failed to appoint a valuation expert to determine the value of the alleged investment. The first instance court neglected to investigate the deficiencies of the Expert Proiect report and failed to take account of the findings of the Financial Guard. Furthermore, like the prior vacated court rulings, the first instance court held that Continent SRL had complied with the procedure for obtaining approval from the Trade Registry judge for a share capital increase and deemed that to be sufficient to prove Continent SRL's fulfillment of the investment obligation (Claimant's Exhibit n°14).

220. In the subsequent appeal initiated by AVAS, the court-appointed accounting expert reported that she *"ha*[d] *not found documents which would show the payment of* [the capital contribution] *by* [Continent SRL]*"* (Respondent's Exhibit n°13). According to the expert, the use by Continent SA of retained earnings to purchase goods and services did not constitute an 'in-kind' contribution that could justify the capital increase reported to AVAS. On October 8, 2007, a divided Court of Appeal nevertheless affirmed the decision of the lower court.

221. Respondent points out that the chair of the court issued a vigorous dissenting opinion. The chair concluded that the secured investment obligation had not been performed and that AVAS was therefore entitled to enforce its lien over the shares.

222. AVAS appealed the decision but the Supreme Court affirmed the Bucharest Tribunal's decision (Respondent's Exhibit n°193).

E. AVAS's proceedings to annul the shareholders' resolution dated December 15, 2000 seek to redress serious improprieties committed by Claimant

223. On August 17, 2007, AVAS filed an action against Continent SA asking the court (i) to rule that the resolution passed by Continent SA's shareholders on December 15, 2000, approving the capital increase, was null and void, and (ii) to register its decision with the Trade Registry and thereby delete the registration of Continent SA's share capital increase.

224. In addition to raising the fraud established at Claimant's criminal trial, AVAS contends that the shareholders' resolution should be declared null and void because it was only passed because Claimant voted in its favor despite being ineligible to do so, and because there is no indication that any of the minority shareholders of Continent SA participated in the vote (see above, ¶180).

225. AVAS submits that it is entitled to having the Continent SA shareholders' resolution set aside as being an absolute nullity. According to Article 2 of Decree 167/1958, in such cases, the exercise of the right to challenge the resolution is not subject to any statute of limitations.

F. Claimant continues to be the majority owner and continues to exercise control over Continent SA

226. Claimant, through his wholly owned company Continent SRL, is currently the registered owner of 1,882,847 shares in Continent SA representing 96.52 percent of the company's total share capital. This includes the 372,523 shares purchased from AVAS pursuant to the Privatization Agreement, 91,676 additional shares acquired by Continent SRL from minority shareholders, and the 1,418,648 shares issued to Continent SRL as a result of the fraudulent share capital increase. Claimant is and has been the sole shareholder of Continent SRL since April 13, 1998.

227. For most of the past ten years, Continent SA's principal assets have included real estate consisting of the properties at 82 Timisoara Blvd, Bucharest and at 1 Razoare Street, Bucharest. On May 15, 2006, Continent SA sold the latter property to SC Spavin Invest SRL for EUR 1,000,000 (Respondent's Exhibit n°60). In addition, Claimant has agreed to sell a plot of 350 sq. m. at Continent SA's warehouse facility at 82 Timisoara Blvd. to a company called SC Stefran International SRL pursuant to a Sale-Purchase Pre-Contract, dated October 10, 2007 (Respondent's Exhibit n°64).

228. Respondent asserts that Continent SA has continued to own and manage its assets without any interference from Respondent. Aside from Continent SA's ability to dispose

of its real estate, Continent SA has enjoyed significant earnings from the exploitation of its commercial assets. The annual turnover of Continent SA increased significantly over the decade of Claimant's ownership (Net Financial Results at Continent SA for years 1998-2007, Respondent's Exhibit n°62). Recently, Claimant arranged with his son Stavros Roussalis to sell Continent SA's commercial assets for EUR 40million. The listing for the property (Respondent's Exhibit n°63) states that Continent SA is earning EUR 120,000 – 150,000 per month through the operation of its refrigerated foods warehouse. In this regard, Respondent points out that it was after Roussalis's claims and Romania's counterclaim were submitted to the exclusive jurisdiction of the Tribunal that Claimant attempted to enlarge the dispute by selling Continent SA surreptitiously. That led to the Tribunal's first decision on provisional measures to halt Claimant's actions.

G. Conclusion

229. Respondent submits that, in light of the facts stated above, Continent SRL did not make the required post-purchase investment in accordance with Article 8.10.1.

230. Respondent contests Claimant's allegation that other experts than Expert Proiect submitted reports in connection with the AVAS litigation, and that all of them confirmed that Continent SRL made the required investment.

231. The Popescu Report: Popescu, like Expert Proiect, accepted the documentation provided by Continent SA without verifying the validity of the invoices that had been challenged. Ms. Popescu undertook no investigation into the "physical reality" or value of the construction and installation works that allegedly constituted the investment. Moreover, her report (Respondent's Exhibit n°66) does not say a word about the source of any investment; indeed, the scope of the assignment was limited to verifying the "actualized value" calculations made by Expert Proiect for construction and installation projects.

232. The Isuf and Mihaila Report (Claimant's Exhibit n°19), for the period from January through December 1999, identifies a total "investment" of USD 285,995, a small fraction of the USD 1,100,000 called for under the Privatization Agreement. For the period from January through December 2000, the authors report an "investment" of USD 649,614. These amounts do not confirm compliance with a USD 1.4 million investment obligation. Moreover, the Isuf and Mihaila Report criticizes the Expert Proiect report for overvaluing the claimed investments and says nothing about the source of the funds for the expenditures they tallied.

233. The Viorel Velicu Report (Claimant's Exhibit n°20) does not address the source of any investments and gives no opinion regarding the amount, if any, contributed, by Continent SRL. Velicu's task was to conduct a technical review of the Expert Proiect and the Isuf/Mihaila reports. Moreover, that report is tainted by an artificial increase in the value of the installations and construction works, and by the inclusion of assets whose value was also artificially inflated or could not be verified.

234. The Nicolae Report (Claimant's Exhibit n°21) was prepared at the request of the court in connection with the determination on remand of whether Continent SRL made the

required investment. Nicolae failed to carry out an important part of his assignment to determine whether the investments were "real or fictional." Instead, he concluded that the "reality of the investment" was confirmed by "the registration of the joint stock increase" at the Trade Registry and the approval by the Trade Registry Judge. Nicolae repeated the conclusion reached in the first court decision, which was criticized and vacated by the Supreme Court. Nicolae merely relied on the Expert Proiect and Popescu reports, without independent verification. His summary conclusion – that the investment "*comes from* [Continent SRL's] *own source or attracted sources*" is unexplained and undocumented.

235. The Maria Glavan Report (Claimant's Exhibit n°22) was prepared to assist Claimant in defending criminal charges brought against him and Ms. Doanta. Ms. Glavan concludes that "[Continent SRL] … *performed a capital contribution in value of USD $1,400,000 for* [Continent SA] *from* [its] *own sources or attracted sources, investments which was* [sic] *registered at the Trading Registry as … the basis of the increase of the joint stock of* [Continent SA]." According to Respondent, no discussion, no analysis, and no data are presented in support of this summary assertion.

236. The Vladimir Popovici Report was prepared as part of the criminal investigation and was the first to scrutinize the source of the claimed investment. It presents a harsh critique of the evidence presented by Roussalis to support the alleged investment. Among other things, Popovici demonstrates that, of the total claimed expenditures identified by Expert Proiect, only about 5 percent could be traced to Continent SRL and the *"financing was not raised and paid integrally by* [Continent SRL]." It goes on to state that *"[t]herefore, the privatization agreement can not be deemed as fulfilled"* (Respondent's Exhibit n°18). Furthermore, Popovici reported that financing supposedly provided by Roussalis himself (or other Roussalis-controlled companies) was *"not supported by documents proving that he had actually made these payments."* As a result, the financing from the supposed assignment agreements, in particular, *"have no real basis."*

237. Respondent submits that there is no documentary proof in any of the foregoing reports to show that Continent SRL, "from its own sources" or sources it procured, invested USD 1.4 million in Continent SA. However, Claimant bears the burden of proof to establish his claim. Claimant has not met that burden.

238. In light of the foregoing, Respondent submits that Claimant has no basis to complain about AVAS's efforts to enforce its rights under the Privatization Agreement.

§ 2. THE LAW

A. On the facts, there is no basis for claiming that Claimant's shareholding interest was expropriated, either directly or indirectly

239. Respondent contests Claimant's allegation that the acts by Romania, taken alone or together, are tantamount to expropriation of his investment under the above-cited provisions.

240. Even under Claimant's incorrect version of the facts, his claims of expropriation must fail for two essential reasons. *First*, Respondent's actions have not deprived Claimant of any

fundamental property rights as he retains full ownership rights in Continent SA: (a) he is still a director of Continent SA; (b) his wholly-owned firm, Continent SRL, remains the controlling shareholder of Continent SA; (c) Continent SA remains a going concern; and (d) there has been no interference with Claimant's management or control of the company's day-to-day operations. *Second*, Claimant's expropriation claims are inconsistent with accepted definitions of expropriation.

1. The law on indirect or creeping expropriation does not support the claim

241. Respondent contends that allegations of indirect expropriation require a "*high level of analytical rigorousness and precision"* (*Generation Ukraine, Inc. v. Ukraine,* ICSID Case No. ARB/00/9). To prove "creeping expropriation," the plea must state with particularity which acts, attributable to the state, have already eroded the investor's rights to the investment to the extent that an expropriation in violation of international norms has clearly occurred. According to Respondent, Claimant's vague statements alleging expropriation as a result of his right to dispose of his shares in Continent SA being "likely" to be affected, or AVAS "attempting" to execute its lien on the original shares, do not provide sufficient factual support to meet the applicable standard for indirect expropriation under the Treaty and international law.

2. The alleged interference with Claimant's management and control of his investment cannot amount to an expropriation

242. Respondent submits that the most commonly used test of indirect or regulatory expropriation is the following: "*even though a State may not purport to interfere with rights to property, it may, by its actions, render those rights so useless that it will be deemed to have expropriated them"* (G.C. Christie, *What Constitutes a Taking of Property Under International Law?*, 38 Brit. Y.B. Int'l L. 311). Respondent alleges that Claimant's rights in Continent SA have not been rendered useless.

243. For example, in *Starrett Housing v. Islamic Republic of Iran* (No. 32-24-1, Award of December 19, 1983, Iran-U.S. C.T.R. 122, 1983), Iran appointed its own "temporary manager" of an Iranian firm in which the claimant owned a majority interest. The tribunal found that this interfered with the investor's ability to manage the company, thus rendering the claimant's rights "useless" and constituting indirect expropriation. According to Respondent, Claimant's allegations in this case, however, would not – even if proven – establish that Respondent has interfered with his property rights to such an extent.

244. In *Marvin Feldman v. Mexico* (ICSID Case No. ARB(AF)/99/1), Feldman, a U.S. citizen, operated an export business in Mexico. When he started exporting cigarettes from Mexico in 1990, Mexico rebated production and sales taxes to cigarette resellers upon export. Two years later, Mexico changed the law to permit export rebates only for cigarette producers. The ICSID panel found no expropriation because Mexico had not interfered with the management or control of Feldman's business.

245. In *Waste Management v. United Mexican States* (ICSID Case No. ARB(AF)/00/3), the tribunal rejected Waste Management's claim that its investment rights under the concession agreement were taken by "creeping expropriation." Because the claimant at all times retained the control and use of its property – when the company ceased the business, assets were sold off in an orderly way – the tribunal concluded that, although Mexican authorities may have breached the concession contract, "*absent arbitrary intervention by the State amounting to a virtual taking or sterilising of the enterprise*," this did not amount to an expropriation.

246. Following the tribunals' reasoning in these cases, Claimant's allegations of expropriation must be rejected. Claimant retains control of more than 96 percent of Continent SA through his 100 percent ownership of Continent SRL and remains a director of Continent SA. No government entity has interfered in the management of the company. In sum, even if Claimant's ability to sell his shares has been allegedly diminished through the ongoing litigation, those shares have not been rendered "useless."

247. Respondent points out that Claimant's reliance on the *Metalclad* decision is unavailing (see above, ¶130). The ICSID tribunal in that case held that a measure needs to *"substantially deprive the investment of economic value"* to constitute indirect expropriation. However, as explained above, Roussalis has not been deprived of the economic value of his investment as a result of the Romanian government's actions.

3. There is no permanent and irreversible interference with Claimant's property rights

248. Respondent submits that a measure needs to be permanent and irreversible, as opposed to temporary, to constitute a compensable taking under international law (see *International Technical Products Corporation*, No. 196-302-3, Award of October 28, 1985, 9 Iran-U.S. C.T.R. 206 at 240-41). Similarly, under European Convention case law, it is clear that if the investor's rights have not been extinguished, but have only been substantially reduced, and the situation is not "irreversible," there is no "deprivation" – and hence no expropriation – for the purposes of the second sentence of Article 1 of Protocol 1 of the European Convention (see *e.g., Handyside v. United Kingdom,* 24 Eur. Ct. H.R. (ser A) at 29, 1976).

249. In light of the above, there is no basis for Claimant's claim that the mere attempt by AVAS to nullify the shareholders' resolution and execute the share pledge amounts to expropriation. Indeed, Claimant's concern about his right to dispose of shares has not become permanent or irreversible.

4. Claimant's allegations demonstrate that the complained-of actions by AVAS and the Supreme Court have not ripened into an expropriation

250. Claimant states that the measures ordered on behalf of the Romanian State by its public authorities are *likely to affect* the investor's right to use the investment (Claimant's Memorial, ¶160). Respondent submits that this argument cannot support a claim of expropriation. A classic example of a case where the arbitrators found state actions had not ripened into an expropriation by the tribunal's jurisdictional cutoff date is *Foremost*

Tehran, Inc. v. Iran (No. 220-37/231-1, Award of April 11, 1986, 10 Iran-U.S. C.T.R. 228). Here, Foremost claimed that the Iranian Government had expropriated its minority share in Pak Dairy through a number of actions. Despite these actions, the tribunal ruled that, at the cutoff date for the Iran-U.S. Claims Tribunal's jurisdiction, Iran had not expropriated Foremost's investment in Pak Dairy. As of the cutoff date, Foremost retained incidents of ownership (shares, two directors on the board, and limited shareholder rights). Despite the significant deprivation of property rights, the key factor in the decision was that the deprivation was not irreversible because Foremost retained its minority ownership. As noted above, Claimant still retains all incidents of ownership in Continent SA, including all of the shares owned through Continent SRL.

5. There is no basis for bringing this claim under Article 4(1) of the Treaty

251. In *International Systems & Controls v. Iran* (No. 256-439-2, Award of September 26, 1986, 10 Iran-U.S. C.T.R. 223), the tribunal rejected the claim for indirect expropriation, reasoning as follows: "*it is to be noted that the owner must at least be deprived of some fundamental rights of ownership and that the deprivation must be not merely ephemeral. The claim for destruction of a business must go beyond a showing of a classical breach of contract... The Respondents' failure to renew a contract or their failure to pay a debt cannot be said to amount to expropriation as in any event the Respondents have rights under the contracts to terminate them for cause or without cause upon making stipulated payments.*"

252. Respondent considers that, similarly, AVAS had the right under the Privatization Agreement to enforce the pledge based on Continent SRL's failure to make the USD 1.4 million investment. Accordingly, AVAS's refusal to accept Continent SRL's unsupported contention that it met this obligation, and AVAS's ensuing litigation to enforce its contractual lien on the shares pledged by Continent SRL, cannot be said to amount to expropriation.

B. The failure to negotiate and the denial of a stay of litigation do not support claims under Article 2(2) of the Treaty

253. Respondent refutes Claimant's allegation that Respondent's failure to negotiate with him, and the Romanian court's denial of his request to stay proceedings in the AVAS enforcement action, violated the "fair and equitable treatment" clause under Article 2(2) of the Treaty.

254. The Treaty neither imposes a legal duty on the state nor creates a legal right for the investor to negotiate a settlement. The so-called "cooling-off" provision of the Treaty, Article 9(2), provides that: "[i]*f such disputes cannot be settled within six months after the date either party requested amicable settlement, the investor concerned may submit the dispute to* [the host state courts] *or to international arbitration*." This clause merely sets aside a period during which settlement discussions may be conducted but does not obligate either party to conduct such discussions.

255. Claimant's complaint that the Romanian courts rejected his argument under Article 26 of the ICSID Convention and refused to decline jurisdiction over the AVAS litigation is now moot. Indeed, Respondent has agreed to a suspension of the pending litigation in the Romanian courts, and Claimant has refused to join in applying for a suspension. Further, Respondent submits that it is fanciful for Claimant to demand USD 25 million on the ground that the courts did not stay the AVAS litigation - especially given that Claimant objects to the Counterclaim.

256. More generally, Claimant's contention that AVAS's maintaining of the Romanian court proceedings evidences a failure by Respondent to accept the exclusive jurisdiction of the Tribunal over the Investment Claim is untrue.

257. First, AVAS initiated the share pledge litigation in Romanian courts before the ICSID case was initiated. Claimant refused to seek a postponement. The Supreme Court conducted a hearing and handed down a final and irrevocable decision on the same day, dismissing AVAS's appeal (see above, ¶222).

258. Second, AVAS commenced the proceedings aiming at annulling the share issuance in August 2007, more than one year before Respondent filed its Counterclaim in this arbitration. AVAS initiated the case after its share pledge enforcement claim was dismissed by the first instance Romanian court on the basis that the shareholders' resolution of December 15, 2000 was valid and had not been challenged. AVAS reasonably concluded that the commencement of the suit to annul the share issuance was the best approach to ensure that it would not be foreclosed from arguing that the shareholders' resolution must not be treated as final for the purposes of deciding AVAS's share pledge claim. AVAS's commencement of the share nullification case was the best way to preserve its right to pursue its long-standing share pledge enforcement claim in the event that the Tribunal later decided that it lacked jurisdiction over the Counterclaim. Shortly after the case was filed, AVAS requested Claimant's voluntary cooperation in seeking a stay of both domestic court cases. Claimant did not agree to seek a stay in either case. AVAS attempted to obtain a stay on its own motion but was unsuccessful. It was at that point that Respondent filed its request for provisional measures in these proceedings.

C. There is no basis under the Treaty for the "Full Protection and Safety" claims

1. The Supreme Court's decision to vacate the AVAS judgment was appropriate under Romanian law and international law

a) The General Prosecutor's motion to vacate was a settled procedure under Romanian law at the time it was filed and granted in this case

259. Article 330 of the Romanian Civil Procedure Code authorized the Supreme Court to vacate final and irrevocable judgments in certain circumstances (see above, ¶216). That article was in force for decades before the Privatization Agreement was executed, subsequently amended over the years, and eventually repealed in 2003 after the Supreme Court rendered its decision in the litigation between AVAS and Claimant's companies.

260. Respondent points out that the Article 330 procedure was the subject of challenges in Romania's Constitutional Court, and was upheld as an important "*protection of the human rights and freedoms against any abuse, including those having the origin in a judicial ruling*" (Decision of June 4, 1996, Official Gazette n°255 of October 22, 1996).

261. Accordingly, given that, at the time the proceedings were commenced, all final and enforceable judgments in Romania remained subject to the set-aside provisions for one year after entry of the judgment, it is clear that the principle of legal certainty was not violated under the circumstances of this case since the parties to the judgment were fully aware that Article 330 could be invoked during that one-year period.

b) No violation of the principle of legal certainty arises from the Supreme Court's decision

262. Respondent denies that the Supreme Court's decision to vacate the judgment violates the "full protection and safety" clause of Article 2(2) because it infringes the principle of legal certainty.

263. Respondent argues that the principle of legal certainty does not absolutely prohibit reopening final judgments. Judicial systems generally provide grounds upon which a final judgment may be vacated, such as in cases where a final judgment was procured on the basis of a fraud committed upon the court. Statutes of limitations are often established to protect against misuse of such procedures.

264. In the United States, for example, federal court judgments may be set aside for the following reasons: (i) mistake, inadvertence, surprise, or excusable neglect; (ii) newly discovered evidence that, with reasonable diligence, could not have been discovered; and (iii) fraud, misrepresentation, or misconduct by an opposing party. This procedural remedy is available within one year of judgment, even after the judgment has become final and all direct appeals are exhausted (Fed. R. Civ. P. 60(b), 2008).

265. In this case, the procedure was in accordance with Article 330 of the Romanian Civil Procedure Code (see above, ¶¶216 and 259-261) when it was invoked by AVAS. It was used in this case because the lower court denied AVAS's request for the commissioning of a judicial expert report and failed to examine serious allegations of fraud regarding Continent SRL's claims that investments were performed and that invoices for goods and services were authentic. The lower court declined even to consider AVAS's allegations because the court incorrectly determined that the Trade Registry approval was binding on AVAS. However, that ruling was in conflict with a 1995 decision of the Romanian Supreme Court, in which the court held that the 15-day period commences upon publication in the Official Gazette, not when the decision was rendered (Supreme Court Decision n°701 of October 19, 1995, Respondent's Exhibit n°74). Under that decision, the 15-day rule would not be applicable to AVAS because the Trade Registry decision was not published in the Official Gazette. Thus, Respondent submits that the Trade Registry's approval did not preclude a full evaluation of the merits of the AVAS claims, which had not been examined by any judge.

c) The reasons stated for the Supreme Court's decision are reasonable, justify the relief granted, and do not interfere with Claimant's right of ownership

266. In this case, as explained in the Supreme Court's decision (Claimant's Exhibit n°13), the General Prosecutor moved to vacate the judgment against AVAS under Article 330 on, *inter alia*, the following grounds: (a) the documents on which the share increase was based reveal that *"the defendant* [Continent SRL] *did not achieve the investments from its own sources or from others gained over its name"*; (b) there were multiple transactions involving Claimant's group of companies, causing concern that *"there is no certainty for the reality of the prices"* charged; (c) there were highly suspicious irregularities in the documentation supporting the investment; and (d) there was an *"obvious conflict of interests between the privatized company* [Continent SA] *and the buyer of the shares* [Continent SRL]".

267. The Court agreed that the Expert Proiect report failed to show how the capital increase was made and thus did not resolve the objections raised by AVAS in the lower court. It instructed the lower court on remand to appoint a new expert that would put this issue to rest. The Supreme Court also found that third parties were not bound by the increase in share capital because the decision approving it was not published in the Official Gazette. The Court also recognized the pendency of criminal charges against Claimant and instructed the lower court on remand to take into consideration the proceedings in the criminal case. Finally, the court acknowledged that the General Prosecutor had found defects in various contracts cited by Claimant as support for the claimed investments that involved transactions between companies controlled by Claimant. The court directed the lower court to address those defects (see above, ¶217).

268. Based on the ruling of the Supreme Court, the lower court judgment was vacated. The Supreme Court set aside the judgment so that serious challenges to the integrity of the vacated judgment could be examined for the first time by the lower court. This is an entirely proper and reasonable rationale under the circumstances.

269. Respondent submits that Claimant's reliance on decisions of the European Court asserting violation of legal certainty is misplaced.

270. Indeed, in *Brumarescu v. Romania*, the claimant had obtained a final judgment in 1993 from a Romanian court, awarding him title to his parents' home, which had been taken in an unlawful nationalization in 1950. The judgment was later set aside by the Supreme Court in 1995, under Article 330 of the Civil Procedure Code. The court reasoned that the 1950 nationalization was carried out pursuant to a legislative act that precluded judicial review. The ECHR held that a law barring judicial review (the basis of the set-aside order) was itself a violation of the right to a fair hearing guaranteed by the Convention. The ECHR also found fault with the challenged decision because, at the time, Article 330 of the Civil Procedure Code had no temporal restriction, a defect later corrected by the Romanian legislature. The ECHR eventually noted that no justification, such as "public interest", was given for the Supreme Court's ruling.

271. None of the *Brumarescu* circumstances are present here. Claimant continues to own all of his shares without interruption, he controls Continent SA, and the Supreme Court's decision was amply justified and in the public interest given the unresolved allegations of fraud. Significantly, in *Brumarescu*, there was no allegation that the initial judgment was tainted by fraud. Moreover, in Claimant's case, the Supreme Court merely remanded for a full and fair consideration of the relevant facts, which is not at all comparable to what occurred in *Brumarescu*. As a result, *Brumarescu* has no application under the facts and circumstances of this case.

272. Similarly in *Ryabykh v. Russia*, a lower court judgment that was favorable to the applicant was quashed as a result of a "supervisory review." The ECHR drew a comparison to *Brumarescu* and observed that the exercise of the "supervisory review" in that case was not subject to any time limit. As in *Brumarescu*, there was no allegation of fraud or criminal misconduct on the part of the complainant or any suggestion that the lower court had failed to inquire into the merits of complainant's case.

273. In *SC Maşinexportimport Industrial Group SA c. Roumanie*, the applicant obtained a favorable decision from the Bucharest Tribunal in a dispute with AVAS, which entitled the applicant to receive ROL 22.28 billion. After the decision became final and no longer subject to appeal, AVAS paid the sum in question. Subsequently, the Supreme Court quashed the Bucharest Tribunal's decision. The applicant was ordered to return the monies he had received. He claimed before the ECHR that the General Prosecutor's intervention at the Supreme Court was a violation of article 6(1) and Article 1 of Protocol 1 of the European Convention. The case is similar to *Brumarescu* in that the original decision had conferred title to a certain sum of money and the complainant was deprived of his property as a consequence of the Supreme Court's exercise of supervisory review.

274. It is notable that, in *Maşinexportimport*, the court partially based its finding that Romania was in breach of the European Convention upon the fact that AVAS had failed to appeal the original court decision through the normal judicial channels and had invoked the supervisory jurisdiction of the Supreme Court in an attempt to escape the consequences of that failure. In the present case, by contrast, AVAS exercised its rights of appeal within good time and invoked the supervisory jurisdiction of the Supreme Court for *bona fide* reasons, namely to avoid a miscarriage of justice arising from alleged fraud.

275. Finally, Respondent submits that ICSID's jurisdiction is limited by the ICSID Convention to deciding investment disputes. Claimant's "legal certainty" claim is not an investment dispute. Whether Romania's Supreme Court applied Romanian civil procedure law in a manner consistent with the European Convention is not an issue that Romania agreed to arbitrate under the Treaty.

d) The principle of proportionality is not violated by the Supreme Court's order vacating the judgment

276. Respondent refutes Claimant's allegation that, by vacating the lower court judgment, the Supreme Court's decision interferes with Claimant's rights of ownership and that such interference is not justified because it fails to pass the test of proportionality.

277. According to Respondent, the question of proportionality does not even come into play based on the Supreme Court's decision, because the admission of the motion to vacate did not amount to an interference with Claimant's ownership rights. The Supreme Court made no determination as to whether the investment was made or whether AVAS is entitled to execute the pledge and repossess the shares. Those issues remained open for decision by the lower court.

278. On remand, the court of first instance ruled in favor of Continent SRL. On appeal, a divided court ruled for Continental SRL. That judgment was appealed and is pending before the Supreme Court, subject to a request to suspend proceedings. Now the matter is before the Tribunal on the counterclaim of Respondent against Continental SRL and Claimant.

<u>2. Claimant's other arguments under Romanian law are equally unavailing</u>

a) Claimant's argument – that the Trade Registry decision has *res judicata* effect – is contrary to Romanian law

279. Respondent refutes Claimant's allegation that the AVAS lawsuit to enforce its rights under the Privatization Agreement, with respect to the pledge of shares as security for the investment obligation, is "illegal" under Romanian Law because approval by the Trade Registry judge had become irrevocable in January 2001, given that no one appealed that decision within 15 days. Respondent denies Claimant's argument that the Trade Registry decision is *res judicata* and bars AVAS from bringing an enforcement action in 2001.

280. Indeed, the Trade Registry judge's issuance of a decision to approve or deny an increase in share capital is not an adversarial proceeding. As such, it does not enjoy *res judicata* effect under Romanian law. Articles 331 and 337 of the Civil Procedure Code provide as follows: *"Article 331. The applications in respect of which the intervention of the court is necessary, but without pursuing the determination of an adversarial right towards another person, such as those regarding the granting of judicial authorizations, or the granting of legal supervision, safeguards or conservatory measures, are subject to the procedural provisions set out below.* […]"; *"Article 337. The decisions do not have the power of res judicata."* Respondent sets forth that approval of resolutions by a Trade Registry judge to authorize a company's share capital increase is a "judicial authorization" under Article 331 and, pursuant to Article 337, is not *res judicata*.

281. Furthermore, according to Article 1201 of the Romanian Civil Code: "[t]*here exists res judicata when the second claim before the court has the same subject-matter, is grounded as the same cause and is between the same parties initiated by them and against them in the same capacity."* Respondent submits that these requirements are not met. Indeed, neither AVAS nor Continent SRL – the two parties to the AVAS enforcement litigation – was a party before the Trade Registry judge. Nor is the subject-matter and cause the same. The AVAS litigation seeks to enforce the Privatization Agreement against Continent SRL and to obtain relief specified in that contract, because Continent SRL failed to make the required investment. The matter before the Trade Registry was a resolution by the shareholders of Continent SA approving an increase in share capital

based on purported investments made in Continent SA. The Privatization Agreement expressly stipulated that the investment would only be *"deemed to be performed"* once it had been *"fully paid by* [Continent SRL]*."* The Trade Registry judge made no finding as to whether Continent SRL complied with the investment requirements of the Privatization Agreement and is not competent to make such a finding.

b) Claimant's argument that AVAS had 15 days to challenge the Trade Registry ruling is incorrect

282. Respondent denies Claimant's assertion that AVAS had 15 days from the date of the Trade Registry decision to lodge an appeal and, because it failed to do so, the April 2001 enforcement action is untimely.

283. Indeed, the relevant legal provision at the material time was Article 60 of the Company Law, which provided that: *"the final appeal term is 15 days and commences upon the rendering of the decision."* However, based on Decision 701/1995 of the Supreme Court (Respondent's Exhibit n°74), for third parties the 15-day period begins to run from the date of publication of the Trade Registry decision (or of the amended articles of association) in the Official Gazette (that procedure has since been incorporated into an amendment to Article 60 of the Company Law). Respondent points out in this regard that the decision of the Trade Registry was never published in the Official Gazette.

284. Furthermore, AVAS's enforcement action is not an appeal of a decision made by the Trade Registry judge concerning the registration of the capital increase. It is a separate action for an alleged breach of the Privatization Agreement by Continent SRL. As such, it is subject to the general prescription period of three years under Romanian law.

285. Respondent notes that Claimant cites Article 6 of Law 26/1990 for the proposition that AVAS had 15 days to dispute the Trade Registry decision. However, the 15-day rule in Article 6 of that law was not even enacted until 2003 (Law 161/2003), three years after AVAS filed its action to enforce the share pledge. Moreover, even under the current version of Article 6, the 15-day period for third parties such as AVAS to challenge a corporate act starts only upon publication of the act in the Official Gazette. Accordingly, a challenge by a third party of an *unpublished* decision would be dismissed as premature.

c) Romanian law authorized AVAS to file an "absolute nullity" claim against Continent SA to set aside the shareholders' resolution

286. Article 131 of the Romanian Company Law provides an express right for any interested party to challenge a shareholders' resolution as an "absolute nullity." Although Article 131 of the Company Law was included in the 2003 amendments, interested third parties have for many years enjoyed the right to challenge shareholders' resolutions on "absolute nullity" grounds under other provisions (St. D. Carpenaru, S. David, C. Predoiu, Gh. Piperea, *The Law of Commercial Companies, Commentary on Articles 400-01,* 3d ed. 2006). Such generally applicable provisions of law include Article 966 of the Romanian Civil Code, which provides that "[a]*n obligation without cause or grounded on a false or illicit cause, cannot have any* [legally-enforceable] *effect*." The right to nullify a legal act,

based on the fundamental principle *fraus omnia corrumpit*, is drawn from Article 5 of the Civil Code: *"It is not allowed to derogate by agreement or unilateral act from laws that concern public order or good morals*," and Article 968 of the Civil Code, which provides that an *"illicit cause is one that is prohibited by law or is contrary to good morals and public order"*.. Respondent submits that the actions of Continent SA, in submitting to its shareholders for a vote, and to the Trade Registry for approval, a resolution premised on investments that never were made by Continent SRL provide valid grounds for a claim of absolute nullity under Article 966 of the Civil Code.

287. Respondent denies Claimant's allegation that Article 966 of the Romanian Civil Code does not apply to shareholder resolutions because they are non-contractual acts. Indeed, the shareholders' resolution which records the common intention of the shareholders to approve a share capital increase, and thereby amends Continent SA's articles of incorporation, is contractual in nature.

288. Contrary to Claimant's assertion, any interested party in Romania has the right to bring an "absolute nullity" claim; it is not a right exclusive to shareholders. Further, a transaction based on fraudulent conduct can be nullified at any time. There is no prescription period for "absolute nullity" claims under Romanian law. The 2007 claim by AVAS was, therefore, timely.

289. In addition, the violation of various mandatory provisions of the Company Law is sanctionable by absolute nullity, *e.g.* decisions made with the vote of directors where such vote was prohibited by the Company Law (see Article 125(5) and Article 145 of the Company Law). In this regard, Claimant's approval of the share capital increase in his fiduciary capacity as a director of Continent SA was in conflict with his personal interest as the sole shareholder, director, and representative of Continent SRL. These interests conflict for obvious reasons: Claimant and his wholly-owned company Continent SRL arranged for approval of the share capital increase because it created the appearance that Continent SRL had fulfilled the investment obligation of the Privatization Agreement. Continent SA and its minority shareholders, on the other hand, would not want to approve the share capital increase if they knew the investment had not been made by Continental SRL.

§3. DAMAGES

290. If the AVAS litigation causes him to lose any shares, Claimant demands the full value of his entire shareholding interest in Continent SA, *i.e.* over USD 85 million, in addition to USD 25 million for moral damages. If the Romanian litigation is suspended, Claimant demands USD 25 million for moral damages. However, Respondent sought suspension of the AVAS claims in local courts and is bringing its counterclaims before the Tribunal so that the factual disputes surrounding the performance of the investment obligation can be decided before this Tribunal. As a result, Respondent submits that Claimant's secondary claim is moot.

<u>1. There is no basis for the award of Claimant's primary demand for moral damages</u>

291. The first issue regarding the primary relief sought in this claim is whether the evidence establishes that Continent SRL invested the USD 1.4 million from its own resources. If the Tribunal finds that Continent SRL failed to meet its burden of proof, then it must deny this claim. Indeed, Claimant is not entitled to recover damages if AVAS acted reasonably in pursuing its contractual rights under the Privatization Agreement.

292. The next issue is whether AVAS had legitimate reasons for challenging the validity of the Expert Proiect report in Romanian courts, in light of the serious issues raised. If the Tribunal finds that it was appropriate for AVAS to raise these issues, then it must deny this claim.

293. If the Tribunal concludes that the USD 1.4 million investment was made by Continent SRL, *and* that the court challenges brought by AVAS were unwarranted, then the Tribunal has reasons to consider the question of damages. In that scenario, there is no basis whatsoever for the USD 25 million moral damages award demanded by Claimant.

294. Claimant cannot request moral damages for himself in his individual capacity because the Tribunal can award damages only for the investment. Indeed, Article 2(2) of the Treaty, the provision under which this claim is asserted, protects "Investments by investors of a Contracting Party."

295. Previous decisions of ICSID tribunals can offer valuable guidance to the Tribunal (*Saipem S.p.A v. The People's Republic of Bangladesh,* ICSID Case No. ARB/05/07, Decision on Jurisdiction). According to Respondent, only two ICSID tribunals have awarded moral damages for serious impairment of an investment, and the circumstances of those cases are not comparable to those present here.

296. In *S.A.R.L. Benvenuti and Bonfant v. People's Republic of Congo* (ICSID Case No. ARB/77/2), an ICSID tribunal awarded moral damages to an Italian corporation for the loss of commercial opportunities in its home country under extreme conditions involving harm to its employees and credit sources. The Congolese military occupied the Claimant's property, its employees were forced to leave Congo, and it lost the opportunity to do business in Italy because its banks and suppliers refused to provide credit. Claimant was unable to prove material damages, but the tribunal awarded a token amount equivalent to approximately USD 15,000. Respondent contends that even such a minimal amount would not have been awarded but for the circumstance that the parties jointly authorized the tribunal to decide the moral damages claim *ex aequo et bono*, pursuant to Article 42(3) of the ICSID Convention. Moreover, because such an award is not rendered on the basis of applicable law, it cannot serve as precedent in this case.

297. The only other case in which moral damages were awarded to a claimant by an ICSID tribunal was *Desert Line Projects LLC v. The Republic of Yemen*, ICSID Case No. ARB/05/17. The tribunal explained that *"investment treaties primarily aim at protecting property and economic values,"* but *"they do not exclude, as such, that a party may, in exceptional circumstances, ask for compensation for moral damages*." The tribunal

emphasized that *"a legal person (as opposed to a natural one) may be awarded moral damages, including loss of reputation, in specific circumstances only."* In that case, the claimant's corporate executives were threatened and detained by the respondent and intimidated in connection with the contracts representing the investment. The claimant's request for payment for completed works was answered with armed forces. Furthermore, the tribunal explained that it awarded moral damages based on evidence that *"the physical duress exerted on executives of the Claimant was malicious and* because *"it affected the physical health of the Claimant's executives"* as well as Desert Line's credit and reputation. Respondent submits that there are no similarities between the extraordinary circumstances of that case and the allegations and claims asserted by Claimant in this case.

298. Claimant's claim for moral damages also fails under Romanian law. Pursuant to Articles 998 and 999 of the Civil Code, the following prerequisites must be met to admit a civil liability claim: (a) an unlawful deed; (b) certain and unrepaired damage; (c) a causal link between the unlawful deed and the claimed damage; and (d) culpability of the party accused of committing the unlawful act.

299. Respondent sets forth that Claimant's damages claim falls short of proving any unlawful character of AVAS's deeds. Respondent submits that AVAS acted in accordance with its contractual and legal rights and statutory duties in attempting to enforce the share pledge against Continent SRL and exercised its constitutional right of free access to justice when it filed the action for the annulment of the shareholders' resolution approving the capital increase.

300. Respondent further submits that, where the injury alleged is an uncompensated expropriation, the appropriate measure of damages is the value of the expropriated company (Article 4 of the Treaty).

301. Respondent points out that even if the Tribunal were to find that Claimant was entitled to an award of moral damages, such damages would need to be compensatory in nature, and commensurate with any discernible loss or harm that Claimant has established. However, Claimant has failed to prove any discernible loss or harm in this case.

302. Finally, Claimant's demand for USD 25 million, without regard for the purported value of Continent SA, runs afoul of the oft-cited standard for damages under international law: "[t]*he fundamental concept of "damages" is . . . reparation for a <u>loss</u> suffered, a judicially ascertained <u>compensation</u> for wrong. The remedy should be commensurate with the loss, so that the injured party may be made whole*" (*The Lusitania Cases,* US-Germany Mixed Claims Commission, VII R.I.A.A., 32, 1923, at 39, emphasis in original). However, Claimant has failed to show that the USD 25 million moral damages he seeks for this claim represents compensation for any discernible loss. Respondent alleges that it is a completely arbitrary and fanciful figure unsupported by law or fact.

303. For clarity's sake, Respondent sets forth that its submissions responding to Claimant's moral damages claims apply to all such claims.

2. Claimant has a heavy burden of proof, which he has failed to meet

304. According to Respondent, Claimant bears the burden to establish the alleged injury, its extent, and its cause. However, Claimant has failed to make out a claim for indirect expropriation given that he continues to own the shares he acquired and enjoys full decision-making authority over his investment. With regard to the claimed damages in particular, Claimant has not proved any specific harm to the business of Continent SA nor quantified his damages on the basis of any accepted valuation principles or methods.

305. Respondent refutes Claimant's assertion that the value of Continent SA was established by Respondent's own evidence. Indeed, Claimant misinterpreted Respondent's arguments from the Interim Measures application dated May 28, 2008. Respondent merely argued that the EUR 40,000,000 listed sale price was *"substantially below the EUR 65,263,750 market value asserted by Claimant in this arbitration. Cl. Mem. ¶ 104."* (Respondent's Request for provisional measures dated May 28, 2008, page 3, para. 2.) Respondent never contended that the EUR 65,263,750 or EUR 40,000,000 numbers were the correct market value of the property; it just noted that the advertised sale price was below the alleged market value claimed by the Claimant. Also, there is no evidence in the record that the EUR 40,000,000 asking price was ever offered by a buyer or that the self-made evaluation of EUR 65,263,750 was ever documented under any applicable evaluation standard.

SUB-SECTION III. DECISION OF THE ARBITRAL TRIBUNAL

§1. THE LEGAL FRAMEWORK APPLICABLE TO THE MERITS

I. The Applicable Law

306. At the first session of the Arbitral Tribunal held on May 4, 2007, the Parties agreed that Romanian law would govern the substantive merits of the dispute and that the BIT would be treated as part of Romanian law (see Minutes First Session, ¶19).

307. Article 9(4) of the BIT provides that:

"The arbitral tribunal shall decide the dispute in accordance with the provisions of this Agreement and the applicable rules and principles of international law (...)."

308. The Parties agree that Claimant's investment is protected by the BIT, more specifically its articles 2(2) and 4(1).

309. According to Claimant, in view of Article 10 of the BIT, the international obligations that Respondent has assumed in Article 6 of the European Convention on Human Rights and Article 1 of the First Additional Protocol to the European Convention are also to be taken into consideration in the instant case. This is disputed by Respondent.

310. Article 10 of the BIT provides that:

"[i]*f the provisions of law of either Contracting Party or obligations under international law existing at present or established hereafter between the Contracting Parties in addition to this Agreement, contain a regulation, whether general or specific, entitling investments by investors of the other Contracting Party to a treatment more favourable than is provided for by this Agreement, such regulation shall to the extent that it is more favourable, prevail over this Agreement"*.

311. In accordance with the interpretation rules of Article 31 of the Vienna Convention[4], the Tribunal considers that the references made in the text of that Article 10 to "*either Contracting Party*," "*between the Contracting Parties*," and "*investors of the other Contracting Party*" refer to the Contracting Parties of the Romania-Greece BIT. The reference to international obligations established between the parties therefore only encompasses international obligations between these two countries.

312. The Tribunal does not exclude the possibility that the international obligations of the Contracting States mentioned at Article 10 of the BIT could include obligations deriving from multilateral instruments to which those states are parties, including, possibly, the European Convention of Human Rights and its Additional Protocol No.1. But the issue is moot in the present case and does not require decision by the Tribunal, given the higher and more specific level of protection offered by the BIT to the investors compared to the more general protections offered to them by the human rights instruments referred above. Consequently Article 10 of the BIT cannot, in its own terms and in the instant case, serve as a useful instrument for enlarging the protections available to the Claimant from the Romanian State under the BIT.

II. The Fair and Equitable Treatment Standard

313. Article 2(2) provides in its relevant part that: "*Investments by investors of a Contracting Party shall, at all times, be accorded fair and equitable treatment (...)"*

314. The Tribunal considers that the Fair and Equitable Treatment standard encompasses *inter alia* the following concrete principles (*Rumeli and Telsim v. Republic of Kazakhstan*, ICSID Case No. ARB/05/16, ¶605) :

- "*the State must act in a transparent manner;*
- *the State is obliged to act in good faith;*
- *the State's conduct cannot be arbitrary, grossly unfair, unjust, idiosyncratic, discriminatory, or lacking in due process;*
- *the State must respect procedural propriety and due process."*

315. Denial of justice - that is, a failure of due process - constitutes a violation of the Fair and Equitable Treatment standard. On the other hand, an "erroneous judgment" by a court would not violate the treaty in the absence of a denial of justice, that is, a violation of the due process principle (*Parkerings-Compagniet AS v. Lithuania*, ICSID Case No.

[4] Vienna Convention on the Law of Treaties (adopted 23 May 1969, entered into force 27 January 1980) 1155 UNTS 331, Art. 31 (the "Vienna Convention").

ARB/05/8, Award, September 11, 2007, ¶317). According to the ICSID tribunal in *Azinian v. United Mexican States*, "*denial of justice could be pleaded if the relevant courts refuse to entertain a suit, if they subject it to undue delay, or if they administer justice in a seriously inadequate way. . . . There is a fourth type of denial of justice, namely, the clear and malicious application of the law."* (ICSID Case No. ARB(AF)/97/2, Award, November 1, 1999, 39 I.L.M., ¶¶102-103).

316. The case law also confirms that to comply with the FET standard, the State must respect the investor's reasonable and legitimate expectations. This view, reflected in the *Tecmed* decision, has been adopted by a succession of tribunals:

"The Arbitral Tribunal considers that this provision of the [BIT], in light of the good faith principle established by international law, requires the Contracting Parties to provide to international investments treatment that does not affect the basic expectations that were taken into account by the foreign investor to make the investment. The foreign investor expects the host State to act in a consistent manner, free from ambiguity and totally transparently in its relations with the foreign investor, so that it may know beforehand any and all rules and regulations that will govern its investments, as well as the goals of the relevant policies and administrative practices or directives, to be able to plan its investment and comply with such regulations." (*Técnicas Medioambientales Tecmed S.A. v. The United Mexican States*, ICSID Case No. ARB(AF)/00/02, Award, May 29, 2003, ¶154; *cited in e.g., LG&E Energy Corp., LG&E Capital Corp. and LG&E International Inc. v. Argentine Republic*, ICSID Case No. ARB/02/1, Decision on Liability, October 3, 2006, ¶127; *CMS Gas Transmission Company v. Argentine Republic*, ICSID Case No. ARB/01/8 Award, May 12, 2005, ¶279*; Occidental Exploration and Production Company v. The Republic of Ecuador*, LCIA Case No. UN 3467 Final Award, July 1, 2004, ¶185; *MTD Equity Sdn. Bhd. and MTD Chile S.A. v. Republic of Chile*, ICSID Case No. ARB/01/7 Award, May 25, 2004, ¶114).

317. On the other hand, the Arbitral Tribunal in *Saluka* has pointed out that *"no investor may reasonably expect that the circumstances prevailing at the time the investment is made remain totally unchanged. In order to determine whether frustration of the foreign investor's expectations was justified and reasonable, the host State's legitimate right subsequently to regulate domestic matters in the public interest must be taken into consideration as well. As the S.D. Myers tribunal has stated, the determination of a breach of the obligation of "fair and equitable treatment" by the host State must be made in the light of the high measure of deference that international law generally extends to the right of domestic authorities to regulate matters within their own borders"*(*Saluka Investments BV v. The Czech Republic*, UNCITRAL, Partial Award, ¶305, relying on *S.D. Myers, Inc*., 40 ILM 1408, ¶263).

318. Beyond these general principles, the scope of the standard is not precisely defined. *"It offers a general point of departure in formulating an argument that the foreign investor has not been well treated by reason of discriminatory or other unfair measures being taken against its interest. It is therefore a concept that depends on the interpretation of specific facts for its content*" (P. Muchlinski, *Multinational enterprises and the law*, 1995, 625). The precise scope of the standard is therefore left to the determination of the

Tribunal which "*will have to decide whether in all the circumstances the conduct in issue is fair and equitable or unfair and inequitable*" (F.A. Mann, "British Treaties for the Promotion and Protection of Investments", 52 *British Y.B. Int'l L.* 1981, 241-244).

III. The Full Protection and Security Standard

319. Article 2(2) provides in its relevant part that: *"Investments by investors, (...) shall enjoy full protection and security in the territory of the other Contracting Party (...)"*

320. As to the scope of the measure, the Tribunal in *Saluka* decided that "*the "full security and protection" clause is not meant to cover just any kind of impairment of an investor's investment, but to protect more specifically the physical integrity of an investment against interference by use of force*" (*Saluka Investments BV v. The Czech Republic*, UNCITRAL, Partial Award, ¶305, relying on *S.D. Myers, Inc.*, 40 ILM 1408, ¶483). This seems to see the prevailing approach (see also for example *Rumeli v. Kazakhstan*, *supra*, *Eastern Sugar v. Czech Republic*, Partial Award, March 27, 2007, ¶203; *Wena Hotels v. Egypt*, Award, December 8, 2000 (2002) 41 ILM 896; *AAPL v. Sri Lanka*, Award, June 21, 1990, 4 ICSID Rep. 246).

321. There is also authority indicating that the principle of full protection and security reaches beyond safeguard from physical violence and requires legal protection for the investor. For example, the tribunal in *Biwater* held that when the terms "protection and security" are qualified by "full", the content of the standard may extend to matters other than physical security. It implies a State's guarantee of stability in a secure environment, both physical, commercial and legal (*Biwater Gauff Ltd.* v. *United Republic of Tanzania,* ICSID Case No. ARB/05/22, ¶729; see also for example *Azurix v. Argentina*, Award, July 14, 2006; *Siemens v. Argentina*, Award, February 6, 2007; *Vivendi v. Argentina*, Award, August 20, 2007, ¶7.4.14). But to this extent, the standard is also covered by Fair and Equitable Treatment.

322. As to the standard of liability, it is generally accepted that the obligation to provide protection and security does not create absolute liability (*Elettronica Sicula Spa (ELSI)* (1989) ICJ Rep 15; *AAPL v. Sri Lanka*, *supra*; *Tecmed v. Mexico*, *supra*; *Noble Ventures v. Romania*, Award, 12 October 2005). The tribunal in *Rumeli* considered that "[i]*t obliges the State to provide a certain level of protection and security to foreign investment from physical damage*." (*Rumeli v. Republic of Kazakhstan*, *supra*, ¶663). In *AMT v. Zaire*, the tribunal has confirmed that in international law, the full protection and security obligation is one of "due diligence" and no more (*American Manufacturing & Trading v. Republic of Zaire*, ICSID Case No. ARB/93/1, Award of February 21, 1997, 36 ILM 1534).

IV. The Non-Impairment Standard: Unjustifiable or Discriminatory Measures

323. Article 2(2) provides in its relevant part that: *"(...) Each Contracting Party shall ensure that the management, maintenance, use, enjoyment or disposal, in its territory, of investments by investors of the other Contracting Party, is not in any ways impaired by unjustifiable or discriminatory measures."*

324. In the case law, the standard is closely associated with "Fair and Equitable Treatment." In order for the State's conduct to be justifiable or reasonable, it requires that the conduct *"bears a reasonable relationship to some rational policy, whereas the standard of "non-discrimination" requires a rational justification of any differential treatment of a foreign investor*" (*see Saluka*, ¶460, *Rumeli*, ¶674).

325. Similarly, the Arbitral Tribunal in *CMS* stated that the standard of protection against discrimination "*is related to that of fair and equitable treatment. Any measure that might involve ... discrimination is in itself contrary to fair and equitable treatment. The standard is next related to impairment*" (¶290). A measure is discriminatory when it provides "*the foreign investment with a treatment less favorable than domestic investment*" (*Biwater,* ¶695).

V. The Expropriation Standard

326. Article 4(1) of the Treaty provides that:

"Investments by investors of either Contracting Party in the territory of the other Contracting Party shall not be expropriated, nationalized or subjected to any other measure the effects of which would be tantamount to expropriation or nationalization (hereinafter referred to as " expropriation"), except under the following conditions:

a) the measures are taken in the public interest and under due process of law;

b) the measures are clear and on a non discriminatory basis;

c) the measures are taken against payment of prompt, adequate and effective compensation (...)"

327. Expropriation can be direct, that is, resulting from a deliberate formal act of taking, or indirect. Indirect expropriation may occur when measures "*result in the effective loss of management, use or control, or a significant depreciation of the value, of the assets of a foreign investor"* (UNCTAD Series on issues in international investment agreements, Taking of Property, 2000, p.2).

328. On the other hand, in order to determine whether an indirect expropriation has taken place, the determination of the effect of the measure is the key question. Acts that create impediments to business do not by themselves constitute expropriation. In order to qualify as indirect expropriation, the measure must constitute a deprivation of the economic use and enjoyment, as if the rights related thereto, such as the income or benefits, had ceased to exist (*Tecmed v. Mexico*, Award, May 29, 2003, 43 ILM (2004) 133, para. 115). In *Telenor*, the Tribunal decided that: *"[t]he conduct complained of must be such as to have a major adverse impact on the economic value of the investment,"* as *"substantially to deprive the investor of the economic value, use or enjoyment of its investment"* (*Telenor Mobile Communications A.S. v. Republic of Hungary*, ICSID Case No. ARB/04/15, Award, September 13, 2006, ¶¶64-65).

329. Expropriation may occur in the absence of a single decisive act that implies a taking of property. It could result from a series of acts and/or omissions that, in sum, result in a

deprivation of property rights. This is frequently characterized as a "creeping" or "constructive" expropriation. In the *Biloune* case the arbitration panel found that a series of governmental acts and omissions which *"effectively prevented"* an investor from pursuing his investment project constituted a "*constructive expropriation*." Each of these actions, viewed in isolation, may not have constituted expropriation. But the sum of them caused an "*irreparable cessation of work on the project*" (*Biloune and Marine Drive Complex Ltd. v. Ghana Investments Centre and the Government of Ghana*, UNCITRAL ad hoc Tribunal, Award on Jurisdiction and Liability of October 27, 1989, 95 ILR 183, 209).

330. The intention or purpose of the State is relevant but is not decisive of the question whether there has been an expropriation. In *Phillips Petroleum Co Iran v The Islamic Republic of Iran* (CLA 61, ¶97), the arbitral tribunal decided that "[t]*he intent of the government is less important than the effects of the measures on the owner, and the form of the measures of control or interference is less important than the reality of their impact... Therefore, the Tribunal need not determine the intent of the Government of Iran...*"

§2. APPLICATION OF THE STANDARDS TO THE FACTS OF THIS CASE

I. Claimant's allegations

331. In his "Investment Claim," Claimant alleges that:

- Romania's refusal to amicably settle the dispute breaches the fair and equitable clause included in Article 2(2) of the BIT;

- AVAS' attempt to execute the Share Pledge Agreement against his shares in Continent SA amounts to an expropriation in violation of Article 4(1) of the BIT and Article 1 of the First Additional Protocol to the European Convention and also breaches Article 2(2) of the BIT;

- The Prosecutor General's application to the Supreme Court requesting that it reverse and remand for further development of the facts the Appellate Court decision in the Share Pledge enforcement litigation, the motion by AVAS to set aside the decision of the Court of Appeal in that case and the Supreme Court decision amount to a violation of Article 2(2) of the BIT (fair and equitable treatment and full protection and security), Article 4(1) of the BIT and Article 6 of the European Convention;

- The absolute nullity claim filed by AVAS to annul the increase in share capital has effects equivalent to an abusive expropriation and also violates Article 2(2) of the BIT (fair and equitable treatment).

332. The Tribunal will examine each of these allegations separately.

II. Refusal to negotiate an amicable settlement

333. The Tribunal notes that Claimant does not elaborate on the reasons why the Respondent's absence of answer to Claimant's letter requesting a negotiation to reach an amicable settlement of the case would amount to an unfair and inequitable treatment.

334. Article 9 of the BIT regulates the "settlement of disputes between an Investor and a Contracting Party" in the following terms:

1. Disputes between an investor of a Contracting Party and the other Contracting Party concerning an obligation of the latter under this Agreement, in relation to an investment of the former, shall, if possible, be settled by the disputing parties in an amicable way.

2. If such disputes cannot be settled within six months from the date either party requested amicable settlement, the investor concerned may submit the dispute either to the competent courts of the Contracting Party in the territory of which the investment has been made or to international arbitration.

335. The Tribunal agrees with Respondent that, in accordance with the interpretation rules of Article 31 of the Vienna Convention, the Treaty neither imposes a legal duty nor creates a legal right for the Parties to negotiate a settlement. Article 9 does not refer to "negotiations." It only refers to an amicable settlement *"if possible."*

336. The Tribunal considers that in view of the numerous procedures which had taken place or were still ongoing before the courts of Romania, Respondent may have believed reasonably and in good faith that an amicable settlement was not "*possible*" and that it should not engage in negotiations.

337. The Tribunal therefore decides that Romania's conduct was reasonable and adequate and did not breach the Fair and Equitable Treatment requirement.

III. AVAS's attempt to execute the Share Pledge Agreement, the proceedings initiated by the General Prosecutor and the subsequent Supreme Court decision

338. The Arbitral Tribunal considers, on the basis of the evidence, that Respondent's conduct was reasonable, appropriate and justified.

339. According to the Privatization Agreement, Continent SRL had to make an additional post-purchase investment of USD 1.4 million over a period of two years from January 1, 1999 to December 31, 2000. This investment had to be carried out by the buyer "*from personal sources or sources attracted on its behalf.*" USD 1.1 million had to be provided in 1999, with the remainder (USD 300,000) to be provided in 2000.

340. The evidence confirms that when AVAS decided to start proceedings against Claimant, there were objective reasons to suspect that Claimant had not fulfilled its post-purchase investment. AVAS acted in accordance with its contractual and legal rights and statutory duties.

341. Mrs. Mariana Pedescu, Director of the Post-Privatization Monitoring Department at AVAS, who managed the verification of Continent SRL's compliance with its post-investment obligations, explained at the hearing the reasons why she took steps to recommend enforcement of the Share Pledge to AVAS's Board of Directors.

342. Documents provided by the investor himself to prove compliance with its obligations showed that contrary to what he had told AVAS, the alleged investment did not come from the investor, but from Continent SA's own funds. This included the report from the expert appointed by Claimant – Expert Proiect – according to which the alleged in-kind investment consisted of various expenditures by Continent SA from its own funds. Mrs. Pedescu's doubts were also confirmed by the report submitted in May 2001 by Continent SA management admitting that 90% of the alleged investment consisted of routine operating expenses and capital expenditures made by Continent SA from its own funds and that Continent SRL "*was obliged to transfer the due sum to Continent SA*."

343. Mrs. Pedescu further testified that AVAS made repeated requests to Continent SRL for additional documents to clear up the inconsistencies in the information provided by Claimant and his company but they were never provided. She concluded that AVAS was never provided with evidence proving that the additional investment had been made by Continent SRL.

344. AVAS's decision to start proceedings for the enforcement of the pledge may therefore be considered justified and reasonable. Contrary to Claimant's allegation, the trade registry decision was not *res judicata*. It could be challenged in subsequent court proceedings.

345. The Tribunal also finds that there were reasons for AVAS not to be satisfied with the first instance and the appellate court decisions. While these decisions were indeed based on the fact that the share capital increase had been registered, the trade registry decision was a non-adversarial procedure and the full facts were not before the judge. The Trade Registry judge did not make an independent assessment of the reality of the investment. He simply relied on the Expert Proiect report without taking into consideration the fact that the report stated that the investment was made by Continent SA and not Continent SRL.

346. Furthermore, in the appellate procedure, the President of the Court expressed a dissenting opinion in which she concluded that "*the modifications operated in the accounting, subsequent to the invalidation by the Financial Guard of the expert report by which the contribution in kind was evaluated .... cannot be validated by the Court*".

347. It must further be noted that in his expert report dated January 29, 2002, Mr. Popivici, an expert appointed in the criminal investigation concluded that the alleged repayment by SRL of the 90% of the additional investment made by Continent SA on its own funds by way of a so-called restatement of accounts that would have transferred a USD 1.294 million debt from Continent SA to Continent SRL, by way of two agreements for the assignment of receivables, was in fact a sham. In addition, the accounting expert Popescu Elena, in her report of October 2002, established that about 50% of the value of restatement of accounts was cancelled by the end of 2001.

348. AVAS had therefore good reasons to suspect that the Court's decisions were incorrect. They relied exclusively on a narrow interpretation of Article 8.10.2 of the Privatization Agreement that established the date when the post-privatization investment obligation was considered to be fulfilled: the date of the registration of the share capital increase with the Trade Registry. The Court did not analyse the contradictions of the Expert Proiect report or the serious allegations of fraud for which Claimant was investigated criminally. Therefore, the decision of AVAS to resort to the last available legal option, *i.e.*, the recourse to the General Prosecutor to submit a motion to vacate the judgements of the lower court, may be considered justified and reasonable.

349. At the relevant time, the General Prosecutor was permitted under the Romanian Code of Civil Procedure to challenge final and irrevocable judgments within one year of their date of entry in order to avoid a miscarriage of justice and he often used such prerogative. The General Prosecutor indeed filed such a motion to vacate the judgment on the share pledge issue.

350. The General Prosecutor's motion was motivated. It indicated among others that on the basis of the available documents, it appeared that Continent SRL did not achieve the investments from its own sources or from others gained over its name, that there were highly suspicious irregularities in the documentation supporting the investments, that there were multiple transactions involving Claimant's group of companies, causing concern that there was no certainty for the reality of the prices charged. Moreover, Continent SA received notice of the intended application and had an opportunity to challenge it before an impartial tribunal. The motion to vacate was heard before the Supreme Court in an adversarial hearing where Claimant was represented and could present its defense.

351. There is no evidence before us that the Supreme Court did not act in an impartial way. Its decision vacating the Appellate Court decision and remanding the case was duly motivated. It noted in particular that the Expert Proiect did not show how the capital increase was made and therefore did not answer the objections raised by AVAS in the lower court; that third parties were not bound by the increase in share capital since the decision approving it was not published in the Official Gazette; that criminal charges were pending against Claimant; that the Prosecutor had found defects in the Debt Assignment Agreement entered into between various companies of the Claimant's group and that therefore it was necessary to determine whether these agreements were real or fictitious.

352. The fact that the decision which was later rendered on remand was again in favour of Continent SA does not mean that the Supreme Court decision was arbitrary.

353. In conclusion, the Arbitral Tribunal considers that AVAS had reasonable suspicions and good reasons to start proceedings for the enforcement of the Share Pledge. At all levels, Claimant was duly summoned, was represented and could present its defence. Given the limited ground on which the Court of First Instance and the Court of Appeal based their decision, and the contradictory evidence in the possession of AVAS, it was reasonable for the latter to use all possible available legal means to try to prevail in accordance with

its deep conviction that the additional investment had not been made. The Arbitral Tribunal does not see anything reprehensible in AVAS's decision to pursue its claim until the end and not to drop the proceedings, in the General Prosecutor's decision to challenge the judgements or in the Supreme Court's decision to remand the case for a new trial. Respondent's conduct did not amount to a breach of the fair and equitable treatment standard.

354. Respondent's conduct also does not amount to an expropriation. The evidence does not demonstrate that Respondent interfered with Claimant's management and control of his investment. Claimant continues to be the sole director of Continent SRL and Continent SA. Between 2004 and 2008, Continent SA transferred assets in excess of USD 2.8 million to Claimant personally. Continent SA transferred to Claimant's company, Ozias, USD 1.5 million for alleged consultancy services and USD 1.37 million for the purchase of equipment (that was never delivered) and Continent SA sold in 2006 a valuable real estate property for EUR 1 million, although it was subject to a sequestration order.

355. Respondent's behaviour did not deprive the investor from its right to use or enjoy its investment. The companies still function and Claimant continues to profit from their operations. Claimant's Counsel recognised in their s oral pleadings that: "[the investment at the moment] *is still functioning, it is still a going concern*" (transcript, day 2, p. 112, line 16 at seq.); "[Continent SA] *is operating, and it is still filing accounts, there is still an accountant. The Claimant has been taking management fees continuously out of the business, there is no dispute about that (...)*" (transcript, day 2, p. 113, line 18 at seq.).

356. Claimant has also acknowledged that the value of the investment's asset base, and more specifically of the land, has exponentially increased in Romania since the date it purchased SC Malimp SA.

357. The additional burden that Claimant may have had to assume in consideration of the legal proceedings instituted against him may not be considered equivalent to expropriation.

358. In light of the evidence as restated above, the Arbitral Tribunal also considers that the management, maintenance, use, enjoyment or disposal of the investment by Claimant was not in any way impaired by unjustifiable or discriminatory measures and that Respondent's conduct did not infringe the principles of legal certainty and proportionality in violation of the full protection and safety clause contained in Article 2(2) of the BIT.

359. In particular, the Tribunal considers that the procedure permitting the General Prosecutor to challenge a final and irrevocable judgement does not breach the principle of legal certainty. During the relevant time, all final and enforceable judgements in Romania remained subject to the set aside provisions for one year (and no longer indefinitely) after entry of the judgement and the parties to the procedure were fully aware that such provision could be invoked during that one year period. The procedure was initiated without delay, was fully transparent and legitimate and cannot be considered to amount to a violation of the principle of *res judicata*. Moreover, we are not in a situation like in the *Bumarescu* case (above, n°156) where the procedure was initiated after the enforcement of the judgement had taken place.

IV. Filing of the request to annul the increase in share capital

360. Faced with contradictory evidence as to the issue whether Claimant has fulfilled his obligation to make the additional investment, AVAS started the share nullification litigation in August 2007. AVAS's request was reasonable and fully motivated. Continent SA received notice of the intended application and had an opportunity to dispute it before an impartial tribunal. And indeed, the Commercial Court ruled against AVAS and refused to nullify the shareholders' resolution.

361. The Arbitral Tribunal therefore considers that Continent SA was granted due process. It accepts Respondent's justification that AVAS filed the suit to preserve its right to pursue its share pledge enforceable claim in the event that this tribunal would later decide that it lacked jurisdiction over the counterclaims.

362. The Tribunal therefore considers that Respondent's decision to file and pursue the share nullification litigation was legitimate, did not violate the fair and equitable treatment standard, the full protection and security requirements and did not constitute an unjustifiable or discriminatory measure. It certainly did not amount to expropriation for the reasons enunciated above.

V. The cumulative effect of the various court proceedings

363. Claimant has not been able to prove how the various court proceedings referred to above, taken collectively, could amount to a violation of Article 2(2) or 4(1) of the Treaty when it was unable to show that, individually, these actions were wrongful.

364. Finally, the Arbitral Tribunal also refers to paragraph 312 above in which it has decided that the application to the present case of Article 6 of the European Convention and of Article 1 of the First Additional Protocol to the latter is denied.

SECTION II. THE FISCAL CLAIM

SUB-SECTION I. CLAIMANT'S POSITION ON THE FISCAL CLAIM

§ 1. THE FACTS

I. The Financial Guard Minutes n°11238 and the DGFPMB Minutes n°191624

365. Continent SA's Board of Directors, during its meeting of November 12, 1998, decided to provide a storage space to Continent SRL, free of charge, as set-off against the investment of USD 1.4 million to be made by Continent SRL (Claimant's Exhibit n°33). As a consequence of this decision, an *Addendum* to a Services Agreement n°1854/15.07.1998 was concluded on November 19, 1998 between Continent SA and Continent SRL. The *Addendum* confirmed Continent SA's Board of Directors' decision (Claimant's Exhibit n°34). The Board of Directors' decision and the *Addendum* were validated by Continent SA's General Shareholders' Meeting on April 8, 1999 (Claimant's Exhibit n°35).

366. On the occasion of an audit performed by the Financial Guard[5], tax inspectors alleged that Continent SA had to register in its books of account the rent that Continent SRL should have been paying for the use of the storage space. The conclusions of this audit were issued in minute n°11238 dated September 2, 1999 (Claimant's Exhibit n° 36).

367. Claimant alleges that the Financial Guard decided to substitute its own decision for that of Continent SA. The Financial Guard forced Continent SA to claim rent for the storage spaces to continent SRL, according to certain imposed tariffs.

368. Based on such tariffs, the Financial Guard calculated certain alleged unrealized incomes, a VAT for such incomes, together with the corresponding delay penalties. Accordingly, Continent SA owed the following to the Romanian State:

- lei 2,318,028,182 representing uncalculated, unrecorded and non-transferred profit tax as of 30 June 1999;

- lei 662,640,884 representing delay penalties related to the profit tax;

- lei 2,428,028,705 representing uncalculated and non-transferred VAT for November 1998 to July 1999;

- lei 109,261,292 representing delay penalties for the VAT.

369. Claimant formulated objections against the Financial Guard minutes. However, the Bucharest Financial Guard rejected these objections in Decision n°86/24.09.1999.

370. Continent SA then challenged the Decision n°86/24.09.1999 before the DGFPMB[6]. The DGFPMB accepted the challenge and cancelled the Decision n°86/24.09.1999 and the minutes n°11238/02.09.1999 (Disposition n°78/14.04.2000, Claimant's Exhibit n°37).

371. Pursuant to this decision, a new audit was conducted by the tax authorities of the 6th District Financial Administration of Bucharest in December 2000. The 6th District Financial Administration carried out the control and ignored the DGFPMB Disposition. On December 22, 2000, new control minutes n°191624 were issued by the 6th District Financial Administration.

372. On January 17, 2001, Continent SA filed a challenge against the control minutes n°191624 before the 5th Civil and Administrative Petitions Department within the Bucharest Court. The Court accepted the challenge and cancelled the minutes on October 18, 2001 (Claimant's Exhibit n°39). This decision became irrevocable.

[5] The Financial Guard is a government agency tasked with preventing, discovering and combating tax evasion. It is part of the Ministry of Economy and Finance and overseen by the National Authority for Tax Administration (the "ANAF") which is a government agency, part of the Ministry of Economy and Finance.

[6] The Bucharest General Department of Public Finance is a department within ANAF responsible for conducting tax inspections and audits with jurisdiction over the municipality of Bucharest.

373. Claimant points out that an “accounting expertise” was carried out during these proceedings by the expert Virgiliu State (Claimant’s Exhibit n°40). This expertise stated that the control authority made a mistake by recalculating the company’s fiscal obligations, and that Continent SA had not made any fiscal evasion.

374. Notwithstanding the above, the Financial Guard minutes n°11238, together with two ascertaining notes, constituted the bases for certain charges brought against Claimant in a criminal file n°4/PA/2000.

375. Moreover, although the payment obligations established in minutes n°191624 were cancelled by the irrevocable judgment of October 18, 2001, the amounts that were fixed in these minutes were stipulated as certain and due debts in the DGFPMB control minutes dated December 17, 2003 (Claimant’s Exhibit n°42).

376. Finally, Claimant submits that final and irrevocable decisions were rendered concerning the dispute relating to the warehouse, Respondent should not be permitted to bring the issue again within the scope of this arbitration.

II. The Financial Guard - Bucharest Department Minutes n°11275/297/13.02.2001

377. The Bucharest Financial Guard conducted another audit at Continent SRL for the period between January and December 2000. It established additional tax liabilities (Profit Taxes and VAT) and delay penalties for failure to pay these taxes on time. The results of the audit were included in minutes n°11275/297/13.02.2001.

378. Continent SRL challenged the determination of the tax liability in proceedings before the Administrative Petition Department of the Bucharest Court of Appeal.

379. An accounting expertise report was drafted in this context by Ionescu Dumitru (Claimant’s Exhibit n°43). The expertise report mentions that the fiscal obligations at stake were based on inadequate accounting records kept by Doanta Angela. Ms. Doanta distorted the records in order to hide the money stolen by her, for which she was criminally convicted. Therefore, the accounting records could not be relied upon before being corrected (the correction process was ongoing when the expertise report was being prepared). Consequently, the documents mentioned in the appendices to the control minutes were not documents by which the company’s fiscal obligations could be established. However, Continent SRL’s challenge was rejected as lacking legal basis.

380. Continent SRL challenged this decision before the Administrative Petitions Department within the Supreme Court of Justice. Continent SRL submitted, in support of its appeal, that the fiscal obligations of the company could not be established on the basis of inadequate accounting.

381. In light of a pending criminal investigation of Roussalis, Continent SRL’s appeal against Decision n°48/17.01.2002 was suspended.

III. The DGFPMB Minutes of December 17, 2003

382. On December 19, 2003, Continent SA received the minutes dated December 17, 2003, prepared by the DGFPMB inspectors, covering the period from November 1998 to June 2003 (Claimant's Exhibit n°42)**.**

383. The control was carried out pursuant to the General Juridical Directorate of the Ministry of Public Finance ("MFP")'s request n°101511/25.04.2003. The request was issued after the civil judgment n°351/08.03.2003 had rejected AVAS's appeal to obtain the enforcement of the share pledge and after the General Prosecutor had filed a motion to vacate the lower court judgments (see above, ¶¶95 *et seq*.).

384. Claimant points out that the minutes were intentionally finalized and communicated before the Christmas and New Year holidays in order to prevent Continent SA from presenting an elaborate defense within the 15 days time limit provided by the law to challenge the minutes.

385. The control determined 11 taxes and duties owed to the state budget and to the social state insurances budget: tax on salaries; a 2% fund for supporting state education; a risk, accidents and solidarity with handicapped persons fund; additional contribution to the solidarity with handicapped persons fund; value added tax; profit tax; withholding tax; state social insurance contributions; a fund for labor accidents and professional diseases; contribution to unemployment insurances; and contribution to the social health insurance fund.

386. The minutes identify unpaid tax liabilities and related penalties amounting to ROL 75.7 billion.

387. Claimant points out that these control minutes started by establishing, as an existing current debt, the fiscal obligations established by the DGFPMB minutes n°191624/22.12.2000. However, these minutes had been cancelled by the judgment n°343/F/18.10.2001, delivered by the Bucharest Court in file n°17/CA/2001, which is final and irrevocable.

388. On January 8, 2004, Continent SA challenged the 2003 tax audit before the Bucharest Court.

389. At the court hearing of March 1, 2004, the court approved Continent SA's application for cancellation of the 2003 tax audit. Moreover, the court considered the application for the suspension of the execution of the audit and stated that "[w]*itholding, on one hand, the fact that the creditor of the amounts in litigation has taken guaranteeing measures necessary for their future achievement, being no risk of its prejudice by evading the goods from the forced execution by the debtor, and having in view, on the other hand, the considerable value of the debt for execution and, at the same time, contested by the petitioner, the risk of bringing the company in incapacity of payment and of current activity unrolling, the Court appreciates that in the case there have been proved the circumstances referred to in art.9 from law 29/1990. As a consequence, the Court shall approve the petitioner's application and shall dispose the annulment of the attacked*

administrative document, namely the report from 17.12.2003 until the settlement of the present cause" (*sic*., Claimant's Exhibit n°46).

390. During these Proceedings, Continent SA requested that the court appoint a judicial accounting expert to review the tax liabilities set out in the tax audit. Mr. Iuliu Anchescu was accordingly appointed. The Anchescu expert report (Claimant's Exhibit n°48) stated that the tax liabilities set out in the tax audit were illegal.

391. Since the DGFPMB representatives considered that the expertise and the Continent SA's arguments were not favorable to them, they invoked the pending criminal proceedings against Roussalis and requested the suspension of the trial. Continent SA's challenge to the tax audit was consequently suspended by the court on September 12, 2005.

392. Claimant further submits that, although the court ordered the suspension of the execution of the 2003 tax audit**,** DGFPMB started the enforcement of the payment obligations contained in the December 17, 2003 minutes. Accordingly, the Tax Agency sought to obtain tax liens to sequester assets, including Continent SA's movable goods and bank account, to recover the alleged tax liabilities identified in the audit report.

393. In the indictment dated March 17, 2003 (Claimant's Exhibit n°51), the Prosecutor stated that "[d]*uring the prosecution, according to the ordinances enclosed at* [sic] *the case file, there have been taken insuring measures* [sic] *upon movables and non-movables of defendant SPYRIDON ROUSSALIS and of the person civilly responsible* [Continent SA], *in order to cover the damage caused to the state budget*" (*sic*., Claimant's Exhibit n°51). Claimant considers that such measures are obviously disproportionate since the value of the assets referred to in the statement is out of proportion with Continent SA's alleged liability. Claimant argues that this "*emphasizes the agressiveness and the permanent character of the administrative-financial harassments to which the company was subjected"* (Claimant's Memorial, ¶136).

394. Moreover, whereas Respondent alleged that Roussalis was able to withdraw at least 5 million dollars from Continent SA, it does not explain why instead of freezing only the cash equivalent to the claimed tax amount, Romania chose, through its fiscal authorities, to sequester all Continent SA's assets, all Continent SRL's assets and bank accounts, and all of Roussalis's assets located in Romania. This decision impaired Claimant's right to dispose of its investment and was taken in breach of the principles of due process, proportionality and reasonableness.

395. Finally, the sequestration of Claimant's assets, against the background of a continuous an exponential increase of the due amounts of tax because of penalties, led to a further deprivation of the foreign investor's rights and legitimate expectations as to the sale and disposal of Continent SA's assets. According to Claimant, the sequestration is ongoing.

396. In light of the above, Claimant considers that the measures taken by Romania were in breach of both its international obligations and the Treaty.

IV. The Ministry of Public Finances' civil action within criminal proceedings: claim for a prejudice not related to the criminal litigation

397. By the indictment dated March 17, 2003, the Prosecutor instituted criminal proceedings against Roussalis. The latter was sued together with Ms. Doanta. The indictment designates Continent SA as *"party civilly responsible"* (Claimant's Exhibit n°51).

398. The Prosecutor's charges refer to prejudice allegedly caused to the state budget by Continent SRL amounting to lei 2,326,101,317 (lei 898,125,354 as VAT and lei 1,427,975,963 as profit tax).

399. The Ministry of Finance elected to intervene in the criminal proceedings as civil party on September 25, 2003. It claimed civil damages for the principal amount of the tax liabilities set out in the December 17, 2003 audit (DGFPMB minutes n°35143), i.e. RON[7] 7,167,136,408.

400. According to Claimant, the December 17, 2003 tax audit did not constitute a relevant basis to claim damages in the criminal proceedings since there is no *"link of causality between the alleged criminal facts and the amounts mentioned in the respective minutes"* (Claimant's Memorial, ¶141). A criminal prejudice may only be established in relation to facts of which the appropriate criminal investigatory bodies have been notified, and which have been effectively investigated.

401. Moreover, the fact that the tax liabilities set out in the December 2003 tax audit became part of the criminal case entail as a consequence the denial of the suspension of the tax audit decided by the Bucharest Court on March 1, 2004. Since civil courts are bound by criminal judgments, any decision of the criminal court would have as a *"consequence the automate* [sic] *rejection of the challenge in the fiscal administrative court, with the consequence of affecting the patrimony."* This amounts, according to Claimant, to an unjustified measure that is equivalent to expropriation (Claimant's Reply, ¶27).

402. Claimant also points out to further irregularities that occurred during the criminal proceedings: the 6th District Criminal Court changed the trial date without legally summoning the parties. Roussalis was summoned to appear at the 6th District "City Hall" and the civilly liable party, Continent SA, was summoned to appear on June 25, 2007 (i.e. after the judgment had already been delivered on May 28, 2007).

403. The criminal court eventually awarded the Romanian State ROL 3.2 million, plus penalties and interest.

[7] RON is the currency abbreviation for the New Romanian lei, as of July 1, 2005, pursuant to Law no. 348/2004 regarding the denomination of the national currency. ROL is converted to RON by cutting four units: e.g. 10,000 ROL = 1 RON.

§ 2. THE LAW

404. Claimant does not dispute the right of the Romanian authorities to carry out control actions and to set tax liabilities as long they offer the opportunity to challenge such tax liabilities. Claimant has challenged the authorities control actions and decisions in Romania. Claimant does not ask the Arbitral Tribunal to solve the tax litigations on the merits. However, he submits that he has been prevented from having the tax litigation solved, since his challenge was suspended. This prevention was worsened by the modification of the nature of his tax liabilities when they were included in the criminal case. These measures affected the investment and represent a serious breach of the Treaty, of Article 6 of the European Convention and of Article 1 of the First Additional Protocol.

405. Claimant submits in the first place that Respondent violated Article 4(1) of the Treaty and Article 1 of the First Additional Protocol to the European Convention. He alleges that the tax liabilities set forth in the December 17, 2003 tax audit are illegal and unfounded and that this is supported by the accounting expertise report carried out by Anchescu Iuliu (Claimant's Exhibit n°48). Claimant further notes that such tax liabilities were never subject to criminal investigation. Therefore, the MFP's abusive election to join the criminal proceedings as a civil party and the subsequent procedure before the Bucharest criminal Court amount to violations of both Article 1 of the First Additional Protocol to the European Convention and of Article 4(1) of the Treaty. According to Claimant, the MFP's actions and their validation by the Romanian courts, specifically by the criminal judgment n°447/28.05.2007, constitute an unjustified measure equivalent to an expropriation.

406. Claimant points out that he is directly affected by the damage suffered by Continent SA, in which he owns 96.51% of the shares.

407. Claimant submits in the second place that Respondent has violated Article 6 of the European Convention (see above, ¶148). He argues that, according to Romanian law, a civil court is bound by a criminal judgement. In this regard, administrative and fiscal bodies are considered civil courts. Therefore, the above mechanism by which pure tax liabilities were awarded in a criminal court's decision without investigation deprived Roussalis, as majority investor, of his rights under Article 6 of the European Convention. Continent SA was deprived of its right to challenge the tax obligations assessed against it in the December 17, 2003 tax audit and, therefore, was denied an equitable and public judgment of its cause under Article 6 of the European Convention. Such an infringement of his right to a fair trial also violates the investor's right to protect its investment.

408. The foregoing is all the more true since the criminal judgment n°447/28 of May 28, 2007 was quashed by the September 22, 2008 decision of the Bucharest Tribunal because Respondent was deprived of a chance to present its defense in the criminal lawsuit (Claimant's Reply Exhibit n°2).

409. Claimant also submits that Respondent violated Article 2(2) of the Treaty.

410. Claimant further objects to the sequestration of Continent SRL's interest in Continent SA as security for the purported tax liabilities identified in the December 17, 2003 tax audit, contending that sequestration was disproportionate and violated the unjustifiable measures clause of Article 2(2) of the Treaty. Claimant alleges that the sequestration is unjustifiable because it interferes with Claimant's right to dispose of, to valorize and use the assets.

§ 3. DAMAGES

411. Claimant seeks USD 5,622,911.34 in compensatory damages, representing the civil damages claimed in the criminal prosecution, USD 1,354,175.16, plus accrued interest and delay penalties (pursuant to the Fiscal Procedure Code) until December 31, 2010, Claimant's estimated completion date of this arbitration.

412. Claimant formulates the following request (Claimant's Memorial, ¶161): *"that the Respondent Romanian State be obliged to pay the amount of USD 5,622,911.34, amount which includes the main debits and interests and delay penalties calculated until 31.12.2010 (ANNEX 53), date on which we estimate that the arbitration litigation is over, this being the influence over the patrimony of the company where I own the shares."*

SUB-SECTION II. RESPONDENT'S POSITION ON THE FISCAL CLAIM

§ 1. THE FACTS

I. Continent SA was subject to a Tax Audit during 2003

413. In 2001, the Department of the Economic-Financial Police, part of the 6th District Police in Bucharest, started a criminal investigation against Claimant and Ms. Doanta. It addressed issues of tax evasion, fraud, forgery, and the use of false documents at Continent SA, Continent SRL, Continent Marine Trading SRL, and Continent Marine Construction SRL (Respondent's Exhibit n°78). The accounting expert reports produced for the purposes of the criminal investigation revealed that the State had lost tax revenues as a result of the alleged criminal activity.

414. On October 23, 2002, the police notified the Ministry of Finance of the existence of the criminal investigation and asked the Ministry of Finance to confirm whether it intended to join the criminal proceedings as a civil party (Respondent's Exhibit n°79).

415. Following these developments, the Financial Guard (a unit subordinate to the Ministry of Finance) advised the police to ask the Tax Agency for a determination of the appropriate civil damages figure to be claimed (Respondent's Exhibit n°80). Accordingly, the Tax Agency began a tax audit of Continent SA in May 2003 (Declaration of Ana Chivu, hereinafter "Chivu Decl.", ¶5.2.2, Respondent's Exhibit n°81).

416. On December 17, 2003, the Tax Agency issued minutes n°35143, identifying unpaid tax liabilities and related penalties in the sum of ROL 75.7 billion.

417. Respondent points out that during the period from December 15, 2003 to December 31, 2003, the Tax Agency finalized thirty other tax audits in Bucharest District 6, where Continent SA is located (Chivu Decl., ¶5.3.1.). Contrary to Claimant's allegations, the timing for completion of the audit and notification thereof was the result of normal case scheduling within the Tax Agency.

418. On January 8, 2004, Continent SA registered a challenge to the tax audit before the Bucharest Court (Respondent's Exhibit n°82). The court appointed a judicial accounting expert, Iuliu Anchescu. Although Anchescu criticized the tax liabilities set out in the tax audit, it did not dispute all the tax liabilities assessed by the Tax Agency (Respondent's Exhibit n°83). No court adopted the report's findings. Furthermore, Respondent questions Anchescu's impartiality in light of the fact that Continent SRL retained him in 2005 as its expert in a litigation concerning the pledge enforcement proceedings initiated by AVAS, and he was serving Continent SRL in that capacity at the time he prepared his judicial accounting report for the court (Respondent's Exhibit n°69).

419. Continent SA's challenge to the tax audit was suspended by the court on September 12, 2005, pending resolution of the criminal proceedings against Claimant and Ms. Doanta.

II. Rights and obligations of taxpayers and Tax Authorities during a Tax Audit

420. At all relevant times, tax audits were regulated by Government Ordinance n°70/1997. To protect their interests and to promote clear communication of relevant information to the authorities, taxpayers subject to an audit are entitled to (i) prior notice of the intended audit; (ii) an opportunity to provide information clarifying their activities; (iii) assistance by professionals during the audit; (iv) fair and equitable treatment by the fiscal authorities including respect for confidentiality; and (v) the right to challenge the findings of the fiscal authorities. Continent SA enjoyed all of the above-mentioned rights during the 2003 tax audit (Chivu Decl., ¶5.1) and throughout the administrative and judicial challenges to the tax audit it never claimed otherwise. Indeed, Continent SA has challenged only the amount of the tax liabilities assessed by the tax authorities. (Respondent's Exhibits n° 82 and 84).

421. Continent SA litigated its challenge to the 2003 tax audit in Romanian courts and it lost before the court of appeals (Respondent's Exhibits n°211, 209). Claimant did not assert any error in the final judgment. It is furthermore undisputed that those liabilities remain unpaid.

III. Continent SA failed to cooperate with the Tax Authorities during the 2003 Audit

422. From the outset of the tax audit in May 2003, Continent SA failed to provide the tax authorities with requested accounting documents. The progress of the tax audit was interrupted several times when the tax authorities formally requested (on June 13 and September 18, 2003) essential accounting documents which Continent SA had failed to produce (Respondent's Exhibit n°85; Chivu Decl., ¶5.3.3). In those requests for documents, as well as prior requests dated June 6, 2003, June 12, 2003, and July 8, 2003,

the tax authorities asked Continent SA to submit the following tax documentation: (i) documents evidencing the works performed by its employees in the period from 1999 to 2003 (with work schedules, technical estimates, and construction authorizations); (ii) the calculation note for the amortization of fixed assets; (iii) documents justifying the accounting registrations of payments to and from Claimant or Continent SRL; and (iv) the services agreements and estimates justifying the invoices issued to Continent SA by suppliers (Respondent's Exhibit n°85, p.32; Chivu Decl., ¶5.3.3).

IV. The tax liabilities covered numerous Tax Code violations

423. The December 17, 2003 tax audit report established additional tax liabilities owed by Continent SA: collectable VAT, deductible VAT, profit tax, salary tax, education fund, risk and accident fund, solidarity fund, nonresident income tax, social security, accident and occupational disease fund, employer-owned unemployment fund, employee-owned unemployment fund and employer/employee health fund (Respondent's Exhibit n°85).

V. The Tax Audit report reassessed penalties for unpaid taxes owed by Continent SA for free storage provided to Continent SRL

424. In September 1999, the Financial Guard had conducted a tax audit of Continent SA and concluded that the rent forgiveness granted by Continent SA to Continent SRL after the conclusion of the Privatization Agreement constituted an evasion of Continent SA's income tax and VAT obligations (Minute n°11238 dated September 2, 1999, Claimant's Exhibit n°36). The liabilities were subsequently cancelled on procedural grounds in Decision n°78, dated April 14, 2000. Pursuant to this decision, a new audit addressing the merits of additional liabilities was conducted by the tax authorities of the 6th District of Bucharest in December 2000 (Claimant's Exhibit n°37). This is contrary to Claimant's allegation that the December 2000 audit was required by the decision.

425. In the December 2000 audit results, the auditor again concluded that Continent SA owed tax arising out of its provision of free storage services to Continent SRL and re-computed the amount owed (Minutes n°191624, Respondent's Exhibit n°51).

426. Continent SA filed an *administrative* challenge to the new assessment before the Ministry of Finance. These proceedings were suspended on July 6, 2001, pending resolution of the criminal proceedings against Claimant and Ms. Doanta (Respondent's Exhibit n°85).

427. Unbeknownst to the tax auditors, Continent SA had commenced a *court* challenge of minute n°191624 on January 17, 2001, which resulted in cancellation of the minute on October 18, 2001 (Respondent's Exhibit n°88.)

428. In accordance with Article 6(n) of Government Ordinance n°70/1997, the tax auditors who performed the December 2003 tax audit reviewed Continent SA's compliance with previous tax audits. Therefore, unaware that the liabilities established in minute n°191624 had been cancelled, the tax auditors again included them in the December 17, 2003 audit report, plus additional penalties, in the sum of ROL 12.6 billion.

VI. The Tax Authorities ordered sequestration of certain assets of Continent SA as security for the additional tax liabilities, but enforcement of the tax audit report was suspended (The Tax Agency's 2004 sequestration order)

429. Continent SA failed to pay the tax liabilities included in the December 17, 2003 tax audit within the time period required (Government Ordinance n°61/2002, Art. 10 (1): *"... if the date of the communication is between 16-31 of the month, the payment term is by the 20th of the following month"*). Upon the expiration of the relevant period, the tax audit minute n°35143 became automatically enforceable (Article 130(2) of the Romanian Code of fiscal procedure). On February 6, 2004, the tax authorities took steps to enforce the liabilities identified in the audit by issuing enforcement titles in accordance with Article 126 of the Romanian code of fiscal procedure (Claimant's Exhibit n°52).

430. On February 16, 2004, the tax authorities issued a sequestration report (Claimant's Exhibit n°49), that (a) required Continent SA to pay assessed taxes within 15 days to avoid any restrictions on the sale of the sequestered assets, and (b) prevented Continent SA from selling the sequestered assets until it paid its taxes. This sequestration report covered Continent SA's improved real estate located at 82 Timisoara Boulevard and 1 Razoare Street, as well as a car.

431. According to Continent SA's balance sheet for 2003, the value of the real estate properties that were the subject of the sequestration report amounted to approximately half of the value of the tax liabilities established by the December 17, 2003 tax audit (ROL 38.9 Billion compared to ROL 75.7 billion, *see* Balance Sheet, Respondent's Exhibit n°91). The value of the assets that were subject to sequestration were therefore not disproportionate.

432. On March 1, 2004, the Bucharest Tribunal suspended enforcement of the tax audit report pending resolution of the challenge to the December 17, 2003 audit (Claimant's Exhibit n° 46).

433. Respondent refutes Claimant's argument that Respondent was responsible for delaying resolution of the challenge to the December 2003 tax audit, causing a denial of justice. The facts are otherwise. Proceedings were suspended in 2005, pending the resolution of the criminal file. Claimant evaded service in the criminal case until the statute of limitations on the enforcement of criminal sanctions had expired. Only then, in November 2009, did Claimant request the reopening of his tax challenge (Respondent Exhibit n°209). The record shows that the Claimant's request was granted promptly and the dispute was resolved expeditiously in 2010. Thus, the delay in resolution of the court challenge of the audit was due to Claimant's own legal strategy.

VII. The criminal authorities issued proper orders restraining Claimant and Continent SA from disposing of their assets

434. Based on evidence collected by the Financial Guard (Respondent's Exhibit n°86), the police investigated Claimant and Continent SA for alleged tax fraud. Pending resolution of the criminal investigation, on June 12, 2000, the police issued their sequestration order

directing the company not to sell its real estate pending resolution of the criminal proceedings (Respondent's Exhibit n°93). It was a standard procedure pursuant to the Romanian Criminal Procedure Code. Claimant has neither alleged nor proved that the 2000 order was discriminatory, disproportionate or otherwise improper under the applicable Romanian law. In addition, Claimant never took advantage of the opportunities provided by Romanian law to challenge the sequestration order.

435. In his sworn declaration to the police dated August 8, 2001 (Claimant Rebuttal Exhibit n°27), Claimant admitted that he owed taxes and penalties totaling ROL 23.32 billion (approximately USD 780,000). He agreed to pay that amount. To secure that admitted tax debt, the police ordered Roussalis to maintain Continent SRL's share capital at the minimum level of USD 360,000 until the payment obligation was met (Respondent's Exhibits n°95 and n°115.) Claimant never disputed the fact that he never paid any of the USD 780,000 in admitted tax liabilities. Further, Claimant failed to establish that the sequestration was unlawful or unjustified.

436. There is also no evidence that the police sequestration had any actual effect on Claimant's investment. The November 13, 2001 police minute merely records Claimant's declaration that the subscribed capital was deposited at Alpha Bank. The best evidence of funds on deposit - copies of Claimant's bank records from Alpha Bank - was uniquely in Claimant's control. Claimant presented no such evidence. This gives rise to a negative inference that no funds were actually sequestered at Alpha Bank. The 2001 sequestration was just a paper order without any adverse consequence for Continent SRL.

437. The Public Finances Department of the 6th District Municipality of Bucharest also issued an order prohibiting Continent SA from selling its assets (Respondent's Exhibit n°96). Finally, in criminal decision n°447/28.05.2007, the 6th District Criminal Court granted a conservatory sequestration order over the movable and immovable assets of Claimant, Ms. Doanta and Continent SA up to the amount of the civil damages ordered by the court, *i.e.,* RON 3.2 billion (Respondent's Exhibit n°42).

438. All of the above orders were issued as standard procedure pursuant to Article 163 of the Romanian Code of Criminal Procedure. Despite these orders, Continent SA sold its real estate property at 1 Razoare Street on May 15, 2006 (Respondent's Exhibit n°60). In addition, Claimant recently tried to sell the entirety of the improved real property owned by Continent SA at 82 Timisoara Blvd. Indeed, it appears that Claimant has already entered into a Sale-Purchase Pre-Contract dated October 10, 2007 to sell part of said property (Respondent's Exhibit n°64).

VIII. ANAF claimed civil damages in the criminal prosecution

A. Victims of criminal offenses may join their civil damages claim to the criminal prosecution of the indicted persons

439. Article 15 of the Romanian Criminal Procedure Code provides that a victim may claim civil damages during a criminal investigation or criminal prosecution as long as such claim is lodged prior to the reading of the indictment before the criminal court. The

Ministry of Finance elected to join the criminal proceedings as civil party on September 25, 2003.

B. ANAF claimed civil damages liabilities identified in the December 17, 2003 tax audit

440. Through ANAF, the Ministry stated the quantum of its civil damages claim on April 26, 2004, and subsequently amended the amount on January 12, 2007 (Letter from Valeria Nistor, General Director, General Legal Department, ANAF, dated May 27, 2008, ("Nistor Letter"), ¶2.6 & Att. M).

441. In essence, ANAF claimed civil damages for the principal amount of the tax liabilities set out in the December 17, 2003 tax audit (minute n°35143, *i.e.,* RON 3.4 million, plus related penalties and interest). Therefore, those tax liabilities became part of the case to be decided by the criminal court.

442. Respondent denies that the 2003 tax audit came before the criminal court without any *"link of causality between the alleged criminal facts and the amounts mentioned in the respective minutes"* (Claimant's Memorial, ¶141). Respondent submits that ANAF has an unrestricted right to assess the full amount of outstanding tax deficiencies as damages, and the criminal court has the duty to determine whether the amounts claimed should be awarded as damages. According to Article 346(1) of the Romanian Criminal Procedure Code, "[i]*n the event of a conviction, acquittal or closure of the criminal proceedings, the court will give judgment on the civil claim in the same decision"*.

443. The criminal court, after reviewing the case, awarded the Romanian State RON 3.2 million, plus penalties and interest (Ex. 42).

C. Claimant did not deny committing tax evasion, and Continent SA had the opportunity to challenge the damages claimed

444. Continent SA participated as civil party in the criminal prosecution of Claimant and Ms. Doanta from the date of the registration of the criminal case. During the four-year duration of the criminal proceedings, not once did Continent SA contest the Ministry's right to participate as a civil party. Nor did Continent SA ever present a defense to the civil damages claimed by ANAF (Nistor Letter, ¶¶2.5-2.7 and 3.1).

445. On April 20, 2007, Claimant and Continent SA jointly submitted written closing arguments in the criminal prosecution. Claimant did not deny tax evasion (see above, ¶195). In addition, despite having had numerous previous opportunities, Claimant and Continent SA disputed *for the first time* the civil damages claimed by ANAF (Respondent's Exhibit n°46). The 6th District Court rejected the arguments raised by Claimant and Continent SA, sentenced Claimant to prison for two years and ordered Claimant, Continent SA, and Ms. Doanta jointly to pay the profit tax and VAT liabilities identified in the December 2003 tax audit (Nistor Letter, ¶2.11). However, the conviction was overturned on appeal, the civil damages award was vacated, and the case was remanded for a new trial. The criminal prosecutor offered to drop the case in 2009, once the statute of limitations on criminal penalties had run. But Roussalis requested that the case proceed.

D. The Financial Guard imposed additional tax liabilities and penalties against Continent SRL based on a February 13, 2001 audit for the year 2000

446. During January and February 2001, the Bucharest Financial Guard conducted an audit at Continent SRL and established (i) additional tax liabilities due to the registration in the books of Continent SRL of forged invoices; (ii) delay penalties for failure to pay its taxes on time; and (iii) unpaid tax liabilities. The results of the audit were included in the minute n°11275/297/13.02.2001 (Respondent's Exhibit n°103). Continent SRL challenged the tax liabilities in proceedings before the Bucharest Court of Appeal.

447. In Decision 48/17.01.2002, the Bucharest Court of Appeal rejected Continent SRL's challenge, holding that *"the examination minutes and the decision issued by the Ministry of Public Finances are legal and, consequently the legal action brought by the plaintiff […] shall be rejected as having no legal grounds"* (Claimant's Exhibit n°44). In light of the pending criminal investigation of Claimant, the final appeal taken by Continent SRL against Decision n°48/17.01.2002 was suspended.

448. Given that Continent SA was designated as the party civilly liable in the criminal proceedings, ANAF did not include Continent SRL's outstanding liabilities in the civil damages requested on January 12, 2007. Respondent denies Claimant's allegation to the contrary.

IX. The taxes and penalties were assessed against Continent SA and included in the criminal judgment.

449. In judgment n°447/28.05.2007 (Respondent's Exhibit n°42), the 6th District Court of Bucharest found Claimant guilty of tax evasion and ordered him, together with Continent SA and Ms. Doanta, to pay RON 1.8 million (representing VAT) and RON 1.4 million (representing profit tax plus additional delay penalties).

X. The criminal court's judgment requiring Continent SA to pay damages has not been enforced

450. On June 6, 2007, Continent SA and Claimant appealed the decision of the 6th District Court, requesting the Bucharest Tribunal to vacate decision n°447/28.05.2007 (Respondent's Exhibits n°105 and 106). Pursuant to Article 370 of the Romanian Code of Criminal Procedure, the filing of this appeal suspended the enforcement of both the civil and criminal elements of the first decision. Eventually, the Criminal Court's decision was vacated on procedural grounds, and the retrial on these issues remains pending. Accordingly there is no obligation to pay the judgment at this time. The damages award is not yet final and has not been paid.

451. Claimant failed to appear at six consecutive hearings, causing further delay in the criminal proceedings (Public Hearing Minutes, Respondent's Exhibits n°109 to 114). However, Claimant was represented by counsel at five of the hearings.

452. If Claimant had come before the Romanian criminal court to defend against the charges of criminal tax fraud, the entire case – including ANAF's civil damages claim – could

have been resolved long ago. There is no merit to Claimant's argument that Romania is pursuing a double recovery through ANAF of tax liabilities from Continent SA. Indeed, the 2010 final judgment in the litigation over the December 2003 tax audit (Respondent's Exhibit n°211) allows the Tax Agency to enforce against Continent SA the established tax liabilities. If ANAF were to prevail on its civil damages claim, it would have the right to recover from Claimant and/or Continent SA any amount still to be owed at that time. As long as the 2010 judgment remains unsatisfied, it may be included in the civil damages claim of ANAF. If the 2010 judgment is paid by Continent SA, ANAF's claim would be reduced accordingly. That is not double recovery.

XI. The criminal case was not a pretense

453. Respondent contends that, even on the assumption that the Court did fail to comply with the strict summoning procedures, it would lack all credibility for Claimant to suggest that he was not in fact aware of the criminal proceedings. Therefore, if Claimant wanted to present evidence directly to the Criminal Court during the first instance criminal proceedings, he could have done so. He should not now be allowed to invoke his failure to participate in the proceedings as a reason for impugning the legitimacy of the proceedings.

454. Second, Claimant adduces no evidence in support of the suggestion that Respondent corrupted the first instance judge in the criminal proceedings in order to change the date of the final hearing.

455. Third, Respondent denies that Respondent exerted administrative pressure over the first instance judge, in order to obtain a "decision that could be used in the arbitration". Indeed, Respondent's first written submission in the arbitration proceedings was not at that time due until March 5, 2008 so it is clear that Respondent gained no material advantage as a result of the change in the final hearing date in the criminal proceedings from June 26, 2007 to May 28, 2007.

456. Finally, the Bucharest Tribunal did *not* find that Claimant is innocent of the charges of tax evasion brought against him. The Bucharest Tribunal overturned the decision of the first instance court on purely procedural grounds.

§ 2. THE LAW

I. ICSID tribunals have no jurisdiction to resolve tax disputes

457. Respondent submits that the Tribunal does not have jurisdiction over the tax disputes between Continent SA and the Romanian Tax Agency. Indeed, it is a *"universally accepted rule that public law cannot be extraterritorially enforced"* (F.A. Mann, "Conflict of Laws and Public Law", 132, *Recueil des Cours,* 1971). Nothing in the Treaty suggests that tax disputes come within the jurisdictional scope intended by the Contracting Parties, particularly where, as here, Claimant has not alleged that the tax laws applicable to Continent SA were somehow different from those applicable to similarly-situated companies or that the State took discriminatory measures of any kind against Continent SA.

458. The principle that tax laws are enforceable only in the place where they are imposed has led tribunals to decline jurisdiction over tax-related disputes.

459. In *Computer Sciences Corp. v. The Islamic Republic of Iran* (N°221-65-1, Award of April 16, 1986, 10 Iran-U.S. C.T.R. 269), the Iran-U.S. Claims Tribunal concluded that the tax claim fell beyond its jurisdiction because tax laws were not enforceable except by organs of the taxing State: "*Tax laws are manifestations of the jus imperii which may be exercised only within the borders of a state. In addition, revenue laws are typically enormously complex, so much so that their enforcement is frequently assigned to specialized courts or administrative agencies. For these reasons, actions to enforce tax laws are universally limited to their domestic forum"*.

460. The Iran-U.S. Claims Tribunal went on to hold that, any exception to the above customary rule must *"presuppose the clearest possible expression"* of the parties' intentions, which was nowhere to be found in the Claims Settlement Declaration on which its jurisdiction was premised. Here, because the Treaty likewise provides no such clear expression, the same conclusion is warranted.

461. The ICSID tribunal in *AMCO Asia v. Indonesia* (*op.cit.*) was faced with a counterclaim for alleged tax fraud on the part of the claimant. The claimant argued that tax fraud was not *"a legal dispute arising directly out of an investment,"* as required by Article 25(1) of the ICSID Convention, but was *"related only in the most indirect way to the investment."* The tribunal denied the tax claim on jurisdictional grounds, stating its reasons as follows*: "126. The obligation not to engage in tax fraud is clearly a general obligation of law in Indonesia. It was not specially contracted for in the investment agreement and does not arise directly out of the investment."* The rationale of *AMCO* is applicable here because, as in that case, no claim is actionable within the scope of the ICSID Convention unless it arises "*directly out of an investment."*

462. Respondent denies that these jurisdictional defects can be overcome with the allegation that the fiscal measures claim also arises under Article 1 of the First Additional Protocol to the European Convention.

463. First, Respondent submits that this article is not applicable to "investments" and, even assuming it is, the European Convention does not provide a jurisdictional platform for the work of the Tribunal. According to Respondent, the right to no deprivation of property granted under Article 1 of the First Additional Protocol is coextensive with the same rights accorded under Article 4(1) of the Treaty. Consequently, Article 1 of the First Additional Protocol does not create any additional obligations and therefore does not come within the jurisdiction of the Tribunal under Articles 2(6) or 10 of the Treaty, which commit the Contracting Parties to honor certain obligations they have made beyond the Treaty. In addition, the European Court of Human Rights was established to enforce Convention rights, and thus the Contracting Parties to the Treaty did not intend for ICSID tribunals to exercise jurisdiction over such claims.

464. Furthermore, Article 1 of the First Additional Protocol seems to indicate that it does not apply under the circumstances alleged here: "[P]*rovisions do not impair the right of*

States to adopt the laws they consider necessary ... in order to ensure the payment of taxes and other contributions, or of fines".

465. Finally, even if the Tribunal finds that it has subject matter jurisdiction to adjudge European Convention issues, previous decisions of the European Convention suggest that companies' shareholders do not have standing to bring claims as an indirect victim of losses sustained by the company as a result of alleged violations of Article 1 of the First Additional Protocol (*Agrotexim and Others v. Greece,* n°14807/89, 24 October 1995).

466. According to Respondent, Claimant's reliance on Article 6 of the European Convention is equally misplaced. That article protects persons with respect to judicial determinations regarding their civil rights and criminal charges brought against them. Continent SA's civil rights were not implicated by this tax claim, nor was Continent SA charged with criminal wrongdoing. Roussalis was criminally charged, but, as noted above, he did not deny that he was guilty of tax evasion. In any event, Claimant's personal rights do not arise "directly out of an investment" within the meaning of Article 25(1) of the ICSID Convention and fall outside the provisions of the Treaty, which protect "investments" not "investors."

467. For the foregoing reasons, Respondent submits that the Tribunal does not have jurisdiction over this tax claim.

II. Claimant failed to establish that the Fiscal Claim has merit

A. The expropriation claim has not been proved

468. Respondent refers to its previous developments to the effect that, Claimant has established no right of expropriation. Further, Continent SA has not paid any of the tax liabilities assessed against it and is challenging them in the Romanian courts. No international wrong can be made out against Respondent while the tax liabilities remain subject to review and have not been reduced to a final and irrevocable judgment. Indeed, "[i]*t would be absurd if measures later quashed by higher authority or a superior court could, for that reason, be said to have been arbitrary in the sense of international law*" (*United States of America v. Italy*, Judgment of 20 July 1989, 1989 ICJ LEXIS 3, ¶124, "ELSI").

469. Moreover, Claimant presented no evidence that any of the fiscal measures had any adverse impact on Claimant's or Continent SA's ability to freely use the assets and manage the business. The record shows that the sequestration orders did not, in fact, prevent Claimant from transferring ownership or divesting assets from Continent SA. The sequestration order was breached in 2006 by the sale for EURO 1 million of real estate owned by Continent SA (Claimant's Exhibit n°60). Further, Claimant continued to transfer millions of dollars of assets from Continent SA to his other companies. Since April 2006, all receivables of Continent SA were collected by Continent Frise Delicatesen, a company controlled by Claimant (Claimant's Exhibits n°215, 218). According to Respondent, millions of additional dollars were paid by Continent SA to Claimant's company Ozias, and to Claimant directly (*See* Claimant's Exhibit n°169).

B. Continent SA has not been deprived of any right to an equitable judgment by an independent and fair court

470. The award of civil damages against Continent SA as a civil party liable for taxes in the course of the criminal case against Claimant for tax evasion is a routine procedure under Romanian law. No violation of Continent SA's rights under international law or Romanian law arises from the use of this procedure.

471. According to *Mondev International Ltd. v. United States of America*, the applicable standard for a denial of justice is whether there was a *"willful disregard of due process of law ... which shocks, or at least surprises, a sense of judicial propriety*" (ICSID Case No. ARB, AF/99/2). Respondent asserts that no such defects can be ascribed to the Romanian court proceedings in this case. Indeed, Continent SA has prevailed in several tax disputes and has been accorded every right granted to taxpayers under Romanian law. Furthermore, the judgment is on appeal, tax liabilities are at issue in the appeal, and neither Claimant nor Continent SA has complained about improprieties in the appellate proceedings.

472. What is more, even assuming that Claimant had established such improprieties: "[I]*nternational law attaches state responsibility for juridical action only if it is shown that there was no reasonably available mechanism to correct the challenged action... States are held to an obligation to provide a fair and efficient system of justice, not to an undertaking that there will never be an instance of judicial misconduct*" (J. Paulsson, Denial of Justice in International Law, 2005, 100).

C. No "unjustifiable measures" result from the sequestration orders

473. Respondent denies Claimant's allegation that the Tax Agency's imposition of tax liens and initiation of enforcement proceedings were disproportionate and likely to affect his interest in Continent SA. Respondent submits that these assertions do not make out a claim under Article 2(2) of the Treaty.

474. Article 2(2) does not protect against potential *future* injury of the kind alleged by Claimant here. Rather, that article ensures that an investment "is not in any way ***impaired*** by unjustifiable . . . measures". The mere possibility that an act could "likely affect" the disposal of property at some indefinite time in the future is not sufficient.

475. By way of Ordinance 01123/18.10.2001 (Respondent's Exhibit n°115), the criminal investigatory body instituted a conservatory measure over Claimant's movable and immovable assets up to the value of ROL 24 Billion (approximately USD 780,000). This Ordinance was implemented by attaching the share capital of Continent SRL subscribed and paid by the Claimant in the amount of USD 360,000 (Respondent's Exhibit n°95). A comparison between the value stated to be guaranteed under the conservatory measure (USD 780,000) and the stated value of the share capital (USD 360,000) reveals that the measure was not disproportionate.

476. Respondent further denies Claimant's argument that the enforcement measures instituted by the tax authorities were disproportionate in relation to the value of the attached goods.

The accounting value of the sequestered assets amounted to ROL 38.9 illion (Respondent's Exhibit n°91), while the additional tax liabilities amounted to ROL 75.7 billion.

477. Furthermore, Claimant has, in fact, disposed of valuable assets of Continent SA, notwithstanding the conservatory measures (see above, ¶438).

478. Finally, Claimant admits that execution proceedings were suspended. Moreover, no bank accounts were seized and no other assets of Continent SA were taken.

D. Respondent did not prevent Continent SA from either challenging the Tax Assessment or from enjoying or disposing of his investment

479. Respondent denies Claimant's allegation that the Tax Court's decision to stay its tax enforcement case against Continent SA pending resolution of the criminal case – coupled with ANAF's inclusion of the assessed taxes in its claim for civil damages in the criminal prosecution – prevented Continent SA from challenging the tax liabilities before the *fiscal* courts for an undetermined period of time and thereby prevented Claimant from enjoying or disposing of his investment.

480. Respondent submits that, even after the suspension of the tax proceedings, Romanian law permitted Continent SA to challenge its tax liabilities before the Tax Court by appealing the suspension order and thereby reopening the Tax Court proceedings (Article 244 of the Romanian Civil Procedure Code). Continent SA chose not to do that. That was Claimant's decision and does not engage Romania's responsibilities under the Treaty or Article 6 of the European Convention.

481. Furthermore, Claimant has failed to provide any proof to support his claim that the alleged denial of Continent SA's right to challenge the tax liabilities before the Tax Court prevented him from enjoying or disposing of his investment in breach of Article 4 of the Treaty and Article 1 of Protocol 1 of the European Convention. In fact, Claimant's right to enjoy and dispose of his investment continues to be respected by Respondent. Claimant's has ongoing control of Continent SA and his ability to dispose of its assets at will. The tax liabilities in question are not the subject of any final judgment. Claimant has never been ordered to pay the taxes assessed against Continent SA. His Fiscal Claim is entirely speculative.

§3. DAMAGES

482. Respondent submits that Claimant's quantification of the damages evidences the baseless nature of this claim. First, he assumes that the Tax Agency will ultimately prevail and that Continent SA will have to pay the full amount of the tax liabilities assessed in the December 17, 2003 tax audit. Then, he assumes payment of the tax liability will be made on December 31, 2010. Next, he adds interest and penalties that will accumulate to December 31, 2010, assuming interest at .06 percent daily and penalties of .5 percent monthly, until paid. Finally, although he assumes he will prevail before the Tribunal on this claim (otherwise he would not be entitled to any damages), he also assumes that

Continent SA will pay the accrued tax bill on that date, which purportedly will correspond with the amount awarded to Claimant (Claimant's Exhibit n°53).

483. Respondent submits that such calculation is speculative. Speculative damages of this kind are not compensable in international arbitration: *"One of the best settled rules of the law of international responsibility of states is that no reparation for speculative damages or uncertain damages can be awarded"* (*Amoco International Finance Corporation v. The Government of the Islamic Republic of Iran*, Award No. 310-56-3, July 14, 1987, 15 Iran-U.S. C.T.R. 189, 1989). Any relief granted by the Tribunal for this claim should be awarded solely to reimburse tax payments actually made by Continent SA.

484. In any event, even if the claimed damages were recoverable, it is evident that any resulting loss would in reality be suffered by Continent SA. There is no legal basis upon which Claimant could legitimately seek to recover for a tax loss allegedly suffered by a nonparty to the arbitration proceedings.

485. Accordingly, no damages should be awarded for this claim in the unlikely event the Tribunal decides in favor or Claimant.

SUB-SECTION **III. DECISION OF THE ARBITRAL TRIBUNAL**

§1. JURISDICTION OVER THE FISCAL CLAIM

486. According to Respondent, ICSID tribunals have no jurisdiction to resolve tax disputes between Continent SA and the Romanian Tax Agency. These disputes do not come within the jurisdictional scope of the BIT, particularly where Claimant has not alleged that the tax laws applicable to Continent SA were discriminatory measures. The Fiscal Measure Claim is not actionable within the scope of the ICSID Convention because it does not arise "*directly out of an investment.*"

487. The Claimant's Counsel declared during the hearings that: "*we agree with the Respondent in that some issues are non-arbitrable before this Tribunal. Though (...), there are current debates as to the arbitratability* [sic.] *of tax before International Tribunals. (...) We are not asking this Tribunal to adjudicate the tax matters, to provide remedies to, to delve into the sovereign right to -- in terms of tax. Similarly, for the other alleged breaches of the Investment Treaty. We have to be clear, I think, at this stage, before the Tribunal; we are not expecting a remedy such as, "We agree that X tax was available on the principles of fiscal law". (...) There is jurisdiction under Article 25 of the ICSID Convention.*" (Transcript, Day 1, p.81, line 12 *et seq*.). And further: *"there are measures taken by the Romanian State by measures of its public institutions which affect the investment and the Investor. These are measures that in our opinion are violations, as many violations of the Bilateral Agreement. (...) The allegation of a violation of the Bilateral Agreement is prerequisite of the jurisdiction of the Arbitral Tribunal, and the claims that are formulated by the Claimant fulfil, or comply with this request. Because in relation to all the claims there are violations of the agreement by way of the administrative measures taken by the Romanian authority, our opinion is that the Tribunal is -- has got jurisdiction (...)"*(Transcript, Day 3, p.62, line 8 *et seq*.).

488. Claimant alleges that the controls carried out and the decisions taken by the Romanian Tax authorities were *inter alia* unfounded, illegal, abusive and tendentious; that the measures taken to enforce these decisions were disproportionate; that the inclusion of the tax issues in a criminal proceeding were abusive; and that he has been prevented from having his tax issues properly resolved. Claimant further submits that the sequestration of his assets against the background of an abusive taxation interfered with his right to dispose and reap the benefits of his investment. Accordingly, Claimant submits that the action of the tax authorities resulted in breaches of Articles 2(2) and 4(1) BIT.

489. Article 25(1) of the ICSID Convention requires a dispute to arise *"directly out of an investment"* to fall under ICSID jurisdiction. It follows that general measures of tax or economic policy not directly related to the investment, as opposed to measures specifically addressed to the operations of the business concerned, will normally fall outside the jurisdiction of the Centre.

490. On the other hand, previous arbitral awards have considered that: "[i]*t may well be, however, that in the context of the commitments assumed by the host State, "general" measures have a 'specific" effect in that they violate specific commitments. The expression "a dispute arising directly out of an investment" (Article 25 (1) of the ICSID Convention) cannot, therefore, be interpreted as meaning that the dispute can only result from a measure "directed to" the investment. The adverb "directly" is not related to the link between the measure and the investment but to that between the dispute and the investment*" (*El Paso Energy International Company v. Argentine Republic*, ICSID Case No. ARB/03/15, Decision on Jurisdiction, §97, *see also*, *GAMI v. Mexico*, UNCITRAL arbitration. ILM, Vol. 44, 2005, p. 545).

491. In the same vein, in its Decision on Objections to Jurisdiction of 17 July 2003 in *CMS Gas Transmission Co. v. Argentina* (ICSID case No. ARB/0I/8, ILM, Vol. 42, 2003, §33), the arbitral tribunal found that it was competent *"to examine whether specific measures affecting the Claimant's investment or general measures of economic policy having a direct bearing on such investment have been adopted in violation of legally binding commitments made to the investor."*

492. In this context, the nature of tax laws as public law that cannot be extraterritorially enforced is not relevant to determine if Claimant's Fiscal Measure Claim comes within the jurisdictional scope of the Tribunal. Indeed, in light of the claims presented by Claimant, the Tribunal will not have to make decisions applying general tax policies. The Tribunal will confine itself to establish in connection with the merits of the case whether the controls carried out and the decisions taken by the Romanian Tax Authorities violate the rights accorded to foreign investors under treaties.

493. In light of the above, the Tribunal considers that, among the matters falling within the scope of its jurisdiction are general measures taken by the host State in the exercise of its public powers, including decisions taken by tax authorities and courts, and actions taken by the State's authorities to enforce such decisions, which allegedly affect the investment in violation of the BIT.

494. The Tribunal therefore decides that it has jurisdiction to rule on the Claimant's Fiscal Claim.

495. The Arbitral Tribunal refers to paragraph 312 above in which it has decided that the application to the present case of Article 6 of the European Convention and of Article 1 of the First Additional Protocol to the latter is denied.

§2. MERITS

I. WAS THERE A BREACH OF THE FAIR AND EQUITABLE TREATMENT REQUIREMENT?

496. In its "Fiscal Claim," Claimant contends that Romania has violated the "Fair and Equitable Treatment" standard in Article 2(2) of the Treaty in a number of ways. The Claimant principally contends that:

- The control actions carried out by the tax authorities and the tax liabilities that were assessed by these tax authorities were harassing and deprived Claimant of its legitimate expectations as to the sale and disposal of Continent SA;

- He was prevented from having the tax litigation resolved because his challenge was suspended in light of the pending criminal investigation and because they were wrongfully integrated into criminal proceedings;

- He faced disproportionate sequestration orders.

497. The Tribunal will examine each of these claims separately.

1. The control actions carried out by the Tax Authorities and the tax liabilities

498. At the hearing, Mrs. Luciana Chivu, the senior auditor who handled the Tax Agency's 2003 audit of Continent SA, testified in relation to the procedure she followed and the basis for the conclusion in her report that the company owed USD 2.3 million in taxes and penalties. She confirmed that the audit was conducted in consultation with representatives of the company who were informed of her findings as she proceeded. Questions arose during the audit about undocumented tax deductions and the company was asked to provide supporting evidence. It failed to do so. In the course of the cross-examination, Claimant's Counsel failed to establish any procedural or substantive error in Mrs. Chivu's tax audit.

499. Claimant's Counsel also admitted at the hearing that the fiscal measures taken by Romania were lawful. He submitted that "*the facts that are measures of the Ministry are 3 such concrete facts, or deeds, but we are not going to analyze them, or we do not claim, we do not emit claims as to the fiscal obligations that derive from them. Some of them have been settled by the courts, by the law courts. For us, they are out of the question from the fiscal point of view*" (transcript, day 3, p. 65, lines 12-18).

500. Furthermore, Claimant did not dispute at the hearing the fact that the USD 780,000 tax liability he admitted in 2001 his company owed (Claimant's Rebuttal, Exhibit 27) remains unpaid.

501. Finally, the Tribunal notes that Continent SA litigated its challenge to the 2003 tax audit in Romanian courts and it lost at the Court of Appeals. Claimant did not assert any error in the final judgment at the hearing. It is also undisputed that those liabilities remain unpaid.

502. On the basis of the evidence, the Arbitral Tribunal is of the view that the controls and decisions of the Tax Authorities were consistent with common tax accounting principles, and consequently that none of them was arbitrary.

503. Each of the tax authorities' decisions was motivated. The tax authorities had legitimate concerns about the fulfillment of Claimant's tax obligations. Claimant did not present any convincing evidence that the control actions and the subsequent decisions of the tax authorities were aimed at harassing Claimant.

504. Romania's tax treatment appears to have been consistent with existing law. The tax authorities' decisions were taken in the proper exercise of the tax authorities' responsibilities. Claimant received notice of the decisions and had the opportunity to challenge the findings of the tax authorities before administrative bodies and eventually before impartial judicial courts.

505. The Tribunal considers that the State authorities acted in transparence and in a manner that cannot be considered arbitrary, unfair, unjust, discriminatory or lacking due process.

506. The Tribunal also considers that, under the circumstances, Claimant's argument that the tax authorities' behavior in conducting too numerous tax controls and assessing too severe and too many tax liabilities would amount to a failure to protect his legitimate expectations, is not justified. The tax regulations which led to the incriminated decisions existed and were enforceable by law at the time of the investment. Each of the controls and decisions was based on Romanian legal provisions. Moreover, Claimant could not reasonably have expected that the Romanian authorities would refrain from resolving reasonable concerns they might have concerning Claimant's fulfillment of its tax obligations.

507. The Tribunal therefore decides that the tax authorities' conduct was reasonable and adequate and did not breach the Fair and Equitable Treatment standard.

2. Prevention from having the tax litigation resolved because of the criminal proceedings

508. The Romanian Code of Criminal Procedure provides that a victim may claim civil damages during a criminal investigation or criminal prosecution. Therefore, the Ministry, through ANAF, elected to join the criminal proceedings in accordance with Romanian law.

509. In the Tribunal's view, Claimant has not submitted any convincing argument to support his claim that ANAF did not have the right to claim the full amount of the outstanding tax deficiencies as damages. The Romanian Procedural Code provides that the criminal court should render a judgment on the civil claim in the same decision as the one deciding on the criminal deeds. Claimant does not demonstrate that a decision of the criminal court granting ANAF's damage claim would lead to double recovery. Respondent has stated in this regard that if the judgment is paid by Continent SA, ANAF's claim would be reduced accordingly.

510. Moreover, Continent SA received notice of the indictment and had an opportunity to challenge it before the criminal court. The civil damages claim remains unresolved because Claimant abused the summons procedure and caused the delay of the criminal case in order to evade criminal jurisdiction. If he had come before the Romanian criminal court to defend against the charges of criminal tax fraud, the entire case, including ANAF's civil damages claim, could have been resolved long ago.

511. At the hearing, Ms. Scrobota, the former Deputy Legal Director of ANAF, appeared as a witness to answer questions about the May 2008 letter that she helped draft for ANAF's former Legal Director. As Ms. Scrobota comprehensively explained, this was a normal part of Romanian criminal procedure to recover unpaid taxes and penalties. Ms. Scrobota reported that Continent SA and Mr. Roussalis did not object to ANAF's claims and did not submit evidence or present a defense on the merits. She explained that Mr. Roussalis was convicted and sentenced to prison, and he and Continent SA were ordered to pay civil damages to ANAF. But the conviction was overturned on appeal, the civil damages award was vacated, and the case was remanded for a new trial. The criminal prosecutor offered to drop the case in 2009, once the statute of limitations on criminal penalties had run. But Mr. Roussalis requested that the case proceed (Transcripts, Day 3, p.148 *et seq*.).

512. Claimant's allegation that Respondent corrupted the first instance judge or exerted administrative pressure has been disputed by Respondent and is not supported by the record.

513. In conclusion, the Tribunal notes that Romanian courts and administrative procedures have been open to Claimant at all relevant times, Claimant has been successful in his efforts to have the first decision overturned and he had the opportunity to have the case heard on remand. Consequently, there appears to have been no denial of due process or denial of justice that would rise to the level of a violation of international law.

514. In light of the foregoing, the Tribunal decides that AVAS's decisions to join the criminal proceedings and the consequent effect of having the tax litigation becoming part of the latter did not breach the Fair and Equitable Treatment standard.

3. The allegedly disproportionate sequestration orders

515. On June 12, 2000, the police issued a sequestration order ordering "*the institution of sequestration of real goods/some goods up to the concurrence ...*" belonging to Continent SA concerning the fixed charges related to the company following an investigation for

tax fraud (Annex 6, Respondent's Rebuttal Documents). The company was ordered not to sell its real estate pending resolution of the criminal proceedings. It was standard procedure pursuant to the Romanian Code of Criminal Procedure. Claimant has not proved that this sequestration order was discriminatory, disproportionate or otherwise improper under Romanian law. In addition, Claimant never challenged the order as he could have done under Romanian law.

516. In a sworn declaration to the police dated August 8, 2001 (Claimant's Rebuttal, Exhibit n°27), Claimant admitted that he owed taxes and penalties totaling RON 23.32 billion (about USD 780,000). He agreed to pay that amount. In order to secure that tax debt, the police ordered Roussalis to maintain Continent SRL's share capital at the minimum level of USD 360,000 until the payment obligation was met (Respondent's Exhibit n°95 and 115). At the hearing, Claimant did not dispute the fact that he never paid any of the above amounts. He also failed to establish that the sequestration was unlawful or unjustified. Moreover, contrary to what Claimant alleged at the hearing, the record contains no evidence whatsoever of any order of seizure of Claimant's shares in SRL or his personal assets or any other property of Claimant's investment.

517. There is also no evidence that the above sequestration order had any effect on Claimant's investment. The November 30, 2001 police minutes record Claimant's declaration that the subscribed capital was deposited at Alpha Bank. Claimant presented no evidence that the USD 360,000 of share capital was on deposit when the sequestration order was issued. It would be justified to believe that as any other business, once Continent SRL's registered share capital was subscribed, it would have been transformed into working capital and used for the activities of the company, with the consequence that the 2001 sequestration did not have any adverse consequence on Continent SRL.

518. Finally, Claimant identified no defect in the 2003 tax audit by which the tax agency established that Continent SA owed additional taxes and penalties of about RON 7.5 million (over USD 2.3 million). The tax agency issued an order in 2004 to sequestrate certain real estate owned by Continent SA until those tax liabilities were paid (Respondent's Exh. 90). The value of the property sequestered was one half of the tax liability. Continent SA did not challenge the sequestration order. It only challenged the merits of the December 2003 tax audit.

519. Having reviewed the evidence and reasons which the Romanian authorities invoked in support of their sequestration orders, the Tribunal is of the view that these decisions were standard procedures pursuant to Article 163 of the Romanian Code of Criminal Procedure.

520. The sequestration orders were legitimate and not disproportionate. The Tribunal finds no breach of the Fair and Equitable Treatment requirement in Respondent's treatment of the investment in this regard.

II. WAS THERE A BREACH OF THE NON-IMPAIRMENT REQUIREMENT?

521. The Arbitral Tribunal considers that the controls carried out and the decisions taken by Respondent, including the sequestration orders, were not in any way discriminatory, for the reasons invoked above, and consequently did not violate the non-impairment standard of Article 2(2) of the BIT.

III. WAS THERE AN EXPROPRIATION OR A MEASURE THE EFFECTS OF WHICH WOULD BE TANTAMOUNT TO EXPROPRIATION?

522. Claimant articulates its expropriation claim as one of indirect expropriation. He argues that the illegal tax decision, the subsequent judicial proceedings and the enforcement procedures constitute an indirect expropriation of the investments because it deprived Claimant of his right to sell and/or dispose of the assets forming part of its investment. Claimant also suggests that these actions deprived the investment of its economic value.

523. The Tribunal has already dealt with this question above and came to the conclusion that Claimant was not deprived of the ownership of its investment, nor from its right to manage, control, use or enjoy its investment. Reference is therefore made to the Tribunal's decision at ¶354 and following.

524. In relation to the Fiscal Claim, it is undisputed that Continent SA has not paid the tax liabilities assessed against him. He is challenging the tax liabilities in the Romanian courts; they remain subject to review and have not been reduced to a final and irrevocable judgment yet. Therefore, Claimant has not proven an actual impairment of the economic value of his investment or that he would have been deprived of its enjoyment.

525. Moreover, the sequestration orders were all conservatory measures. No bank accounts were seized and no other assets of Continent SA were actually taken.

526. In light of the foregoing, the Tribunal decides that the State's actions invoked by Claimant under the "Fiscal Claim" - taken separately or altogether - did not breach Article 4(1) of the Treaty.

SECTION III. THE INTERDICTION CLAIM

SUB-SECTION I. CLAIMANT'S POSITION ON THE INTERDICTION CLAIM

§ 1. THE FACTS

A. The criminal proceedings

527. On May 18, 2001, the police initiated criminal proceedings against Spyridon Roussalis, the director of Continent SRL, and against Angela Doanta, for fraud, tax evasion, use of false documents, and instigation to commit forgery.

528. Claimant disputes Respondent's allegation that the criminal case was delayed because Claimant, having indicated a wrong address in Greece, could not be summoned. Indeed, Claimant was summoned at the same address for the criminal appeal.

529. As far as the findings in the criminal proceedings are concerned, Claimant points out that the criminal judgment n°447/28 of May 28, 2007 was quashed by the September 22, 2008 decision of the Bucharest Tribunal. Consequently, all the allegations and references made by Respondent on the basis of this judgment are groundless. The Bucharest Tribunal overturned the decision of the first instance court and sent the case back to the first instance court for retrial. The case is still pending. Claimant submits that it is unreasonable that a criminal case that started in 1999 and concerns the compliance of nine invoices should still be pending today. Claimant also refutes Respondent's allegation that Roussalis did not deny having committed tax evasion:

- First, a defendant is not obliged, under Romanian law, to confess or deny the charges brought against him in criminal proceedings, and even if a defendant confesses such charges, this should not be taken into account by the court.
- Second, Respondent's allegation is based on the written notes submitted by Continent SA. Claimant submits that Continent SA could not admit that the offenses had been perpetrated by another person, *i.e.* Roussalis.
- Third, Claimant did not choose to "merely" rely on a statute of limitations without also expressly denying the charges. Instead, Claimant alleged that the summons procedure was not properly complied with. According to Claimant, the procedure was conducted in violation of fundamental principles of Romanian Law such as the adversarial principle, the right to be heard and the non-mediation principle (see Article 289 of the Criminal Procedure Code). The breach of the above principles renders the decision an "absolute nullity".

530. Claimant further asserts that *"the entire criminal ... case was a pretense trial"* (Claimant's Reply Memorial, ¶298).

531. First, the evidence was presented indirectly through lawyers rather than directly by Claimant.

532. Second, Respondent exerted "administrative pressure" over the first instance judge handling the criminal case. The Bucharest Tribunal which quashed the first decision expressly stated that *"By examining the appealed sentence, the Court finds it to be null due to breach of the legal provisions regarding the summoning of the parties, (…), although the defendant Spyridon Roussalis has mentioned his residence address in Greece, the court did not summon him at this address for each hearing term, delivering the evidences alone – the hearing of five witnesses – at a hearing term when there was a lack of procedure with the defendant (…), there were breached the principles of verbal proceedings, nonmediation and contradictory principle, as well as the provisions regarding the hearing of the defendant (…). By all these breaches of norms of criminal procedures there were breached the right to a fair trial as mentioned also in art. 6 of the*

European Convention of Human Rights (…)" (*sic.*, Claimant's Reply Exhibit n°2). According to Claimant, *"Roussalis was subjected to legal and administrative harassment (…) which had as a result the fact that the normal usage of the attributes of the ownership rights over the investment cannot be enforced*" (*sic.*, Claimant's Reply Memorial, ¶299).

533. Third, Respondent's motive in exerting such administrative pressure over the first instance judge was to obtain a decision that could be used by Respondent in the arbitration. Claimant points out that the court issued its decision on May 28, 2007, immediately after the Arbitral Tribunal held its first hearing on May 4, 2007.

534. Finally, no expert reports were presented during these proceedings. The only expert report that was taken into consideration by the court was the one which was submitted by the Prosecutor, without being discussed at the hearing or checked by the court.

B. The prohibition on leaving the country

535. On July 31, 2001, the 6th District Police Department in Bucharest - Economic Financial Police Service requested the General Customs Police Inspectorate (both institutions being subordinate at that time to the Ministry of Internal Affairs) to order that the Border Police prohibit Claimant from leaving Romania until the criminal investigation was complete (Claimant's Exhibit n°54).

536. Claimant filed an objection to the 6th District Police Department's interdiction order with the Prosecutor's Office at the 6th District Court, under whose jurisdiction the criminal investigation was being conducted. The 6th District Prosecutor's Office granted Claimant's challenge and declared the order illegal.

537. On August 9, 2001, responsibility for the criminal investigation was transferred to the General Department of the Bucharest Police ("Bucharest Police") under the direction of the Prosecutor's Office at the Bucharest Court of Appeal (Claimant's Exhibit n° 56). According to Claimant, the administrative re-location of the file triggered the impossibility of enforcing the 6th District Prosecutor's Office ordinance which declared the administrative measure unlawful.

538. The Prosecutor's Office at the Bucharest Court of Appeal issued a new order prohibiting Roussalis from leaving the locality of Bucharest during the 30-day period from September 21, 2001 to October 20, 2001 (Claimant's Exhibit n° 57). This was done without the Prosecutor's approval.

539. On October 4, 2001, the Bucharest Police rejected Claimant's subsequent request that the interdiction order preventing him from leaving Romania be lifted on the ground that the September 21, 2001 order forbidding Claimant from leaving Bucharest until October 20, 2001 was still in place (Claimant's Exhibit n° 58).

540. Article 29(1) of Law 123/2001 provides that an alien may be forbidden from leaving the *country* only if it is established that the alien both has been accused of criminal wrongdoing and is subject to an order preventing him from leaving the *locality*.

541. On October 17, 2001, the Bucharest Police requested that the interdiction order remain in force, after October 20, 2001, until the completion of the criminal investigation.

542. On April 23, 2002, Claimant requested that the Ministry of Internal Affairs lift the interdiction order (Claimant's Exhibit n°59).

543. On April 30, 2002, Claimant argued that the interdiction order was illegal; he directed these arguments to the Administrative Court attached to the Court of Appeal in Bucharest (Claimant's Exhibit n° 60). On June 24, 2002, the Administrative Court cancelled the interdiction order preventing Claimant from leaving Romania (Claimant's Exhibit n°61).

544. Following that ruling, the Ministry of Internal Affairs informed Claimant that it would appeal this decision to the Supreme Court and that the interdiction order would remain in effect until the Supreme Court issued a final, irrevocable decision on the matter (Claimant's Exhibit n° 62). The Ministry of Internal Affairs thus challenged the decision before the Supreme Court. On February 11, 2003, the Supreme Court upheld the lower court's ruling that the interdiction order was illegal. The interdiction order was lifted, and Claimant was free to leave Romania as from February 12, 2003.

545. Claimant submits that the interdiction order, deemed unlawful by both the Court of Appeal in Bucharest and by the Supreme Court of Justice, violated Law 123/2001, the Romanian Constitution and Article 2(2) of Protocol 4 to the European Convention.

546. Claimant disputes Respondent's allegation that forbidden measures, declared illegal by the Romanian courts, may be justified by the fact that the police bodies acted on the basis of a routine. According to the Claimant, such an argument is contrary to the rule of law.

§ 2. THE LAW

547. In light of the foregoing, Claimant submits that Respondent has violated Article 2(2) of the Treaty.

548. According to Claimant, Continent SRL is a trade company established in Romania since 1997. Its main income is derived from import activities. However, since the State unlawfully barred Roussalis from leaving Romania for a period of almost two years, the import activity was blocked, affecting Claimant's right to administer his investment. Indeed, it prevented Continent SRL from obtaining income, the sole shareholder and managing director being Roussalis.

549. Claimant further submits that the Romanian authorities did act in breach of due process. The severity of the interdiction measures, the unnecessary length of the criminal proceedings and their obvious link to the SPA can only be understood as an attempt to regain Continent SA's assets and shares.

§ 3. DAMAGES

550. Claimant claims moral damages. He formulates the following request (Claimant's Memorial, ¶181): *"The requested compensation amounts as material and moral damages to be payed* [sic] *by the Respondent – the Romanian State is 25,000,000. USD"*.

SUB-SECTION II. RESPONDENT'S POSITION ON THE INTERDICTION CLAIM

§ 1. THE FACTS

551. On May 18, 2001, when criminal proceedings were formally commenced against Claimant, the 6th District Police reported that the Financial Guard had observed fraudulent conduct in Continent SA's accounting practices, *inter alia* in relation to the post-purchase investment, and the fraudulent avoidance of fiscal duties (Respondent's Exhibit n°78).

552. Law 123/2001 was adopted in April 2001 and became effective on May 3, 2001. Article 29(1) of Law 123/2001 provides that an *"alien shall not be permitted to leave the country"* under certain circumstances. Under part (b) of that article, for example, such an order may be issued if it can be established that the alien both has been accused of criminal wrongdoing and is subject to an order (issued by a magistrate) preventing him from leaving the locality.

553. On July 31, 2001, with the criminal investigation under way, the 6th District Police asked the Border Police to prevent Claimant from leaving Romania until the end of the criminal investigation (Claimant's Exhibit n°54).

554. Claimant filed an objection to the interdiction order with the Prosecutor's Office at the 6th District Court. Claimant complained that no order restricting him from leaving the locality had been issued, as Article 29(1)(b) required. On August 6, 2001, the Prosecutor's Office granted Claimant's challenge and informed both the Border Police and Claimant accordingly.

555. On August 9, 2001, responsibility for the criminal investigation was transferred to the General Department of the Bucharest Police ("Bucharest Police"). Claimant was notified of the transfer and, on August 21, 2001, he renewed his prior objection to the July 31, 2001 interdiction order with the Prosecutor's Office at the Bucharest Court of Appeal, informing the latter that the Prosecutor's Office at the 6th District Court had quashed the July 31, 2001 interdiction order (Respondent's Exhibit n°122).

556. On September 21, 2001, the Bucharest Police requested that the Prosecutor's Office prevent Claimant from leaving Bucharest in order to ensure the proper conduct of the criminal investigation (Respondent's Exhibit n°123).

557. The Prosecutor's Office at the Court of Appeal issued an order prohibiting Claimant from leaving the locality during the 30-day period from September 21, 2001 to October 20,

2001 (Claimant's Exhibit n°57). That office was authorized to issue such an order pursuant to Article 136(2) of the Criminal Procedure Code.

558. Claimant again requested that the July 31, 2001 interdiction order preventing him from leaving Romania be lifted, and, on October 4, 2001, the Bucharest Police rejected that request on the ground that the September 21, 2001 order forbidding Claimant from leaving Bucharest was still in place (Claimant's Exhibit n°58).

559. On October 17, 2001, the Bucharest Police requested that the interdiction order remain in force until the completion of the criminal investigation (Respondent's Exhibit n°126). The Border Police and the Prosecutor's Office at the Court of Appeal concluded that the interdiction order met the requirements of Law 123/2001 and could remain in effect until the conclusion of the criminal case (Respondent's Exhibits n°127 and 128).

560. Between February 2002 and April 2002, the Bucharest Police responded to three requests by Claimant to revoke the interdiction order. Each time, the Bucharest Police determined, after a review of the evidence obtained in the criminal investigation, that the interdiction order would remain in place until the conclusion of the criminal proceedings, in accordance with Law 123/2001 (Respondent's Exhibits n°129, 130, 131). In its February 6, 2002 response, the Bucharest Police advised Claimant to address further objections to the supervising case prosecutor or to the competent court (Respondent's Exhibit n°129).

561. On April 23, 2002, Claimant requested that the Ministry of Internal Affairs lift the interdiction order, claiming that it was excessive and unconstitutional, and had caused Claimant serious moral and material damage (Claimant's Exhibit n°59). One week later, Claimant argued that the interdiction order violated: (i) the Romanian Constitution; (ii) his right to free movement under Article 2 of Protocol 4 to the European Convention; and (iii) his right to perform contractual obligations under Article 1 of Protocol 4 to the European Convention. Claimant directed these arguments to the Administrative Court attached to the Court of Appeal in Bucharest (Claimant's Exhibit n°60, pp. 3-4).

562. On June 24, 2002, the Administrative Court cancelled the interdiction order preventing Claimant from leaving Romania on the ground that it did not satisfy the procedural requirements of Article 29(1)(b) of Law 123/2001 (Claimant's Exhibit n°61). Following that ruling, the Ministry of Internal Affairs appealed the decision. On February 11, 2003, the Supreme Court upheld the lower court's ruling that the interdiction order did not meet the requirements of Article 29(1)(b) of Law 123/2001. The interdiction order was lifted. Roussalis left the country around a month later, on March 9, 2003.

563. On May 14, 2003, Claimant was indicted for instigation to commit forgery, use of false documents in fraudulently substantiating Continent SRL's post-privatization obligation in Continent SA, and tax evasion (Claimant's Exhibit n°51). The criminal trial was delayed repeatedly because Claimant gave an erroneous address for his residence in Greece, as a result of which he could not be served with process in Greece. The criminal trial eventually started on November 20, 2006 (Nistor Letter at Att. K).

564. Claimant never appeared in person. On May 28, 2007, Claimant was convicted *in absentia* for tax evasion committed in conjunction with the fraudulent substantiation of Continent SRL's post-privatization investment obligation. The Criminal Court noted that Claimant *"eluded the legal search, tried to mislead the legal bodies* […] *during the criminal prosecution* [by saying] *that he did not know about the* […] *accounting records*, [and caused] *a high quantum of* […] *damage* [which] *he did not try to remedy* […] [instead,] *he left Romania*." Accordingly, the court imposed a sentence of two years in prison because it considered Claimant to be dangerous (Respondent's Exhibit n°42). Claimant appealed the conviction and the appellate court overturned the decision on procedural grounds.

§ 2. THE LAW

I. The Treaty does not confer subject matter jurisdiction for this claim

565. The Treaty provision on which Claimant relies only applies to *"investments by investors,"* not to the investors themselves (Treaty, Article 2(2)).

566. Moreover, Respondent submits that there is no jurisdiction under the Treaty if a dispute is not *"in relation to an investment"* and not somehow tangentially connected to the investment (Treaty, Article 9(1)). This requirement is reinforced by Article 25(1) of the ICSID Convention, which further limits the jurisdiction of the Tribunal to disputes that arise *"directly out of an investment."* Because this claim does not satisfy these jurisdictional requirements, it should be dismissed for lack of subject matter jurisdiction.

567. The linkage between the subject matter of the alleged fraud and the investment is not sufficient to establish jurisdiction for the Interdiction Claim. The ICSID Convention requires that disputes within the jurisdiction of the Centre must arise *directly* out of an investment. The facts that the underlying crimes of tax fraud and forgery for which Claimant initially was convicted were committed at the premises of Continent SA, and relate to his operation of the business, are not sufficient to meet that test. The interdiction order and Claimant's "interdiction claim" arise directly out of the application of Romanian criminal procedure law to him as an accused criminal; they do not arise directly out of his investment.

568. Respondent notes that the State imposed no restrictions on Claimant's activities in Romania and did not confine Claimant to the custody of the State. Rather, Claimant was free to do as he wished – on the sole exception that he could not leave the country and, for one month could not leave the locality of Bucharest, without permission. He was otherwise free to travel within Romania, conduct his business, and pursue personal interests.

569. In *Biloune v. Ghana Investments Centre* (Award of 27 October 1989 and 30 June 1990, XIX Yearbook Commercial Arbitration 11, 1994), the claimant, after being arrested and deported from Ghana, made a demand for arbitration, alleging that these actions interfered with his investment (a Ghanaian corporation in which the claimant was the principal shareholder). The claimant contended that because the deprivation of his human

rights, by detention and deportation, interfered with his investment, the dispute fell within the tribunal's jurisdiction. Rejecting this argument, the tribunal made clear that more is required than an act that merely touches the investment in some indirect way and decided that it "*lack*[ed] *jurisdiction to address, as an independent cause of action, a claim of violation of human rights."* This reasoning applies with equal force here.

570. According to Respondent, the interdiction claim arises out of domestic law and is not arbitrable before an ICSID tribunal. Indeed, in *Loewen v. United States of America,* ICSID Case No. ARB, AF/98/3, the ICSID tribunal dealt with a claimed denial of justice by a United States court. It distinguished between a right of action brought into existence by domestic law and enforceable through a domestic tribunal and a NAFTA treaty claim, which stems from public international law. The tribunal emphasized that "[t]*here is no warrant for transferring rules derived from private law into a field of international law where claimants are permitted for convenience to enforce what* [are] *in origin the rights of Party states*". Similarly, in this case there is nothing in Claimant's allegations that would justify the enforcement of his domestic law claim through ICSID.

II. The alleged wrongful conduct does not violate the "unjustifiable measures" clause

A. The burden of proof

571. Respondent submits that Claimant has the burden of demonstrating that his claim states a legally cognizable violation of the Treaty, and that claimant has failed to meet his burden.

572. Respondent points out that the standard of arbitrariness in the Romania-United States BIT was defined by another ICSID tribunal as *"something opposed to the rule of law …* [and] *a willful disregard of due process of law, an act which shocks, or at least surprises, a sense of juridical propriety."* (*Noble Ventures v. Romania*, ICSID Case No. ARB/01/11).

573. The standard also must accord with general principles of customary international law giving rise to state responsibility. Under those principles, mere violations of domestic law, without more, do not trigger state responsibility, as the United Nations codification of international law on this subject makes clear: *"Conduct, attributable to a state and causing injury to an alien, that violates the law of the state does not depart from the international standard of justice specified in section 165 merely by reason of such violation. Such conduct departs from the international standard only if it would depart therefrom in the absence of the state law"* (R. Ago, First Report on State Responsibility, *Yearbook of the Int.l Law Comm'n,* 1971, Vol. 2, 193-194).

B. The interdiction order does not constitute an "unjustifiable measure"

1. Preventing flight to avoid criminal prosecution promotes a rational public policy

574. Respondent submits that Claimant was under investigation for serious crimes. Because he was a citizen of Greece, there was a legitimate risk that Claimant might flee Romania and seek to avoid prosecution for these crimes. The interdiction order was issued to minimize that risk. Indeed, the concern that Claimant would avoid the criminal proceedings proved

to be well founded. After the interdiction order was lifted, Claimant left Romania and refused to participate further in the criminal proceedings.

575. Procedures for restricting persons suspected of serious crimes from fleeing the jurisdiction promote the public interest by helping to ensure that the criminal laws are enforced and that those accused of crimes remain subject to the jurisdiction of the courts so they can stand trial and, if convicted, serve their sentences.

576. Against this backdrop, the measure used in this case is not particularly intrusive and allowed Claimant to conduct his business and personal affairs, provided that he remained in the country. The interdiction order represented a reasonable balance between Claimant's risk of flight, on the one hand, and avoiding undue interference in his life, on the other.

2. The measure does not shock the conscience; it is defensible and can be justified in view of the unsettled and confusing state of the law at the time it was issued

577. Claimant complained that no order restricting him from leaving the *locality* had been issued, which in his view was required by Article 29(1)(b) of Law 123/2001 (see above, ¶554). The authorities later obtained such an order, and it remained in effect for 30 days (until October 20, 2001). Claimant then argued that the interdiction order against leaving the *country* also expired on October 20, 2001.

578. Romanian authorities objected that such a reading conflicted with the express terms of Article 30(b) of Law 123/2001, which permit aliens under an interdiction order to leave Romania only if they eventually are not charged with criminal wrongdoing, are acquitted, or the criminal investigation or trial is otherwise discontinued. Accordingly, the requirement of a pre-existing interdiction order restraining the individual from leaving the locality was a pre-condition only to the issuance of an interdiction order to leave the country. Respondent submits that this position was a reasonable attempt to harmonize the various ambiguous legal provisions involved.

579. In the end, the latter interpretation was not adopted by the Supreme Court. The Supreme Court held that the interdiction order was effective only when a valid order restricting Claimant's travel outside the locality was in force (Claimant's Exhibit n°61, p. 5). The Court thus interpreted the new law as having the effect of revoking the authority of magistrates to issue indefinite interdiction orders during the pendency of criminal investigations, a practice that was followed before the enactment of Law 123/2001.

580. Under these circumstances, the actions of the Romanian authorities cannot be said to "shock the conscience" on the ground that they are "indefensible or "incapable of being justified." It does not follow that the authorities acted unjustifiably merely because the courts reached a contrary decision. The issues raised by Claimant were unsettled under a statutory scheme that was new and susceptible to different reasonable interpretations.

<u>3. There is no violation of any international standards of justice that would trigger state responsibility</u>

581. A violation of domestic law does not trigger state responsibility unless the international standard of justice is violated as well. Respondent submits that Claimant identifies no principles of international law entitling him to relief for the alleged violation of Romanian law at issue.

582. Respondent further asserts that the interdiction order does not violate the international standard of justice. When the order was issued, Claimant had complete access to the Romanian courts, the order was quashed, and Claimant was allowed to leave the country. There can be no state responsibility under these circumstances. Indeed, *"it would be absurd if measures later quashed by higher authority or a superior court could … be said to have been arbitrary in the sense of international law"* (*ELSI, op.cit,* at 133).

§ 3. DAMAGES

I. Claimant has failed to prove both the existence and quantum of material damages

583. Respondent contests Claimant's argument that having fulfilled the USD 1.4 million investment obligations, Continent SRL would have resumed its import operations and thereby recouped the cost of its investment in Continent SA. Respondent further denies that the interdiction order prevented Continent SRL (of which he is the sole shareholder and director) from conducting income-earning activities.

584. Claimant presents no evidence to support the above assertions. Therefore, Respondent alleges that such plan to resume allegedly profitable import is fabricated by Claimant to drive up his damage demand. Respondent submits that the Tribunal may not award damages based on an undocumented, speculative, and unproven business venture.

585. Claimant similarly fails to establish that the supposed impairment to Continent SRL's business ventures was caused by the restriction on Claimant's travel outside Romania. Claimant neither identifies any negative impact, nor explains why it could not be mitigated or avoided altogether by Claimant conducting business from Romania or by using agents to conduct business outside Romania.

586. Respondent points out that the consensus of European legal systems is that proof of certain loss and causation is required before an award of damages will be made. However, the amount of material damages claimed has not been proven and Claimant has cited no accepted method of determining the quantum of damages.

II. Moral damages are not appropriate for this claim

587. Claimant also demands an unspecified amount of moral damages for this claim. Respondent submits that such a demand reveals the true purpose of this claim: to reward the investor for the personal deprivation Claimant attributes to the restriction on his travel, rather than to compensate for any damages allegedly sustained by the investment.

588. Because Claimant is not entitled to recover for any personal deprivation under the Treaty, he claims that Continent SRL was impaired so that he can recover moral damages on behalf of his investment. However, a corporation is not entitled to recover moral damages for business opportunities it supposedly lost as a consequence of restrictions imposed by the State. According to Respondent, the fact that Claimant seeks moral damages is a tacit admission that the business income allegedly lost by Continent SRL is purely speculative and cannot be quantified as compensable material damages, such as lost profits or lost business opportunities.

589. Respondent submits that the Tribunal should dismiss Claimant's speculative moral damages.

590. In any case, should the Tribunal conclude that Claimant is entitled to damages in his personal capacity for the restrictions imposed by the interdiction order, Respondent points out that moral damages are reserved for cases of extreme infliction of distress, often involving severe physical abuse of some kind. However, no such instances of physical violation of the investment or of its personnel and assets are implicated in this case. As explained above, Claimant was not held in custody.

591. Finally, under Romanian law, damages against the State arising out of errors such as those alleged by Claimant are governed by Article 504 of the Code of Criminal Procedure which provides as follows: "*Any person who was finally convicted is entitled to obtain compensation from the state, if after the case's retrial, the final decision provides that the action was not perpetrated by that person or the action does not exist.*" Accordingly, under Article 504 of the Criminal Procedure Code, as in force at the time, damages were available only if defendant was acquitted or the criminal investigation was closed without charges being brought. Claimant, of course, was charged and ultimately convicted. In this regard, Respondent points out that Claimant's first instance conviction for tax evasion provides *prima facie* evidence that the measures impugned by Claimant in his Fiscal Claim were in fact fully justified. On September 22, 2008, the Bucharest Tribunal quashed Claimant's and Continent SA's criminal convictions on purely procedural grounds without directly challenging any of the conclusions reached by the first instance court. Accordingly, Claimant is not entitled to damages under Article 504 of the Criminal Code for the Border Police's enforcement of the interdiction order.

592. In light of the foregoing, Claimant's claim based on the interdiction order should be denied.

SUB-SECTION **III. DECISION OF THE TRIBUNAL**

§1. JURISDICTION OVER THE INTERDICTION CLAIM

593. According to Respondent, the tribunal has no jurisdiction over the Interdiction Claim because the Treaty violation on which Claimant relies only applies to "*investments by investors,*" not to the investors themselves (Treaty, Article 2(2)).

594. The Interdiction Claim is actually based on a violation by the State of its Treaty obligations who arguably harmed its investment. The Tribunal considers that it is

therefore irrelevant that the conduct which allegedly harmed the investment in violation of the Treaty was directed against the director of the business, which is also the investor.

595. Respondent further submits that there is no jurisdiction under the Treaty if a dispute is not *"in relation to an investment"* (Treaty, Article 9(1)) and does not arise *"directly out of an investment"* (Article 25(1) of the ICSID Convention). Respondent argues that the measures alleged by Claimant are not specifically related to his investment. They are measures arising out of the application of the Romanian procedure law generally applicable to those who are convicted of tax fraud or forgery crimes.

596. According to Claimant, on the other hand, the illegal interdiction orders forbid Roussalis, who was running the business, to leave the country and travel for about two years, preventing the investment to be properly managed. This allegedly adversely impacted on the investment in violation of Article 2(2) of the Treaty.

597. The Tribunal considers, in light of the foregoing, that what is at stake in Roussalis' Interdiction Claim is the specific negative impact of the measure on the investment, in violation of the BIT.

598. Respondent also submits that Claimant, in his Interdiction Claim, is asking for the enforcement of a domestic law claim through ICSID. However, a claim arising out of domestic law is not arbitrable before an ICSID tribunal.

599. In this regard, the Tribunal agrees with the ICSID tribunal's finding in *Continental Casualty Company v. Argentine Republic*, ICSID Case No. ARB/03/9, Decision on Jurisdiction, February 22, 2006, ¶68): *"alleged violation of domestic laws* [by the host State] *would not give rise* per se *to an international claim cognizable by the present ICSID Tribunal in the absence of an allegation that the BIT has been thereby breached* [by the host State]. *It will be of course for the merits to determine whether such breaches have indeed taken place to the prejudice of the protection to which the Claimant, as a U.S. investor, is entitled under the treaty. In the Tribunal's view, these indications set forth in detail by the Claimant allow the Tribunal to conclude that the Claimant has made legal claims against* [the host State], *so that the Tribunal is presented with a legal dispute within its jurisdiction*."

600. Claimant is indeed alleging that Respondent's illegal decisions to prohibit Roussalis from leaving the municipality or country have breached the BIT. Therefore, the Tribunal considers that the Claimant has made legal claims against the host State, so that the Tribunal is presented with a legal dispute within its jurisdiction.

601. In light of the foregoing, the Tribunal decides that it has jurisdiction to rule on the Claimant's Interdiction Claim.

§2. Merits

I. Length of the criminal proceedings

602. The criminal proceedings lasted for more than ten years. The Tribunal acknowledges that undue delay to rule on a dispute may amount to a denial of justice. Ten years is a significant period, but a long delay does not automatically result in a breach of due process. The Tribunal must also consider evidence regarding the reasons for the delay to determine whether it was undue.

603. In light of the evidence, the Tribunal notes that:

- The whole situation, and the criminal case in particular, were rather complex;

- The significance of the interests at stake in the case was large,

- The criminal court noted that Claimant was not cooperative, he *"eluded the legal search, tried to mislead the legal bodies* […] *during the criminal prosecution* [by saying] *that he did not know about the* […] *accounting records*, [and caused] *a high quantum of* […] *damage* [which] *he did not try to remedy* […] [instead,] *he left Romania* (Respondent's Exhibit n°42, p. 6).

- The ten years proceedings include the court's first judgment which was rendered in April 2007, the decision vacating the civil damages award on appeal, and the conduct of a new trial on remand. The criminal prosecutor offered to drop the case in 2009, once the statute of limitations on criminal penalties had run. But Claimant requested that the case proceed.

604. In light of all such circumstances, the Tribunal comes to the conclusion that the delay in issuing a final ruling did not exceed the threshold of reasonableness.

605. The Tribunal is further convinced that the criminal proceedings were not a "pretense trial." The record shows that they concerned alleged fraudulent conduct in Continent SA's accounting practices, *inter alia* in relation to the post-purchase investment and the fraudulent avoidance of fiscal duties.

II. Severity of the interdiction measures

606. Regarding the underlying policy permitting the issuance of the interdiction orders, the Tribunal notes that such policies are commonplace in many countries and promote the rational public policy of preventing the accused of fleeing the country in avoidance of criminal prosecution.

607. The interdiction orders were motivated. The record shows that the orders were communicated to Claimant and he had an opportunity to contest them. Indeed, the orders were challenged and were ultimately lifted. And Claimant finally left the country.

608. The Tribunal considers that the fact that the interdiction order was lifted does not mean that the orders were arbitrary or not reasonable. In any case, an "erroneous judgment" by a court would not violate the Treaty in the absence of a denial of justice, that is, a violation of due process.

609. In light of the above, the tribunal considers that the temporary restriction order did not amount to a denial of due process or to unfair, inequitable, unjustifiable or discriminatory treatment in violation of Article 2(2) of the Treaty; or to a breach of the full protection and security standard, as there has been no allegation that the temporary interdiction order compromised the physical integrity of Claimant's investment against interference by use of force.

610. In light of the foregoing, the Tribunal decides that the State's behavior actions invoked by Claimant under the "Interdiction Claim" did not breach Article 2(2) of the Treaty.

SECTION IV. THE FOOD AND SAFETY CLAIM

SUB-SECTION I. CLAIMANT'S POSITION ON THE FOOD AND SAFETY CLAIM

§ 1. THE FACTS

I. The FSD Order regarding the interdiction to carry out the activities, n°57/06.05.2005

611. According to Claimant, Romania became obliged to implement Regulation n°852/2004/CE, concerning foodstuff hygiene, only after having joined the European Union in 2007. Accordingly, contrary to Respondent's submission, food and safety regulations were not introduced in Romania in order to transpose EU Directives for public health purposes. Rather, such regulations were introduced in order to impose tariffs and levy taxes.

612. Continent SA is the owner of food outlets and a refrigerated food warehouse in Bucharest, which it rents to retail and wholesale sellers of food products.

613. On December 10, 2003, Continent SA obtained a permit (A.S.V n°71832/10.12.2003) from the FSD[8], to operate its refrigerated food warehouse.

614. On May 6, 2005, FSD issued Order n°57/06.05.2005 prohibiting Continent SA from operating its refrigerated warehouse until Continent SA obtained a new operating permit. Continent SA was prohibited from carrying out its reception, storage and delivery activities in relation to frozen and refrigerated products (Claimant's Exhibit n°63).

615. Continent SA objected to the suspension of its permit and filed an administrative challenge seeking cancellation of the FSD order. FSD answered that: *"Ordinance no.*

[8] "FSD" (or "DSVSAB") is the Sanitary-Veterinary and Food Safety Directorate of Bucharest – Food Safety Department sub-unit with jurisdiction over the city of Bucharest. Its tasks include inspections of commercial operators in the food industry and sanitary-veterinary and food safety assistance.

57/06.05.2005 on forbidding carrying the activities of taking-over, warehousing and delivery of frozen and refrigerated products does not refer as an administrative deed in terms of administrative contentious" (Claimant's Exhibit n°64).

616. In parallel with the above challenge, Claimant sought a re-authorization and obtained a new operating permit from FSD (A.S.V. n°103/29.06.2005).

617. On February 1, 2006, the Bucharest Court cancelled the FSD's May 6, 2005 order n°57/06.05.2005. Claimant submits that the court, by cancelling the Order, confirmed the fact that it was abusive and that Continent SA had fulfilled the sanitary and veterinary conditions to carry out its activity.

618. Claimant contends that the measure ordered by FSD in its order n°57/06.05.2005 was meant to deliberately block the economic activity of the company. Indeed, CSVSA[9] issued an "informative note" n°4042/17.06.2005 to this effect (Claimant's Exhibit n°66). This notified economic agents about the measure and forbid them to accept products of animal origin coming from Continent SA and 34 other trade companies.

619. Claimant asserts that the impact of this informative note was huge. It *"gave a direct blow to the commercial relationships, by an administrative, abusive and tendentious measure, (Ordinance 57/2005), which was cancelled by a court order (judgment 572/01.02.2006)"* (Claimant's Memorial, ¶187). Indeed, more that 95% of income realized by Continent SA came from activities carried out at the refrigerating warehouses and food outlets.

<u>II. The FSD Order regarding the provisional cancellation of activity n°45/06.03.2006</u>

620. Claimant submits that the MAPDR[10] and the ANSVSA[11] are competent to issue normative acts in relation to the organization of the sanitary veterinary activity and to the food safety activity. However, there is no regulation establishing the technical conditions for the functioning of refrigerating warehouses. Therefore, there is no objective criterion for the assessment of an authorization.

621. On its own initiative, Continent SA decided to restructure, re-arrange and modernize the space dedicated to the wholesale and retail trade of animal food products, before December 2006. This program was approved by the FSD.

622. In good faith, Continent SA notified its intention to terminate the works in December 2007. Continent SA explained that the delay was due to a shortage of funds preventing

---

[9] CSVSA is the Local Food Safety Department office, with jurisdiction over a particular administrative area of Bucharest.

[10] The MAPDR is the Ministry of Agriculture, Forests and Rural Development: the central public authority having competences in the sanitary veterinary domain and in the food safety domain.

[11] The ANSVSA is the National Sanitary-Veterinary and Food Safety Authority ("Food Safety Department"), a government agency, part of the Ministry of Agriculture. Its tasks include promulgation of sanitary-veterinary and food safety regulations.

the investments being made, as well as adverse climatic conditions preventing the performance of construction works (Claimant's Exhibit n°67).

623. Following the notification, the FSD conducted an inspection on March 3, 2006. The inspectors confirmed Continent SA's failure to execute the modernization works in accordance with the initial schedule (minutes n°745/03.03.2006, Claimant's Exhibit n°68). Consequently, for the second time, the FSD suspended Continent SA's operating permit pending completion of the modernization works stipulated in the modernization program. FSD issued order n°45/06.03.2006 regarding the "provisional cancellation of activity." All the reception, storage and delivery activities involving frozen and/or refrigerated products were provisionally prohibited.

624. Continent SA challenged the suspension of its permit by filing an administrative action before the Bucharest Court of Law on June 5, 2006. The court did not issue a decision on the merits but ruled against Continent SA on procedural grounds (Claimant's Exhibit n°70). Continent SA appealed that decision.

625. Claimant contends that, whereas Continent SA was not in breach of any special regulation, it was severely sanctioned for its partial failure to make an investment. The provisional cancellation pending fulfillment of the investment schedule was an unjustified measure, aimed at prejudicing the company by depriving it of its primary income. Indeed, such measure deprived Claimant of its right to use its investment.

626. Claimant further points out that a number of privately owned enterprises were allowed to operate in the same building as Continent SA, while Continent SA's permit was suspended. The witness evidence confirms that Continent SA received discriminatory treatment in relation to other traders on the same premises (Transcript, Day 4, pp. 116-117).

627. The witnesses at the hearing confirmed that Continent SA had not been trading illegally without a license:

"Mr. Bajan: In the numerous Inspections that were performed ever since 2006, by verification of the traders, of the trade companies which operate by verifying the origin and the quality of products that are sold within the precinct have you ever found commodities, or goods, belonging to Continent SA that Continent SA should have been trading in their own name?

Mrs Dulgheria [head of the veterinary service for hygiene and public health for Bucharest]: *No."* (Transcript, Day 4, pp. 116-117).

628. Claimant disputes the testimony given by representatives of the food safety department to the effect that they did not encounter any company except Continent SA that did not comply with the alleged regulations (Transcript, Day 4, page 107). According to Claimant, this is due to the fact that Romania's agents specifically targeted Roussalis's investment in order to eventually force him to abandon it.

III. Continent SA did not require a permit in order to operate its refrigerated warehouse facility after the abrogation of Order 139/2004

629. Claimant asserts that Continent SA did not require a permit to operate its cold storage warehouse after the abrogation of Order 139/2004. Therefore, Continent SA legally operated its refrigerated food warehouse without a valid operating permit.

630. Indeed, Orders 276/2006 and 301/2006 – which replaced the abrogated Order 139/2004 beginning December 29, 2006 – only required *producers* of foodstuffs of animal origin to obtain a permit. Since Continent SA is not a foodstuff producer, the FSD measures were illegal, unjustified and impaired Claimant's right to use his investment.

§ 2. THE LAW

631. Claimant submits that Respondent violated Article 2(2) of the Treaty. According to Claimant, the series of measures and orders taken by FSD, including banning activities in the premises and the refrigeration warehouses, triggered the closure of the warehouses and consequently blocked the company's economic activity. Such unjustified measures affected the functioning of Continent SA and impaired the Claimant's right to use the investment. The removal of the license to perform the trade activity also deprived Claimant of its rights and legitimate expectations as to the sale and disposal of Continent SA's assets.

632. Moreover, permits and licenses held by foreign investors are considered protected investments. Therefore, measures taken against such investments such as Government controls, indirect seizure of licenses or cessation of permits or licenses, whether or not of direct benefit to the State, is a matter for referral to an international tribunal in case there is evidence that the removal was somehow unjustifiable and/or discriminatory.

§3. DAMAGES

633. Claimant submits that *"for the investor, sources of the moral prejudice are the elements affecting the company's reputation, bringing uncertainty upon the planning of its decisions, producing anomalies in the company's administration, producing a state of distress and unpleasant situations to the company's administrators"* (Claimant's Memorial, §197).

634. The uncertain status of Continent SA's investments led to anomalies in the planning of its decisions regarding its economic activities, and "unpleasant situations" in relation to other companies. Claimant also alleges that the reputation of Continent SA was affected.

635. Claimant formulates the following request: *"Moral damage is quantified as amounting to USD 5,000,000 and we request to be payed* [sic] *by the Respondent – Romanian State"* (Claimant's Memorial, ¶198).

<u>SUB-SECTION **II. RESPONDENT'S POSITION ON THE FOOD SAFETY CLAIM**</u>

<u>§1. THE FACTS</u>

<u>I. Prior to Romania's accession to the EU (January 1, 2007), Romania's Food Safety Regulations were updated to conform to EU standards</u>

636. Romanian law requires that all businesses connected to the food industry in Romania (including operators of refrigerated food warehouses, such as Continent SA) comply with the food safety regulations, including those promulgated by the National Sanitary Veterinary and Food Safety Authority ("NSVFSA"), the public authority entitled to transpose into national legislation EU Directives on food safety. This legislation is intended to protect public health (Declaration of Alexandrina Stoica, "Stoica Decl.", ¶3.2, Respondent's Exhibit n°139).

637. On December 10, 2003, Continent SA obtained a permit (n°71832) from the FSD, a subsection of the NSVFSA, to operate its refrigerated food warehouse in compliance with the food safety regulations in force at that time.

638. With Romania's impending accession to the European Union, Romania's food safety regulations were updated to comply with EU standards (*see* EU Accession Partnership with Romania that required Romania to bring its regulations, including those dealing with Food Safety, in line with EU standards before accession, Council Decision 98/261/EC of March 30, 1998, Official Journal of the European Communities, L 121 of April 23, 1998; this Accession Partnership was subsequently amended in December 1999, January 2002 and May 2003).

639. In their 2003 Regular Report, the EU Commission stated that: *"[a]s regards food safety and foodstuffs legislation the majority of the transposed vertical foodstuff directives entered into force in September 2002 … In the area of food safety, Romania has transposed legislation setting the general principles for official control of foodstuffs, foodstuff hygiene, including the introduction of HACCP (hazard analysis and critical control points), and good laboratory practices."* Accordingly, Claimant's contention that that neither EU law nor Romanian law established technical standards regarding the building and functioning of refrigerated warehouse facilities, and that conformity of such facilities was determined at the whim of the NSVFSA, does not stand.

640. In 2004, the NSVFSA issued Order n°139/2004 providing that, by June 30, 2006, it would inspect all permit holders and re-authorize only those that were in compliance with the new regulations. A noncompliant operator could, however, avoid having its permit revoked if it had obtained – prior to the inspection – the approval of the local subsection of the NSVFSA for a modernization plan that ensured full compliance with the regulations by December 31, 2006.

641. Article 7, paragraph 5 of Order n°139/2004 required permit holders to comply with certain general hygiene requirements even if they were in the process of implementing a modernization plan. Failure to so comply was sufficient reason to shut down an operator.

Operators of refrigerated food warehouses that did not bring their facilities into full compliance with the new regulations were shut down.

II. Continent SA did not comply with Romania's updated food safety standards and its permit to operate a refrigerated warehouse was revoked

642. The FSD inspected Continent SA's facilities on March 29, 2005. The inspectors found that Continent SA's refrigerated warehouse was not in compliance with the food safety regulations. Continent SA's General Director, Mr. Horia Cornaciu, signed and stamped the report adding the handwritten words *"with objections*" and "*immediate action shall be taken to remedy the deficiencies"* (Minutes n°1325/29.03.2005, Respondent's Exhibit n°142; see also, Declaration of Maria Dulgheriu, "Dulgheriu Decl.", Respondent's Exhibit n°140). The inspection report details approximately eighteen specific deficiencies in Continent SA's facility including: no hot water; broken taps; missing temperature control devices; moldy walls; cracked and dirty floors; meat deposited on rotten wooden pallets; frozen meat displayed out of its packaging; and no locker rooms for specialized personnel.

643. On March 30, 2005, as a result of the inspectors' findings, the FSD temporary suspended Continent SA's permit (Ordinance n°36).

644. On March 30, 2005, one day after the first inspection, Continent SA requested that the FSD re-inspect its facilities (Respondent's Exhibit n°143). On April 5, 2005, FSD inspectors conducted the re-inspection and found that the refrigerated warehouse still was not in compliance with the regulations (Respondent's Exhibit n°139). The inspectors recorded the remaining deficiencies in their re-inspection report, which was signed by Continent SA's General Director, who added a handwritten note agreeing that Continent SA would *"ensure* [that] *compliance with the hygiene rules shall be continued and finalized*" (Respondent's Exhibits n°139 and141).

645. On April 18, 2005, upon receiving from Continent SA another re-inspection request, FSD inspectors re-inspected Continent SA. They found that Continent SA still was not in compliance with regulations regarding the handling of products of animal origin or regulations concerning storage temperature restrictions. The inspection report n°2651, dated April 18, 2005**,** was again signed and stamped by Mr. Cornaciu (Respondent's Exhibit n°139). The FSD decided to maintain the temporary suspension in place, but Continent SA was given another opportunity to cure the deficiencies.

646. After receiving a further re-inspection request from Continent SA on April, 20 2005, FSD inspectors performed a re-inspection on May 6, 2005. They concluded that Continent SA's refrigerated facilities again failed to meet regulatory standards (Minutes n°2062, Respondent's Exhibit n°140). The company inexplicably refused to participate in the inspection or sign the report.

647. Based on Continent SA's repeated failure to bring its facilities into compliance with the food safety regulations**,** the FSD issued Order n°57/06.05.2005 on May 6, 2005,

prohibiting Continent SA from operating its refrigerated warehouse effective May 11, 2005, until Continent SA obtained a new operating permit (Respondent's Exhibit n°140).

648. On June 22, 2005, Continent SA objected to the suspension of its permit. It filed an administrative challenge seeking cancellation of the order (petition n°164/2005, Respondent's Exhibit n°144). Under the requirements of the NSVFSA Order n°139/2004, noncompliant permit holders, such as Continent SA, were not entitled to continue their operations until June 30, 2006 without an FSD approved modernization and restructuring program in place.

649. On June 13, 2005, Continent SA submitted a petition to the FSD seeking renewal of its operating permit based on the submission of modernization plan n°19997/13.06.2005. Continent SA's modernization plan recognized the existence of the deficiencies identified by the FSD and detailed how Continent SA would bring its refrigerated warehouse into compliance by December 31, 2006 (Dulgheriu Decl., Att. G). The modernization plan set out certain key items for each deficiency previously reported by the FSD. Respondent points out that the modernization plan included references to the legal source of each technical requirement. This contradicts Claimant's unsupported and baseless assertions that: (i) the regulations failed to make clear the technical requirements to be met by operators of refrigerated food warehouses; and (ii) no objective criteria clearly established how FSD would assess the conditions at Continent SA.

650. The modernization plan was approved by a commission of four inspectors, including Ms. Dulgheriu and Ms. Stoica, on June 27, 2005 (Dulgheriu Decl. ¶4.2 and Att. G; Stoica Decl. §5.2). The FSD's approval official report covered all of the elements of the modernization plan, including FSD's expectation that the interim deadlines (to cure the deficiencies) in the modernization plan would be met.

651. Following approval of the modernization plan, the FSD issued a new operating permit to Continent SA (A.S.V. n°103/29.06.2005), which was subject to the same requirements as the modernization plan approved several days earlier (Dulgheriu Decl. §4.3).

652. On February 1, 2006, eight months after Continent SA had obtained a new operating permit based on the modernization plan, the Bucharest Court of Law cancelled the FSD's order of May 6, 2005 (which had not been in force since June 29, 2005 when a new permit was issued to Continent SA). The court did not find that Continent SA was in compliance with the regulations. It held that the approval of the modernization plan in June 2005 constituted a change in circumstances after the revocation of the May 6, 2005 permit, entitling Continent SA to continue its operations (Respondent's Exhibit n°145).

653. On February 2, 2006, one day after the court cancelled the superseded order, Continent SA wrote to the FSD seeking relief from the interim deadlines in the modernization plan asking that all the interim deadlines be extended to the final completion date of December 31, 2006. Continent SA based its request on alleged financial constraints, which were neither explained nor substantiated, and on *"winter weather"* (Respondent's Exhibit n°148). Respondent submits that this explanation for failure to timely perform its obligations is at odds with the minutes of Continent SA shareholders' meeting April 29,

2005 (Respondent's Exhibit n°149). The minutes stress the urgency of implementing the plan, and the approved estimated budgets denote the availability of funds for completion of the modernization plan in advance of the plan's submission. Moreover, the alleged financial constraints are also at odds with two management reports (Respondent's Exhibits n°150 and 151) indicating that RON 1.3 million, in 2005, and RON 1.7 million, in 2006, was available for the company's modernization plan.

654. In the light of the interim deadline of February 28, 2006 set out in Continent SA's modernization plan, FSD inspectors conducted a follow-up inspection. This revealed that none of the planned improvements scheduled for completion prior to that date had been implemented (Dulgheriu Decl. §5.1). Mr. Horia Cornaciu signed a copy of the inspection report (Dulgheriu Decl., Att. I).

655. On March 6, 2006, the FSD suspended Continent SA's operating permit A.S.V. n° 103/20.06.2005 for failure to meet the implementation milestones set out in the approved modernization plan. The suspension order provided that Continent SA's permit could be restored if and when the improvements required under the modernization plan were completed.

656. Respondent points out that Continent SA has continued to operate its refrigerated food warehouse despite the FSD's suspension order. Moreover, Continent SA defied the FSD order by renting out space at its refrigerated warehouse to other commercial entities in the period after the suspension of its permit (Dulgheriu Decl., Att. J).

657. Although Claimant filed this arbitration with ICSID in January 2006, Continent SA challenged the March 6, 2006 suspension of its permit by filing an administrative action in the Bucharest Court of Law on June 5, 2006. The court ruled against Continent SA on procedural grounds. Continent SA appealed the decision. On January 31, 2008, the appellate court granted Continent SA's request to remand the case for a trial on the merits. On January 23, 2009, the Bucharest Tribunal dismissed Continent SA's challenge to the order dated March 6, 2006 on the following grounds: (1) Continent SA admitted that it had not complied with the interim deadlines or with its other obligations under the modernization plan; (2) Continent SA's permit to operate the refrigerated warehouse was subject to the observance and completion of the modernization plan; (3) Continent SA failed to comply with the modernization plan despite numerous inspections and written notices from FSD; (4) the alleged financial constraints invoked by Continent SA have not been proven, and the winter weather could not possibly have prevented Continent SA from executing the works because the modernization plan required mainly indoor works; (5) Continent SA's purported good faith has not been proven, since it has done nothing at any stage to remedy the deficiencies identified in the modernization plan.

658. Indeed, inspections performed by the FSD on February 7, 2008 and April 25, 2008 confirmed that Continent SA had still not completed the work required under the modernization plan, and food safety conditions in the warehouse had deteriorated (Respondent's Exhibits n°154-159). Further, Continent SA continued to operate its refrigerated warehouse illegally, without a permit, and it failed even to apply for a new permit by the deadline established by FSD in an updated food safety regulation, Order n°

276/2006. In this regard, Respondent denies Claimant's assertion that Continent SA did not require a permit after the abrogation of Order 139/2004. Claimant's position is based on the incorrect assumption that Order 276/2006 – which replaced the abrogated Order 139/2004 beginning December 29, 2006 – only required *producers* of foodstuffs of animal origin to obtain a permit. It is clear from the order itself that it required businesses such as Continent SA, operating refrigerated food warehouses, to carry out their activities only after obtaining a permit. Indeed, Article 3(1) of Order 276/2006 provides that: *"Business units shall carry out the activities specified in Annex 1 only after obtaining the authorization issued by the competent sanitary-veterinary authority"*. Annex 1 A(1) of Order 276/2006 lists: *"Refrigerated warehouse: unit having adequate premises and low temperature installations for the reception, storage and delivery activities of deep-frozen and/or refrigerated animal origin products"*.

659. Respondent emphasizes in its Post Hearing Brief that, when Mrs. Dulgheriu and Mrs. Stoica were shown short segments from the video survey of the premises and operations of Continent SA during the Hearing, the witnesses pointed out numerous health and safety violations (Transcript, Day 3, pages 101-105): a decrepit building, moldy walls, improper ceilings, meat stored out of packaging and without refrigeration which allows bacteria to breed, floor in disrepair allowing bacteria to breed, dogs roaming on the access ramp where food is loaded, unsanitary garbage removal. Mrs. Dulgheriu testified that the images in the video were consistent with what she had seen during her regulatory inspections at Continent SA, but in some instances what she found during the inspections was "*even worse than you can see in the images*." Therefore, Respondent submits that Claimant obviously operated his company with total disdain for the health and safety rules applicable to the type of business he purchased.

§2. THE LAW

I. The Tribunal lacks subject matter jurisdiction to decide this claim, as matters of purely domestic law fall outside ICSID's jurisdiction

660. Claimant's Food Safety Claim arises from matters of general domestic law in Romania. Continent SA's obligation not to violate the food safety regulations applicable to its refrigerated foods warehouse was not specifically contracted for in the Privatization Agreement and does not arise directly out of Claimant's investment. Accordingly, this claim does not fall within Article 25(1) of the Convention. Rather, it is to be decided under Romanian law by the Bucharest Court of Law, before which Claimant filed an administrative action on June 5, 2006 challenging the FSD's March 2006 order.

661. Respondent submits that Claimant provides no justification for transforming these issues of purely domestic law into matters involving State responsibility for alleged violations of international norms, or for asking the Tribunal to sit as an appellate body in review of domestic administrative decisions. The Tribunal should thus decline to exercise jurisdiction over this claim.

II. The claim does not assert any Treaty violation

A. Romania did not take any "unjustifiable or discriminatory measures" against Claimant

662. Respondent points out that Claimant presents no evidence to support its assertion that the revocation of the operating permit for Continent SA's refrigerated food facilities was unjustifiable or discriminatory.

663. Claimant does not allege that the FSD's regulatory measures somehow discriminated against Continent SA. Indeed, in practice, all operators of refrigerated facilities (domestic and foreign) were under identical obligations. In this regard, it is a principle of customary international law that compensation is not required where economic injury results from a *bona fide*, non-discriminatory regulation that falls within the police power of the State (R. Ago, *First Report on State Responsibility, op.cit*. at 197). Respondent asserts that the FSD measures taken against Continent SA are not discriminatory and they constitute an appropriate exercise of the police power of the Romanian State, especially given Continent SA's admission that it was not in compliance with food safety regulations.

664. Given the absence of any discriminatory conduct, Claimant's sole basis for this claim is the contention that the orders suspending Continent SA's operations were unjustifiable. The FSD's regulatory measures, however, were justified by an important public safety purpose, namely, serious public health and safety considerations.

665. Respondent notes that Claimant does not allege that Continent SA's refrigerated warehouse facilities complied with the food safety regulations applicable when its operating permit was suspended and eventually revoked. On the contrary, on March 29, 2005, Continent SA's General Manager promised the FSD inspectors, in writing, that *"immediate action shall be taken to remedy the deficiencies."* Moreover, Continent SA admitted in its modernization plan that it was not in compliance with a number of requirements. Therefore, in light of the acknowledged deficiencies and the company's repeated failure to remedy those deficiencies, the FSD's actions were not only justified, but also necessary.

666. Faced with Continent SA's inspection record, its disregard of its Managing Director's commitment to take "immediate action" to correct the deficiencies, and its lack of meaningful progress toward the commitments made in the modernization plan, it is not surprising that the FSD gave short shrift to the company's 2006 proposal to relax the deadlines under the modernization plan. By failing to comply with food safety regulations for at least a year, Continent SA destroyed any credibility it may have had. Therefore, suspension of Continent SA's permit was justified under the circumstances.

667. The inspections were not excessive in frequency or scope and were carried out with a team of inspectors whose number was appropriate for a facility of this size. Claimant, over a period of years, failed to come into compliance with sanitary and veterinary regulations governing the operation of a refrigerated food warehouse. Nevertheless, Continent SA has continued unlawfully to operate an unsanitary and substandard facility,

even after its operating permit was suspended and eventually revoked (*See* Dulgheriu Testimony, Transcripts, Day 3, pp. 95, 96, 100, 101).

B. The Bucharest Court's decision does not establish that the FSD's actions violate the Treaty

668. The Bucharest Court of Law issued a decision on February 1, 2006, cancelling the May 6, 2005 order. Respondent denies Claimant's allegation that the decision confirmed that the May 2005 order was "abusive" and that Continent SA was in compliance with the food safety regulations. Rather, the court observed that, since Continent SA had submitted a modernization report and the FSD had accepted that plan and issued a new operating permit, the FSD could have imposed a less severe sanction than suspension of the permit to achieve the purposes of Order n°139/2004.

669. The court stated that some unspecified, less burdensome sanction might have been imposed. However, Respondent submits that the mere availability of less onerous remedies fails to establish that the May 2005 order was "abusive." The May 2005 order was appropriate in view of Continent SA's failed inspections from March to May 2005 and its failure to submit a modernization plan to the FSD at that time.

§ 3. DAMAGES

670. Respondent submits that Claimant bears the burden to establish his claim but has put forth no evidence to support any of his contentions.

I. Claimant has demonstrated no compensable damages incurred by Continent SA as a result of the May 2005 order

671. Respondent denies Claimant's allegation that the "informative note" issued to a company named S.C. Teonel Impex SRL in June 2005 had a huge impact (see above, ¶¶618-619).

672. There is no evidence that this notice caused Continent SA to experience any compensable loss under the Treaty. The notice lists Continent SA and three dozen other companies whose refrigerated food warehouse operations were suspended (presumably due to violations of food safety regulations), and notifies Teonel Impex that "*the receipt of animal origin products from this company is hereby forbidden*" (Claimant's Exhibit n°66). This notice demonstrates that numerous other companies were subjected to measures similar to those applied to Continent SA and that Continent SA was not singled out for disparate treatment.

673. Such notes are common practice and serve to inform retailers about the suspension or revocation of an operator's permit for noncompliance with food safety regulations. The purpose of such notes is to protect public health. Moreover, given that the notice purportedly was issued on June 17, 2005 and Continent SA's operating permit was restored twelve days later, on June 29, 2005, any adverse impact would have been minimal. Claimant offers no evidence that Continent SA was harmed as a consequence of either the informative note or the enforcement actions of the FSD.

II. Claimant's allegations of damages caused by the March 2006 order are unproven

674. Respondent denies Claimant's assertions that the May 2005 permit revocation had a "huge" impact on Continent SA, that the latter's reputation was affected, that there were uncertainties and unspecified "anomalies" in administering the company, and that unnamed company directors have experienced "distress and unpleasant situations." (Claimant's Memorial, ¶197). The complete failure of proof of these vague assertions requires that the claim be denied.

675. Furthermore, Respondent submits that Continent SA failed to mitigate any damage it may have suffered after the order suspending its operating permit in March 2006. Continent SA would have been able to resume operations under a restored permit if it had completed the improvements called for under its own modernization plan.

III. The alleged damages fall short of what is required for compensable moral damages

676. Respondent reiterates that moral damages are not available for alleged investment treaty violations except in the most extreme circumstances, which are not present here (see above, ¶¶294 *et seq*., in particular ¶¶296-297). Claimant's allegation of reputational harm caused to Continent SA by the FSD's regulatory actions does not meet this standard.

677. Respondent points out that Claimant caused his company, Continent SA, to continue to operate its refrigerated foods warehouse in violation of the FSD shut down order and in contravention of Romania's food safety regulations.

678. In light of the foregoing, Respondent submits that the claim for damages is unsupported by any evidence, baseless and should be dismissed.

SUB-SECTION **III. DECISION OF THE TRIBUNAL**

§1. JURISDICTION OVER THE FOOD SAFETY CLAIM

679. Respondent submits that because Claimant's Food Safety Claim arises from matters of general domestic law in Romania, the Tribunal should decline to exercise jurisdiction over this claim.

680. The Claimant objects submitting *inter alia* that the orders banning activities in the premises and the refrigerating warehouse, blocked Continent SA's activity, thus impairing the investment. Claimant further submits that those measures which have been taken by FSD, a State authority, have affected its legal rights stemming from the BIT.

681. The Tribunal agrees with the arbitral tribunal's finding in *Continental Casualty Company v. Argentine Republic* referred to in ¶599 above (ICSID Case No. ARB/03/9, Decision on Jurisdiction, February 22, 2006, ¶68).

682. Here, Claimant alleges that Respondent's *illegal* decisions to suspend or prohibit the operation permits of its investments have breached the BIT. The Claimant is therefore

making legal claims against the host State, with the consequence that the Tribunal is presented with a legal dispute within its jurisdiction.

683. Consequently, the Tribunal decides that it has jurisdiction to rule on the Claimant's Food Safety Claim.

§2. MERITS

684. In its Food Safety Claim, Claimant argues that Romania has violated Article 2(2) of the Treaty. Claimant principally contends that the measures taken were unjustifiable, disproportionate, discriminatory, and deprived Claimant of its rights and legitimate expectations.

685. Having reviewed the evidence and the reasons which the State authorities have invoked in support of their several control minutes and decisions, the Tribunal is of the view that these decisions were not "unjustifiable measures."

686. Indeed, food and safety policies are commonplace in many countries and promote an important public safety purpose, namely public health. Each of the State authorities' decisions was motivated in regard to these food and safety regulations. The Tribunal is therefore not convinced at all that the control actions and the subsequent decisions of the tax authorities were aimed at blocking the activity of the company.

687. Moreover, suspending or revoking operating permits may be regarded as a reasonable and appropriate measure to penalize serious irregularities to the food and safety regulations.

688. The record shows that the State authorities had legitimate concerns about the fulfillment of Claimant's obligations in regard to the food and safety regulations. Moreover, as Mrs. Maria Dulgheria and Mrs. Alexandrina Stoica – veterinary doctors specialising in food hygiene and employed by Romania's Food Safety Department – pointed out in their testimony, the inspections were carried out in accordance with Romania's National Strategic Plan, developed in consultation with the European Union. Their frequency was not excessive, based on objective criteria, such as the level of risk, and they were carried out with a team of inspectors whose number was appropriate for a facility of that size. The witnesses explained their observations and their determinations that the company, over a period of years, failed to come into compliance with sanitary and veterinary regulations governing the operation of a refrigerated fueled warehouse; and that, nevertheless, Continent SA has continued unlawfully to operate the facility, even after its operating permit was suspended and eventually revoked. They also pointed to Claimant's persistent refusal to address the deficiencies that were identified in the inspections. During the cross-examination Claimant did not establish any procedural or substantive irregularities in the inspections conducted by the Food Safety department.

689. The Tribunal does not agree with Claimant's allegation that on the basis of the evidence, Continent SA received discriminatory treatment in relation to other traders on the same premises. Indeed, Ms Dulgheria stated in this regard: "*There was just one licence for Continent SA and all the tenants operate on the basis of such a licence*" (Transcript, Day

4, p.114, line 14). In the Tribunal's view, this is consistent with Respondent's explanation that, according to the lease agreements between Continent SA and the tenants who operated food sales concessions at Continent SA's premises, compliance with the food safety regulations was Continent SA's responsibility; that is why the "other traders on the same premises" were not directly subject to the regulations. Accordingly, Claimant has not proven that the measures targeted Claimant's investment specifically.

690. The Tribunal therefore considers that Claimant did not prove that the measures of which he here complains were unjustifiable, disproportionate and discriminatory.

691. Moreover, Claimant's argument that the State authorities' behavior in conducting too many inspections and imposing too severe penalties, namely suspensions or revocations of operating permits, would amount to a failure to protect its legitimate expectations is not justified. The regulations which lead to the incriminated decisions were taken by FSD in the course of exercising its obligations to implement the food and safety regulations. Such regulations by a state reflect a clear and legitimate public purpose. In the Tribunal's view, Claimant may not have expected that the State would refrain from adopting regulations in the public interest, nor may Claimant have expected that the Romanian authorities would refrain from implementing those regulations.

692. In light of the foregoing, the Tribunal decides that the State's actions invoked by Claimant under the "Food and Safety Claim" did not breach Article 2(2) of the Treaty.

SECTION V. THE OZIAS TAX CLAIM

SUB-SECTION I. CLAIMANT'S POSITION ON THE OZIAS TAX CLAIM

§ 1. THE FACTS

693. In 2001, Continent SA and Ozias Marine Company ("Ozias") entered into consulting contracts pursuant to which Ozias was to provide Continent SA with management and technical consulting services to help Continent SA improve its performance, satisfy its existing customers, and attract new customers (Claimant's Exhibit n°71). On October 26, 2001, Continent SA declared and registered the contracts with the 6th District Administration of Public Finance in Bucharest.

694. Claimant submits that Continent SA's income increased during the period when the consulting contracts were in force (Claimant's Exhibits n°42 and 72). Such a spectacular and continuous rise in income evidences the effectiveness of the consulting services. Claimant denies Respondent's allegation that Ozias was dissolved in February 2005. In any case, Claimant points out that the relevant time for considering Ozias's work is 2002-2003, as mentioned in the December 17, 2003 tax audit report at issue.

695. Indeed, the Tax Agency audited Continent SA and, in its December 17, 2003 tax audit report, refused tax deductions for the Ozias consulting fees and held Continent SA liable for unpaid profit tax, VAT, interest and penalties.

696. Whereas the Tax Agency did not recognize the consulting services as having been rendered, the Tax Agency also held Continent SA liable for VAT on the cost of Ozias's fees. Because Continent SA did not pay the required VAT, the Tax Agency assessed additional VAT liabilities, interest, and penalties.

§ 2. THE LAW

697. Claimant contends that the measures taken by the Tax Agency impaired the company's management and discouraged good management. According to Claimant, the Romanian institutions abusively sanctioned Claimant and prevented him from optimizing his business relating to the investment.

698. Claimant submits that the denial of deductions and the imposition of additional taxes were unjustified, and therefore in violation of Article 2(2) of the Treaty, for the following three reasons.

699. First, Claimant asserts that the higher profit tax liability was an unjustified measure since the increase in Continent SA's income proved the efficiency of the consulting services. Indeed, the Tax Agency, when auditing Continent SA's accounts and evaluating the services rendered by Ozias under the consultancy contracts, adopted a formalistic approach and ignored substantive evidence, such as the fiscal results obtained by Continent SA which proved the provision of consultancy services by Ozias.

700. Second, the Romanian State, through its Tax Agency, had a contradictory attitude:

- one the one hand, the effects of the consulting contracts were not acknowledged, resulting in the recalculation of the profit tax and VAT;

- on the other hand, the consulting contracts were invoked in order to claim VAT.

701. Third, the law regarding taxable profits, in force on the date of the tax audit (*i.e.*, December 17, 2003), did not entitle the Tax Agency to deny profit tax deductions on the basis of the economic purpose of a commercial operation. The Tax Agency only became entitled to deny profit tax deductions on the above ground after the enactment of Law 571/2003 (in particular, Article 11), which entered into force on January 1, 2004.

§ 3. DAMAGES

702. Claimant alleges "moral prejudice" and bases his claim for moral damages on the grounds that the denial of tax deductions and imposition of additional taxes affected Continent SA's reputation, brought uncertainty to the company's business planning, and caused distress among Continent SA's directors.

703. In this regard, Claimant formulates the following request: *"Moral damage is quantified as amounting to USD 1.000.000 and we request to be payed* [sic] *by the Respondent-Romanian State"* (Claimant's Memorial, ¶198).

SUB-SECTION II. RESPONDENT'S POSITION ON THE OZIAS TAX CLAIM

§ 1. THE FACTS

I. Continent SA allegedly contracted with Ozias for Consulting Services

704. On July 1, 2001, Continent SA and Ozias entered into three contracts for consulting services to be provided to Continent SA (Respondent's Exhibits n°161, 162 and 163).

705. The first two contracts purport to provide Continent SA with the services of "Commercial Managers." These required Ozias to provide advice to Continent SA on the following issues: (1) the development of Continent SA's business; (2) the identification of potential clients in Greece; and (3) any other commercial issues Continent SA might face. The third contract made available the services of a "Technical Manager." The latter's role was to provide technical assistance to develop Continent SA's business. He was required to help with the modernization, reparation and exploitation of the refrigerated warehouse. The contract also required him to identify potential clients in Greece and provide Continent SA with useful information related to business strategy.

706. Each contract: (i) had an indefinite term; (ii) called for a monthly consulting fee of USD 3,500 to be paid to Ozias; and (iii) required Continent SA to pay any additional expenses incurred by the individual consultants for transportation, accommodation, or meals when traveling to Romania. On July 5, 2002, after the contracts had been in force for one year, each contract was amended to increase the monthly consulting fee to USD 5,500, beginning with the July 2002 payment (Respondent's Exhibits n°164, 165, and 166). In November 2005, the monthly consulting fee apparently increased to USD 7,500 per contract (*See, e.g.,* Ozias's Invoice N°147 for services performed under all three Consultancy Agreements, Respondent's Exhibit n°167). The monthly consulting fee increased again to EUR 12,000 per contract for the period from May to November of 2006. (*See, e.g.,* Ozias's Invoice N°48 for services performed under all three Consultancy Agreements, Respondent's Exhibit n°168). In total, Ozias billed Continent SA for consulting fees from July 2001 through November 2006 (*See* Respondent's Exhibit n°169).

II. Ozias was formed to be a shipping company

707. Respondent points out that Ozias's corporate records show that Ozias was formed in Greece in 1995 to operate as a shipping company. According to its articles of incorporation, *"the company's exclusive object of activities* [was] *to own, operate and manage Greek merchant and fishing ships"* (Respondent's Exhibit n°170). Claimant was the majority shareholder of Ozias with 70 percent ownership; his son, Stavros Roussalis, owned the remaining 30 percent of the company's shares.

708. On February 9, 2005, at a general meeting, the Ozias's shareholders decided to dissolve the company (Respondent's Exhibit n°171). The fact that Ozias was dissolved in February 2005 is further confirmed by a letter dated November 21, 2006 from the Greek Ministry of Commercial Shipping (Respondent's Exhibit n°201). Claimant was responsible for liquidating the assets and winding up the business affairs of the company.

However, in February 2005, Ozias continued to send monthly invoices to Continent SA and raised its fee rates under the contracts until at least November 2006.

III. Continent SA has not substantiated Ozias's work product

709. According to Respondent, there is no evidence that Ozias actually provided any services to Continent SA. The invoices sent by Ozias to Continent SA contain no description of the services supposedly provided.

710. Respondent refutes Claimant's assertion that Continent SA's increased revenue during the period in which the Ozias contracts were in force is sufficient to prove that Ozias rendered the services as claimed.

IV. Claimant took tax deductions on payments made to Ozias

A. The Tax Agency disallowed Continent SA's profit tax deductions for the Ozias fees

711. Law 414/2002 sets forth the supporting documentation that Continent SA was required to provide in order to obtain a tax deduction for the consulting fees paid to Ozias. Article 9(7) of Law 414/2002 requires both a written contract and proof that services were rendered with a view to generating income for the company. The Tax Agency informed Continent SA that its documentation was inadequate because Ozias's invoices did not *"detail* […] *the service performed"* and failed to show "*the number of consultancy hours"* (Respondent's Exhibit n°85, p. 16). Because Continent SA's expenses, supposedly for consulting fees, were not properly documented in accordance with the Romanian tax legislation, the Tax Agency denied Continent SA tax deductions for payments made to Ozias and assessed additional profit taxes (Chivu Decl., ¶5.4.2).

712. The Tax Agency's decision in December 2003 to deny profit tax deductions was taken absent any documentary proof of Ozias having provided any services whatsoever to Continent SA. Indeed, Article 27(1) of Law n°414/2002 enables the Tax Agency to verify and recalculate the taxable profit of a company, stating that *"the expenses related to management services, consultancy, assistance or the supply of services are not considered deductible expenses if written agreements are not concluded and if the beneficiary cannot evidence the supply of such services."*

B. The Tax Agency also assessed VAT liabilities that Continent SA had failed to pay

713. The Tax Agency also held Continent SA liable for VAT on the cost of Ozias's fees. Romanian tax law in effect before June 2002 required Continent SA to pay the VAT for Ozias's services within seven days after Continent SA received an invoice from Ozias, and immediately upon receipt of the invoice after June 2002 (Respondent's Exhibit n°85, p. 6). Because Continent SA did not pay the required VAT, the Tax Agency assessed additional VAT liabilities, interest, and penalties.

C. Continent SA objected to the profit tax and VAT assessments

714. Continent SA objected to the assessment of additional profit taxes and VAT in the Tax Agency's December 17, 2003 tax audit by filing an administrative challenge on January 5, 2004 (Respondent's Exhibit n°84). Continent SA argued that its revenue growth during the period when Ozias allegedly provided services was sufficient to prove that Ozias had provided services to Continent SA. Continent SA also contested that it owed VAT, arguing that consulting services provided by foreign entities did not incur VAT liability.

715. Continent SA registered a formal challenge to the Tax Agency's tax audit before the Bucharest Court of Law. Continent SA's dispute with the Tax Agency is pending and the company has not paid the Ozias-related tax liabilities assessed by the Tax Agency.

§ 2. THE LAW

I. The Tribunal lacks subject matter jurisdiction over the Ozias Tax Claim

716. Respondent points out that Claimant does not allege that Continent SA was somehow treated differently from other similarly-situated corporate taxpayers with respect to the application of the relevant tax laws. Nor does Claimant allege that the Tax Agency took any discriminatory action against Continent SA with respect to the application of the taxes in this claim.

717. Respondent further submits that the Treaty does not extend its jurisdiction to garden-variety tax disputes of the kind Claimant raises here. The Tribunal should thus decline to exercise jurisdiction over Claimant's claim alleging unjustified tax assessments for the same reasons set out regarding the Fiscal Claim (see above, ¶¶457 *et seq.*).

II. Claimant has neither alleged nor proved a Treaty violation

A. Claimant was not subjected to any "unjustifiable or discriminatory measures"

718. Respondent points out that Claimant does not allege that the Tax Agency's assessment of additional taxes discriminated against Continent SA. Absent any allegedly discriminatory conduct, Claimant's sole basis for this claim is the contention that the additional tax liabilities relating to the Ozias payments were not justified.

719. State responsibility is not triggered, and thus no compensation is required, where economic injury results from a *bona fide* non-discriminatory regulation that falls within the police power of the State (see above, ¶663). Thus, Romania is not responsible for loss of property or for other economic disadvantage resulting from *bona fide* general taxation.

720. Moreover, Respondent denies Claimant's allegation that this tax dispute *"impair*[ed] *the company's management, by discouraging the use of good management"* and prevented him from trying *"to optimize the course of* [the company's] *business related to the investment"* (Claimant's Memorial, ¶202). Indeed, Claimant bears the burden to establish the alleged injury, its extent, and its cause. He has failed to do so.

721. Indeed, Respondent submits that the premise of Claimant's argument is seriously flawed as a matter of basic logic. An increase in the income of Continent SA during 2002 and 2003 could have resulted from any number of factors having nothing to do with any services allegedly provided by Ozias.

B. There are reasonable grounds to question the legitimacy of the claimed consulting fees

722. Respondent points out that the Tax Agency specifically requested documentation that Ozias did, in fact, render services to Continent SA, and the company provided none. That failure raises a reasonable doubt as to whether such work was ever performed. Claimant similarly provides no such documentation in support of his claim here.

1. The absence of an arm's-length agreement raises reasonable doubts as to whether any services were ever provided

723. Respondent points out that Claimant used his control as majority owner of both Continent SA and Ozias to commit one Roussalis company to pay another Roussalis company substantial sums for alleged consulting services under circumstances where neither entity has provided any evidence that such services were, in fact, rendered. Respondent submits that the contracts were a scam designed to repatriate a portion of Continent SA's profits as purported consulting fees, whilst claiming a bogus tax deduction for doing so.

2. The contracts raise serious questions that have not been answered

724. First, Ozias's articles of incorporation state that its "*exclusive object*" was to "*own, operate and manage Greek merchant and fishing ships*." This raises a reasonable question about Ozias's qualifications to render consulting services.

725. Second, Ozias is a company in dissolution, which raises questions as to the *bona fide* purpose of the Ozias contracts and the tax deductibility of payments made under them.

726. Finally, Respondent notes the dubious potential benefit of management consultancy services to Continent SA's *refrigerated warehouse*. Whilst the contracts contemplated that the consultants would travel to Romania at Continent SA's expense, in order "to provide information" and "facilitate new agreements," Ozias never invoiced Continent SA for a single trip. These anomalies give rise to reasonable doubts as to whether the services were rendered.

727. Similarly, the fact that the FSD suspended Continent SA's permit for operating a refrigerated warehouse for failing to implement the modernization plan submitted by the company raises reasonable doubts over whether Ozias ever provided services under the contract for technical services. From May 2006 to November 2006, Continent SA paid Ozias EUR 36,000 per month, a total of EUR 216,000 (Respondent's Exhibit n°169). During that same period, it failed to complete a single improvement required by the modernization plan.

728. To prevail on this claim, Claimant has the burden of producing sufficient evidence for the Tribunal to find that the Tax Agency's denial of Continent SA's tax deduction for lack of documentation is impossible to excuse or justify under any circumstances. Claimant has come nowhere close to meeting this burden.

729. Respondent submits that there were several grounds for questioning the propriety of the tax deductions (see above, ¶¶723 to 727). Moreover, the failure to produce any documentation evidencing that services were rendered by Ozias would itself justify denial of the tax deduction under the documentation requirement of Article 9(7) of Law 414/2002. Indeed, the Romanian Supreme Court gave a definitive ruling on the documentation required to obtain a profit tax deduction for consulting services. In a decision denying profit tax deductions for consulting services, the Supreme Court required proof that consulting services were actually rendered (Decision 248/2006).

C. Claimant's complaint about the Tax Agency's inconsistent positions is baseless

730. The profit tax and VAT are governed by different provisions of Romanian tax legislation.

731. VAT is incurred by a company headquartered in Romania that engages consulting services from companies headquartered outside Romania (Chivu Decl. ¶5.4.3.). The applicable law required Continent SA to pay the VAT on those fees within seven days of receiving the invoice from Ozias for the period up until June 2002, and immediately upon receipt of the invoice for the period beginning June 2002. Because the company failed to pay the required VAT, the Tax Agency thus assessed liability for the unpaid VAT and related interest and penalties.

732. Respondent points out that the deductibility of the consulting fees for profit tax depends upon the required documentation. A failure to document the expenses merely disqualifies the taxpayer from claiming a profit tax deduction.

733. Accordingly, contrary to Claimant's allegations, there is no inconsistency in the Tax Agency's position. Continent SA had every opportunity to present documentation that consulting services were rendered by Ozias. Moreover, by receiving Ozias invoices, Continent SA itself showed that it was liable for the VAT. The position of the Tax Agency is grounded in the relevant provisions of the tax legislation and is entirely reasonable.

§ 3. DAMAGES

734. Claimant bears the burden of establishing the alleged injury, its extent, and its cause. It has failed to meet this burden.

A. Continent SA has not paid the assessed tax liability and there is no evidence to prove that this issue affected Continent SA's reputation, business planning, management, or employee morale

735. Respondent denies Claimant's allegation that it should be awarded moral damages because the reputation of Continent SA was affected and because there was uncertainty and unspecified "anomalies" in administering the company (Claimant's Memorial, ¶207).

736. Claimant boasts that Continent SA enjoyed a "spectacular increase in income" during the very period when this dispute arose (Claimant's Memorial ¶204). Moreover, as of this date, Continent SA has not paid any part of the tax liability for Continent SA's payments to Ozias. Until Continent SA is required to pay the assessed tax liability, it has not suffered any injury. Furthermore, Continent SA and Claimant have appealed the ruling of the Criminal Court which held Continent SA liable for the tax liabilities related to the Ozias contracts. The appeal remains pending. It is thus premature to put these issues before the Tribunal.

B. The USD 1 million sought by Claimant does not qualify as compensable moral damages

Respondent reiterates that moral damages are not available for alleged investment treaty violations except in the most extreme circumstances, which are not present here (see above, ¶¶294 *et seq.*). Claimant's allegation of reputational harm certainly does not rise to such a level. Moreover, Claimant failed to offer any proof in support of the amount of moral damages he claims. Indeed, the moral damages claim is duplicative of Claimant's Fiscal Claim, in which he seeks damages based on the amount of the tax liabilities assessed, including the liabilities related to the Ozias payments.

SUB-SECTION **III. DECISION OF THE TRIBUNAL**

§1. JURISDICTION OVER THE OZIAS TAX CLAIM

737. Respondent argues that ICSID tribunals have no jurisdiction to resolve tax disputes between Continent SA and the Romanian Tax Agency. It submits that tax disputes do not come within the jurisdictional scope of the BIT, particularly where Claimant has not alleged that Continent SA was somehow treated discriminatorily or differently from other similarly-situated corporate taxpayers with respect to the application of the relevant tax laws.

738. On the other hand, Claimant submits that the Tax Agency's decisions were abusive and unjustified and prevented a good management of Continent SA, therefore arguably having an adverse impact on the investment in violation of Article 2(2) of the Treaty.

739. In line with the reasoning set out above regarding the Fiscal Measures Claim (see above, ¶¶489 to 492), the Tribunal considers that, among the matters falling within the scope of its jurisdiction are general measures taken by the host State in the exercise of its public powers, including decisions taken by tax authorities which allegedly affected the investment in violation of the BIT.

740. On the basis of the foregoing reasoning, the Tribunal decides that it has jurisdiction to rule on Claimant's Ozias Tax Claim.

§2. MERITS

741. In its Ozias Tax Claim, Claimant contends that Romania has violated Article 2(2) of the Treaty, by taking unjustified measures.

742. Having reviewed the evidence and reasons that the Tax Agency invoked in support of its decision regarding the Ozias issue in its December 17, 2003 tax audit report, the Tribunal is of the view that the Tax Agency had legitimate concerns about the fulfillment of Claimant's tax obligations. The initiation and the conduct of the audit were plainly justified and consistent with the existing law.

743. Claimant did not rebut Respondent's submissions that Continent SA advanced to Ozias approximately USD 1.37 million for the purchase of various refrigeration and construction products which were never delivered to Continent SA or proved to be purchased, that Continent SA made payment to Ozias in excess of USD 1.5 million for alleged consultancy services, that Continent SA never substantiated that any consulting services were provided by Ozias, that Ozias exclusive function was to operate merchant and fishing ships, not to provide management consulting services and finally that Ozias was dissolved in 2005, as proven by the certificate presented during the hearing.

744. Claimant did not prove its allegations that "*the Greek family employed Greek people pursuant to those management consultants to perform management services up until the time that the Claimant was forced to leave the country*" (Transcript, day 3, p. 79, lines 11-16), that the contracts were concluded because "*the foreign workers that are all named in there wanted to be paid in their own country*" (idem, p. 87, lines 23-25) and that under these contracts, "*the foreign workers were installing the marble and the flooring*" (idem, p. 86, lines 16-17). Respondent has also rightly observed that if the Ozias' "consultants" were merely foreign workers who were paid in Greece for installing marble at Continent SA, that would support the Tax Agency's denial of tax deductions for alleged management consulting services and although the record shows that Claimant left Romania of his own initiative on March 9, 2003, the transfer of money from Continent SA to Ozias for alleged consulting services continued for many years after Claimant left Romania.

745. In light of the foregoing, the Tribunal decides that the State's actions invoked by Claimant under the Ozias Tax Claim did not breach Article 2(2) of the Treaty.

OVERALL CONCLUSION

746. After its analysis of each individual claim made by Claimant, the Arbitral Tribunal has reached the conclusion that they were unfounded. The Tribunal further considers that even taken collectively, the actions of Respondent do not amount to violations of Articles 4(1) and 2(2) of the BIT. Claimant's claims are therefore dismissed.

CHAPTER V. THE RESPONDENT'S COUNTERCLAIM

SECTION I. RESPONDENT'S POSITION ON ITS COUNTERCLAIM

I. THE COUNTERCLAIM

747. Respondent, on behalf of AVAS, asserts counterclaims against Claimant and his companies, Continent SRL and Continent SA, arising out of the failure of Claimant and Continent SRL to make the USD 1.4 million investment on which Claimant bases his Investment Claim.

A. Counterclaim against Claimant

748. Claimant controls Continent SRL directly, as its sole shareholder and director, and Continent SA indirectly, through Continent SRL's majority shareholding interest in Continent SA. The claims made by Roussalis, who purportedly seeks compensation for damages sustained by these two corporations, thus stem from his controlling shareholding interest in both companies. By asserting claims as investor for these companies, Claimant implicitly admits that he is the *alter ego* of Continent SRL and Continent SA.

749. Accordingly, Respondent seeks an order directing him, as *alter ego* and controlling shareholder, to take such steps as may be necessary for Continent SRL to transfer the shares of Continent SA to AVAS pursuant to the contractual pledge of those shares. The counterclaim also seeks to hold Roussalis jointly and severally liable with Continent SRL for any damages awarded to Respondent by the Tribunal for his looting of funds from Continent SA.

750. In this regard, Respondent contests Claimant's arguments that he was not himself a party to the Privatization Agreement and therefore cannot be held accountable for the breach of that agreement by Continent SRL. Indeed, Claimant's complete control over the day-to-day operations of Continent SA and Continent SRL warrant treating Claimant and his two companies as one and the same for the purposes of Respondent's counterclaims. Respondent points out that Claimant is the sole shareholder and director of Continent SRL, the majority shareholder (96.52 percent) of Continent SA. He signed the Privatization Agreement on behalf of Continent SRL and is the ultimate beneficiary of the privatization transaction. He is also the sole authorized signatory for the companies. Roussalis also abused the corporate form, and used more than USD 5 million of the company's assets as his own personal assets. Accordingly, those companies are his *alter ego*.

751. Claimant's control over Continent SRL and Continent SA is extensive enough to permit Romanian courts to pierce the corporate veil and hold Claimant accountable for the misappropriation of their assets. According to Romanian legal doctrine, a director or shareholder is deemed the alter ego of his company when "*there is confusion between the patrimonies of the company and its owner … resulting from the use of the company's assets for the owner's personal benefit*" (Florentin Tuca, *Revista de Drept Comercial*, Volume 6, No. 10, 112, 1996, at 115).

B. Counterclaim against Continent SRL

752. The counterclaim against Continent SRL seeks to enforce the contractual pledge over the 372,523 shares acquired by Continent SRL pursuant to the Privatization Agreement. In its Rejoinder, Respondent amended its counterclaims to assert alternative claims for monetary damages in lieu of obtaining the original shares sold by AVAS to Continent SRL, and in connection with the additional shares issued by Continent SA to Continent SRL.

753. The central factual issue related to this counterclaim is whether Continent SRL failed to invest USD 1.4 million in Continent SA.

754. In addition, Respondent seeks an order from the Tribunal requiring Continent SRL to pay damages in a sum representing the value of all funds and assets of Continent SA that were misappropriated by Continent SRL and/or Claimant after privatization. Respondent seeks to hold Continent SRL jointly and severally liable for such damages with Claimant.

C. Counterclaim against Continent SA

755. Respondent's next counterclaim seeks to obtain a declaration that the resolution to increase the share capital that was approved by Continent SA's shareholders in December 2000 was groundless.

756. AVAS filed an "absolute nullity" claim in the Romanian courts in August 2007 to annul the increase in share capital. The share capital increase was based on the purported investment of over USD 1.4 million by Continent SRL in Continent SA. However, that investment was not made and the December 2000 resolution to increase share capital by the shareholders of Continent SA was based on unreliable and intentionally misleading information. AVAS's pending claim against Continent SA in the Romanian courts is premised in significant part on this factual contention.

757. Given that its annulment claim is inextricably intertwined with Claimant's Investment Claim, AVAS has agreed to seek a suspension of proceedings before the Romanian court. This counterclaim is intended to avoid inconsistent rulings on common issues of fact raised by Claimant and by AVAS in these parallel proceedings.

II. JURISDICTION

A. The Tribunal has jurisdiction to decide Respondent's Counterclaim

1. In General

758. Article 46 of the ICSID Convention states: *"[e]xcept as the parties otherwise agree, the Tribunal* ***shall, if requested by a party****, determine* ***any*** *… counter-claims arising directly out of the subject-matter of the dispute provided that they are within the scope of the consent of the parties and are otherwise within the jurisdiction of the Centre"* (emphasis added). According to Respondent, the Convention thus guarantees Romania's right to arbitrate a closely related counterclaim. Indeed, once an investment dispute is submitted

to ICSID, Article 9(4) of the BIT requires that all aspects of the dispute be decided in accordance "*with the provisions of this Agreement [BIT] and the applicable rules and principles of international law.*" The applicable rules and principles of international law necessarily include the Convention in its entirety, including Article 46, which governs relations between Romania and Greece and their respective nationals with respect to BIT arbitrations.

759. Under Rule 40(1) of the ICSID Arbitration Rules, "*a party may present…* [a] *counter-claim arising directly out of the subject matter of the dispute, provided [it] is within the scope of the consent of the parties and is otherwise within the jurisdiction of the Centre."* Because there is no explicit exclusion of counterclaims in the Treaty, Claimant has failed to establish that Respondent is precluded from asserting a counterclaim. Indeed, contrary to Claimant's argument, there is no ICSID precedent requiring an explicit *authorization* in the BIT as a precondition for asserting a counterclaim.

760. The Tribunal has *subject matter jurisdiction* over Respondent's counterclaims. Indeed, each counterclaim is a dispute that centers on whether Claimant, as investor acting through Continent SRL, made a USD 1.4 million investment in Continent SA in accordance with the Privatization Agreement. Because that investment was not made, the counterclaims are presented here to protect and enforce the State's rights under the Privatization Agreement to enforce its lien and recover the shares pledged by Continent SRL to secure performance of its investment obligation. Moreover, presenting these counterclaims here advances the goals of economy and efficiency in international dispute resolution because they will resolve disputes that need not be relitigated in the Romanian courts.

761. Under Article 25(1) of the ICSID Convention, the Tribunal has jurisdiction over *"any legal dispute arising directly out of an investment"* between an investor and a signatory State. These counterclaims satisfy this jurisdictional prerequisite. Indeed, the claims and counterclaims turn on the same factual question and arise out of the investment obligation of the privatization contract.

762. Furthermore, the counterclaims are arbitrable under Article 9(1) of the Treaty, which authorizes arbitration of disputes *"in relation to an investment."* The factual dispute concerning the investment obligation is the focal point of Claimant's Investment Claim and Romania's counterclaims. Indeed, the term "investment" is defined expressly in the Treaty as including, among other things, *"shares in and stock and debentures of a company and any other form of participation in a company*" (Treaty, Art. 1(b)). That definition covers the shares acquired by Claimant through Continent SRL in the Privatization Agreement and the additional shares created as a result of the shareholders' resolution approved on December 15, 2000.

763. Under Rule 40(2) of the ICSID Arbitration Rules, counterclaims are timely if they are filed no later than the filing of the counter-memorial. Respondent duly filed its counterclaims as part of its Counter-Memorial.

764. The Tribunal also has jurisdiction *ratione personae* under the Treaty to adjudicate counterclaims against Continent SRL and Continent SA.

765. Respondent submits that Article 9 of the Treaty encompasses disputes *"in relation to an investment"* which includes Claimant's locally incorporated companies. For that reason, and regardless of the Romanian nationality of Continent SRL and Continent SA, claims against these entities fall within the scope of disputes contemplated in Article 9 of the Treaty and are therefore subject to the Tribunal's jurisdiction.

766. Indeed, first, these two companies together comprise the "investment" Claimant has made and his claims seek compensation for alleged damages to his investment. In that sense, the corporate entities are interested parties in this case because the actions Claimant complains about were, with the exception of the Interdiction Claim, allegedly taken against these companies alone. Under these circumstances, it is entirely reasonable to expect that Continent SRL and Continent SA should answer for any unlawful actions they took with respect to the investment obligation. Respondent contends that the companies took such action at the direction of Roussalis.

767. Second, there would neither be any added burden on the Tribunal nor any inequity to the parties for the Tribunal to render an award enforcing the share pledge and declaring the shareholders resolution to be ungrounded if it were to conclude that the required investment was not made by Continent SRL.

768. If the companies are not impleaded, an award in favor of Respondent on counterclaims brought against Roussalis alone, as *alter ego,* could prove extremely difficult, if not impossible, to enforce. He could interfere with enforcement of any award against him alone by using his control over Continent SRL and Continent SA to ignore or refuse to carry out any directives issued by the Tribunal. It would force Respondent to bring enforcement proceedings against Roussalis in Greece or wherever he may be found.

769. Furthermore, such enforcement would be far more complicated and more costly than executing a money award. Impleading these corporations will greatly simplify enforcement of the Tribunal's award, as they are Romanian companies subject to the jurisdiction of the Romanian courts.

770. Respondent points out that, in *Klöckner v. Republic of Cameroon,* ICSID Case No. ARB/81/2*,* an ICSID tribunal was faced with a similar request to implead a corporation through which the investor made an investment. Noting that Cameroon had negotiated the investment agreement with the foreign investor, but had formally signed the agreement only with the local subsidiary, the tribunal concluded that the case presented *"an indivisible whole"* and thus that it had jurisdiction *ratione personae* to rule on the counterclaim against both the investor and its local subsidiary.

771. In sum, Respondent's counterclaims against Continent SRL and Continent SA are within the Tribunal's jurisdiction. Claimant used Continent SRL and Continent SA as local investment vehicles. His dominant share ownership and actual control of those companies

constitute investment under Article 1(1) of the Treaty. These investments thus fall within the dispute resolution provisions of the Treaty and the Tribunal's jurisdiction.

772. In addition, the fact that Continent SRL and Continent SA are Claimant's *alter egos* provides an additional basis for asserting jurisdiction over the counterclaims against the companies. Since the Tribunal clearly has jurisdiction over the counterclaims asserted against Mr. Roussalis, it also has jurisdiction over the counterclaims against his corporate *alter egos*.

2. The Counterclaim's contractual basis does not negate the Tribunal's jurisdiction to decide this closely related counterclaim

773. Romania's counterclaim arises directly out of the subject matter of the dispute addressed in Claimant's claim. This condition means that *"the factual connection between the original and ancillary claim is so close as to require the adjudication of the latter in order to achieve the final settlement of the dispute, the object being to dispose of all grounds of dispute arising out of the same subject matter*" (Note B(a) to ICSID Rule 40, 1 ICSID Reports 100).

774. As the tribunal held in *Klöckner* v. *Cameroon* (*op.cit*.), this jurisdictional requirement is met, and a counterclaim is admissible, where it forms *"an indivisible whole"* with the primary claim asserted by the claimant, invoking substantive obligations undertaken for *"the accomplishment of a single goal,* [so as to be] *interdependent.*" That is the case here. Claimant's Investment Claim and Romania's counterclaim both arise out of Claimant's post-privatization obligations under the Share Purchase Agreement. Both require the Tribunal to answer the same questions: did AVAS properly conclude that Claimant failed to make the post-privatization investment? Is Romania entitled to enforce the share pledge against Claimant and Continent SRL? That close factual connection gives rise to a presumption of admissibility of Romania's counterclaim.

B. Claimant consented to arbitrate Respondent's Counterclaim

775. Contrary to Claimant's contention, he has consented to the arbitration of Romania's counterclaims in this case. When Claimant resorted to ICSID arbitration for the settlement of his claims, he agreed to settle *all disputes* relating to Claimant's investment, including Respondent's counterclaims. Indeed, by submitting his claim to ICSID he accepted Romania's offer to arbitrate contained in the BIT in accordance with the ICSID Convention and Rules, which carries with it the possibility that he would be required to arbitrate the closely related counterclaims.

776. Claimant's written consent to arbitrate the share pledge claim initially was manifested in the "cooling off" letter he sent to Romania on December 9, 2003 as a predicate to commencing this arbitration. The letter states: *"Furthermore, the assertion of a counterclaim pursuant to Article 46 is fully consistent with Romania's BIT obligations. APAPS' [AVAS's] actions for the execution of the security […] motivated by the nonaccomplishment by the undersigned's assumed obligations as a foreign investor […] represented a dispute in relation to the investment, as it is stipulated by the […] [BIT].*

The undersigned, taking into consideration the provisions of the Agreement, I don't understand to submit the dispute towards settlement to the Romanian legal courts and […] I consider that the provisions of art. 9(1) from the Agreement have not been observed by APAPS" (*sic*., Claimant's Exhibit n°3). Shortly before ICSID registered his Request for Arbitration, Claimant represented to the Romanian court in the share pledge litigation that Article 9 of the Treaty *required* AVAS's share pledge enforcement action to be decided at ICSID (Claimant's Exhibit n°26). These submissions should be deemed as Claimant's consent to arbitrate Respondent's counterclaims.

777. Similarly, Claimant's Request for Arbitration states: *"The dispute between the undersigned, as the sole associate of SC Continent Marine Enterprise Import Export SRL and the Romanian State, having as scope APAPS [AVAS]'s action to execute the security formed by those 372,523 shares, owned by SC Continent Marine Enterprise SA […] belongs to the settlement competence, by arbitration, to the International Centre for Settlement of Investments Disputes*" (Claimant's request, p. 8).

778. According to Respondent, Claimant's assertions to the Romanian courts that they should dismiss the State's share pledge enforcement action in favor of resolving that claim before ICSID constitute unambiguous consent to arbitrate the State's claim for relief in this arbitration. Indeed, in 2004, Claimant submitted to the Romanian court in which the share pledge enforcement action was pending a statement contesting the court's jurisdiction on the ground that the dispute must be resolved in arbitration at ICSID (Respondent's Exhibit n°207).

779. Moreover, after urging that Respondent terminate the two cases pending before the Romanian court and rely instead on ICSID to resolve the share pledge and nullification disputes, Claimant cannot dispute that he has consented to arbitration of the disputes in question.

780. As the tribunal in *SGS v. Pakistan* (*op.cit*.) concluded: "[i]*t would be inequitable if, by reason of the invocation of ICSID jurisdiction, the Claimant could on the one hand elevate its side of the dispute to international adjudication and, on the other, preclude the Respondent from pursuing its own claim for damages by obtaining a stay of those proceedings for the pendency of international proceedings, if such international proceedings could not encompass the Respondent's claim*."

C. The Tribunal has jurisdiction over Respondent's Counterclaim by virtue of the umbrella clause in Article 2(6) of the Treaty

781. Applying the umbrella clause in Article 2(6) of the Treaty, the Tribunal has jurisdiction over Claimant's Investment Claim, as well as Respondent's counterclaims, without regard for the dispute resolution clause in the Privatization Agreement. Article 2(6) of the Treaty provides that "[e]*ach Contracting Party shall observe any other obligation it may have entered into with regard to investments of investors of the Contracting Party*". Thus, the contractual obligations under the Privatization Agreement become arbitrable before ICSID by operation of the umbrella clause.

782. In *Noble Ventures, Inc. v. Romania* (*op.cit*), the tribunal interpreted a virtually identical umbrella clause in the U.S.-Romania BIT. The issue was whether the tribunal had jurisdiction over a dispute arising under a very similar Privatization Agreement. The tribunal decided that the claimant's breach of contract claim *"constitutes a* [claim of] *breach of the BIT."* Similarly, the tribunal in *Eureko v. Poland* (*Ad Hoc Partial Award*, August 19, 2005) interpreted the Netherlands-Poland BIT with an almost identical umbrella clause, and extended its jurisdiction over a contractual claim.

D. Romania is under no obligation to exhaust local remedies before submitting its Counterclaim

783. Article 26 clearly states that "[a] *Contracting State* ***may*** require the exhaustion of local administrative or judicial remedies as a condition of its consent to arbitration under this Convention" (emphasis added). The fact is that under Article 26 Romania *may* require exhaustion of local remedies. A Contracting State must actually include in its BIT an explicit provision requiring exhaustion of local remedies in order for exhaustion to become a condition precedent to the exercise of ICSID jurisdiction over investor-state claims. Romania has not done so.

784. Respondent further contends that, since Article 26(2) does not require Roussalis to exhaust local remedies, he has no basis for insisting that Romania exhaust its local remedies before asserting its counterclaims.

E. Romania's claim for losses incurred in the period from November 1998 to December 1999 is not time-barred

785. During the period from November 1998 to December 1999, Continent SRL used warehouse space rent-free, which resulted in an estimated USD 900,000 in lost revenues for Continent SA. Respondent's damages claim includes that USD 900,000.

786. Respondent denies Claimant's allegation that Romanian Decree n°167/1958 bars Romania's claim for the above losses incurred in the period from November 1998 to December 1999. According to Respondent, the Tribunal is not constrained by municipal statutes of limitations.

787. In *Wena Hotels Limited v. Arab Republic of Egypt* (ICSID Case No. ARB/94/4), the ICSID tribunal held that: *"municipal statutes of limitation do not necessarily bind a claim for a violation of an international treaty before an international tribunal.*" Indeed, international tribunals may consider equitable principles of prescription. Applying equitable principles of prescription to the facts of the *Wena* case, the tribunal concluded that there was no reason to deny a claim on limitations grounds where Egypt had ample notice of Wena's claims and where neither party appeared to be substantially harmed in its ability to bring its case at ICSID.

788. According to Respondent, equitable principles militate in favor of rejecting Claimant's statute of limitations defense. By invoking the Tribunal's jurisdiction to evaluate the relevant facts from the period 1999-2001 for his Investment Claim, Claimant cannot fairly rely on a domestic statute of limitations to avoid the adjudication of a counterclaim

based on the same or related facts from the same time period. Claimant has had ample opportunity to respond to the counterclaims and has pointed to no prejudice he has suffered as a result of the counterclaims being asserted against him. Moreover, Claimant has been litigating with AVAS over the same issues in the share pledge litigation since AVAS commenced suit in 2001. By commencing this arbitration, Claimant accepted the Tribunal's authority to resolve all claims and counterclaims involving the same underlying facts, whether or not they would be time-barred in a Romanian court.

789. Moreover, Article 41(2) of the Romanian Criminal Code provides that *"an offence is continuing when a person commits such offence at different times, but on the basis of the same resolution, acts or omissions, each of them presenting the content of the same criminal offence."* Accordingly, even if the 3-years statute of limitations were applicable, Claimant's misappropriation of funds from Continent SA is a continuing act that began in 1998 and continues to the present day. Therefore, the three-year statute of limitations has not even started to run.

F. Romania was not required to annul the Ozias contracts before filing its Counterclaim

790. Finally, Respondent refutes Claimant's contention that Romania's counterclaim for damages arising out of the consulting contracts concluded between Continent SA and Ozias Marine is inadmissible because Romania failed to seek the prior annulment of those contracts.

791. Romania's counterclaim for damages is a tort claim. There is no requirement under the ICSID Convention or Romanian law that would require Romania to nullify the consultancy contracts (to which Romania is not even a party) as a precondition to advancing a tort claim flowing from the sham nature of those consultancy contracts.

III. BASIS OF COUNTERCLAIMS

A. Enforcement of Share pledge against Continent SRL and damages for misappropriated funds

792. As demonstrated above (see ¶¶174-203), Continent SRL failed to invest USD 1.4 million in Continent SA during the period from January 1, 1999 to December 31, 2000.

793. Under Article 8.10.3 of the Privatization Agreement, Continent SRL agreed (a) to grant and register a pledge of the 372,523 shares acquired by Continent SRL, and (b) that *"in case* [Continent SRL] *does not fulfill its obligations stipulated at Article 8.10.1 and 8.10.2, then* [AVAS] ***will*** *execute the pledge over the shares*" (emphasis added). Therefore, if the Tribunal finds that the required investment was not made by Continent SRL in accordance with the Privatization Agreement, it should enforce the share pledge and order Claimant and Continent SRL to cause the 372,523 shares obtained pursuant to the contract to be pledged and transferred to AVAS, as contemplated by Article 8.10.3(e).

794. This counterclaim also seeks damages against Continent SRL for funds misappropriated from Continent SA after privatization:

- Continent SRL exerted control over Continent SA by allowing Continent SRL to use a space rent-free, costing Continent SA an estimated USD 900,000 in lost revenues from November 1998 through December 1999 (see above, ¶¶199 *et seq*.).

- Continent SRL caused Continent SA to expend considerable resources to convert buildings located at 1 Razoare Street into a personal residence for Roussalis (see above, ¶174). Roussalis did not reimburse Continent SA for these personal expenses.

- Roussalis, through his group of companies, inflated the cost of various capital items allegedly purchased as part of the investment obligation by directing his companies to issue invoices to Continent SA for the items with a substantial mark-up in price (see above, ¶¶189 *et seq*.).

- Payments of USD 696,000 and EUR 216,000 were made by Continent SA to a Roussalis-owned company (Ozias), for purported consulting services that were, in fact, never rendered. This represents a significant drain of resources from Continent SA directly to Roussalis and his son, the co-owners of Ozias (see above, ¶704 *et seq*.).

795. In this regard, Respondent requested that the Tribunal bifurcate proceedings on this claim, so that the quantum of damages can be determined in separate proceedings to be conducted after liability for misappropriation of funds has been established.

796. Respondent's counterclaim for damages owed as a result of the misappropriated funds is grounded in Articles 998-999 of the Romanian Civil Code, which lay down the principle of civil tort liability:

- Art. 998: "*Any deed of a person, which causes to another person a loss, obliges the person due to whose fault the loss was occasioned to repair such loss*".

- Art. 999: "*The person is liable not only for the loss caused by his own deed, but also for the loss caused by his negligence or imprudence*"..

797. Respondent asserts that Romania has standing to submit its Counterclaim under Articles 998 and 999 because the Romanian state has been harmed by Roussalis's failure to honor his obligations under the Privatization Agreement. If the Tribunal holds that it has jurisdiction to decide the Counterclaim, and that Roussalis, and his two companies, are liable, then the Tribunal should award an appropriate remedy to Romania, which may be entitled to receive an award of monetary damages.

798. Moreover, Article 272 of Romania's Law 31/1990 on commercial companies provides that: "[i]*t is punished with imprisonment from one to three years the shareholder, director, officer or legal representative of the company who: […] 2. uses, with bad faith, the assets or the credit standing of the company for a purpose contrary to the company's interests or to its own benefit or to favor another company in which he holds directly or indirectly a stake*."

799. Finally, pursuant to Article 1003 of the Romanian Civil Code, *"when the civil delict* […] *is imputable to more than one person, such persons are jointly and severally liable for damages"*. Consequently, Claimant and Continent SRL must be held jointly and severally liable for the damages incurred by AVAS, acting on behalf of Romania, due to the misappropriation of the corporate funds following the privatization of Continent SA.

800. Under the relevant provisions of Romanian law, AVAS has a duty to conduct privatization processes in accordance with sound commercial principles and to take reasonable steps to enhance the value of companies being privatized. This duty is central to the mission of AVAS to make former state enterprises attractive to private investors and thus achieve the highest market prices for privatized companies, in accordance with Article 43 of the Government Ordinance 88/1997 regarding the privatization of commercial companies. Respondent submits that the market value for Continent SA has been adversely affected by misappropriation and self-dealing on the part of Claimant and Continent SRL. Therefore Romania is entitled to recover as damages all amounts they improperly took from Continent SA following the privatization sale.

B. Declaration that the shareholders' resolution is not properly grounded

801. Respondent submits that the Expert Proiect report is unreliable and failed to establish that Continent SRL made the investment required under the Privatization Agreement. Therefore, Respondent asks the Tribunal to declare, as part of the Award, that the shareholders' resolution was groundless.

C. Counterclaim against Claimant for each of these foregoing claims

802. The claims against Roussalis are the same as set forth above against Continent SRL for damages and enforcement of the share pledge, and against Continent SA for a declaration concerning the ungrounded resolution of the shareholders in approving the share capital increase. Respondent requests that the Tribunal direct Claimant to pay any damages that may be awarded and to cause Continent SRL to transfer the shares acquired pursuant to the Privatization Agreement to AVAS, thereby enforcing the share pledge, as the contract contemplates, for the breach of the investment obligation.

803. If the Tribunal grants any relief sought in the counterclaims against Continent SRL and Continent SA, the same relief should be granted, jointly and severally, against Roussalis. According to Respondent, he was the mastermind of the unlawful schemes and should therefore be held accountable by the Tribunal.

D. Amendment of Respondent's Counterclaim

804. In its Rejoinder, Respondent amended its Counterclaim. The amendment is based on the same facts as those alleged in support of the Counterclaim as originally filed. The amendment revises the Request For Relief to include, as additional and/or alternative relief, a request (1) that the Tribunal hold Roussalis and Continent SRL jointly and severally liable to pay money damages for the value of the 372,523 shares in Continent SA, originally sold by AVAS to Roussalis in 1999; and (2) that the Tribunal hold Roussalis and Continent SRL jointly and severally liable to pay money damages to the

value of the additional 1,414,648 shares issued to Continent SRL resulting from the share capital increase, but provide that the award of such damages will be deemed satisfied by cancellation of the registration of those shares with the Trade Registry immediately following the Tribunal's final Award; and (3) that the Tribunal hold that Respondent is entitled to an award of compound interest on all the damages awarded to Romania, to be calculated in accordance with applicable ICSID precedent, which will be addressed by the parties during the damages phase of the case.

805. Respondent submits that the amendment to the Counterclaim was not untimely and should be allowed because Claimant had sufficient opportunity to respond to the proposed amendment in his Rejoinder, and will again have it again during the damages phase of the proceedings. In *Atlantic Triton v. Guinea* (Award of April 21, 1986, 3 ICSID Rep. 18), Guinea added additional elements to its counterclaims in its rejoinder. Since Guinea's Rejoinder was the last scheduled submission in the written procedure, the ICSID tribunal in that case permitted Atlantic Triton to file its own rejoinder on the counterclaims to address Guinea's added points.

IV. Request for Relief

806. In its Counter-Memorial, Respondent requested that the Tribunal:

(1) declare that Continent SRL failed to fulfill its investment obligation and is therefore in breach of the Privatization Agreement;

(2) order Continent SRL to transfer, and Claimant to cause Continent SRL to transfer, to AVAS the shares in Continent SA purchased under the Privatization Agreement (372,523 shares numbered from 1 to 372,523);

(3) order Claimant and Continent SRL, jointly and severally, to pay damages, to be assessed after liability is determined, in a sum representing the value of all funds misappropriated from Continent SA after privatization; and

(4) declare that the resolution of the Continent SA shareholders on December 15, 2000 to increase the share capital was ungrounded.

807. In its Rejoinder, Respondent has requested that the Tribunal:

(1) declare that Claimant Roussalis and/or Continent SRL failed to fulfill the postprivatization obligation to invest USD $1.4 million in Continent SA and that they are therefore in breach of the Privatization Agreement;

(2) order Claimant Roussalis and Continent SRL, jointly and severally, to pay money damages to Romania equal to the value of the 372,523 shares in Continent SA numbered from 1 to 372,523 as of a date determined by the Tribunal in accordance with evidence to be presented during the damages phase of the proceedings on the Counter-Claim; PROVIDED HOWEVER that said award of money damages will be deemed fully satisfied if Claimant Roussalis, immediately upon issuance of the Tribunal's final Award, delivers to Respondent the 372,523 shares in Continent SA numbered from 1 to 372,523 and causes the cancellation of the registration with the

Trade Registry of the additional 1,414,648 shares in Continent SA issued to Continent SRL in relation to the shareholders' resolution approving a share capital increase;

(3) order Claimant Roussalis and Continent SRL, jointly and severally, to pay damages equal to the amount of all funds determined during the damages phase of the Counter-Claim proceedings to have been misappropriated from Continent SA after the date of Privatization Agreement by Claimant Roussalis and/or Continent SRL and/or other companies owned and controlled by Claimant Roussalis;

(4) declare that the resolution of the Continent SA shareholders on December 15, 2000 to increase its share capital was ungrounded and shall be deemed to have no legal effect;

(5) order Claimant Roussalis and Continent SRL, jointly and severally, to pay additional money damages to Romania equal to the value of the additional 1,414,648 shares issued to Continent SRL pursuant to the resolution of the Continent SA shareholders on December 15, 2000; PROVIDED HOWEVER that said award of money damages will be deemed fully satisfied if Claimant Roussalis delivers to Romania all of the aforementioned additional shares in Continent SA immediately upon issuance of the Tribunal's final Award;

(6) order Claimant Roussalis and Continent SRL, jointly and severally, to pay damages to Respondent Romania for the diminution in the value of the 372,523 shares that are the subject of item 2, above, as a result of misappropriation of assets of Continent SA, or as a result of the dilution of Continent SA's shares by issuing 1,414,648 additional shares to Continent SRL based on fraudulent or insufficient evidence of a corresponding capital contribution;

(7) order Claimant Roussalis and Continent SRL, jointly and severally, to pay compound interest on the amounts awarded to Respondent Romania as provided in sub-paragraphs 2 and 5, above, to be calculated in accordance with recent ICSID decisions.

808. In its Post Hearing Brief, Respondent formulates its prayer for relief as follows:

Romania asks that the Tribunal enter an interim award that includes the following elements:

From Spyridon Roussalis and Continent SRL:

- *A declaration that Claimant and/or Continent SRL failed to fulfill the obligation to invest USD $1.4 million in Continent SA and that they are therefore in breach of the Privatization Agreement. Resp. Rej. para. 230(1).*
- *An order that Claimant and Continent SRL tender to Romania the privatized shares or pay damages to Romania equal to the value of the originally privatized shares, Resp. Rej. para. 230(2).*
- *An order that Claimant and Continent SRL tender the shares issued in connection with the fraudulent share capital increase or pay damages to Romania equal to the value of those shares plus any uncompensated diminution in value to the privatized shares. Resp. Rej. para. 230(5).*

- *An order that Claimant and Continent SRL pay damages to Romania equal to the value of the funds misappropriated by him or on his behalf from Continent SA since the date of the Privatization Agreement. Resp. Rej. para. 230(3).*
- *Pre- and post-award compound interest on the above money damages in accordance with recent ICSID decisions. Resp. Rej. para. 230(7).*

From Continent SA:

- *declare that the resolution of the Continent SA shareholders on December 15, 2000 to increase its share capital was ungrounded and shall be deemed to have no legal effect.*

809. Finally, Respondent submits that the Tribunal has discretion pursuant to Article 61(2) of the ICSID Convention to direct the losing party to reimburse the prevailing party for its attorneys' fees and costs. Claimant's institution of this arbitral proceeding has required Romania to incur significant fees and costs to defend claims that that are wholly without merit and exceed the jurisdiction of the Tribunal. In particular, Claimant's contention that Continent SRL met its post-privatization investment obligation is not only incorrect, but Claimant also knew it to be incorrect at the time he submitted his claims to ICSID. Further, Claimant knew or should have known at the time he submitted his claims to ICSID that his Food Safety, Interdiction, Fiscal and Ozias claims do not arise out of his investments in Continent SRL and Continent SA and are clearly not within the Tribunal's jurisdiction. Further, he surely knew or should have known, that those claims were utterly without merit.

810. Respondent alleges that Claimant's conduct in this proceeding has exemplified bad faith. Claimant's misconduct has necessitated two requests for provisional measures – both of which were granted by the Tribunal – to stop the sale of Continent SA's assets during the pendency of these proceedings, and to require Respondent to take appropriate steps to obtain a suspension of the parallel proceedings in Romanian courts. In addition, Claimant failed to comply with Respondent's reasonable discovery requests by the agreed deadline.

811. Accordingly, the Tribunal should follow the principle that "costs follow the event," making the losing party bear the costs of the proceeding and reimburse Respondent for its attorneys' fees and expenses related to this case.

812. In conclusion, Respondent requests that *"the Tribunal deny Claimant's claims, rule that it has jurisdiction over Respondent's counter-claims, and hold Claimant, together with its two companies, liable for the counter-claims."*

SECTION II. CLAIMANT'S POSITION ON RESPONDENT'S COUNTERCLAIM

I. THE INADMISSIBILITY OF THE COUNTERCLAIM ON JURISDICTIONAL AND PROCEDURAL GROUNDS

A. In general

813. Claimant points out that, in order to assert the Tribunal's jurisdiction over the counterclaims, Respondent employed a subterfuge and redefined the investment by breaking it down into two different investments. Respondent admitted that the first one, the purchase of Continent SA's shares, was made but alleged, at the hearing, that the second one, the post purchase investment, was not performed in accordance with the SPA (Transcript, Day 4, pages 124 *et seq*.).

814. According to Claimant, on the one hand, if Respondent chose to contest the investment through the non-performance of the SPA, it should have challenged the overall jurisdiction of the Tribunal and would not therefore have been able to bring a counterclaim. In this regard, the absence of a challenge on jurisdiction by Respondent in this context is an implicit admission that the SPA was duly performed.

815. On the other hand, if Respondent chose to contest only the post purchase investment and not the purchase of Continent SA's shares, then, if Respondent were successful, the Tribunal would only have had jurisdiction over the investment that was not contested. Therefore Respondent's counterclaims should be dismissed. Accordingly, the Tribunal does not have jurisdiction over Respondent's Counterclaim, in any of the above schemes.

816. Claimant refutes Respondent's allegations that its Counterclaim has the same object as the issues raised in Claimant's Request. Indeed, Claimant has brought his case before the Tribunal to address Respondent's breach of Article 4(1) of the Treaty, Article 2(2) part 1 of the Treaty, Article 2(2) part 2 of the Treaty, Article 1 of the First Additional Protocol to the European Convention, and Article 6 of the European Convention. Each of Claimant's subsequent submissions was confined to the analysis of these breaches and the facts that represent these breaches.

817. Claimant submits that ICSID tribunals only have jurisdiction over disputes concerning breaches of bilateral investment treaties. Therefore, Respondent's Counterclaim is made up of claims that must be brought before national courts since they do not relate to Treaty breaches. According to Claimant, Respondent should wait until the Arbitral Tribunal issues an award on Claimant's requests, and subsequently, if Romania is awarded a favorable decision, turn to the national courts.

818. Moreover, Claimant denies that application of the umbrella clause in Article 2(6) of the Treaty defeats Claimant's argument that since the Counterclaim is contractual and arise under the Privatization Agreement, they can only be submitted to national courts. Article 2(6) of the Treaty provides that "[e]*ach Contracting Party shall observe any other* ***obligation*** *it may have entered into* ***with regard to investments of investors*** *of the Contracting Party*" (emphasis added). Claimant points out that Article 2(6) *"refers to the liabilities the contracting parties have in relationship with the investors, and it does NOT*

refer to the rights the contracting parties have in relationship with the investors [sic]*"*. Accordingly, the umbrella clause can only apply to Claimant's obligations, not to Respondent's rights.

819. *Noble Ventures, Inc. v. Romania,* ICSID Case N°ARB/01/11, involved interpretation of a similar umbrella clause in the U.S.-Romania BIT. The tribunal considered Claimant's contractual obligations and admitted that their breach may constitute a breach of the BIT. Similarly, the tribunal in *Eureko v. Poland* (*Ad Hoc Partial Award*, August 19, 2005) interpreted the umbrella clause in the Netherlands-Poland BIT, and asserted jurisdiction over a contractual claim, although not over a counterclaim.

B. Lack of Claimant's consent

820. Article 46 of the ICSID Convention provides that: "[e]*xcept as the parties otherwise agree, the Tribunal shall, if requested by a party, determine any incidental or additional claims or counterclaims arising directly out of the subject-matter of the dispute provided that they are within the scope of the consent of the parties and are otherwise within the jurisdiction of the Centre"*. Similarly, Rule 40 of the ICSID Arbitration Rules provides: "[e]*xcept as the parties otherwise agree, a party may present an incidental or additional claim or counter-claim arising directly out of the subject-matter of the dispute, provided that such ancillary claim is within the scope of the consent of the parties and is otherwise within the jurisdiction of the Centre."*

821. In light of the above, Claimant submits that the respondent in an investment dispute is permitted to submit counterclaims only with the claimant's agreement. However, Claimant did not consent to the arbitration of Romania's Counterclaim in this case, having expressly objected thereto in his Counter-Memorial (*see* Claimant's Counter-Memorial, ¶11).

822. Moreover, Claimant's representation to the Romanian court in the share pledge litigation that AVAS's share pledge enforcement action should be decided at ICSID cannot be construed as an agreement that Respondent may submit counterclaims. Claimant has consistently requested the termination of the domestic litigation, since this dispute, under its investment aspects, was indeed to be settled by the Arbitral Tribunal.

823. In the same vein, Claimant's argumentation developed in its Submission on the Request for Provisional Measures should not be read as an agreement that Respondent submit counterclaims. According to Claimant, Respondent's request that Claimant agree to stay the domestic litigation amounted to a request to forego the application of Article 26 of the ICSID Convention. Indeed, the registration of the ICSID case should have resulted in the termination of the internal procedures and the withdrawal of Respondent's requests before the national courts.

824. In this regard, Respondent cannot rely on the findings of the tribunal in *SGS Société Générale de Surveillance S.A. v. Islamic Republic of Pakistan,* ICSID Case No. ARB/01/13, which states that it is equitable that a respondent be allowed to submit

counterclaims. Indeed, in *SGS v. Pakistan,* the disputed counterclaim could be settled on the basis of the provisions of the relevant bilateral investment treaty.

825. Claimant denies Respondent's allegation that the Tribunal should decide on the counterclaims because it would not make sense to have half of the dispute decided before the Tribunal and half of the dispute decided before the Romanian courts (Transcript, Day 4, p.134 *et seq*.). According to Claimant, there is no general principle of international law that allows a State to appeal against its own courts' rulings under the protection of an investment treaty. The Tribunal lacks the competence to do so under the operation of Article 9 of the Treaty.

826. Moreover, Article 41 of the ICSID Convention compels the Tribunal to determine the extent of its own competence. The determinations of Romanian law that are the object of the counterclaims do not fall within the subject matter jurisdiction of the Tribunal. The Tribunal is not competent to allow a further appeal against the Romanian courts' findings on behalf of the State.

C. The Tribunal has no jurisdiction to decide counterclaims against Roussalis

827. Claimant points out that the Treaty concerns the protection of investments. The Treaty provides obligations owed by its Contracting States to investors and not vice versa. Indeed, the Treaty restricts the possibility of the State to file counterclaims.

828. Under Article 9(1), the jurisdiction of an ICSID tribunal is strictly limited to disputes *"between an investor of a contracting party and* ***the other*** *contracting party* ***concerning an obligation of the latter*** *under this agreement..."* (emphasis added). Accordingly, the jurisdiction of ICSID tribunals is limited to disputes concerning obligations owed to the investor by the State party.

829. Claimant contends that Romania is not permitted to assert claims against Roussalis because Article 9(2) of the Treaty provides that "*the investor concerned may submit the dispute (…) to international arbitration*." Accordingly, investment disputes can only be heard by an ICSID tribunal when it is the investor, not the State, who has submitted the dispute. Article 9(3) further provides that only the investor has the power to submit disputes and *"may submit"* them to either an *ad hoc* tribunal established pursuant to the UNCITRAL Rules or to a tribunal established under the auspices of ICSID.

830. Claimant points out that the meaning of "*the dispute*" for the purposes of Article 9 is related to the issue of compliance with the Treaty.

831. According to Claimant, the purpose of the Treaty was clear. Both in the text and the preamble, the aim of the Treaty obligations entered into by the State was set out as to promote and protect in accordance with its terms, the investment of the foreign investor.

832. According to the above provisions, Respondent *can only be sued* before arbitral tribunals for breaches of the obligations it assumes under the Treaty. It *cannot be a claimant* for this kind of claim; otherwise it would *"deny its own sovereignty"* (Claimant's Rejoinder, p.14).

833. Moreover, Claimant submits that Romania is not permitted to assert claims against Roussalis based on actions of Continent SA and Continent SRL. Indeed, Respondent's Counterclaim is related to obligations contained in the Privatization Agreement. However, Claimant is not a party to that contract, only Continent SRL is a party to it.

834. According to Claimant, since Respondent's Counterclaim relates to breaches of Continent SRL's obligations under the Privatization Agreement, they should be resolved before the Romanian courts.

D. The Tribunal has no jurisdiction to decide counterclaims against Continent SRL and Continent SA

835. Article 25 of the ICSID Convention provides that : *"(1) The jurisdiction of the Centre shall extend to any legal dispute arising directly out of an investment, between a Contracting State (or any constituent subdivision or agency of a Contracting State designated to the Centre by that State)* ***and a national of another Contracting State****, (...) (2) "National of another Contracting State" means: (a) any natural person who had the nationality of a Contracting State* ***other than the State party to the dispute"*** (emphasis added).

836. Accordingly, the Tribunal has no jurisdiction over Continent SRL and Continent SA, as locally incorporated entities. As Romanian companies, they cannot become parties to this arbitration.

837. In this regard, Claimant denies Respondent's contention that jurisdiction over Continent SA and Continent SRL is triggered by the fact that Roussalis must be considered an *alter ego* of the two companies. Indeed, according to Article 1(3) and 1(4) of the Treaty (see above, ¶¶44-45), in this case, the investor must be a Greek person.

838. In addition, Claimant submits that the *Klöckner v. Republic of Cameroon,* ICSID Case No. ARB/81/2*,* where the tribunal decided that it had jurisdiction to rule on the counterclaim against both the investor and its local subsidiary, cannot presently be invoked since it runs counter the provisions of the Treaty.

839. Moreover, Continent SRL and Continent SA are not claimants in this arbitration. Therefore, counterclaims cannot be submitted against them.

E. Romania failed to exhaust local remedies before submitting its Counterclaim

840. Article 26 of the ICSID Convention provides as follows: *"Consent of the parties to arbitration under this Convention shall, unless otherwise stated, be deemed consent to such arbitration to the exclusion of any other remedy. A Contracting State may require the exhaustion of local administrative or judicial remedies as a condition of its consent to arbitration under this Convention."*

841. Accordingly, Claimant contends that Romania was obliged to exhaust local remedies before submitting its Counterclaim to ICSID arbitration, which it did not do.

842. Claimant refutes Respondent's theory that a Contracting State must include in its BIT an explicit provision requiring exhaustion of local remedies in order for this to be a precondition to ICSID jurisdiction. Claimant's contention is based on the ICSID Convention, ratified by Romania prior to conclusion of the Treaty, without reservation to Article 26.

843. Moreover, Romania's contention that, since Article 26(2) does not require Claimant to exhaust his local remedies as a precondition to ICSID arbitration, he has no basis for insisting that Romania exhaust its local remedies before asserting its Counterclaim, is misconceived. This arbitration was filed because of the unjustified local measures taken by AVAS, not by Claimant. Furthermore, Claimant is not a party and therefore not subject to the ICSID Convention.

F. The Counterclaim is time barred under the Romanian statute of limitations

844. During the period from November 1998 to December 1999, Continent SRL used warehouse space rent-free, resulting in an estimated USD 900,000 in lost revenues for Continent SA, which Respondent claims as damages.

845. Romanian Decree n°167/1958 provides for a 3-year general prescription for material claims. Accordingly, Claimant contends that Romania's claim for losses incurred in the period from November 1998 to December 1999 is time-barred.

846. Claimant denies that Respondent can rely on Claimant's alleged misappropriation being continuous and ongoing as ground that the limitation period has not started running. Indeed, the Counterclaim at stake is of a civil nature, the criminal argument invoked by Respondent has therefore no relevance. Moreover, Roussalis is not subjected to any criminal investigation in relation to this Counterclaim.

G. Romania lacks standing to bring a Counterclaim for damages

847. Claimant challenges Respondent's standing to assert its Counterclaim under Articles 998 and 999 of the Romanian Civil Code regarding civil tort liability. Articles 998 and 999 enable one who has sustained a loss to recover that loss from the person who caused it. Claimant argues that Respondent does not have standing to assert counterclaims based on these statutes because Respondent did not sustain a *direct* loss as a result of Continent SRL's non-fulfillment of the required investment. Claimant alleges that the loss was sustained by Continent SA and that Respondent would have needed to be a majority shareholder of Continent SA at the time in order to recover under these provisions.

848. Claimant further submits that Respondent lacks standing to assert its Counterclaim against Claimant and Continent SRL based on Article 272 of Romania's Law 31/1990 on commercial companies. This article is not applicable between legal entities.

H. The Counterclaim for damages arising out of the Ozias contracts is inadmissible because Romania must seek the annulment of those contracts as a condition precedent to bringing a damages claim

849. Claimant states that the Arbitral Tribunal *"has not been requested to sentence the annulment of these contracts, with the sentence it will pronounce, which is inadmissible"* (Claimant's Reply, ¶92).

II. THE AMENDMENT OF THE COUNTERCLAIM IS INADMISSIBLE

850. Claimant further submits that Article 40(2) of the ICSID Arbitration Rules sets the deadline for the filing of a Counterclaim. It provides that *"An incidental or additional claim shall be presented not later than in the reply and a counter-claim no later than in the countermemorial..."* Accordingly, Respondent may not, as it has sought, present a Counterclaim in its Rejoinder.

III. THE COUNTERCLAIM IS MERITLESS

851. As established above, Claimant has fulfilled its post-purchase investment obligations. Respondent's claim relating to this issue should therefore be dismissed.

852. As regards the AVAS share pledge dispute, the Supreme Court affirmed the lower courts' decisions and ruled in favor of Continent SRL. The June 30, 2009 decision of the Romanian Supreme Court held that the investment obligation had been fulfilled (Claimant's Rejoinder Exhibit n°1). This decision is final and irrevocable. Therefore, AVAS's lien execution request related to the 372,523 shares should be denied.

853. As far as the "absolute nullity" issue is concerned, Claimant contends that the Commercial Court decision of July 8, 2009 dismissed Respondent's claims as groundless (Claimant's Rejoinder Exhibit n°2). Therefore, Respondent's arguments that are derived from the purported nullity of the shareholders' resolutions should be rejected.

854. In particular, in light of the irrevocable determination that Claimant's investment obligations were properly fulfilled, Respondent's claims requesting delivery to Respondent, cancellation of the Continent SA shares, or payment of money damages for the value of the shares, should be dismissed.

855. In any case, since the Romanian courts determined that no funds were misappropriated by Continent SA after the date of the Privatization Agreement, Respondent's claim in this respect should be dismissed.

856. The Romanian authorities' decisions imposing tax, VAT and penalties have been declared illegal by Romanian courts. Accordingly, Respondent should not be permitted to bring the issue again within the scope of this arbitration and claims related to this issue should be dismissed.

857. Respondent's claim concerning the Ozias dispute is meritless.

858. Finally, Respondent's claim concerning the arbitration expenses should be dismissed. Indeed, Claimant's claim is mainly based on Respondent's abusive measures, the main request being that Respondent put an end to such abusive remedies. In this regard, the Romanian courts have rendered judgments by means of which AVAS's proceedings have been rejected. Consequently, Respondent's Counterclaim is without merit. Claimant submits that since Respondent incurred significant fees and costs to submit counterclaims that are wholly without merit, "*the Respondent shall integrally bear the payment of these expenses, and no compensation right shall be granted*" (Claimant's Rejoinder, p. 25).

SECTION III. DECISION OF THE TRIBUNAL

859. Respondent presents several counterclaims which have been outlined above.

860. Being the party asserting that the Tribunal has jurisdiction to hear and determine the counterclaims which it seeks to bring before the Tribunal, the Respondent carries the burden of establishing that jurisdiction exists.

861. Article 46 of the ICSID Convention provides that:

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

862. Similarly, Rule 40 of the ICSID Arbitration Rules provides:

"*Except as the parties otherwise agree, a party may present an incidental or additional claim or counter-claim arising directly out of the subject-matter of the dispute, provided that such ancillary claim is within the scope of the consent of the parties and is otherwise within the jurisdiction of the Centre.*"

863. Under these rules, the Tribunal shall determine any counterclaims arising directly out of the subject-matter of the dispute provided that they are within the scope of the consent of the Parties and are otherwise within the jurisdiction of the Centre.

864. Therefore, the first issue which the Tribunal has to determine is whether – and irrespective of the particular counterclaims advanced in these proceedings by the Respondent – the Parties *consented* to have the State's counterclaims arbitrated.

865. Under the system created by the ICSID Convention, consent by both parties is an indispensable condition for the exercise of the Centre's jurisdiction. The Convention only requires that consent be in writing, leaving the parties otherwise free to choose the manner in which to express their consent.

866. It is not disputed that Respondent expressed its consent to arbitration in the BIT and that Claimant accepted Romania's offer to arbitrate. Contrary to Claimant however, Respondent considers that such consent included consent to arbitrate counterclaims.

Whether it is so must be determined in the first place by reference to the dispute resolution clause contained in the BIT. The investor's consent to the BIT's arbitration clause can only exist in relation to counterclaims if such counterclaims come within the consent of the host State as expressed in the BIT.

867. In determining how to interpret agreements to arbitrate under the ICSID Convention, the Tribunal is guided by an ICSID decision which held that:

"[A] convention to arbitrate is not to be construed restrictively, *nor, as a matter of fact,* broadly *or* liberally. *It is to be construed in a way which leads to find out and to respect the common will of the parties.... Moreover, ...any convention, including conventions to arbitrate, should be construed in good faith, that is to say by taking into account the consequences of the commitments the parties may be considered as having reasonably and legitimately envisaged"* (*Amco Asia et al. v. Indonesia*, Decision on Jurisdiction of September 25, 1983, 23 I.L.M. 359 (1984).

868. In this respect, Article 9 of the BIT provides in its relevant parts that:

*"**Disputes between an investor of a Contracting Party and the other Contracting Party concerning an obligation of the latter under this Agreement, in relation to an investment of the former**, shall, if possible, be settled by the disputing parties in an amicable way...*

*If such disputes cannot be settled within six months from the date either party requested amicable settlement, the investor concerned **may submit** the dispute either to the competent courts of the Contracting Party in the territory of which the investment has been made or to international arbitration"*(emphasis added).

869. Pursuant to the interpretation rules of Article 31 of the Vienna Convention and the above quoted ICSID decision, the Tribunal in its majority considers that the references made in the text of Article 9(1) of the BIT to *"disputes ... concerning an obligation of the latter"* undoubtedly limit jurisdiction to claims brought by investors about obligations of the host State. Accordingly, the BIT does not provide for counterclaims to be introduced by the host state in relation to obligations of the investor. The meaning of the "dispute" is the issue of compliance by the State with the BIT.

870. Article 9(4) of the BIT further provides, in respect of the applicable law, that:

"The arbitral tribunal shall decide the dispute in accordance with the provisions of this Agreement [the BIT] *and the applicable rules and principles of international law..."*

871. As mentioned above, the BIT imposes no obligations on investors, only on contracting States. Therefore, where the BIT does specify that the applicable law is the BIT itself, counterclaims fall outside the tribunal's jurisdiction. Indeed, in order to extend the competence of a tribunal to a State counterclaim, *"the arbitration agreement should refer to disputes that can also be brought under domestic law for counterclaims to be within the tribunal's jurisdiction"* (P. Lalive and L. Halonen, "On the availability of

Counterclaims in Investment treaty Arbitration," *Czech yearbook of international law,* 2011, p.141, n°7.19).

872. In light of the foregoing, the Tribunal considers that the Parties did not consent to have Respondent's Counterclaim arbitrated.

873. Contrary to the Respondent's position, this absence of consent to have the State's counterclaim arbitrated cannot be overcome by the application of the umbrella clause in Article 2(6) of the Treaty.

874. Article 2(6) of the BIT provides that:

"*Each Contracting Party shall observe any other obligation it may have entered into with regard to investments of investors of the Contracting Party*" (emphasis added).

875. Pursuant to the interpretation rules of Article 31 of the Vienna Convention, the reference in the text of Article 2(6) of the BIT to "*any other obligation ... with regard to investments of investors"* confirms that the host State commits itself to comply with obligations it has entered into with regard to investments of investors. It does not permit that claims be brought about obligations of the investor.

876. For all these reasons, by a majority opinion, the Tribunal finds that the Counterclaim is beyond its jurisdiction in the present proceedings.

877. The Tribunal therefore declares the proceeding closed and issues the present award.

CHAPTER VI. COSTS

878. Article 61 of the ICSID Convention addresses three types of costs which are to be assessed and allocated by the Arbitral Tribunal, namely (a) the expenses incurred by the Parties in connection with the proceedings; (b) the fees and expenses of the members of the Tribunal, and (c) the fees and expenses of ICSID itself.

879. Items (b) and (c) above are referred to collectively below as the "costs of the arbitration."

880. Each party in this case has claimed the costs it has incurred in relation to these proceedings, and detailed submissions have been made in this regard. The Parties do not dispute that the Tribunal has the discretion to allocate costs.

881. In the Arbitral Tribunal's view, the following matters are of key significance in relation to the allocation of costs in this case:

(a) Roussalis has not demonstrated that Romania acted in violation of the BIT, all his claims were rejected, and to this extent Romania has been successful;

(b) On the other hand, Romania has submitted a lengthy Counterclaim and failed to demonstrate that the Tribunal had jurisdiction over the Counterclaim.

882. Therefore, although Romania has prevailed on the substance of the dispute, it has failed on its allegations regarding the Counterclaim. On this basis, using its discretion, the Tribunal considers fair that Claimant be ordered to pay 60% of the costs of the arbitration and of Respondent's legal costs and fees as detailed in Romania's submission in support of its claim for an award of costs of June 7, 2011 (with appendices under tab 1 to 5). Accordingly, the Tribunal orders Claimant to pay to the Respondent the sum of USD 217,290, representing 60% of the estimated expended portion of the Respondent's advance on the costs of the arbitration (USD 362,150),[12] as well as EUR 6,053,443.78, representing 60% of the Respondent's legal fees and expenses (EUR 10,089,072.98).

AWARD

For the foregoing reasons, the Arbitral Tribunal decides and declares as follows:

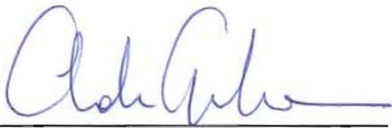
(a) That the Arbitral Tribunal has jurisdiction over this dispute, in so far as it concerns alleged claims of violations of the BIT put forward by Claimant; but that it has no jurisdiction over the Respondent's Counterclaim;

(b) That Claimant's claims are unfounded and are therefore dismissed;

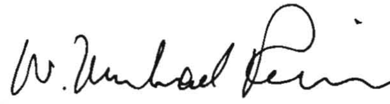
(c) That Claimant shall pay to the Respondent USD 217,290 in reimbursement of 60% of the expended portion of the Respondent's advance on the costs of the arbitration and EUR 6,053,443.78 representing 60% of the Respondent's legal fees and expenses;

(d) This award puts an end to the provisional measures adopted by the Arbitral Tribunal on July 22, 2008 and July 2, 2009.

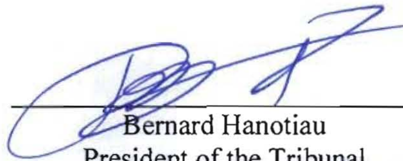
[12] The ICSID Secretariat will in due course provide the Parties with a financial statement of the case account and the Parties will be reimbursed the remaining balance proportionally to the amount which was paid by each Party.



Andrea Giardina
Arbitrator
Date: 23 November 2011



W. Michael Reisman
Arbitrator
Date: 28/11/2011



Bernard Hanotiau
President of the Tribunal
Date: 24 November 2011

International Centre for Settlement of Investment Disputes

BAYINDIR INSAAT TURIZM TICARET VE SANAYI A.Ş.

CLAIMANT

v.

ISLAMIC REPUBLIC OF PAKISTAN

RESPONDENT

ICSID Case No. ARB/03/29

AWARD

Rendered by an Arbitral Tribunal composed of:

Prof. Gabrielle Kaufmann-Kohler, President
Sir Franklin Berman, Arbitrator
Prof. Karl-Heinz Böckstiegel, Arbitrator

Martina Polasek, Secretary

Date of Dispatch to the Parties: August 27, 2009

TABLE OF CONTENTS

TABLE OF ABBREVIATIONS .... **VI**

I. THE FACTS **1**

A. The Parties **1**

a. The Claimant 1

b. The Respondent 1

B. Summary of the Main facts **2**

a. The M1 Motorway Project 2

b. The origin of the present dispute 5

c. Related litigation 10

II. PROCEDURAL HISTORY **12**

A. Initial phase **12**

B. The proceedings on provisional measures **14**

C. The jurisdictional phase **17**

D. The proceedings on the merits **20**

III. THE PARTIES' POSITIONS **24**

A. Bayindir's position and request for relief **24**

B. Pakistan's position and request for relief **26**

IV. ANALYSIS **28**

A. Preliminary matters **28**

a. The law applicable to the merits 29

b. Attribution of NHA's acts 29

c. Applicability *ratione temporis* of the Treaty 36

d. Treaty claim in the context of a contractual relationship 36

e. Burden of proof 39

f. The relevance of previous ICSID decisions or awards 40

B. Fair and Equitable Treatment 40
a. Importation of FET obligation by operation of MFN clause 41
1. Bayindir’s position 41
2. Pakistan's position 42
3. Tribunal's determination 42
b. Identification of the FET obligation 44
1. Bayindir’s position 44
2. Pakistan's position 45
3. Tribunal's determination 45
c. Content of the FET standard 47
1. Bayindir's position 47
2. Pakistan's position 49
3. Tribunal's determination 49
d. Conduct leading to the expulsion of Bayindir 52
(i) Were Bayindir's reasonable expectations frustrated? 52
1. Bayindir's position 52
2. Pakistan’s position 53
3. Tribunal's determination 53
(ii) Bayindir's expulsion 56
1. Was there a conspiracy to expel Bayindir? 56
1.1 Bayindir's position 56
1.2 Pakistan's position 59
1.3 Tribunal's determination 63
2. Reasons underlying the expulsion of Bayindir 74
2.1 Bayindir's position 74
2.2 Pakistan's position 78

2.3 Tribunal's determination 82
2.3.1. Expulsion unrelated to Contract performance? 82
2.3.1.1. Political shifts 82
2.3.1.2. Financial difficulties 83
2.3.1.3. Local contractors 86
2.3.2. Bayindir's performance 87
(iii) Did Pakistan exert illegitimate pressure or coercion on Bayindir? 93
1. Bayindir's position 93
2. Pakistan's position 94
3. Tribunal's determination 95
(iv) Was Bayindir deprived of due process and/or procedural fairness? 100
1. Bayindir's position 100
2. Pakistan's position 101
3. Tribunal's determination 101
e. Conduct following the expulsion 103
1. Bayindir's position 103
2. Pakistan's position 104
3. Tribunal's determination 104
f. Attempted encashment of the Mobilisation Advance Guarantees 106
1. Bayindir's position 106
2. Pakistan's position 107
3. Tribunal's determination 108
g. Respondent's acts taken together 111
C. National Treatment and MFN Standards 112
a. Applicable standards 112
1. Bayindir's position 112
2. Pakistan's position 113

3. Tribunal's determination 113

b. National treatment 115

1. Bayindir's position 115

2. Pakistan's position 116

3. Tribunal's determination 117

c. MFN 120

1. Bayindir’s position 120

2. Pakistan's position 121

3. Tribunal's determination 121

d. The Respondent's acts taken together 123

D. Expropriation 123

a. Applicable standard 123

1. Bayindir’s position 123

2. Pakistan's position 125

3. Tribunal's determination 127

b. Contractual rights 129

1. Bayindir's position 129

2. Pakistan's position 130

3. Tribunal's determination 131

c. Machinery, plant, equipment, material, spare parts and office inventory 133

1. Bayindir’s position 133

2. Pakistan's position 134

3. Tribunal's determination 134

d. Mobilisation Advance Guarantees 136

1. Bayindir’s position 136

2. Pakistan's position 136

3. Tribunal's determination 137

e. Respondent's acts taken together 138

E. Provisional Measures 138

F. Costs 139

V. RELIEF 140

TABLE OF ABBREVIATIONS

1997 Contract	Agreement for the Revival of Contract Agreement for the Construction of Islamabad-Peshawar Motorway of 29 March 1997
Arbitration Rules	ICSID Rules of Procedure for Arbitration Proceedings
Award	The present award on the merits of the dispute
Bayindir	Bayindir Insaat Turizm Ticaret Ve Sanayi A.Ş.
C-Mem. J.	Bayindir's Counter-Memorial (on Jurisdiction) dated 31 March 2005
C-Mem. M.	Pakistan's Counter-Memorial (on the Merits) dated 25 August 2006
Contract	1993 Contract as revived by the1997 Contract
EOT	Extension of time
Exh. [Bay.] B	Bayindir's Exhibit filed with its RA
Exh. [Bay.] CX	Bayindir's Exhibit (Documentary Evidence)
Exh. [Bay.] CLEX	Bayindir's Exhibit (Legal Materials)
Exh. [Bay.] RP	Bayindir's Exhibit filed with its RP
Exh. [Pak.] C	Pakistan's Exhibit (Principal Contractual Documents) [Volume 2 of Mem. J.]
Exh. [Pak.] CM	Pakistan's Exhibit (Documentary exhibits) filed with its C.-Mem. M.
Exh. [Pak.] CM LEX	Pakistan's Exhibit (Legal Materials) filed with its C.-Mem. M.
Exh. [Pak.] D	Pakistan's Exhibit (Documentary exhibits) [Volume 7 of Mem. J.]
Exh. [Pak.] L	Pakistan's Exhibit (Legal Materials) [Volume 3 to 6 of Mem. J.]
Exh. [Pak.] R	Pakistan's Exhibit (Documentary exhibits) filed with its Rej. M.
Exh. [Pak.] RB	Pakistan's Exhibit (Documentary exhibits attached to the witness statement of Raymond Bridger) [Volumes 7 to 8 of C.-Mem. M.]
Exh. [Pak.] Resp RP	Pakistan's Exhibit filed with its Resp RP
Exh. [Pak.] RL	Pakistan's Exhibit (Legal Materials) [Volume 3 to Reply J.]
Exh. [Pak.] R LEX	Pakistan's Exhibit (Legal Materials) filed with its Rej. M.
FET	Fair and equitable treatment
FWO	Frontier Works Organization
ICSID	International Centre for Settlement of Investment Disputes
ICSID Convention	Convention on the Settlement of Investment Disputes between States and Nationals of other States

IPA	Interim Payment Application
IPC	Interim Payment Certificate
M-1 Project	Pakistan Islamabad-Peshawar Motorway
Mem. J.	Pakistan’s Objections to Jurisdiction dated 31 December 2004
Mem. M.	Bayindir's Memorial (on the Merits) dated 25 April 2006
MFN	Most favoured nation
NHA	National Highway Authority of Pakistan
PHB [Bay.]	Bayindir's post-hearing brief (on the Merits) dated 16 July 2008
PHB [Pak.]	Pakistan's post-hearing brief (on the Merits) dated 16 July 2008
PMC-JV	Pakistani Motorway Contractors Joint Venture
PSDP	Public Sector Development Programme
RA or Request	Bayindir’s Request of Arbitration of 15 April 2002
Rejoinder J.	Bayindir’s Rejoinder (on Jurisdiction) dated 17 June 2005
Rej. M.	Pakistan's Rejoinder (on the Merits) dated 24 May 2007
Reply J.	Pakistan’s Reply (on Jurisdiction) of 9 May 2005
Reply M.	Bayindir's Reply (on the Merits) dated 21 February 2007
RP	Bayindir's Request for Provisional Measures of 20 July 2004
Resp RP	Pakistan's Response of 27 August 2004 to RP
Tr. P.	Transcript of the preliminary hearing
Tr. J.	Transcript of the hearing on jurisdiction
Tr. M.	Transcript of the hearing on the merits
Treaty	Bilateral investment treaty; specifically “Agreement Between the Republic of Turkey and the Islamic Republic of Pakistan Concerning the Reciprocal Promotion and Protection of Investments” of 16 March 1995
VCLT	Vienna Convention on the Law of Treaties, done at Vienna on 23 May 1969 - UN Treaty Series, vol. 1155, p. 331
WS	Witness Statement

I. THE FACTS

1. This Chapter summarizes the factual background of this arbitration in so far as that is necessary to understand the issues raised in the present case.

A. THE PARTIES

a. The Claimant

2. The Claimant, Bayindir Insaat Turizm Ticaret Ve Sanayi A.Ş. ("Bayindir") is a company incorporated and existing under the laws of the Republic of Turkey. Its principal office is situated at Tunus Caddesi No. 24, Kavaklidere, Ankara, Turkey.

3. The Claimant is part of the Bayindir group of companies. It is engaged in the business of construction of motorways and other larger infrastructure projects in Turkey and abroad.

4. The Claimant has been represented in this arbitration by Mr. Farrukh Karim Qureshi from the law firm of Samdani & Qureshi, Islamabad. The following have acted as co-counsel: Michael Bühler, John F. Crawford, Sigvard Jarvin and Jonathan Eades from the law firm of Jones Day, Paris, France (from 21 January 2004 to 30 June 2005); Emmanuel Gaillard and John Savage from the law firm of Shearman & Sterling LLP (from 1 July 2005 to 14 July 2005); Gavan Griffith from Essex Court Chambers, London (from 18 July 2005 to 6 December 2005); and Sir Michael Wood from 20 Essex Street Chambers, London (from June 2007 to 16 November 2007).

5. In the last stage of the arbitration concerning the merits, Bayindir was represented by: Farrukh Karim Qureshi and Nudrat Ejaz Piracha, Samdani & Qureshi, Islamabad; Stanimir A. Alexandrov, Marinn Carlson and Jennifer Haworth McCandless, Sidley Austin LLP, Washington D.C; and Judge Stephen M. Schwebel, Washington D.C.

b. The Respondent

6. The Respondent is the Islamic Republic of Pakistan ("Pakistan").

7. The Respondent has been represented in this arbitration by: the Hon. Malik Muhammad Qayyum, Attorney General for Pakistan (from 2007 to 2008), and by the former Attorney General for Pakistan Mr. Makdoom Ali Khan during the proceeding on jurisdiction (up until 2007). The following have acted as co-counsel: Christopher Greenwood CMG, QC (up until 5 February 2009), Samuel Wordsworth of Essex Court Chambers, London (since 19 July 2004); V. V. Veeder QC from Essex Court Chambers, London (from 19 July 2004 to 28 November 2007); Umar Atta Bandial from Umar Bandial & Associates, Lahore (from 19 July 2004 to 16 July 2005); Rodman R. Bundy, Loretta Malintoppi and Nicholas Minogue from Eversheds, Paris (since 19 July 2004), and Iftikharuddin Riaz from Bhandari; Naqvi & Riaz, Lahore, Pakistan (since 16 July 2005).

B. SUMMARY OF THE MAIN FACTS

8. The following summary is meant to give a general overview of the present dispute. It does not claim to include all factual aspects which will later turn out to be of relevance, particularly as they emerged from the extensive testimony of witnesses and experts at the hearing. The latter will be discussed, as far as relevant, in the context of the Tribunal's analysis of the disputed issues.

a. The M1 Motorway Project

9. The National Highway Authority ("NHA") is a public corporation established by the Pakistani Act No XI (National Highway Authority Act) of 1991 to assume responsibility for the planning, development, operation and maintenance of Pakistan's national highways and strategic roads. Although controlled by the Government of Pakistan, NHA is a body corporate under Pakistani law with the right to sue and to be sued in its own name (Section 3(2) National Highway Authority Act 1991).

10. Among other projects, NHA planned the construction of a six-lane motorway and ancillary works known as the "Pakistan Islamabad-Peshawar Motorway" (the "M-1 Project").

11. In 1993, NHA and Bayindir entered into an agreement for the execution of the M-1 Project (the "1993 Contract") (Exh. [Pak.] C-1). The 1993 Contract was a two page

document incorporating, inter alia, Addenda No.1-9 (Exh. [Pak.] C-1), the Conditions of Contract - Part I and II (Exh. [Pak.] C-4), General Specifications, Special Provisions and Addenda to General Specifications, Drawings, Priced Bill of Quantities (BOQ), as well as the Bid and Appendices "A to M." In particular, it bears noting that Part I incorporated the FIDIC General Conditions of Contract for Works of Civil Engineering Construction (1987 edition), and Part II, entitled "Conditions of Particular Applications," incorporated the amendments and supplements to Part I negotiated by the parties.

12. Disputes arose under the 1993 Contract, which NHA and Bayindir resolved in 1997. As part of this resolution, the parties executed a Memorandum of Agreement on 29 March 1997 "with the objective of reviving the Contract Agreement dated 18 March 1993" (Exh. [Pak.] C-5). Under Clause 8 of the Memorandum of Agreement, the parties agreed "to apply to the arbitration tribunal in the appropriate manner to seek the decision of the tribunal on only the issue of the quantum of expenses incurred by Bayindir as specified in Bayindir's claim for expenses only."[1]

13. On 3 July 1997, the parties entered into a new contract, the "Agreement for the Revival of Contract Agreement for the Construction of Islamabad-Peshawar Motorway" (the "1997 Contract") (Exh. [Pak.] C-6). The 1997 Contract incorporated the 1993 Contract "in its entirety" with some "overriding conditions" agreed in the Memorandum of Agreement signed on 29 March 1997.

14. For the sake of simplicity, the Tribunal will use the terminology "clause" or "sub-clause" of the Contract to mean the relevant clause of the (FIDIC) General Conditions of Contract (Conditions of Contract – Part I incorporated in the 1993 agreement), supplemented by the Conditions of Particular Applications (Conditions of Contract – Part II incorporated in the 1993 agreement), as revived and amended by the 1997 Contract. The Tribunal will refer to the (revived) contractual relationship as the "Contract."

15. The Contract contains a choice of the laws of Pakistan as the governing law.

---

[1] By an arbitral award of 30 June 1999, Bayindir was ordered to pay USD 12,909,935 to NHA but was declared entitled to retain USD 10,721,595 of the advance payment made under the Contract in 1993 (Exh. [Pak.] L-27).

16. It was a term of the Contract that NHA would pay to Bayindir 30% of the Contract price as an advance payment (the "Mobilisation Advance"). Accordingly, NHA paid to Bayindir, as Mobilisation Advance, two separate amounts of USD 96,645,563.50 and PKR 2,523,009,751.70 respectively (RP, ¶ 22; Mem. J., ¶ 2.16).

17. It was a further term of the Contract that Bayindir would provide a bank guarantee equivalent to the amount of the Mobilisation Advance. On 9 January 1998, a consortium of Turkish banks (comprising Türkiye İş Bankasi A.Ş., Türkiye Vakiflar Bankasi T.A.O., Türkiye Halk Bankasi A.Ş., Finansbank A.Ş., Denizbankthe A.Ş. and Kentbank A.S., which subrogated its rights to Bayindirbank A.Ş.) issued two guarantees on behalf of Bayindir to secure the Mobilisation Advance in accordance with the Contract (the "Mobilisation Advance Guarantees"). Consistent with the Contract, the Mobilisation Advance Guarantees were payable to NHA "on his first demand without whatsoever right of objection on [the Bank's] part and without his first claim[ing] to the Contractor." The amounts of the Mobilisation Advance Guarantees were to decrease, as interim payments were made for work in progress.[2]

18. The performance of the Contract was to be supervised by an Engineer. Under the Contract, the Engineer was to be appointed by the Employer (Part I – General Conditions – sub-clause 1.1(iv)) and to obtain the Employer's approval before exercising his authority whenever the terms of his appointment so provided (Part I – General Conditions – sub-clause 2.1(b)). The Engineer was, for instance, required to obtain the prior written approval of the Employer before deciding on a request for an extension of time by the Contractor under clause 44 of the Contract (Part II – Conditions of Particular Applications – sub-clause 2.1(e)).

19. By contrast, in those cases where the Contract required the Engineer to exercise his discretion, he was to do so "impartially within the terms of the Contract and having

---

2 The terms of the reimbursement were later modified. In June 1999, this mechanism was replaced with a rollover system; if the amount of a given month's Mobilisation Advance deduction exceeded the amount due to Bayindir under a particular Interim Payment Certificate (IPC), the difference due to Pakistan would be carried forward and deducted from the next IPC. Second, in Addendum No. 9, the fixed Mobilisation Advance repayment schedule was replaced by a percentage deduction from each IPC, as a result of which the Mobilisation Advance deduction would always be a percentage of Bayindir's IPC payment, and could never exceed the IPC payment due to Bayindir.

regard to all the circumstances" (Part I – General Conditions – sub-clause 2(6)). The issuance of the notices contemplated in sub-clauses 46.1 and 63.1(b)(ii) are examples of cases in which the Engineer was to exercise his discretion and did not need the Employer's prior approval. According to sub-clause 46.1, the Engineer was to notify the Contractor if "in the opinion of the Engineer" the rate of progress of the works in any section was too slow to comply with the agreed time for completion, for any reason other than one which would entitle the Contractor to an extension of time. Similarly, if in the Engineer's opinion the Contractor had failed to proceed with the works without a reasonable excuse, the Engineer was to issue a certificate under sub-clause 63.1(b)(ii).

20. The Engineer was entitled to appoint a representative, the "Engineer's Representative," who was to carry out the duties and exercise the authority delegated to him (Part I – General Conditions – sub-clause 2.2).

21. The Contract also set forth a multi-tier mechanism for the settlement of disputes, providing first for an Engineer's decision and then for arbitration as follows:

- Any matter in dispute must first be referred in writing to the Engineer (67.1(1) of the Contract);
- A party dissatisfied with the ensuing decision of the Engineer[3] "may give notice to the other party of his intention to commence arbitration" (67.1(3) of the Contract);
- The parties must then attempt to settle the dispute amicably and, unless they agree otherwise, cannot commence arbitration at the earliest 56 days after the notice of intention to commence arbitration;
- The dispute will then be resolved by arbitration "under the rules and provisions of the Arbitration Act [of Pakistan] 1940 as amended or any statutory modification or re-enactment thereof for the time being in force."

22. Other relevant provisions of the Contract will be referred to later in the context of the consideration of the disputed issues.

b. The origin of the present dispute

23. On 3 June 1998, the Engineer issued the order to commence construction; the original completion date foreseen was 31 July 2000.[4]

---

[3] The same applies "if the Engineer fails to give notice of his decision on or before the eighty-fourth day after the day on which he received the reference."

24. Between September 1999 and 20 April 2001, Bayindir submitted several claims for payment and four claims for extension of time (EOT) invoking different omissions on the part of Pakistan (in particular delays in handing over the possession of the land[5]). The first two EOT claims (EOT 01 and EOT 02) were settled by agreement during a meeting held on 18 February 2000. This agreement[6] led to the execution of Addendum No. 9 of 17 April 2000, which set out, among other things, that "the revised Contract Completion Date shall be 31st December 2002" and that "NHA will hand over the remaining land as expeditiously as possible but not later than 4 months from the signing" of Addendum No. 9. The detailed schedule attached to Addendum No. 9 provided that two priority sections had to be completed before 23 March 2001 (the Priority Sections).

25. It is disputed whether, after the revival of the Contract, the performance of Bayindir was satisfactory or not. However, Bayindir has not seriously disputed that before the conclusion of Addendum No. 9 in April 2000, it had almost stopped work on the site. Moreover, as will be discussed later, the evidence on the record shows that even after the conclusion of Addendum No. 9, serious concerns remained over the pace of the work and the quality of the equipment that Bayindir used on the site.

26. On 2 December 2000, the Engineer's Representative, Mr. Raymond Bridger, issued a notice pursuant to sub-clause 46.1 of the Contract advising Bayindir that "the rate of progress of the works is currently too slow to comply with the Time for Completion of the Contract" and asking it to "submit details as to the actions that [it] propose[s], in order to comply with the Time for Completion of the Contract" (Exh. [Pak.] CM-76).

---

4 *See* 1997 Contract. This date was extended to 31 December 2002 by Addendum No. 9 dated 17 April 2000 (see *infra* ¶¶ 24-28).

5 During the same period, Bayindir also issued several claims for delay in the settlement of Bayindir's monthly progress payments (IPC).

6 Under the agreement reached during the meeting of 18 February 2000, it was decided, inter alia, that "December 2002 as the new completion date for the Project with about one year advance completion of two sections from Islamabad to Burhan and Indus to Mardan" (Exh. [Bay.] B13). Among other new conditions that were not contemplated by the agreement of 18 February 2000, Addendum No. 9 provided that Bayindir had to "complete the two Priority Sections mentioned therein by 23 March 2001." It is Bayindir's contention that it accepted this new demand by NHA "[a]s a result of the pressure, coercion and duress exercised by Pakistan" (RA p. 5 ¶ 13).

27. By letter of 11 December 2000, Bayindir disputed the sub-clause 46.1 notice and referred to a number of reasons why it was entitled to an extension of time (Exh. [Pak.] CM-78). In several letters sent shortly thereafter to Bayindir, Mr. Bridger observed that there were no significant reasons preventing Bayindir from achieving the required targets (Exh. [Pak.] RB-58) and proposed to hold a meeting with Bayindir "to discuss in detail feasible dates for completion of all remaining works in Section-I (Part-I) to ensure overall completion of Part I by March 23, 2001" (Exh. [Pak.] CM-80). By late December 2000, the Engineer's Representative further reminded Bayindir of the need to submit a revised program for the completion of the Priority Sections (Exh. [Pak.] CM-82).

28. At a contract progress meeting on 4 January 2001, Bayindir's representatives announced that a revised program was under preparation and would be submitted in the following week (Exh. [Pak.] RB-99). A few days later, on 13 January 2001, Bayindir contended however that the sub-clause 46.1 notice was unjustified and announced a detailed claim for extension for the following week. Two days later, it submitted EOT 03 for the completion of the two Priority Sections by October instead of March 2001, asserting primarily that NHA had failed "to hand over the site pursuant to Addendum No. 9" (Exh. [Bay.] B-15). At the same time, Bayindir submitted a revised program for the completion of the works.

29. At another contract progress meeting on 30 January 2001, Mr. Bridger noted that he was very much concerned about Bayindir's lack of progress, in particular in connection with the productivity levels in the Priority Sections 1 and 5. He further added that "shortage of equipment/machinery available with BCI [was] the obvious cause of delays" and that he had long been reminding this to Bayindir (Exh. [Pak.] RB-100).

30. On 26 February 2001, the President of Bayindir Construction, Mr. Sadik Can, asked the Turkish Ambassador in Islamabad to arrange an opportunity for him "to explain to H.E. the Minister for Communications and the Chairman of National Highway Authority about our continuing efforts and sincere desire to achieve the completion of this prestigious Project" (Exh. [Pak.] CM-180). The Ambassador proposed a "high level meeting between the Company and National Highway Authority" (Exh. [Pak.] CM-181 and Exh. [Pak.] CM-182), which took place on 19 March 2001. The contents of this meeting are disputed and will be discussed later. It is however established that,

following this meeting, Mr. Bridger wrote to Bayindir observing that the list of obstructions referred to by Bayindir at the meeting was "obsolete and in no way indicative of the situation at site" (Exh. [Pak.] RB-67).

31. In the meantime, Mr. Bridger had again expressed concern about the insufficient progress on the Priority Sections and mentioned that the Contract provided for liquidated damages under such circumstances (Exh. [Pak.] CM-92). Bayindir replied shortly thereafter that the delays were due to the reasons explained in EOT 03 and that the imposition of liquidated damages would be in breach of the Contract (Exh. [Pak.] CM-93).

32. The draft minutes of the contract progress meeting of 29 March 2001 referred to a joint meeting, held on 21 March 2001 at NHA headquarters, during which Bayindir had informed that "US$ 16 Million worth PIB equipment (including spares) currently on site [was] all that BCI shall be handling over to NHA upon completion and nothing more" (Exh. [Bay.] CX-153). According to this document "BCI also claimed that they are not contractually obliged to meet the shortfall as stated by PMC/NHA, PMC/NHA is presently reviewing this stand of BCI under the terms of the Contract." A few days later, Mr. Bridger requested Bayindir to revise its position on permanent equipment (Exh. [Pak.] RB-54). Bayindir replied on 7 April 2001 disputing that it was required to import any specific quantity of equipment on a permanent basis (Exh. [Pak.] RB-54).

33. On 3 April 2001, in response to Bayindir's EOT 03, a limited extension of 27 days for Part I was communicated to Bayindir (Exh. [Pak.] CM-101). Bayindir challenged such extension and referred it to the Engineer for a decision pursuant to Clause 67.1 of the Contract (Exh. [Pak.] R-20).

34. On 12 April 2001, the Chairman of NHA made a presentation to General Musharraf regarding *inter alia* the M-1 Project (Exh. [Bay.] CX-221). The content of this meeting is disputed and will be discussed later.

35. On 14 April 2001, Mr. Bridger wrote to Bayindir stating *inter alia* that it had failed to comply with the sub-clause 46.1 notice and that it had come to his attention that Bayindir was considerably behind in payments to its subcontractors (Exh. [Pak.] RB-

69). Bayindir replied *inter alia* reiterating its entitlement to a longer extension of time and referring to the pending decision of the Engineer under Clause 67.1 (Exh. [Pak.] CM-107).

36. On 19 April 2001, the Engineer certified to NHA that "pursuant to Sub-Clause 63.1/b(ii) of the Conditions of Contract in [his] opinion the Contractor without reasonable excuse has failed to proceed with the Works, within 28 days after receiving notice pursuant to Sub-Clause 46.1 of the Conditions of Contract" (Exh. [Pak.] R-22).

37. On 20 April 2001, NHA informed Bayindir that liquidated damages would be imposed on Bayindir for late completion of the two Priority Sections with effect from 20 April 2001; that is, the end of the limited extension granted on 3 April 2001 (Exh. [Bay.] B-20). On the same day, Bayindir notified NHA that it had been unable to complete the Priority Sections "due to reasons beyond [its] control" and requested that "the procedure [i.e. the submission of EOT 03 to the Engineer for decision under Clause 67.1] be allowed to follow to determine [its] entitlement for time extension" (Exh. [Bay.] B-21). It is therefore undisputed that the two Priority Sections were not completed on the dates set in Addendum No. 9 (23 March 2001) extended under EOT 03.

38. On 23 April 2001, NHA served a "Notice of Termination of Contract" upon Bayindir requiring the latter to hand over possession of the site within 14 days (Exh. [Bay.] B-26). Thereafter, staff from the Frontier Works Organization ("FWO"), the civil engineering section of the Pakistani army, secured the site and Bayindir's personnel were evacuated.

39. On 23 December 2002, NHA concluded a contract for the "Completion of Balance Works of Islamabad – Peshawar Motorway (M-1) Project" with "M/s Pakistan Motorway Contractors Joint Venture (PMC JV)" providing for a completion period of 1460 days (Exh. [Bay.] CX-29).

c. Related litigation

40. From January to July 2001, Bayindir served several notices of intention to commence arbitration pursuant to sub-clause 67.1 of the Contract. The arbitration was not pursued, although the matters remained unsettled.[7]

41. On 30 April 2001, Bayindir filed a constitutional challenge against the notice of termination served by NHA before the Lahore High Court (Exh. [Pak.] D-15). A few days later, on 7 May 2001, the Lahore High Court dismissed Bayindir's constitutional challenge on the ground that the Contract contained an arbitration clause (Exh. [Pak.] D-16, in particular pp. 17-18).[8]

42. Between 2001 and early 2003, NHA raised a series of claims against Bayindir and served a notice of arbitration. On 31 March 2003, NHA sought Bayindir's concurrence in the appointment of a sole arbitrator. Bayindir replied on 10 April 2003 that it had already submitted the matter to ICSID and requested that the award in the ICSID arbitration be awaited (Exh. [Pak.] D-23).

43. On 5 January 2004, NHA applied for the appointment of an arbitrator in Pakistan under section 20 of the Arbitration Act 1940. On 28 May 2004, the Court of Civil Judge in Islamabad appointed Mr. Justice (Retd.) Afzal Lone as arbitrator. The court subsequently upheld an objection of NHA (claiming that Mr. Lone was too closely linked with the previous government of Pakistan, that is the government that had decided to revive the Contract in 1997) and appointed Mr. Justice (Retd.) Zahid. Following a request by Pakistan, NHA moved for an extension of time limits in such a manner that the arbitration would not proceed prior to this Tribunal's Decision on Jurisdiction. After the Tribunal's Decision on Jurisdiction (14 November 2005), the Claimant requested the Tribunal to recommend, by way of a provisional measure, that

---

[7] With specific regard to a claim introduced on 7 September 2001, concerning escalation payment, Bayindir filed an application under Section 20 of the 1940 Arbitration Act for the appointment of an arbitrator on 19 April 2001 (Exh. [Pak.] D-13). The application was dismissed as premature (failing notice under sub-clause 67.4 of the Contract) on 24 March 2003 (Exh. [Pak.] D-17). An appeal against this decision was dismissed as withdrawn (Exh. [Pak.] D-19).

[8] An appeal against this decision was dismissed as withdrawn by the Supreme Court of Pakistan on 16 November 2003.

the Respondent desist from pursuing the arbitration in Pakistan. By Procedural Order No. 12 of 14 April 2008, the Tribunal rejected Bayindir's application.

44. In the meantime, on 24 April 2001, NHA had called the Mobilisation Advance Guarantees in an amount of approximately USD 100,000,000. Bayindir obtained an order from the Turkish courts enjoining the Banks from paying. This injunction was lifted on 12 September 2003. Execution proceedings against the Banks, to which Bayindir is not a party, are currently stayed following this Tribunal's Procedural Order No. 1 (PO#1) that Pakistan take steps to ensure that NHA does not enforce any final judgment it may obtain from the Turkish courts with regard to the Mobilisation Advance Guarantees.

45. On 26 April 2006, NHA filed an action against Is Bank for the collection of the interest accrued (and to accrue) on the amount of part of the Mobilisation Advance Guarantees. On 14 March 2007, Is Bank filed an application before the same court requesting that no default interest be deemed to have accrued, since NHA had not sought to enforce the judgment granted in its favour. In its response dated 10 April 2007, NHA disputed Is Bank's contentions based in particular on the fact that the first encashment request was made well before the Tribunal's first decision and that immediately after the encashment request, Is Bank and Bayindir colluded to obtain an order from this Tribunal.

46. Pursuant to Procedural Order No. 11 of 14 April 2008 (PO#11), the Claimant was directed to take the steps necessary and use its best endeavours to procure the withdrawal by Is Bank of its application dated 14 March 2007. By letter of 24 July 2008, the Claimant informed the Tribunal and the Respondent that Is Bank was prepared to agree with NHA to suspend the Turkish Court proceedings over NHA's claim for interest until the Tribunal's Award. On 1 August 2008, the Respondent opposed the Claimant's proposal and requested security. The procedure following the Respondent's request is described *infra* at paragraphs 64-66.

II. PROCEDURAL HISTORY

A. INITIAL PHASE

47. On 15 April 2002, Bayindir submitted a Request for Arbitration (the "Request" or "RA") to the International Centre for the Settlement of Investment Disputes ("ICSID" or the "Centre"), accompanied by 41 exhibits (Exh. [Bay.] B-1 to B-41). In its Request Bayindir sought the following relief:

    (i) payment of outstanding Interim Payment Certificates US$62,514,554.00;

    (ii) payment of additional financial claims related to the Works completed by Bayindir provisionally quantified as US$27,000.000.00;

    (iii) reimbursement of all costs incurred in anticipation of completing the Project by Bayindir US$19,071,449.00;

    (iv) payment against all fixed and movable assets expropriated by Pakistan US$43,050,619.00;

    (v) compensation for mobilisation and demobilisation costs US$7,444,854.00;

    (vi) compensation for profits lost through Pakistan's unlawful acts and omissions provisionally quantified as US$107,154,634.00;

    (vii) compensation for damage to Bayindir's reputation resulting from Pakistan's unlawful acts and omissions provisionally quantified as US$150,000,000.00;

    In addition to the amounts set out in paragraph 39 above Bayindir is entitled to recover compensation and costs on account of the following items:

    (i) the reimbursement of all costs incurred by Bayindir in pursuing the resolution of the claims brought in this arbitration, including but not limited to the fees and/or expenses of the arbitrators, ICSID, legal counsel, experts and Bayindir's own experts and staff;

    (ii) compounded interest on all amounts awarded at an appropriate rate or rates and over an appropriate period or periods;

    (iii) compensation for opportunities lost as a direct result of Pakistan's unlawful acts and omissions;

    (iv) compensation for losses and damages suffered by Bayindir in Turkey as a direct consequence of Pakistan's unlawful acts and omissions;

    (v) any other relief that the Arbitral Tribunal may deem fit and appropriate in the circumstances of this case.

    (RA ¶¶ 39-40)

48. On 16 April 2002, the Centre, in accordance with Rule 5 of the ICSID Rules of Procedure for the Institution of Conciliation and Arbitration Proceedings (the "Institution Rules"), acknowledged receipt and transmitted a copy of the RA to Pakistan and to the Pakistani Embassy in Washington D.C.

49. After a long and extensive exchange of correspondence between Bayindir,[9] Pakistan,[10] NHA[11] and the Centre, on 1 December 2003, the Secretary-General of the Centre registered Bayindir's RA, pursuant to Article 36(3) of the Convention on the Settlement of Investment Disputes between States and Nationals of other States (the "ICSID Convention" or "the Convention"). On the same date, the Secretary-General, in accordance with Institution Rule 7, notified the Parties of the registration of the Request and invited them to proceed, as soon as possible, to constitute an Arbitral Tribunal.

50. In the absence of agreement between the Parties, on 6 February 2004, Bayindir elected to submit the arbitration to a panel of three arbitrators, as provided in Article 37(2)(b) of the ICSID Convention, and appointed Prof. Karl-Heinz Böckstiegel, a national of Germany. On 26 February 2004, Pakistan appointed Sir Franklin Berman, a national of the United Kingdom, as arbitrator. On 27 April 2004, the Parties agreed to appoint Prof. Gabrielle Kaufmann-Kohler, a national of Switzerland, as the President of the Tribunal.

51. On 15 June 2004, the Secretary-General of ICSID, in accordance with Rule 6(1) of the ICSID Rules of Procedure for Arbitration Proceedings (Arbitration Rules), notified the parties that all three arbitrators had accepted their appointments and that the Tribunal was therefore deemed to be constituted and the proceedings to have begun on that

---

9 In particular, on 10 February 2003, Bayindir supplemented its RA by the submission of a Volume III, with 13 exhibits (Exh [Bay.] B-41 to B-53).

10 In particular, on 23 May 2002, the Republic of Pakistan stated that "[t]he nomination of Secretary Communication by [Bayindir] is without any relevance to the terms of Contract. In view of provisions of Contract Agreement and various guarantees given by [Bayindir] to NHA for faithful performance of [Bayindir]'s obligations and against Mobilization Advance; NHA is the party to the Contract and not the Secretary Communication. The alleged dispute is manifestly outside the jurisdiction of the Centre, pursuant to sub-para. 1 Article 25, sub-para. 3 of Article 36, sub-para. 1(b) of Rule 6 of INSTITUTION RULE of the Centre. The contents of the requests by [Bayindir] are in contravention to Rule 2 of the INSTITUTION RULE of the Centre" (Pakistan's submission of 23 May 2002). The Government of Pakistan further "requested that all future communication and notices if required, regarding the subject issue, are to be sent to the [NHA]" (Pakistan's submission of 19 February 2003).

11 In particular, on 28 August 2003, NHA submitted its "Observation and Reply to ICSID" with reference to Bayindir's RA. In its submission NHA concluded that "[t]he documented statements as given in this submission provide further material to conclude the fact that *Bayindir had never been an Investor neither* the dispute referred to *ICSID has any bearing with the relevant provision of BIT*. Therefore, the 'Request for Arbitration' submitted by Bayindir to ICSID is void of merits at its own account and manifestly *beyond the jurisdiction of ICSID. Therefore, the Secretary General is requested to refuse the registration of Bayindir's 'Request for Arbitration'* pursuant to Article 36(3) and institution Rule 6(1)(b) of the Convention" (NHA's submission of 28 August 2003, p. 2, emphasis in the original).

date. The same letter informed the Parties that Mr. José-Antonio Rivas, Counsel, ICSID, would serve as Secretary of the Tribunal.[12]

B. THE PROCEEDINGS ON PROVISIONAL MEASURES

52. On 20 July 2004, Bayindir submitted a Request for Provisional Measures (RP), seeking in substance recommendations by the Tribunal that the Respondent stay all proceedings pending before the Courts of Pakistan and Turkey. On 27 August 2004, Pakistan filed its Response to Claimant's Request for Provisional Measures (Resp RP).

53. The Arbitral Tribunal held a session on procedural matters and provisional measures (the "preliminary hearing") on 24 September 2004, at the offices of the World Bank in Paris. At the outset of the preliminary hearing, the Parties expressed agreement that the Tribunal had been properly constituted (Arbitration Rule 6) and stated that they had no objections in this respect. The Parties further agreed on a set of procedural rules to apply to the present proceedings. The preliminary hearing was tape-recorded, a *verbatim* transcript was taken and later distributed to the Parties (Tr. P.).

54. During the course of the preliminary hearing, the Parties' counsel also presented oral arguments on Bayindir's request for provisional measures. At the end of the preliminary hearing, Bayindir withdrew its request seeking a stay of the arbitration pending in Pakistan between NHA and Bayindir before the sole arbitrator, Mr. Justice (Retd.) Zahid,[13] as a result of an offer by Pakistan to request NHA to move for an extension of the time limits fixed in the latter in such a manner that the Pakistani arbitration would not proceed before this Tribunal rendered its Decision on Jurisdiction (Tr. P. 153:17–155:25).

55. On 29 November 2004, the Tribunal rendered its Decision on the RP (PO#1), which provided as follows:

---

[12] In the course of the proceedings, Mr. Rivas was replaced by Ms. Martina Polasek, Counsel, ICSID, on 11 May 2005.

[13] As amended at the preliminary hearing, this request read as follows: "1. The Parties immediately take all steps required to obtain a temporary stay of all proceedings brought under the Pakistan Arbitration Act 1940 and pending before the Courts of Pakistan and/or before an arbitrator" (Bayindir's amended Request for provisional measures submitted at the preliminary hearing of 24 September 2004).

Having reviewed the Claimant's and the Respondent's written submissions and having heard oral argument, the Tribunal issues the following order:

(i) The Tribunal acknowledges that Bayindir withdrew the request seeking a stay of the Pakistani arbitration as a result of an offer of Pakistan to request NHA to move for an extension of time limits in such a manner that that arbitration will not proceed prior to this Tribunal's decision on jurisdiction.

(ii) The Tribunal recommends that Pakistan take whatever steps may be necessary to ensure that NHA does not enforce any final judgment it may obtain from the Turkish courts with regard to the Mobilisation Advance Guarantees. This recommendation remains in effect until: (a) an arbitral award declining jurisdiction is issued; or (b) an arbitral award is rendered on the merits; or (c)·any other order of the Tribunal amending the recommendations is issued; whichever comes first.

(iii) The Tribunal dismisses Pakistan's request to recommend, as a matter of principle, that Bayindir should provide security for Pakistan's costs.

(iv) The Tribunal will rule on the costs of this application in its decision on jurisdiction or, if it asserts jurisdiction, in its decision on the merits of the dispute.

(PO#1 ¶ 78)

56. As a threshold matter in its decision on provisional measures, the Tribunal emphasized that the reasons leading to such decision were "without prejudice to a later decision of this Tribunal on Pakistan's objection to the jurisdiction of the Tribunal" (PO#1 ¶ 40).

57. NHA later obtained a final judgment from the Turkish courts with regard to the encashment of the Mobilisation Advance Guarantees. On 26 April 2006, NHA filed an action against Is Bank for the collection of the interest accrued (and to accrue until the date of payment) on the amount of part of these Guarantees. On 14 March 2007, Is Bank filed an application before the same court requesting that no default interest be deemed to have accrued, since NHA had not sought to enforce the judgment granted in its favour.

58. On 1 November 2007, Pakistan filed a request for provisional measures seeking that Bayindir ensures the withdrawal of Is Bank's application of 14 March 2007. On 30 November 2007, Bayindir filed a response to Pakistan's request. In accordance with the directions of the Tribunal, the Parties further submitted a reply and a rejoinder, respectively, on 19 December 2007 and on 7 January 2008.

59. On 14 April 2008, the Tribunal issued Procedural Order No. 11 (PO#11) on the Respondent's request for provisional measures. The operative part of PO#11 provided as follows:

> On the basis of the foregoing reasons, having reviewed the parties' written submissions, the Tribunal issues the following order:
>
> (i) Bayindir shall take whatever steps may be necessary and use its best endeavours to procure the withdrawal by Is Bank of its application dated 14 March 2007;
>
> (ii) In accordance with the rationale of the Tribunal's decision of 29 November 2004, Pakistan shall take whatever steps may be necessary to ensure that NHA does not enforce any final judgment it may obtain from the Turkish courts with regard to the encashment of interest on the Mobilisation Advance Guarantees;
>
> (iii) The foregoing directions remain in effect until (a) an arbitral award is rendered on the merits; or (b)·they are amended or revoked by order of the Tribunal;
>
> (iv) The Tribunal will rule on the costs of this application in its decision on the merits of the dispute.
>
> (PO#11, ¶ 41)

60. At the same time, on 30 November 2007, Bayindir filed a request for provisional measures seeking in substance the Tribunal's recommendation that NHA be caused to discontinue the arbitration under way in Pakistan with regard to the Contract. On 19 December 2007, Pakistan submitted a response to Bayindir's Request seeking its dismissal. In accordance with the directions of the Tribunal, the Parties further submitted a reply and a rejoinder, respectively, on 7 and 16 January 2008.

61. Also on 14 April 2008, the Tribunal issued Procedural Order No. 12 (PO#12) on the Claimant's request for provisional measures. The operative part of PO#12 provided as follows:

> On the basis of the foregoing reasons, the Tribunal:
>
> (i) denies Bayindir's request "that Respondent should be instructed to ensure that NHA desists from pursuing the arbitration in Pakistan that was suspended under Procedural Order No. 1, which NHA has since restarted, or be caused to suspend such, proceedings pending resolution of this dispute before this Tribunal";
>
> (ii) will rule on the costs of this application in its decision on the merits.
>
> (PO#12, ¶ 30)

62. At the end of the hearing on the merits, the Respondent inquired into the implementation of PO#11 and the Claimant undertook to revert shortly to the Respondent and the Tribunal on this issue.

63. By letter of 16 June 2008, the Claimant advised that it had again urged Is Bank to act promptly to respect the Tribunal's instructions given in PO#11 and attached a copy of its letter to this effect, dated 13 June 2008, as well as an English translation.

64. By letter of 24 July 2008, the Claimant informed the Tribunal and the Respondent that Is Bank was prepared to agree with NHA to suspend the Turkish Court proceedings over NHA's claim for interest until the Tribunal's award on the merits. In accordance with the Tribunal's directions, on 1 August 2008, the Respondent filed a response in which it opposed the Claimant's proposal as insufficient and requested the Tribunal, *inter alia*, to order the Claimant to provide security for the amount of interest that may be forgone by NHA in case Is Bank's application would be successful. In accordance with the directions of the Tribunal, the Parties further submitted a reply and a rejoinder, respectively on 8 and 14 August 2008.

65. On 19 August 2008, the Tribunal denied the Respondent's request for security, and invited the Parties to revert, if possible jointly, regarding the implementation of the proposal communicated by the Claimant in its letter of 24 July 2008.

66. By letter of 29 August 2008, the Respondent stated that it could not agree with the Claimant on such implementation. The Claimant responded by letter of 4 September 2008, noting that it had again written to Is Bank in connection with PO#11. On 10 September 2008, the Tribunal invited the Respondent to clarify its position. In accordance with these directions, the Respondent clarified its position by letter of 26 September 2008, and the Claimant replied by letter of 10 October 2008. The issue raised by these submissions is addressed in section IV(E) of this Award.

C. THE JURISDICTIONAL PHASE

67. In accordance with the timetable agreed during the preliminary hearing, on 31 December 2004, Pakistan submitted its Memorial on jurisdictional objections (Mem. J.) accompanied by one volume of contractual documents (Annexes C-1 to C-13), four

volumes of legal materials (Annexes L-1 to L-43) and one volume of Documentary Exhibits (Exhibits 1 to 35). Pakistan did not append any witness statement or expert opinion.

68. Pursuant to the timetable, Bayindir submitted its Counter-Memorial on jurisdiction on 31 March 2005, (C-Mem. J.) accompanied by one volume of documentary evidence (CX-79 to CX-124) and five volumes of legal materials (Exhibits CLEX-18 to CLEX-55). Bayindir did not append any written witness statement or expert opinion.

69. On 9 May 2005, still according to the timetable, Pakistan submitted its Reply on jurisdiction (Reply J.) accompanied by one volume of documentary exhibits (Exhibits R-1 to R-74) and one volume of legal materials (Exhibits RL-1 to RL-22).

70. Within the extension of time allowed by the Tribunal, on 17 June 2005, Bayindir submitted its Rejoinder on jurisdiction (Rejoinder J.) accompanied by one volume of documentary exhibits (Exhibits CX-125 to CX-156)[14] and one volume of legal materials (Exhibits CLEX-56 to CLEX-61).

71. On 5 July 2005, pursuant to Article 19 of the ICSID Arbitration Rules, the Tribunal invited Pakistan to file a written response limited to the new factual allegations contained in paragraphs 101 to 104 of the Rejoinder J. on or before 15 July 2005.

72. On 7 July 2005, the Tribunal held a preparatory telephone conference to organize the hearing on jurisdiction for which the dates of 25, 26 and 27 July 2005 had previously been retained. None of the Parties having submitted witness statements or expert opinions, it was agreed that the hearing on jurisdiction would be limited to oral arguments.

---

14 At the outset of the hearing on jurisdiction (Tr. J, 17, 29-39), Pakistan pointed out that some of these exhibits – namely Exh. [Bay.] CX-127, an internal letter dated 4 November 2000; Exh. [Bay.] CX-131, an internal letter dated 2 May 2001; Exh.[Bay.] CX-145, an internal letter of June 2001; Exh. [Bay.] CX-146, an internal letter dated May 2001; Exh. [Bay.] CX-151, an internal letter of April 2001; Exh. [Bay.] CX-152, a confidential letter from the World Bank dated 26 May 2000 to the Government of Pakistan; Exh. [Bay.] CX-153, a confidential letter from the World Bank to the Government of Pakistan dated 5 June 2000 – constituted "confidential and privileged legal materials which have apparently been taken from the files of the Government of Pakistan" (Tr. J., 17, 26-28). Pakistan did not however object to their production in this arbitration.

73. On 22 July 2005, Counsel for the Respondent informed the Tribunal that Pakistan had ratified the New York Convention and attached the ratification instrument dated 9 June, deposited with the Secretary-General of the United Nations on 14 July. He added that the New York Convention had been enacted in the form of the Recognition of Enforcement of Arbitration Agreements and Foreign Arbitral Awards Ordinance of 2005, which had come into force with retroactive effect on 14 July 2005.[15]

74. The Arbitral Tribunal held the hearing on jurisdiction from 25 July 2005, starting at 11:00 am, to 26 July 2005, ending at 4:15 pm, at the Salons des Arts et Métiers, 9 bis avenue d'Iéna, Paris. In addition to the Members of the Tribunal[16] and the Secretary, the following persons attended the jurisdictional hearing:

(i) On behalf of Bayindir:

- Mr. Gavan Griffith QC, Essex Court Chambers
- Mr. Farrukh Karim Qureshi; Walker Martineau Saleem
- Mr. Sadik Can; Bayindir Insaat Turizm Ticaret Ve Sanayi AS
- Mr. Zafer Baysal; Bayindir Insaat Turizm Ticaret Ve Sanayi AS
- Ms. Gokce Cicek BIcioglu
- Ms. Nudrat Ejaz Piracha

(ii) On behalf of Pakistan:

- Mr. Aftab Rashid; Ministry of Communications of Pakistan
- Mr. Raja Nowsherwan Sultan; NHA
- Lt. Col. (Ret'd.) Muhammad Azim; Consultant, NHA
- Mr. Iftikharuddin Riaz; Bhandari, Naqvi & Riaz
- Prof. Christopher Greenwood, CMG, QC; Essex Court Chambers
- Mr. V. V. Veeder, QC; Essex Court Chambers
- Mr. Samuel Wordsworth; Essex Court Chambers
- Mr. Rodman R. Bundy; Eversheds
- Ms. Loretta Malintoppi; Eversheds
- Mr. Charles Claypoole; Eversheds

---

15 At the hearing on jurisdiction, the Tribunal granted Pakistan's formal application to introduce these legal materials into the record (Tr. J., 17, 30-32).

16 With the agreement of the Parties, Dr. Antonio Rigozzi, an attorney practising in the law firm of the President of the Tribunal, attended the hearing as well.

- Ms. Cheryl Dunn; Eversheds
- Ms. Victoria Forman-Hardy; Eversheds
- Mr. Nicholas Minogue; Eversheds

75. During the jurisdictional hearing, Messrs. Veeder, Greenwood, Wordsworth and Bundy addressed the Tribunal on behalf of Pakistan and Mr. Griffith addressed the Tribunal on behalf of Bayindir. At the outset of the hearing, Mr. Griffith stated on behalf of Bayindir that it was not pursuing any claims on the basis of the Contract and was henceforth only bringing claims based on the Treaty. Pakistan replied that an earlier withdrawal would have saved substantial costs and insisted that its costs incurred to defend the Contract claims be compensated.

76. The jurisdictional hearing was tape-recorded, a *verbatim* transcript was taken and later distributed to the Parties (Tr. J.). It ended earlier than scheduled, both Parties having fully presented their arguments and agreeing to such change of schedule.

77. On 14 November 2005, the Tribunal issued a decision ("Decision on Jurisdiction"), which is attached to this Award, concluding that it had jurisdiction over the claims asserted by Bayindir against Pakistan for breaches of the Treaty, namely for breaches of provisions on national and most favoured nation treatment, fair and equitable treatment and expropriation without compensation (hereinafter generally referred to as "Treaty Claims"). The operative part of the Decision on Jurisdiction stated:

> For the reasons set forth above, the Tribunal makes the following decision:
>
> a) The Arbitral Tribunal has jurisdiction over the dispute submitted to it in this arbitration.
> b) The Tribunal denies Respondent's application to suspend these proceedings.
> c) The Tribunal will, accordingly, make the necessary order for the continuation of the proceedings on the merits.
> d) The decision on costs is deferred to the second phase of the arbitration on the merits.
> (Decision on Jurisdiction, operative part).

D. THE PROCEEDINGS ON THE MERITS

78. In accordance with the timetable set by the Tribunal in Procedural Order No. 2 of 23 December 2005 (PO#2), on 25 April 2006, Bayindir submitted its Memorial on the merits (Mem. M.) accompanied by one volume of contractual documents (exhibits C-1 to C-18), nine volumes of documentary exhibits (exhibits CX-1 to CX-123), including

two witness statements (exhibits CX-7 and CX-68, this latter accompanied by annexures A to Z), and four volumes of legal exhibits (exhibits CLEX-1 to CLEX-47).

79. On 25 August 2006, pursuant to the same timetable, Pakistan submitted its Counter-Memorial on the merits (C-Mem. M.) accompanied by four volumes of documentary evidence (exhibits CM-1 to CM-197), three volumes of witness statements (with five witness statements, the first one being accompanied by exhibits RB-1 to RB-87) and two volumes of legal materials (Exhibits CM LEX-1 to CM LEX-15).

80. In accordance with PO#2, as amended by Procedural Order No. 5 of 18 January 2007 (PO#5) and the Tribunal's directions of 19 January 2007, on 21 February 2007 Bayindir submitted its Reply on the merits (Reply M.) accompanied by two volumes of witness statements (exhibits CX-124 to CX-127), eight volumes of documentary exhibits (exhibits CX-128 to CX-261) and two volumes of legal materials (exhibits CLEX-48 to CLEX-74).

81. On 30 April 2007, after considering the views of the Parties, the Tribunal decided to invite Mr. John Wall of the World Bank to appear as a witness to be questioned by the Tribunal on the basis of a list of questions to be submitted to him in advance. Further, in accordance with PO#5, the Parties filed their list of witnesses and experts for direct and cross-examination on 29 May 2007.

82. On 24 May 2007, according to PO#2, PO#5, and the Tribunal's directions of 4 May 2007, Pakistan submitted its Rejoinder on the merits (Rej. M.) accompanied by three volumes of documentary exhibits (exhibits R-1 to R-79), four volumes of witness statements and expert opinions with annexures and five volumes of legal materials (exhibits R LEX-1 to R LEX-50).

83. By letter of 3 June 2007, the Claimant requested *inter alia* that "the Tribunal adopt an appropriate order, in consultation with the parties, for rescheduling of the oral hearing" and that it also reschedule the telephone conference to be held on 5 June 2007.

84. On the following day, the Tribunal acknowledged receipt of Bayindir's request for postponement and informed the Parties that it had decided to maintain the telephone

conference and to discuss the Claimant's request for postponement of the hearing at the outset of the telephone conference.

85. The telephone conference was held as scheduled. During the course of the telephone conference, the Tribunal drew the Parties' attention to the fact that a postponement of the hearing would lead to a significant delay in the proceedings, since the Tribunal's next availability for a 10-day hearing was in May 2008. Bayindir nevertheless confirmed its request and Pakistan agreed with it. It was further agreed that the Parties would jointly report to the Tribunal on the status and on the need to resume the proceedings by 10 August 2007.

86. On this basis, the Tribunal issued Procedural Order No. 8 of 20 June 2007 (PO#8) *inter alia* postponing the hearing on the merits, inviting the Parties to report on 10 August 2007 and reserving the period from 26 May to 4 June 2008 in case a hearing would be needed.

87. The Parties reported as scheduled and requested that the proceedings be resumed. They submitted a common position on the duration of the hearing and other procedural matters and separate proposals on the time allocation and the schedule of the hearing.

88. On 22 August 2007, in accordance with PO#8, the Tribunal held another telephone conference to address issues arising from the Parties' joint report of 10 August 2007. Following this telephone conference, the Tribunal issued Procedural Order No. 9 of 27 September 2007 (PO#9) giving detailed directions for the conduct of the hearing on the merits to be held from 26 May 2008 to 4 June 2008.

89. Shortly before the hearing, on 12 May 2008, the Tribunal held a preparatory telephone conference to address any outstanding organizational issues after which it issued further directions for the hearing.

90. The Arbitral Tribunal held the hearing on the merits from 26 May to 4 June 2008 at the International Centre for Dispute Resolution, in London. In addition to the Members of the Tribunal,[17] the following persons attended the hearing on the merits:

---

[17] With the agreement of the Parties, Dr. Jorge E. Viñuales, an attorney practising in the law firm of the President of the Tribunal, attended the hearing.

(i) On behalf of Bayindir:

- Mr. Stanimir Alexandrov; Sidley Austin LLP
- Ms. Marinn Carlson; Sidley Austin LLP
- Ms. Jennifer Haworth McCandless; Sidley Austin LLP
- Mr. Theodore Kill; Sidley Austin LLP
- Ms. Meredith Moroney; Sidley Austin LLP
- Mr. Farrukh Karim Qureshi; Samdani & Qureshi
- Mr. Nudrat Piracha; Walker Martineau Saleem
- Mr. Kamuran Çörtük; Bayindir
- Mr. Hasan Mutlu Akpinar; Bayindir
- Mr. Guray Mik; Bayindir
- Mr. Haşim Bora Ozerman; Bayindir

(ii) On behalf of Pakistan:

- The Hon. Malik Muhammad Qayyum; Attorney General for Pakistan
- Prof. Christopher Greenwood, CMG, QC; Essex Court Chambers
- Mr. Samuel Wordsworth; Essex Court Chambers
- Mr. Rodman R. Bundy; Eversheds
- Ms. Loretta Malintoppi; Eversheds
- Mr. Nicholas Minogue; Eversheds
- Mr. Iftikharuddin Riaz; Bhandari, Naqvi & Riaz

91. During the hearing, Messrs. Greenwood, Wordsworth and Bundy addressed the Tribunal on behalf of Pakistan and Mr. Alexandrov and Ms. Carlson addressed the Tribunal on behalf of Bayindir.

92. The hearing on the merits was transcribed and the transcript was distributed to the Parties at the end of each day. The complete version of the *verbatim* transcript was later distributed to the Parties (Tr. M.), one confidential portion being subject to limited distribution.

93. At the end of the hearing on merits the Tribunal directed the Parties to submit simultaneous post-hearing briefs on 16 July 2008 and cost statements on 1 September 2008. The deadline for the submission of the Parties' cost statements was later

extended to 26 September 2008. Following the hearing the Tribunal confirmed these directions in writing.

94. Accordingly, the Parties submitted simultaneous post-hearing briefs on 16 July 2008. (PHB [Bay.] and PHB [Pak.]) and cost statements on 26 September 2008.

III. THE PARTIES' POSITIONS

95. The Tribunal has deliberated and thoroughly considered the Parties' written submissions on the merits and the oral arguments delivered in the course of the evidentiary hearing. It will now summarize the positions of the Parties (III) and analyze the issues in dispute (IV) before setting out the relief granted (V).

A. BAYINDIR'S POSITION AND REQUEST FOR RELIEF

96. Bayindir's position is essentially the following:

> "[the] Respondent, acting at the highest levels of the Government of Pakistan, exercised its sovereign prerogative to change government policy about the M-1 motorway in the face of budget shortfalls, advice from international organizations, and internal opposition to the M-1 Project. While no one would contest the Government of Pakistan's right to decide that it could no longer afford a 'Mercedes' motorway, such a decision could not be made without consequences. The hearing made clear that Respondent sought to escape those consequences by dressing its policy decision in ill-fitting contractual garb in order to expel Bayindir from the Project. In so doing, Respondent engaged in unfair and inequitable conduct, it expropriated Bayindir's investment in the M-1 Project, and it treated Bayindir less favorably than the Pakistani contractors that replaced Bayindir on the same Project. Respondent's conduct in violation of the Treaty is thus manifested in, but is not limited to, the act of expelling Bayindir from the M-1 Project. Respondent's subsequent conduct – in ensuring that Bayindir was stripped of all prospects of contractual recovery, and in destroying the Bayindir Group with an unjustified call on the mobilization advance guarantees – also gave rise to Treaty breaches."
>
> (PHB [Pak.] ¶ 3)

97. More specifically, in its written and oral submissions, Bayindir advanced the following main contentions:

(i) The Respondent breached the protections afforded by the Treaty through three series of actions, involving the expulsion of Bayindir, the conduct following

Bayindir's expulsion, and the attempted encashment of the Mobilisation Advance Guarantees;

(ii) Pakistan breached the fair and equitable treatment standard to which Bayindir is entitled on the basis of the MFN clause contained in Article II(1) of the Treaty by reason of its expulsion of Bayindir for motives unrelated to Bayindir's performance of the Contract, through its efforts to frustrate and extinguish any rights Bayindir may have retained under the Contract, and through its arbitrary and unfair attempts to encash the Mobilisation Advance Guarantees.

(iii) Pakistan breached the MFN and national treatment standards contained in Article II(1) and (2) of the Treaty by reason of its expulsion of Bayindir to favour local contractors, its more favourable treatment of both local contractors and other foreign contractors, its actions following Bayindir's expulsion, and its attempts to encash the Mobilisation Advance Guarantees.

(iv) Pakistan breached the guarantee against expropriation without compensation given in Article III(1) of the Treaty by reason of its expulsion of Bayindir, its efforts to complete the deprivation of Bayindir's investment following said expulsion, and its call on the Mobilisation Advance Guarantees.

98. On the basis of these contentions, Bayindir requested in its Memorial that the Tribunal

> "[F]ind the Respondent has violated the Claimant's rights under the Treaty. The acts and omissions of Pakistan and its emanation, the NHA, for which the Respondent is internationally responsible, have denied the Claimant fair and equitable treatment, the most favored nation treatment/national treatment and have expropriated Claimant's investment without compensation. As a result of that conduct, Claimant is entitled to and request that the Tribunal award to the Claimant compensation and damages in the amount of US$ 756,196,108.00 inclusive of compound interest. The conduct of the Respondent has caused irreparable damage to the reputation of the Claimant in respect of which the Claimant reserves its right to submit an additional claim in respect thereof.
> In addition the Claimant requests that it be awarded litigation costs and expenses."
> (Mem. M., ¶ 287)

99. In its Reply, the Claimant requested the following relief:

> "In view of the above Bayindir respectfully seeks the following relief from the Tribunal:
>
> (i) Declaring that Pakistan has breached its obligations under Article II(2) of the Treaty by failing to observe obligations that it entered into with regard to Bayindir's investment.
> (ii) Declaring that Pakistan has breached its obligations under the Treaty by failing to accord to Bayindir fair and equitable treatment.
> (iii) Declaring that Pakistan has breached Article III of the Treaty by indirectly expropriating Bayindir's investment without complying with the requirements of the Treaty.

(iv) Ordering Pakistan to pay to Bayindir full compensation and damages in the amounts set forth below:

a) US$ 22,650,834 payable on account of Certified Payment Certificates;
b) US$ 60,234,608 on account of value of Works completed up till the date of Expulsion;
c) US$ 34,188,378 on account of value of Machinery, Plant, Equipment, Spare Parts etc;
d) US$ 4,265,164 on account of Costs of Camp facilities;
e) US$ 3,877,075 on account of value of Custom Guarantee letters;
f) US$ 121,770,030 on account of Loss of Profit;
g) US$ 21,474,234 on account of reimbursement of costs incurred by Bayindir in anticipation of completing the Project;
h) US$ 219,842,618 on account of Loss of opportunity;
i) US$ 96,600,000 on account of Punitive Damages;
j) Plus pre-and post-award compound interest as prayed for in the Memorial;

(v) Ordering Pakistan to return to Bayindir the Performance Bond;
(vi) Ordering Pakistan to return the Letters of Guarantee issued by the consortium of Turkish Banks;
(vii) Ordering Pakistan to pay all costs and expenses of this arbitration proceedings, including the fees and expenses of the Tribunal and the cost of Bayindir's legal representation, plus interest thereon;
(viii) Such other or additional relief as may be appropriate under the Treaty or may otherwise be just and appropriate in the circumstances of this case."
(Reply M., pp. 200-201).

100. In its post-hearing submission, the Claimant requested the following relief:

"[A]ward it compensation in the amount of US $494.6 million plus interest of 8% compounded annually. In addition, Respondent must be permanently barred from enforcing any Turkish court judgments or otherwise seeking to encash the mobilization advance guarantees. Bayindir also respectfully requests an award of its legal fees and other costs incurred in connection with this proceeding."
(PHB [Bay.] ¶ 126)

B. PAKISTAN'S POSITION AND REQUEST FOR RELIEF

101. Pakistan's position is essentially the following:

"Bayindir's claim turns on the allegation that Pakistan treated Bayindir in a way which was not fair and equitable; its allegations of other treaty breaches are little more than window dressing and its claim for expropriation flies in the face of authority and common sense. There is no legal basis on which Bayindir could succeed in its other claims if it fails on fair and equitable treatment.
In an attempt to sustain that case for unfair and inequitable treatment, Bayindir has made numerous wild allegations about conspiracy, improper motivation and bad faith [...] Bayindir bears the burden of proof on those allegations and it has failed to discharge that burden. On the contrary, the record [...] shows that there was no conspiracy and no improper motive and that both NHA and the Government of Pakistan acted in good faith throughout."
(PHB [Pak.] ¶¶ 1.17-1.18)

102. More specifically, in its written and oral submissions, Pakistan advanced the following main arguments:

(i) Bayindir's claim that it was denied fair and equitable treatment is unfounded as it is not based on any specific fair and equitable treatment clause that could be applied through the MFN clause in the Treaty, and Bayindir has failed to establish that its expulsion as well as Pakistan's acts following said expulsion were anything else than Pakistan's legitimate exercise of its rights under the Contract;

(ii) Bayindir's claims for breach of the MFN and national treatment clauses contained in Article II paragraphs (1) and (2) of the Treaty and discrimination are unfounded to the extent that Bayindir has failed to establish any conduct of Pakistan aimed at favouring local or other foreign contractors over Bayindir;

(iii) Bayindir's claim for breach of the expropriation clause contained in Article III(1) of the Treaty is unfounded, in particular because Bayindir's expulsion was in accordance with the Contract, because Bayindir retained rights under the Contract to a final settlement, and because the plant and equipment left at the site were treated in accordance with the Contract;

(iv) Bayindir's claim for breach of the expropriation clause in connection with the attempts to encash the Mobilisation Advance Guarantees is unfounded, especially because it concerns separate parties, because it is new and the Tribunal has no jurisdiction over it, and because these guarantees are in any event not an investment and have not been expropriated.

103. In reliance on these arguments, Pakistan set forth the following requests in its Counter-Memorial:

> "On the basis of the facts and legal considerations set out in this Counter-Memorial, and rejecting all contrary submissions made by Bayindir, Pakistan respectfully requests the Tribunal to adjudge and declare:
> (i) that the Respondent has not breached the Pakistan-Turkey Treaty with respect to the claims introduced by the Claimant, and that the Claimant's claims are thereby rejected; and
> (ii) that the Claimant reimburse the Respondent for the costs and expenses the Respondent has incurred as a result of this arbitration."
> (C-Mem. M., p. 175).

104. In its Rejoinder, Pakistan requested the Tribunal to conclude as follows:

> "On the basis of the facts and legal considerations set out in this Rejoinder, and rejecting all contrary submissions made by Bayindir, Pakistan respectfully requests the Tribunal to adjudge and declare:

> (i) that the Respondent has not breached the Pakistan-Turkey Treaty with respect to the claims introduced by the Claimant, and that the Claimant's claims are thereby rejected; and
> (ii) that the Claimant reimburse the Respondent for the costs and expenses the Respondent has incurred as a result of this arbitration."
> (Rej. M., p. 168).

105. In its post-hearing submission, Pakistan concluded as follows:

> "Pakistan's primary submission is that Bayindir's claim fails and that there is no liability in damages at all [...].
> On the basis of the above, the maximum sum that may be found as owing to Bayindir is $ US14,612,315, as shown in Table 2 below [...].
> It follows from Table 2 that NHA, not Bayindir, is very substantially out of pocket.
> If a set-off were appropriate, NHA would recover the amount of US$78,078,592.
> As Table 2 shows, this is an exceptional case, as the Claimant has been paid very considerable sums up front. That must not, however, impact on the sums that the Claimant may be awarded in damages. The reality is that Bayindir did not spend a very significant portion of the mobilisation advance on the Project, and it should not be allowed to recover on the basis that it did."
> (PHB [Pak.] ¶¶ 7.1, 7.126-128).

Pakistan's statement that it may be found to owe at most approximately US$14.6 million reflects an alternative position for the event that the Tribunal would find liability (PHB [Pak.] ¶ 7.1)

106. While Part I of this Award summarizes the main facts and Part III the main arguments of the Parties, other arguments were made and considered by the Tribunal. They will be referred to in Part IV to the extent that the Tribunal considers necessary.

IV. ANALYSIS

A. PRELIMINARY MATTERS

107. The Tribunal has reviewed all of the numerous arguments presented by the Parties. The manner in which the Claimant has pleaded its case has not facilitated the Tribunal's task. Although it has considered the entire record, the Tribunal will rely more particularly on the arguments last presented by Claimant and concentrate on those arguments that it itself regards as decisive for the outcome of the dispute.

108. Before turning to the actual issues raised by the claims, the Tribunal wishes to address certain preliminary matters, i.e., the law applicable to the merits of the present dispute

(a), the attribution of NHA's acts to the Respondent under international law (b); the applicability *ratione temporis* of the Treaty (c); the requirements for establishing a treaty claim in the context of a contractual relationship (d), the allocation of the burden of proof (e), and the relevance of previous ICSID decisions or awards (f).

a. The law applicable to the merits

109. The present proceedings are based on the "Agreement between the Republic of Turkey and the Islamic Republic of Pakistan Concerning the Reciprocal Promotion and Protection of Investments" of 16 March 1995 (the "Treaty"), which entered into force on 3 September 1997. It is common ground that the Tribunal must decide the merits of the case on the basis of the Treaty. As the Claimant notes, "[treaty claims] are analyzed under the Treaty's legal standards and advanced under the Treaty's procedures, not those of the Contract" (PHB [Bay.] ¶ 2). Similarly, the Respondent states that "... the present case turns on one question: does the conduct of Pakistan amount to a breach of the bilateral investment treaty between Pakistan and Turkey" (PHB [Pak.] ¶ 1.4).

110. In deciding these questions the Tribunal will take into account the applicable rules of international law.[18]

b. Attribution of NHA's acts

111. In their submissions on the merits, both Parties have focused their argumentation on whether the acts of NHA amounted to an exercise of sovereign authority or merely of contractual rights. Before dealing with this distinction, the Tribunal must logically first review whether the acts of NHA allegedly in breach of the Treaty are attributable to Pakistan.

---

[18] See Article 42 of the ICSID Convention. See also the *Vivendi ad hoc* Committee, which held that a claim based upon a substantive provision of a BIT is "*governed by* […] *the BIT and by applicable international law*". *Compañia de Aguas del Aconquija S.A. and Vivendi Universal v. Argentine Republic* (ICSID Case No. ARB/97/3) (hereafter*, Vivendi v. Argentina*), Decision on Annulment of 3 July 2002, ¶¶ 96 and 102; *see* also *Azurix Corp. v. Argentine Republic* (ICSID Case No. ARB/01/12) (hereafter*, Azurix v. Argentina*), Award of 14 July 2006, ¶ 67; *MTD Equity Sdn. Bhd. and MTD Chile S.A. v. Republic of Chile* (ICSID Case No. ARB/01/7) (hereafter*, MTD v. Chile*), Award of 25 May 2004, ¶ 87; *Wena Hotels Ltd. v. Arab Republic of Egypt* (ICSID Case No. ARB/98/4) (hereafter*, Wena Hotels v. Egypt*), Award of 8 December 2000, ¶¶ 78-79.

112. When specifying in its post-hearing brief the acts in breach of the Treaty, the Claimant refers to (i) the expulsion of Bayindir, (ii) following the expulsion, the failure by NHA to proceed to a number of actions under the Contract (such as the evaluation of the works completed, the certification of certain IPAs (Interim Payment Application), the payment of certain IPCs, or the refusal to acknowledge and certify extensions of time granted by the Engineer) and NHA's claim for approximately US$ 1 billion in the Pakistani arbitration, and (iii) the actions taken in connection with the encashment of the Mobilisation Advance Guarantees.

113. In respect of each of these three series of actions, Bayindir asserts a breach of the FET, non-discrimination and expropriation protections of the Treaty (see for instance PHB [Bay.], ¶¶ 80, 94, 106, 108). From a contractual standpoint, these actions were those of NHA and not of the Government of Pakistan. The Tribunal must therefore determine whether they are attributable to the Respondent under the international law rules of attribution reflected in Articles 4, 5 and 8 of the International Law Commission's Articles on Responsibility of States for internationally wrongful acts ("ILC Articles").[19]

114. Without clearly distinguishing between each of these three series of acts, the Claimant argues in essence that the Government of Pakistan, in the exercise of its sovereign prerogatives, took the decisions that led to the violation of Bayindir's rights under the Treaty, and that these decisions were subsequently implemented by NHA through contractual means. More specifically, while acknowledging that "[t]he Contract to construct the M-1 Motorway was entered into between Bayindir and NHA" (PHB [Bay.] ¶ 20), the Claimant argues that

> "the key decisions with respect to Bayindir's ongoing involvement in the M-1 Project, including ultimately the decision to expel Bayindir, were repeatedly referred to and taken by others at the highest levels of the Government of Pakistan, including the head of state of the Islamic Republic. The involvement of these government actors, above and outside of NHA, in itself demonstrates that the decision to expel Bayindir was a sovereign and not a contractual act [...] the record is clear that decisions on the M-1 Project were referred to senior government officials and agencies above NHA, and ultimately to General Musharraf himself." (PHB [Bay.] ¶ 20)

---

19 Articles on Responsibility of States for internationally wrongful acts, with commentaries (2001), Yearbook of the International Law Commission, 2001, Vol. II, Part Two. The ILC Articles are widely regarded as expressing current customary international law, see J. Crawford, The International Law Commission's Articles on State Responsibility – Introduction, Text and Commentaries, 2002.

115. Referring to the decision in *Wena Hotels*,[20] Bayindir further contends that even if the Tribunal were to conclude that the Respondent had no involvement in the Treaty-violative acts taken against Bayindir, the record shows that the Respondent "took no steps to prevent the unjustified expropriation of Bayindir's investment or the discriminatory and unfair treatment to which Bayindir was subjected" (PHB [Bay.] ¶ 33). More specifically, it asserts that

> "[t]here can be no question that the Government of Pakistan at a minimum was well aware of the expulsion of Bayindir and the attempted encashment of the guarantees. The expulsion was discussed with General Musharraf, and the attempted encashment was coordinated with Pakistan's Foreign Office. At the very least, Respondent stood by and did not act to protect Bayindir or its investment from mistreatment by entities under its control." (PHB [Bay.] ¶ 33).

116. Pakistan concedes that there was some government involvement, but insists that the decisions allegedly in breach of the Treaty were taken in the exercise of NHA's contractual rights as opposed to the exercise of sovereign prerogatives, or in the words used in the post-hearing brief:

> "the decision to expel was made by NHA, acting on its own following the issuance of a Clause 63.1 Certification by the Engineer, subsequent to 12 April 2001, albeit with the high level approval that – so far as concerns the general diplomatic fallout – it could act in accordance with the terms of the Contract [...] the case comes down to the exercise by NHA of a contractual right, divorced from interference by the State. The fact that President Musharraf might have, but did not, discourage NHA from exercising its contractual rights because of broader diplomatic reasons in no way constitutes relevant interference." (PHB [Pak.] ¶¶ 2.76, 2.78)

117. It is not disputed that it was NHA which exercised the rights under the Contract in a manner allegedly in breach of the Treaty. The debate thus hinges on the following questions: (i) whether NHA is an organ of the State; (ii) whether NHA is an instrumentality acting in the exercise of governmental powers; and (iii) whether NHA acted under the direction or control of the State. These issues were not clearly articulated in the Parties' submissions and pleadings on the merits, but they received attention in earlier phases of the proceedings. The Tribunal considers nevertheless that issues (i) to (iii) are implied in the Parties' arguments and constitute a necessary step in the Tribunal's analysis.

[20] *Wena Hotels v. Egypt*, *supra* footnote 18, ¶ 99.

118. Given NHA's position as Bayindir's contract partner, the logical starting point for the Tribunal's analysis is question (i). In its RP, Bayindir argued that Pakistan was the proper party and that:

> "attempts to view NHA as somehow structurally or functionally distinct from the Government of Pakistan are erroneous as can be seen on review of, *inter alia*, the following:
>
> -NHA's constituting statute, which places the Prime Minister, Minister of Finance and Minister of Communications in control of this entity [...]
> -The purposes and duties of NHA are clearly national in scope, as both the name 'National Highway Authority' and the purposes of the NHA Act make plain [...]
> -In both the 1993 Contract and 1997 Contract, Bayindir contracted with 'NATIONAL HIGHWAY AUTHORITY, GOVERNMENT OF PAKISTAN' [...]
> -The February 9, 2000 Minutes of Meeting which recorded the extensions of time permitted to Bayindir for the one of the Priority Sections, were negotiated with, and then recorded by, the Government of Pakistan [...] After Bayindir had been expelled from Site, it was the Pakistani Ministry of Communications which explained on behalf of the Pakistan Government that it was to the benefit of the Government and local contractors that Bayindir was removed [...]
> - Claim concerns BIT breaches, not contractual breaches"
> (RP ¶ 129)

119. Pakistan submits that NHA is a distinct legal personality under the laws of Pakistan (Mem. J., ¶ 4.17). The Tribunal shares this view. Indeed, pursuant to section 3(2) of the National Highway Authority Act of 1991 ("NHA Act"), NHA is a "body corporate having perpetual succession and a common seal with power to acquire, hold and dispose of property, and may in its own name sue and be sued" (Exh. [Bay] RP-1). The fact that there may be links between NHA and some sections of the Government of Pakistan does not mean that the two are not distinct. State entities and agencies do not operate in an institutional or regulatory vacuum. They normally have links with other authorities as well as with the government. Because of its separate legal status, the Tribunal discards the possibility of treating NHA as a State organ under Article 4 of the ILC Articles. The Claimant also asserts, however, that NHA's conduct was in fact the mere execution of decisions taken by government officials. This argument would appear to suggest that the acts incriminated emanate from government officials, who are themselves organs of the State under Article 4 of the ILC Articles. Given that – as already indicated above – NHA is a separate legal entity and that the acts in question are those of NHA as a party to the Contract, the Tribunal considers that there are no grounds for attribution by virtue of Article 4.

120. As a next step, the Tribunal must review whether NHA's conduct may be attributable pursuant to Article 5 (State instrumentalities) of the ILC Articles. Article 5 ILC reads as follows:

> "The conduct of a person or entity which is not an organ of the State under article 4 but which is empowered by the law of that State to exercise elements of the governmental authority shall be considered an act of the State under international law, provided the person or entity is acting in that capacity in the particular instance."

121. It is not disputed that NHA is generally empowered to exercise elements of governmental authority. Section 10 of the NHA Act vests broad authority in NHA to take "such measures and exercise such powers it considers necessary or expedient for carrying out the purposes of this Act," including to "levy, collect or cause to be collected tolls on National Highways, strategic roads and such other roads as may be entrusted to it and bridges thereon." Other relevant provisions of the NHA Act are section 12 on "Powers to eject unauthorized occupants" and section 29 on the NHA's "Power to enter" upon lands and premises to make inspections.

122. The existence of these general powers is not however sufficient in itself to bring the case within Article 5. Attribution under that provision requires in addition that the instrumentality acted in a sovereign capacity in that particular instance:

> "If it is to be regarded as an act of the State for purposes of international responsibility, the conduct of an entity must accordingly concern governmental activity and not other private or commercial activity in which the entity may engage."[21]

123. To determine whether NHA acted in a sovereign capacity for the different acts at issue, the Tribunal has had to review the numerous arguments and extensive evidence presented by the parties. Its detailed analysis will be found later on in this Award when dealing with the merits of Bayindir's individual claims. It will make for better readability of the Award, however, if the Tribunal were to signal at this point the first of its main findings on the question of attribution. This is that (although there are indications in the opposite direction) the Tribunal is not persuaded on the balance of the evidence presented to it that in undertaking the actions which are alleged to be in breach of the Treaty, the NHA was acting in the exercise of elements of the governmental authority. The Tribunal's conclusion is accordingly that these actions are thus not attributable to Pakistan under Article 5 of the ILC Articles.

[21] Commentary to the ILC Articles, ad Article 5, ¶ 5.

124. Whatever the Tribunal's finding on that question may be, however, the possibility remains of attribution to the State under Article 8 of the ILC Articles. Article 8 reads as follows:

> "The conduct of a person or group of persons shall be considered an act of a State under international law if the person or group of persons is in fact acting on the instructions of, or under the direction or control of, that State in carrying out the conduct."

125. As before in connection with Article 5, in order to assess whether an act was carried out "on the instructions of, or under the direction or control of" the State, the Tribunal has reviewed the parties' arguments and extensive evidence. The Tribunal concludes that each specific act allegedly in breach of the Treaty was a direct consequence of the decision of the NHA to terminate the Contract, which decision received express clearance from the Pakistani Government. A detailed analysis of the connections existing between the decision of the NHA and the involvement of the Pakistani Government with respect to the termination of the Contract is provided in the Tribunal's discussion of Bayindir's FET claim, albeit its scope covers the other claims as well. On this basis, the Tribunal signals the second of its main findings on the question of attribution, namely that NHA's conduct is attributable to Pakistan under Article 8 of the ILC Articles.

126. This finding is comforted by the fact that the Respondent conceded in its oral and written submissions (see for instance Tr. M., 26 May 2008, 155, 6-23, 4 June 2008, 174, 13-22, 223, 13-16; PHB [Pak.] ¶¶ 2.76, 2.78) that the government was involved to a certain degree in the M-1 Project. So for instance, in the opening statement:

> "[O]ne of the refrains you heard this morning repeatedly was, 'The Government of Pakistan, contrary to what the Respondent is trying to tell you, kept intervening in this Contract'. The Government of Pakistan was closely interested in this Contract, as any responsible Government being asked to stump up hundreds of millions of Dollars, is going to be. But there is another reason why the Government of Pakistan was involved, and that is that the Claimant kept asking it to get involved."
> (Tr. M., 26 May 2008, 155, 6-17).

127. Or in the post-hearing brief:

> "the decision to expel was made by NHA, acting on its own following the issuance of a Clause 63.1 Certification by the Engineer, subsequent to 12 April 2001, albeit with the high level approval that – so far as concerns the general diplomatic fallout – it could act in accordance with the terms of the Contract."
> (PHB [Pak.] ¶ 2.76)

128. These statements are consistent with the evidence on record. There was indeed a certain degree of government involvement, as will be discussed in detail later. During the hearing on the merits, it became in particular clear that at a meeting held on 12 April 2001, General Musharraf gave clearance to the Chairman of NHA, General Javed, to resort to the available contract remedies, including termination (Tr. M., 29 May 2008, 74-75). Similarly, General Qazi, Minister of Communications, confirmed that the decision to terminate the Contract could not have been taken without some guidance from higher levels of the Pakistani government (Tr. M., 28 May 2008, 318-319).

129. The Tribunal also notes that attribution under Article 8 is without prejudice to the characterization of the conduct under consideration as either sovereign or commercial in nature. For the sake of attribution under this rule, it does not matter that the acts are commercial, *jure gestionis,* or contractual. The Commentary to the ILC Articles stresses this point in the following terms:

> "The attribution to the State of conduct in fact authorized by it is widely accepted in international jurisprudence. In such cases it does not matter that the person or persons involved are private individuals nor whether their conduct involves 'governmental activity."[22]

In other words, a finding of attribution does not necessarily entail that the acts under review qualify as sovereign acts. The Tribunal will address this latter issue in the context of the discussion of each specific claim whenever relevant.

130. Finally, the Tribunal is aware that the levels of control required for a finding of attribution under Article 8 in other factual contexts, such as foreign armed intervention or international criminal responsibility, may be different. It believes, however, that the approach developed in such areas of international law is not always adapted to the realities of international economic law and that they should not prevent a finding of attribution if the specific facts of an investment dispute so warrant.

---

[22] *Id.*, ad Article 8, ¶ 2, footnotes omitted. See also *Noble Ventures, Inc. v. Romania* (ICSID Case No. ARB/01/11) (hereafter*, Noble Ventures v. Romania*), Award of 12 October 2005, ¶ 82; I. Fadlallah, Are States Liable for the Conduct of Their Instrumentalities? ICSID Case Law, in E. Gaillard, J. Younan (eds.), *State Entities in International Arbitration*, IAI, 2008, p. 27.

c. Applicability *ratione temporis* of the Treaty

131. Another preliminary question concerns the applicability *ratione temporis* of the Treaty. Pursuant to Article IX(1), the Treaty "shall apply to investments existing at the time of entry into force as well as to investments made or acquired thereafter." It is therefore clear that whether made prior to or after the entry into force of the Treaty on 3 September 1997, an investment benefits from the protections of the Treaty.

132. However, in accordance with the well-established principle of non-retroactivity of treaties and absent any indication to the contrary in the text of the Treaty itself, the protections accorded by the Treaty can only apply to acts committed after its entry into force.[23] In the present case, no issue arises in this respect as the disputes arising out of the events pre-dating the entry into force of the Treaty were settled (see Exh. [Bay.] C-17, C-8). That notwithstanding, the Tribunal considers that acts pre-dating the entry into force can be taken into account to the extent that they may assist in understanding the significance of acts which do fall within the scope of the Treaty *ratione temporis*.

d. Treaty claim in the context of a contractual relationship

133. The Parties are at odds on the significance of contract matters in the assessment of treaty claims. Referring to *Vivendi I*,[24] *SGS v. Pakistan*[25] and *Impregilo v. Pakistan*,[26] Bayindir argues in substance that

> "A breach of the Contract [...] is not a necessary precondition for this Tribunal to find that Respondent violated its Treaty obligations; these are independent inquiries. What Claimant must establish, and has established here, is one or more violations by Respondent of its Treaty obligations."
> (PHB [Bay.] ¶ 7)

---

23 Pursuant to Article 28 of the Vienna Convention on the Law of Treaties (hereafter, VCLT), done at Vienna on 23 May 1969 (UN Treaty Series, vol. 1155, p. 331): "Unless a different intention appears from the treaty or is otherwise established, its provisions do not bind a party in relation to any act or fact which took place or any situation which ceased to exist before the date of the entry into force of the treaty with respect to that party." Article 13 of the ILC Articles states a similar principle in the following terms: "An act of a State does not constitute a breach of an international obligation unless the State is bound by the obligation in question at the time the act occurs."

24 *Vivendi v. Argentina*, *supra* footnote 18, ¶ 96.

25 *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 of 6 August 2003, ¶ 147.

26 *Impregilo SpA v. Islamic Republic of Pakistan* (ICSID Case No. ARB/03/3), Decision on Jurisdiction of 22 April 2005, ¶ 258, (hereafter*, Impregilo v. Pakistan*).

134. In contrast, Pakistan argues that "it is not the role of this Tribunal (as it has rightly reminded the Parties) to substitute itself for the contractual tribunal to which Bayindir could have taken its case against NHA" (PHB [Pak.] ¶ 1.4). However, it asserts that

> "a breach of Contract by the NHA is a necessary, but not a sufficient condition of a breach of the BIT. In the absence of a breach of Contract there cannot be a breach of the Treaty in this case [...] It is a well-established proposition that a breach of Contract by the State is not in itself a breach of international law. That is still more true when one looks at a breach of Contract not by a State, but by a State agency such as the NHA [...] They have got to show more than just an ordinary breach of Contract."
> (Tr. M., 26 May 2008, 164-166: 18-22, 15-20, 6-7).

135. As a threshold matter, the Tribunal recalls that its jurisdiction covers treaty and not contract claims. This does not mean that it cannot consider contract matters. It can and must do so to the extent necessary to rule on the treaty claims. It takes contract matters, including the contract's governing municipal law, into account as facts as far as they are relevant to the outcome of the treaty claims. Doing so, it exercises treaty not contract jurisdiction.

136. This approach is in conformity with international law[27] and arbitral practice. As noted by the *ad hoc* Committee in *Vivendi v. Argentina*, in assessing whether there has been a treaty breach a tribunal may review contract matters "at least so far as necessary in order to determine whether there had been a breach of the substantive standards of the BIT,"[28] adding that "it is one thing to exercise contractual jurisdiction [...] and another to take into account the terms of a contract in determining whether there has been a breach of a distinct standard of international law."[29] This approach was confirmed in *Vivendi II*:

> "the Tribunal would not be *applying* the contract by deciding a contractual issue, determining the parties' respective rights and obligations or granting relief under the agreement. It would be doing no more than the Respondent concedes is its

---

27 In *Certain German Interests in Polish Upper Silesia*, the Permanent Court of International Justice observed: "It might be asked whether a difficulty does not arise from the fact that the Court would have to deal with the Polish law of July 14, 1920. This, however, does not appear to be the case. From the standpoint of International Law and of the Court which is its organ, municipal laws are merely facts which express the will and constitute the activities of States, in the same manner as do legal decisions or administrative measures. The Court is certainly not called upon to interpret the Polish law as such; but there is nothing to prevent the Court's giving judgment on the question whether or not, in applying that law, Poland is acting in conformity with its obligations towards Germany under the Geneva Convention." PCIJ, The Merits, Judgment of 25 May 1926, Series A, No. 7, p. 19.

28 *Vivendi v. Argentina*, *supra* note 18, ¶ 110.

29 *Id.*, ¶ 105.

right – *ie*, taking the contractual background into account in determining whether or not a breach of the Treaty has occurred."[30]

137. These considerations do not imply that the assessment of a treaty breach in the context of a contractual relationship requires a determination that the contract has been breached. Breach of contract and breach of treaty are separate questions giving rise to separate inquiries. Or in the words of the *ad hoc* Committee in *Vivendi v. Argentina*:

> "whether there has been a breach of the BIT and whether there has been a breach of contract are different questions. Each of these claims will be determined by reference to its own proper or applicable law in the case of the BIT, by international law; in the case of the Concession Contract, by the proper law of the contract."[31]

And in the same vein, *Impregilo v. Pakistan*:

> "[T]he fact that a breach may give rise to a contract claim does not mean that it cannot also – and separately – give rise to a treaty claim. Even if the two perfectly coincide, they remain analytically distinct, and necessarily require different enquiries."[32]

Or in the words of the tribunal in *Duke Energy*:

> "[I]n and of itself the violation of a contract does not amount to the violation of a treaty. This is only natural since treaty and contract breaches are different things, responding to different tests, subject to different rules."[33]

138. Because the enquiries are different, the fact that a State exercises a contract right or remedy does not in and of itself exclude the possibility of a treaty breach.[34] The ad hoc Committee in *Vivendi v. Argentina* stressed this consequence in the following words:

---

30 *Compañía de Aguas del Aconquija S.A. and Vivendi Universal S.A. v. Argentine Republic* (ICSID Case No. ARB/97/3) (hereafter *Vivendi II*), Award of 20 August 2007, ¶ 7.3.9 (italics original).

31 *Id.*, ¶ 96.

32 *Impregilo v. Pakistan*, *supra* footnote 26, ¶ 258. See also *RFCC v. Morocco:* "The Tribunal must assess whether the State [...] has breached the obligations imposed on it by the substantive provisions of the Bilateral Agreement. Such a breach could of course result from a breach of the contract, but a potential breach of the contract does not amount, ipso jure and as such, to a breach of the Treaty". The Tribunal's translation of the following text in French: "Le Tribunal doit rechercher si l'Etat [...] a violé les obligations que lui imposent les dispositions matérielles de l'Accord bilatéral. Une telle violation peut certes résulter d'une violation du contrat, mais sans qu'une éventuelle violation du contrat ne constitue, *ipso jure* et en elle-même, une violation du Traité", *Consortium RFCC* v. *Kingdom of Morocco* (ICSID Case No. ARB/00/6) (hereafter, *RFCC v. Morocco*), Award of 22 December 2003, ¶ 48.

33 *Duke Energy Electroquil Partners and Electroquil SA v. Republic of Ecuador*, (ICSID Case No. ARB/04/19) (hereafter, *Duke Energy v. Ecuador*), Award of 18 August 2008, ¶ 342.

34 *See* Decision on Jurisdiction, ¶ 157.

> "[T]he passage [which concluded that it was impossible to separate the analysis of treaty breaches from that of contract breaches] appears to imply that conduct of Tucumán carried out in the purported exercise of its rights as a party to the Concession Contract could not, *a priori*, have breached the BIT. However, there is no basis for such an assumption: whether particular conduct involves a breach of a treaty is not determined by asking whether the conduct purportedly involves an exercise of contractual rights."[35]

139. In conclusion, the Tribunal will take contract matters into account in its determination of whether the Respondent has breached the Treaty whenever relevant, while noting that a breach of contract is neither a necessary nor a sufficient condition for a breach of treaty.

e. Burden of proof

140. The Parties concur that the burden of proving treaty breaches lies upon Bayindir (PHB [Bay.] ¶ 7, PHB [Pak.] ¶ 1.5). They disagree, however, on the relevant standards.

141. The Claimant refers to the decision of the International Court of Justice in the *Corfu Channel Case*[36] in support of a liberal recourse to inferences of fact and circumstantial evidence when such inferences are based "on a series of facts linked together and leading logically to a single conclusion" (Tr. M., 4 June 2008, 107, 5-7). It submits this argument particularly with regard to the absence from the record of minutes of the meeting with General Musharraf on 12 April 2001, at which, according to the Claimant, the "political decision was made to get rid of Bayindir" (Tr. M., 4 June 2008, 107, 14-15). By contrast, the Respondent replies that the standard of proof is a demanding one for certain issues, noticeably conspiracy. It also finds that no adverse influence can be drawn from the lack of minutes of the meeting just referred to, in light of the Claimant's allegations of bad faith as well as of its own failure to disclose internal documents.

142. The Tribunal notes that, in its reference to the *Corfu Channel case*, the Claimant has omitted to mention that the Court expressly held that "proof may be drawn from inferences of fact, provided that they leave *no room* for reasonable doubt."[37] Hence, the Tribunal will have to assess whether or not the evidence produced by the Claimant is sufficient to exclude any reasonable doubt.

---

35 *Vivendi v. Argentina*, *supra* note 18, ¶ 110.

36 *Corfu Channel Case* (UK v. Albania), Merits, Judgment of 9 April 1949, *ICJ Reports 1949*, p. 4.

37 *Id.*, p. 18.

143. The Tribunal further considers that, as argued by the Respondent, the standard for proving bad faith is a demanding one, in particular if bad faith is to be established on the basis of circumstantial evidence.

f. The relevance of previous ICSID decisions or awards

144. In support of their positions, both Parties have relied extensively on previous ICSID decisions and awards, either to conclude that the same solutions should be adopted in the present case or in an effort to explain why this Tribunal should depart from a certain solution.

145. The Tribunal is not bound by previous decisions of ICSID tribunals.[38] At the same time, it is of the opinion that it should pay due regard to earlier decisions of such tribunals. The Tribunal is further of the view that, unless there are compelling reasons to the contrary, it ought to follow solutions established in a series of consistent cases, comparable to the case at hand, but subject of course to the specifics of a given treaty and of the circumstances of the actual case. By doing so, it will meet its duty to seek to contribute to the harmonious development of investment law and thereby to meet the legitimate expectations of the community of States and investors towards certainty of the rule of law.[39]

B. FAIR AND EQUITABLE TREATMENT

146. Bayindir's allegations of the many acts supporting its FET claim are loosely organized and have undergone significant variations throughout the proceedings. To structure its analysis, the Tribunal has sought to organize the earlier allegations within the framework adopted in Bayindir's post-hearing brief. It is aware that such choice may entail some repetition.

147. After discussing the admissibility of the importation of an FET obligation by operation of the MFN clause (a), the identification of the relevant FET obligation (b), and the content

---

[38] *See e.g.*, *AES Corporation v. the Argentine Republic* (ICSID Case No. ARB/02/17), Decision on Jurisdiction of 13 July 2005, ¶ 30.

[39] On the precedential value of ICSID decisions, *see* Gabrielle Kaufmann-Kohler, *Arbitral Precedent: Dream, Necessity or Excuse?*, *The 2006 Freshfields Lecture*, published in Arbitration International*, Vol. 23,* 2007, pp. 357-378.

of the applicable standard (c), the Tribunal will analyze the Respondent's conduct which led to the expulsion of Bayindir (d), followed by the expulsion of Bayindir (e), and aimed at encashing the Mobilisation Advance Guarantees (f), as well as the characterization of all these acts taken together (g).

a. Importation of FET obligation by operation of MFN clause

1. Bayindir's position

148. The Claimant argues in essence that, despite the absence of a specific clause in the Treaty providing for fair and equitable treatment, an FET obligation can be derived both from the fourth paragraph of the preamble of the Treaty and from the operation of the MFN clause in Article II(2) of the Treaty (Mem. M., ¶ 142). In this latter respect, the Claimant seeks to import through Article II(2) of the Treaty the provisions on fair and equitable treatment contained in the bilateral investment treaties ("BITs" or, individually "BIT") concluded by Pakistan with France, the Netherlands, China, Australia, Switzerland and the United Kingdom. At the hearing on the merits, Bayindir added a reference to the BITs concluded by Pakistan with Lebanon, Sri Lanka and Denmark (Tr. M., 4 June 2008, 92, 9-13). It refers more particularly to the FET provision in the BIT between Pakistan and the United Kingdom[40] ("Pakistan-UK BIT") (Reply M., ¶ 255).

149. The Claimant emphasizes that the interpretation of the Treaty's MFN clause supports the importation of an FET guarantee in the light of (i) the Treaty's preamble and of its object and purpose, as directed by Article 31 of the VCLT; (ii) Article II(4) of the Treaty, which deliberately excludes some matters from the scope of operation of the MFN clause and, *a contrario*, implies that matters not excluded such as FET are covered; and (iii) the decisions in *MTD v. Chile*[41] (Mem. M., ¶ 145), *Plama v. Bulgaria*[42] and *Salini v. Jordan,*[43] which, in Claimant's submission, make it clear that the specific

---

40 Agreement between the United Kingdom of Great Britain and Northern Ireland and the Government of the Islamic Republic of Pakistan of 30 November 1994, which entered into force on 30 November 1994, available at: http://www.unctad.org/sections/dite/iia/docs/bits/uk_pakistan.pdf.

41 *MTD. v Chile, supra* footnote 18.

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

43 *Salini Costruttori SpA and Italstrade SpA v. Hashemite Kingdom of Jordan* (ICSID Case No. ARB/02/13) (hereafter, *Salini v. Jordan*), Decision on Jurisdiction of 29 November 2004.

purpose of an MFN clause in a BIT is to "allow an investor to benefit from a more favourable substantive protection of another Treaty" (Tr. M., 4 June 2008, 92, 15-17).

2. *Pakistan's position*

150. The Respondent argues that reliance on the MFN clause of the Treaty to import an FET clause from another BIT is only possible if it is not excluded by the intention of the contracting parties at the time of signing the Treaty. In the present case, the intention had clearly been to exclude the FET standard to the extent that Turkey and Pakistan deliberately decided not to include an FET clause in the Treaty "notwithstanding that the preamble acknowledges the importance of fair and equitable treatment and clauses requiring such treatment [...] were already common by 1995 when the Pakistan-Turkey BIT was signed" (Rej. M., ¶ 4.7).

151. With respect to the Pakistan-UK BIT to which Claimant makes special reference, the Respondent noted at the hearing that the Claimant's interpretation would mean that the decision of Pakistan and Turkey not to include an FET guarantee, while including an MFN clause, would have had no effect at all, given that the Pakistan-UK BIT was already in force (Tr. M., 26 May 2008, 299, 1-12).

152. According to Pakistan, the Claimant's argument would amount to "precisely the kind of 'treaty shopping' against which the tribunals in cases like *Maffezini* and *Telenor* warned, albeit in the context of substantive, rather than jurisdictional, provisions" (Rej. M., ¶ 4.14).

3. *Tribunal's determination*

153. In its Decision on Jurisdiction, the Tribunal noted that, in the absence of a specific provision in the Treaty, it was doubtful that the sole text of the preamble would provide a sufficient basis for a self-standing FET obligation.[44] *Prima facie* for the sole purpose of jurisdiction, it then considered that through the operation of Article II(2) of the Treaty Bayindir could rely on Pakistan's obligation to act in a fair and equitable manner[45] contained in other BITs concluded by Pakistan. The Tribunal must now assess

---

44 Decision on Jurisdiction, ¶ 230.

45 *Id.*, ¶¶ 230-232.

whether or not the *prima facie* applicability of an FET obligation can be confirmed in the light of the submissions of the Parties on the merits.

154. The relevant passage of the preamble reads as follows:

> "Agreeing that fair and equitable treatment of investment is desirable in order to maintain a stable framework for investment and maximum effective utilization of economic resources." (Exh. [Bay.] B-33).

155. In the Tribunal's view, such language is of little assistance as it does not establish any operative obligation. It is true that the reference to FET in the preamble together with the absence of a FET clause in the Treaty might suggest that Turkey and Pakistan intended not to include an FET obligation in the Treaty. The Tribunal is, however, not persuaded that this suggestion rules out the possibility of importing an FET obligation through the MFN clause expressly included in the Treaty. The fact that the States parties to the Treaty clearly contemplated the importance of the FET rather suggests the contrary. Indeed, even though it does not establish an operative obligation, the preamble is relevant for the interpretation of the MFN clause in its context and in the light of the Treaty's object and purpose pursuant to Article 31(1) of the VCLT.

156. Article II(2) of the Treaty reads in relevant part as follows:

> "Each Party shall accord to these investments, once established, treatment no less favourable than that accorded in similar situations to investments of its investors or to investments of investors of any third country, whichever is the most favourable." (Exh. [Bay.] B-33)

This provision is limited by Article II(4) as follows:

> "The provisions of this Article shall have no effect in relation to following agreements entered into by either of the Parties;
> (a) relating to any existing or future customs unions, regional economic organization or similar international agreements,
> (b) relating wholly or mainly to taxation."
> (Exh. [Bay.] B-33)

157. The ordinary meaning of the words used in Article II(2) together with the limitations provided in Article II(4) show that the parties to the Treaty did not intend to exclude the importation of a more favourable substantive standard of treatment accorded to investors of third countries. This reading is supported by the preamble's insistence on FET.

158. It is further supported by the decision of the tribunal in *MTD v. Chile* regarding the application of MFN to import an FET obligation:

> "The Tribunal has concluded that, under the BIT, the fair and equitable standard of treatment has to be interpreted in the manner most conducive to fulfill the objective of the BIT to protect investments and create conditions favorable to investments. The Tribunal considers that to include as part of the protections of the BIT those included in Article 3(1) of the Denmark BIT and Article 3(3) and (4) of the Croatia BIT is in consonance with this purpose. The Tribunal is further convinced of this conclusion by the fact that the exclusions in the MFN clause relate to tax treatment and regional cooperation, matters alien to the BIT but that, because of the general nature of the MFN clause, the Contracting Parties considered it prudent to exclude. *A contrario sensu*, other matters that can be construed to be part of the fair and equitable treatment of investors would be covered by the clause."[46]

159. The fact that there is no uniform case law on MFN and procedural rights and that certain decisions, including *Maffezini v. Spain* and *Telenor v. Hungary* referred to by the Respondent, as well as *Plama v. Bulgaria* and *Salini v. Jordan*, have adopted a different view than the one applied here is of little relevance. Indeed, the *ejusdem generis* principle that is sometimes viewed as a bar to the operation of the MFN clause with respect to procedural rights does not come into play here and the words of the Treaty are clear.

160. As noted by the Respondent, the FET provision to which the Claimant more specifically referred, namely Article II(2) of the Pakistan-UK BIT, pre-dates the MFN clause in the Treaty. In and of itself that chronology does not appear to preclude the importation of an FET obligation from another BIT concluded by the Respondent. In any event, the Claimant has also referred to BITs concluded subsequently to the Treaty. The issue is therefore not whether the Claimant can invoke an FET obligation, but rather which one.

b. Identification of the FET obligation

1. Bayindir's position

161. The Claimant refers more specifically to Article II(2) of the Pakistan-UK BIT, according to which

> "Investment of nationals or companies of each Contracting Party shall at all times be accorded fair and equitable treatment and shall enjoy full protection and security in the territory of the other Contracting Party. Neither Contracting Party shall in any

[46] *MTD v. Chile*, *supra* footnote 18, ¶ 104.

> way impair by unreasonable or discriminatory measures the management, maintenance, use, enjoyment or disposal of investments in its territory."[47]
> (Reply M., ¶ 255)

It has also pointed to the FET provisions included in the BITs concluded by Pakistan with France, the Netherlands, China, Australia, Switzerland, Lebanon, Sri Lanka and Denmark.

2. Pakistan's position

162. As discussed above, Pakistan objects to importing Article II(2) of the Pakistan-UK BIT into the Treaty, arguing that the Pakistan-UK BIT pre-dates the Treaty and, therefore, Turkey and Pakistan could not have intended to include that FET obligation into the Treaty.

3. Tribunal's determination

163. In its Decision on Jurisdiction, the Tribunal noted that Pakistan had not disputed that the BITs concluded by Pakistan with France, the Netherlands, China, the United Kingdom, Australia and Switzerland contained an explicit fair and equitable treatment clause.[48] At the hearing, Bayindir further referred to the BITs between Pakistan and Lebanon, Sri Lanka and Denmark. The Respondent has not specifically disputed this reference, focusing instead on the applicability of the FET provision of the Pakistan-UK BIT.

164. At the outset, the Tribunal notes that the basis for importing an FET obligation into the Treaty is provided by its MFN clause, from which it follows that the applicable FET standard is a self-standing treaty obligation as opposed to the customary international minimum standard to which the Respondent referred. That being so, whether international customary law and the observations of other tribunals in applying the minimum standard may be relevant here will depend upon the terms of the applicable FET standard.

---

[47] The Claimant incorrectly refers to this provision as Article III of the Pakistan-UK BIT (Reply M., ¶ 255, footnote 550), whereas the text cited by the Claimant corresponds to Article II(2) of said BIT. Later in the proceedings, in its opening statement at the hearing on the merits, the Claimant correctly referred to Article II(2) of said BIT (Tr. M., 26 May 2008, 116, 5-7).

[48] Decision on Jurisdiction, ¶ 231.

165. The Claimant has especially referred to Article II(2) of the Pakistan-UK BIT, quoted above. It has also referred to Article 4 of the Agreement between the Swiss Confederation and the Islamic Republic of Pakistan concerning the promotion and the reciprocal protection of investments ("Pakistan-Switzerland BIT"),[49] which was concluded more than three months after its Turkish counterpart. In relevant part, the Pakistan-Switzerland BIT provides as follows:

> "(1) Each Contracting Party shall protect within its territory the investments made in accordance with its laws and regulations by investors from the other Contracting Party and shall not hinder through unjustified or discriminatory measures the management, maintenance, use, enjoyment, accrual, sale and, as the case may be, liquidation of such investments [...]
> (2) Each Contracting Party shall grant within its territory fair and equitable treatment to investments of investors from the other Contracting Party." [50]
> (Exh. [Bay.] CLEX-18.11)

166. A comparison between Article II(2) of the Pakistan-UK BIT and Article 4 of the Pakistan-Switzerland BIT suggests that the FET protection offered by these two provisions is very similar. There is a difference, however, between the two treaties in terms of chronology. The Pakistan-UK BIT was concluded before and the Pakistan-Switzerland BIT after the Treaty. This difference matters in connection with the Respondent's objection that, when they concluded the Treaty, Turkey and Pakistan cannot have intended to include an FET clause such as the one in the Pakistan-UK BIT or else they would have inserted an express provision. That argument only applies to clauses that pre-date the conclusion of the Treaty. It does not apply to Article 4 of the Pakistan-Switzerland BIT which was concluded after the Treaty. The fact that the latter entered into force thereafter is irrelevant to ascertain the intention of the State parties at the time of conclusion. As a result, the Tribunal cannot follow Respondent's chronological objection.

167. Hence, by virtue both of the time of its conclusion and its close similarity to Article II(2) of the Pakistan-UK BIT, Article 4 of the Pakistan-Switzerland BIT can be used as the

---

[49] Concluded on 11 July 1995 and entered into force on 6 May 1996.

[50] Tribunal's translation of the French text provided by the Claimant as Exh [Bay.] CLEX-18.11, which states: "(1) Chaque Partie Contractante protégera sur son territoire les investissements effectués conformément à ses lois et règlements par des investisseurs de l'autre Partie Contractante et n'entravera pas, par des mesures injustifiées ou discriminatoires, la gestion, l'entretien, l'utilisation, la jouissance, l'accroissement, la vente et, le cas échéant, la liquidation de tels investissements [...] (2) Chaque Partie Contractante assurera sur son territoire un traitement juste et équitable aux investissements des investisseurs de l'autre Partie Contractante."

applicable FET standard in the present case. This said, a similar result would be reached by applying Articles 2(2) and 3(1) of the Pakistan-Denmark BIT of 18 July 1996.

c. Content of the FET standard

1. Bayindir's position

168. It is Bayindir's submission that the applicable FET standard is based on a treaty and is therefore not limited to the minimum standard under customary international law (Reply M., ¶¶ 257-280):

> "Article II(2) of the UK-Pakistan BIT contains no such limitation, either on its face or in substance. Nor do any of the other Pakistan BITs that I have just mentioned [with Lebanon, Sri Lanka, Australia and Denmark]."
> (Tr. M., 26 May 2008, 116, 19-22)

With reference to *PSEG v. Turkey,*[51] it adds that the applicable FET standard is "a free-standing obligation which does not depend for its meaning on the customary international law minimum standard of treatment" (Tr. M., 4 June 2008, 94, 5-8).

169. Regarding the content of the applicable standard of fair and equitable treatment, the Claimant has submitted that

> "Fair and equitable treatment [...] includes a number of component principles, including, the provision of a stable framework for the investment; refraining from arbitrary and discriminatory conduct; providing transparency and due process; acting in good faith; providing security for reasonable investment-backed expectations and refraining from harassment, intimidation and coercion of the investor."
> (Mem. M., ¶ 148)

170. In reliance on *Tecmed*,[52] Bayindir further submits that the FET standard protects the basic expectations taken into account by a foreign investor in making the investment, and requires the State to act in a "consistent and transparent manner so that the investor can adapt to comply with shifts in Government policies" (Tr. M., 26 May 2008, 119, 1-3) and "to maintain a stable framework for investment" (Tr. M., 26 May 2008, 119, 3-5). *Tecmed v. Mexico* defines the components of FET as follows:

---

[51] *PSEG Global Inc. and Konya Ilgin Elektrik Üretim ve Ticaret Limited Sirketi v. Republic of Turkey* (ICSID Case No. ARB/02/05) (hereafter, *PSEG v. Turkey*), Award of 19 January 2007, ¶ 239.

[52] *Técnicas Medioambientales Tecmed, SA v. United Mexican States* (ICSID Case No. ARB(AF)/00/2) (hereafter, *Tecmed v. Mexico*), Award of 29 May 2003.

"[t]o provide to international investments treatment that does not affect the basic expectations that were taken into account by the foreign investor to make the investment. The foreign investor expects the host State to act in a consistent manner, free from ambiguity and totally transparently in its relations with the foreign investor, so that it may know beforehand any and all rules and regulations that will govern its investments, as well as the goals of the relevant policies and administrative practices or directives, to be able to plan its investment and comply with such regulations. Any and all State actions conforming to such criteria should relate not only to the guidelines, directives or requirements issued, or the resolutions approved thereunder, but also to the goals underlying such regulations. The foreign investor also expects the host State to act consistently, i.e., without arbitrarily revoking any preexisting decisions or permits issued by the State that were relied upon by the investor to assume its commitments as well as to plan and launch its commercial and business activities. The investor also expects the State to use the legal instruments that govern the actions of the investor or the investment in conformity with the function usually assigned to such instruments, and not to deprive the investor of its investment without the required compensation."[53]

171. The Claimant also relies in particular on *Saluka v. The Czech Republic,*[54] *Eureko v. Poland*,[55] and *Victor Pey Casado v. Chile*[56] to submit that the unreasonable frustration of an investor's good faith efforts to solve a problem may amount to a breach of the FET standard, particularly when such frustration involves discriminatory action in favour of host State nationals (Tr. M., 26 May 2008, 119-120, 16-25, 1; 4 June 2008, 96, 4-17).

172. Finally, Bayindir contends that unfair and inequitable treatment does not need to be identified "on the basis of individual or isolated acts" (Mem. M., ¶ 149), but that the Tribunal must appreciate whether "in all the circumstances the conduct in issue is fair and equitable or unfair and inequitable" (Mem. M., ¶ 149). It refers in this regard to *Desert Line v. Yemen*[57] (Tr. M., 26 May 2008, 120, 2-8).

---

53 Decision on Jurisdiction, ¶ 237, citing *Id*, ¶ 154.

54 *Saluka Investments BV (The Netherlands) v. The Czech Republic* (hereafter*, Saluka v. Czech Republic*), *Ad Hoc* Arbitration (UNCITRAL Rules), Partial Award of 17 March 2006, available at http://www.pca-cpa.org/showpage.asp?pag_id=1029.

55 *Eureko B.V v. Republic of Poland* (hereafter, *Eureko v. Poland*), *Ad Hoc* Arbitration (Netherlands-Poland BIT), Partial Award of 19 August 2005, ¶ 233, available at http://ita.law.uvic.ca/alphabetical_list_content.htm.

56 *Victor Pey Casado and President Allende Foundation v. Republic of Chile* (ICSID Case No. ARB/98/2) (hereafter, *Victor Pey Casado v. Chile*), Award of 8 May 2008.

57 *Desert Line Projects LLC v. Republic of Yemen* (ICSID Case No ARB/05/17), Award of 6 February 2008.

2. Pakistan's position

173. Pakistan submits that even if the FET provision in the Pakistan-UK BIT were to be applied, the content of such provision is linked to the existing standards of customary international law (Tr. M., 26 May 2008, 300-301, 16-25, 1-3). It refers in particular to *Siemens v. Argentina*,[58] which "says that one has to look for the content of that standard in international law" (Tr. M., 26 May 2008, 303, 20-22).

174. Moreover, it is Pakistan's submission that the content of the applicable FET standard should be assessed not by reference to the *Tecmed* case, which is controversial and concerned a different situation, but rather by reference to *Thunderbird v. Mexico,*[59] which stands for the proposition that "the threshold [for a breach of FET] remains a high one" (Tr. M., 26 May 2008, 303, 18-19). It adds that *Tecmed* does not provide an authoritative statement of the general content of the FET standard and must be regarded as "the high watermark of one particular view of fair and equitable treatment" (Tr. M., 26 May 2008, 302, 23-25). It also challenges its relevance as it concerned a different situation.

175. Furthermore, Pakistan submits, following *Mondev v. United States*[60] and *ADF v. United States*,[61] that the Tribunal may not adopt its own idiosyncratic standard of what is fair or equitable without reference to established sources of law, as Bayindir seems to imply (Rej. M., ¶¶ 4.44 – 4.46).

3. Tribunal's determination

176. As an initial matter, the Tribunal notes that Article 4 of the Pakistan-Switzerland BIT makes no reference to general international law. However, as already mentioned, customary international law and decisions of other tribunals may assist in the

---

[58] *Siemens AG v. Argentine Republic* (ICSID Case No. ARB/02/8) (hereafter, *Siemens v. Argentina*), Award of 6 February 2007.

[59] *International Thunderbird Gaming Corporation v. United Mexican States* (hereafter, *Thunderbird v. Mexico*), NAFTA Arbitration (UNCITRAL Rules), Award of 26 January 2006, available at http://ita.law.uvic.ca/alphabetical_list_content.htm.

[60] *Mondev International Ltd. v. United States of America (*ICSID Case No ARB(AF)/99/2) (hereafter, *Mondev v. United States*), Award of 11 October 2002, ¶ 119.

[61] *ADF Group Inc. v. United States of America* (ICSID Case No. ARB(AF)/00/1) (hereafter, *ADF v. United States*), Award of 9 January 2003, ¶ 184.

interpretation of this provision. This is particularly apposite here given that Article 4(2) of the Pakistan-Switzerland BIT simply states a general obligation of fair and equitable treatment. The Tribunal must therefore set forth the meaning of such a general obligation.

177. In its Decision on Jurisdiction, the Tribunal stated by reference to *Tecmed v. Mexico* that it could not rule out *prima facie* that Pakistan's fair and equitable treatment obligation comprised an obligation to maintain a stable framework for investments[62] and that "a State can breach the 'stability limb' of its [FET] obligation through acts which do not concern the regulatory framework but more generally the State's policy towards investments."[63] It must now define the contours of the FET standards for purposes of the merits.

178. The Tribunal agrees with Bayindir when it identifies the different factors which emerge from decisions of investment tribunals as forming part of the FET standard. These comprise the obligation to act transparently and grant due process,[64] to refrain from taking arbitrary or discriminatory measures,[65] from exercising coercion[66] or from frustrating the investor's reasonable expectations with respect to the legal framework affecting the investment.[67]

179. The Tribunal also agrees with the Respondent that the *Tecmed* case lays out a broad conception of the FET standard. Yet, it notes that the decision of the tribunal in *Thunderbird*, to which the Respondent refers, speaks of the *Tecmed* decision as an "authoritative precedent" with respect to the doctrine of legitimate expectations.[68] Similarly, the decision in *Siemens v. Argentina*, also cited by the Respondent, relies on

---

62 Decision on Jurisdiction, ¶ 239.

63 *Id.*, ¶ 240.

64 *See Metalclad Corporation v. United Mexican States* (ICSID Case No. ARB(AF)/97/1) (hereafter, *Metalclad v. Mexico*), Award of 30 August 2000, ¶ 76.

65 Several tribunals have linked lack of arbitrariness and non-discrimination to the FET standard. *See inter alia Waste Management, Inc. v. United Mexican States* (ICSID Case No. ARB(AF)/00/3) (hereafter, *Waste Management v. Mexico*), Award of 30 April 2004, ¶ 98; *Ronald S. Lauder v. Czech Republic*, *Ad Hoc* Arbitration (UNCITRAL Rules), Award of 3 September 2001, ¶ 292 (hereafter, *Lauder v Czech Republic*).

66 *Saluka v. Czech Republic*, *supra* footnote 54, ¶ 308.

67 *Duke Energy v. Ecuador*, *supra* footnote 33, ¶ 340.

68 Separate Opinion of Prof. Thomas Wälde in *Thunderbird v. Mexico, supra* footnote 60, ¶ 30.

Tecmed in its discussion of the contents of the FET standard.[69] More recently, relying in part upon *Tecmed*, the tribunal in *Duke Energy v. Ecuador* stressed that the investor's expectations are an important element of FET, while at the same time emphasizing their limitations:

> "The stability of the legal and business environment is directly linked to the investor's justified expectations. The Tribunal acknowledges that such expectations are an important element of fair and equitable treatment. At the same time, it is mindful of their limitations. To be protected, the investor's expectations must be legitimate and reasonable at the time when the investor makes the investment. The assessment of the reasonableness or legitimacy must take into account all circumstances, including not only the facts surrounding the investment, but also the political, socioeconomic, cultural and historical conditions prevailing in the host State. In addition, such expectations must arise from the conditions that the State offered the investor and the latter must have relied upon them when deciding to invest."[70]

180. Furthermore, because a treaty breach is different from a contract violation, the Tribunal considers that the Claimant must establish a breach different in nature from a simple contract violation, in other words one which the State commits in the exercise of its sovereign power. This view is consistent with a line of cases including *RFCC v. Morocco,*[71] *Waste Management,*[72] *Impregilo v. Pakistan,*[73] *and Duke Energy v. Ecuador,*[74] even though other tribunals have been less demanding.[75]

181. Finally, the Tribunal agrees with the Claimant that such a breach need not necessarily arise out of individual isolated acts but can result from a series of circumstances, and that it does not presuppose bad faith on the part of the State.[76]

---

69 *Siemens v. Argentina, supra* footnote 58, ¶¶ 298-299.

70 *Duke Energy v. Ecuador, supra* footnote 33, ¶¶ 339-340.

71 *RFCC v. Morocco*, *supra* footnote 32, ¶¶ 33-34.

72 *Waste Management Inc. v. Mexico*, *supra* footnote 65, ¶ 115.

73 *Impregilo v. Pakistan*, *supra* footnote 26, ¶¶ 266-270.

74 *Duke Energy v. Ecuador*, *supra* footnote 33, ¶ 345.

75 *Mondev v. United States*, *supra* footnote 60, ¶ 134; *Noble Ventures v. Romania*, *supra* footnote 22, ¶ 182; *SGS v. Philippines* (ICSID Case No ARB/02/6), Decision on Jurisdiction of 29 January 2004, ¶¶ 162.

76 *See CMS Gas Transmission Company v. Argentine Republic* (ICSID Case No. ARB/01/8) (hereafter *CMS v. Argentina*), Award of 12 May 2005, ¶ 280; *Azurix v. Argentina*, *supra* footnote 18, ¶ 372 referring to *CMS v. Argentina*; *Loewen Group, Inc. and Raymond L. Loewen v. United States of America* (ICSID Case No. ARB(AF)/98/3) (hereafter, *Loewen Group v. United States*), Award on Merits of 26 June 2003, ¶132*; Waste Management v. Mexico, supra* footnote 65, ¶ 93, referring to *Mondev v. United States* and *ADF v. United States; Tecmed v. Mexico, supra* footnote 52.

182. On the basis of the FET standard as defined above, the Tribunal will now examine the disputed conduct of Pakistan before (d) and after the expulsion (e), as well as in connection with the encashment of the Guarantees (f), or when all of the Respondent's acts are considered together (g). In doing so, the Tribunal will bear in mind that "a judgment of what is fair and equitable [...] must depend on the facts of the particular case"[77] and that the standard "must be adapted to the circumstances of each case."[78]

d. Conduct leading to the expulsion of Bayindir

183. The Tribunal will discuss in turn Bayindir's case relating to the frustration of its reasonable expectations (i), the existence of a conspiracy to expel it (ii), undue pressure and coercion (iii), and the lack of due process and procedural fairness (iv).

(i) Were Bayindir's reasonable expectations frustrated?

1. Bayindir's position

184. The Claimant argues in essence that its reasonable expectations that the legal framework affecting its investment would remain stable and that the Respondent would cooperate in resolving any issues that could arise under the Contract were based "on a clearly perceptible and transparent legal framework and on undertakings and representations made explicitly or implicitly by Pakistan" (Mem. M., ¶ 157), and that these expectations were frustrated particularly after General Musharraf came to power in October 1999.

185. The Claimant submits that since 1993, its investment was exposed to the "vagaries of changing political winds in Pakistan" experiencing "several drastic changes of direction" (Mem. M., ¶ 145). It explains that when the Project was revived in 1997, the then Prime Minister Nawaz Sharif "repeated assurances of Pakistan's commitment to the project" (Tr. M., 26 May 2008, 14, 20-23). It also puts forward Prime Minister Nawaz Sharif's continued interest and support for the Project in February 1999, at a time when the Respondent was allegedly having financial difficulties in pursuing the Project (Tr. M., 26 May 2008, 20, 4-17).

---

77 *Mondev v. United States*, *supra* footnote 60, ¶ 118.

78 *Waste Management v. Mexico*, *supra* footnote 65, ¶ 99.

186. According to Bayindir, such assurances were frustrated when General Musharraf came to power:

> "[A]s soon as General Musharraf came to power, Pakistan seriously considered terminating Bayindir's Contract. The solution the Committee settled upon in November 1999 was to reduce the scope of the Project in view of financial difficulties." (Tr. M., 26 May 2008, 25, 16-21).

187. Months later, when Bayindir agreed to Addendum No. 9 in April 2000, it was only because it believed that "with the signing of Addendum 9, Pakistan had made a serious commitment to the M-1 Project, commitment that the M-1 Project would move forward unhindered" (Tr. M., 26 May 2008, 30, 15-18). Later, as the Respondent encountered further financial problems, Bayindir claims to have had a legitimate expectation "that Pakistan would continue to support Bayindir's investment, working collaboratively to page [sic] reasonable adjustments" (Tr. M., 26 May 2008, 123, 1-3).

2. Pakistan's position

188. The Respondent acknowledges that legitimate expectations are protected by the FET standard but refers to the decision of the a*d hoc* Committee in *MTD v. Chile*, pursuant to which such expectations "are not a substitute for the language of the Treaty itself" (Tr. M., 26 May 2008, 304, 15-17).

189. In reliance on *Aminoil,*[79] it also contends that in the context of an investment agreement, it is above all the text of the Contract itself which embodies the legitimate expectations of the Parties and that the Claimant could not reasonably expect that the terms of the Contract would not be enforced (Tr. M., 26 May 2008, 305-305, 4 June 2008, 166, 16-25).

3. Tribunal's determination

190. The Tribunal must first determine the relevant time for the formation of the investor's expectations. Several awards have stressed that the expectations to be taken into account are those existing at the time when the investor made the decision to invest.[80]

---

[79] *Arbitration between the Government of the State of Kuwait and The American Independent Oil Company (AMINOIL)* (hereafter, *Kuwait v. Aminoil*), Award of 24 March 1982, 21 ILM 1982, pp. 976 – 1053.

[80] *See Duke Energy v. Ecuador, supra* footnote 33, ¶ 340, referring to *Occidental Exploration and Production Company v. The Republic of Ecuador* (hereafter, *Occidental v. Ecuador*), LCIA Case

191. There is no reason not to follow this view here. The result is that the expectations to be taken into account are those of the Claimant at the time of the revival of the Contract in July 1997. The Tribunal chooses this time as opposed to an earlier one, because the issues relating to the termination of the 1993 Contract had been settled, as the Claimant acknowledged in its Request for Arbitration (RA, ¶ 8). The revival of the Contract can thus be viewed as a new start. Moreover, at the hearing on the merits, the Claimant put particular emphasis on Prime Minister Nawaz Sharif's expressions of interest made at this same period (Tr. M., 26 May 2008, 14, 20-24).

192. A second question concerns the circumstances that the Tribunal must take into account in analyzing the reasonableness or legitimacy of Bayindir's expectations at the time of the revival of the Contract. In doing so, it finds guidance in prior decisions including *Saluka,*[81] *Generation Ukraine*[82] and *Duke Energy v. Ecuador* quoted above, which relied on "all circumstances, including not only the facts surrounding the investment, but also the political, socioeconomic, cultural and historical conditions prevailing in the host State."[83]

193. In the present case, the Tribunal is of the view that the Claimant could not reasonably have ignored the volatility of the political conditions prevailing in Pakistan at the time it agreed to the revival of the Contract. Indeed, the Claimant expressly acknowledges that it suffered severely from political changes in Pakistan during the preceding years (PHB [Bay.] ¶¶ 35-38).

194. In its submissions, the Claimant acknowledges that it was well aware of the potentially adverse impact of a change in government. It specifically refers to the fact that, after Prime Minister Nawaz Sharif was forced to resign in 1993, the new government adopted a position opposed to the Project and decided to terminate it under Clause 74 of the 1993 Contract (Tr. M., 26 May 2008, 14, 1-13; PHB [Bay.] ¶ 37). The Claimant further notes that: "[i]n 1997, winds shifted again, and Nawaz Sharif returned to power.

No. UN3467, Award of 1 July 2004, ¶ 185, *LG&E Energy Corp., LG&E Capital Corp., LG&E International Inc. v. Argentine Republic* (ICSID Case No. ARB/02/1) (hereafter, *LG&E v. Argentina*), Decision on Liability of 3 October 2006, ¶ 127 and *Tecmed v. Mexico,* ¶ 154.

81 *See Saluka v. Czech Republic*, *supra* footnote 54, ¶ 304.

82 *Generation Ukraine v. Ukraine* (ICSID Case No. ARB/00/9) (hereafter *Generation Ukraine v. Ukraine*), Award of 16 September 2003, ¶ 20.37.

83 *Duke Energy v. Ecuador, supra* footnote 33, ¶ 340.

He immediately resurrected the M-1 Project" (Tr. M., 26 May 2008, 14, 14-16). According to the Claimant, Mr. Sharif gave "repeated assurances of Pakistan's commitment to the project" (Tr. M., 26 May 2008, 14, 20-23) based on which the Claimant agreed to enter into the Contract. However, in the light of the foregoing circumstances, the Tribunal considers that Bayindir could not ignore the fact that the future of the Project was linked to the shifts then affecting Pakistan's politics as well as to the position of Mr. Sharif. Bayindir entered into the Contract in full knowledge of these circumstances. It appears difficult to now accept that Bayindir had wider expectations of stability and predictability so as to justify protection under the FET standard.

195. When in 1999 General Musharraf took power in Pakistan, the political volatility prevailing in Pakistan was again manifest. The Claimant nevertheless chose to conclude Addendum No. 9 on 17 April 2000, although it argues in these proceedings that the government of General Musharraf was hostile to the continuation of the Project. Whether this latter assertion is sufficiently established is a matter that the Tribunal will consider later. For the purposes of the present assessment, the conclusion of Addendum No. 9 is another illustration of the fact that the Claimant elected to pursue its activities in Pakistan despite a degree of political volatility of which it was fully aware.

196. At the hearing on the merits, the Claimant asserted however that

> "Bayindir believed that with the signing of Addendum 9, Pakistan had made a serious commitment to the M-1 Project, commitment that the M-1 Project would move forward unhindered."
> (Tr. M., 26 May 2008, 30, 14-18)

197. In the opinion of the Tribunal, this latter allegation, even if proved, would not be sufficient to establish a breach of the Respondent's obligation not to frustrate the legitimate expectations of investors. As already noted, in the light of the political changes of the preceding years, the Claimant could not reasonably expect that no further political changes would occur. Moreover, in the present context of a contractual relationship between Bayindir and the NHA, as the Respondent rightly stresses, the expectations of the Claimant are largely shaped by the contractual relationship between the Claimant and NHA. In this connection, there was no basis for the Claimant to expect that NHA would not avail itself of its contractual rights. Although the

Tribunal has no jurisdiction to assess whether there has been a breach of the Contract under the Contract's proper law, the Tribunal must nevertheless take into account the terms of the Contract as a factual element reflecting the expectations of the Claimant. The allegations made by the Claimant in this regard are discussed by the Tribunal in section IV(B)(b) to (e) below.

198. This conclusion does not imply that the events which led to the expulsion of the Claimant were necessarily the result of a shift in political priorities. It is reached irrespective of whether such a shift took place as a result of the assessment of the Claimant's expectations as they stood well before the expulsion.

199. Therefore, the Tribunal is of the opinion that Bayindir's claim relating to the frustration of its legitimate expectations cannot be sustained.

(ii) Bayindir's expulsion

200. The Claimant has sought to establish, first, that its expulsion was the result of a conspiracy between different branches of the Pakistani government also involving the Engineer and its Representative acting under the Contract (1), and, second, that such expulsion was based on reasons unrelated to Bayindir's performance of the Contract, namely changing political priorities, funding difficulties, a balance of payment crisis, and conduct favouring local contractors (2).

201. These two contentions overlap to some extent, but not entirely, which is why the Tribunal will deal with them separately.

1. Was there a conspiracy to expel Bayindir?

1.1 Bayindir's position

202. Bayindir contends that for reasons unrelated to its performance of the Contract (see Reply M., ¶ 119), which will be discussed in the following section, the Respondent conspired to misuse the provisions of the Contract in order to expel Bayindir. The alleged conspiracy involved not only different divisions and officials of NHA and the Pakistani government but also the Engineer and the Engineer's Representative (see

Reply M., ¶ 55; Tr. M., 4 June 2008, 61, 12-17). In this respect, the Claimant has particularly invoked the circumstances discussed in the following paragraphs.

203. First, Bayindir extensively refers to a "discussion paper" (Tr. M., 4 June 2008, 19, 24) prepared by the then Joint Secretary of Communications, Mr. Ashraf Hayat, dated 14 October 2000 (Exh. [Bay.] CX-140). It focuses on the handwritten notes attributed to the then Secretary of Communications, Mr. Nazar Shaikh, and approved by the then Minister of Communications, General Qazi, saying:

> "[a]s for M-1 Project, we should wait for any default by the Contractor and then terminate the Project. They are likely to default in Burhan Section. NHA should ensure not to default in any way and also not entertain requests for extension."
> (Tr. M., 4 June 2008, 21, 3-8)

204. According to the Claimant, these handwritten notes evidence the existence of a conspiracy to use the provisions of the Contract to expel Bayindir for reasons unrelated to its performance. Based on the oral testimony of Mr. Shaikh, the Claimant submits that the "discussion paper was prepared for the purposes of discussion, and was in fact discussed, at an interministerial meeting held on 7 November 2000, chaired by the Minister of Communications and attended by the Secretaries of Communications, the Finance Division, the Planning and Development Division and including the Chairman of NHA" (Tr. M., 4 June 2008, 22-23, 24-25 and 1-5). Specifically, Bayindir contends that the course of action manifested in the handwritten notes lay beneath the decision taken at that meeting to continue with the Project but to bring any default of Bayindir to the notice of the government (Tr. M., 4 June 2008, 25, 2-12).

205. As a second circumstance evidencing conspiracy, Bayindir points to the preparation of a milestone review meeting held on 19 March 2001. It notes that one day before the meeting, the Chairman of NHA wrote to the Ministry of Communications and set out

> "[E]xactly how the March 19 meeting would proceed. What the Engineer will say about Bayindir, what the Engineer will say about NHA, how the limited Extension of time will be announced, and how that extension will be made contingent upon the extraction of a commitment from Bayindir."
> (Tr. M., 4 June 2008, 61, 19-20; see also Exh. [Bay.] CX-38).

206. Third, the Claimant submits that the decision to expel Bayindir was taken by General Musharraf himself at the meeting held on 12 April 2001, specifically organized on the request of General Qazi for this purpose. It considers that the steps followed thereafter by the Chairman of NHA were intended to cover this reality and to suggest that the

expulsion decision had been made by the Chairman of NHA, among others, on the basis of a brief legal opinion issued by Mr. Ebrahim on 23 April 2001 (Tr. M., 4 June 2008, 77-81).

207. As a fourth and related consideration, the Claimant asserts that the Engineer and Engineer's Representative were involved in this conspiracy, and that such involvement is what lies behind the unjustified treatment of requests for extension of time made by Bayindir as well as the issuance of the notices under sub-clauses 46.1 and 63.1(b)(ii) of the Contract.

208. Regarding the treatment of the requests for extension, Bayindir argues in essence that the Engineer and Engineer's Representative eliminated and added work to Bayindir's schedule in order to cause it to default on its obligations (Reply M., ¶ 56; see also CX-134), that contrary to sub-clause 44.1 of the Contract they did not consult the Contractor in the course of the evaluation of its requests for extension (EOT 01, 02), nor did they share with Bayindir the evaluation report of EOT 03, and that they failed to take into account that progress on the site was being prevented because of the unavailability of land and not for lack of equipment. Bayindir further argues that the evaluation of EOT 03 was orchestrated in preparation for the milestone review meeting held on 19 March 2001 (Tr. M., 4 June 2008, 43, 2-15 and 61, 12-17).

209. With respect to the issuance of the notice under sub-clause 46.1 of the Contract on 2 December 2000, Bayindir argues that there is no evidence on the record showing that the Engineer formed his opinion in a reasonable, independent and professional manner. Moreover, Bayindir further argues that the Engineer was instructed in a letter of 16 November 2000[84] to issue a sub-clause 46.1 notice, despite the fact that Bayindir had brought to the attention of the Engineer's Representative that its progress was being obstructed by reasons that were not attributable to it and that a formal request for extension would be submitted. Furthermore, the Claimant contends that as late as September 2000, the Engineer's Representative had reached the conclusion that Bayindir would find it difficult to complete the Priority Section 1 in time, but did not issue a sub-clause 46.1 notice at the time, allegedly in order to make it more difficult for

[84] In this regard, Claimant refers in paragraph 88 of its Reply on the merits to Exh. [Pak.] CM-23, which appears to be unrelated to this allegation.

Bayindir to react once the sub-clause 46.1 notice was actually issued in December 2000 (Reply M., ¶¶ 93-94).

210. Regarding the sub-clause 63.1(b)(ii) notice, the Claimant essentially asserts that such notice was improperly issued on the basis of an invalid sub-clause 46.1 notice. The purpose of this latter notice is to alert the Contractor to the need to take measures to meet the completion date. At the time of issuance of the sub-clause 46.1 notice, Bayindir's construction activities on the site were in full swing (Exh. [Pak.] CM-14). Bayindir argues that it did "proceed with the Works" and that a valid sub-clause 63.1(b)(ii) notice presupposes that the Contractor has stopped the works, as recognized by Mr. Mirza in his letter to the Chairman of NHA (see Exh. [Bay.] CX-138) and further confirmed by Mr. Pickavance, Bayindir's expert witness on construction projects (Reply M., ¶¶ 100-105).

211. Bayindir further suggests that the consultancy group of the Engineer, Pakistan Motorways Consultants (PMC), was economically dependent upon Pakistan because PMC's lead partner, ECIL, has undertaken 60 out of its 79 road sector projects for the government of Pakistan (Reply M., ¶¶ 116-118). Moreover, in Bayindir's submission, the correspondence between the Engineer and NHA with respect to Bayindir's request EOT 04 suggests subservience of the Engineer to NHA (Reply M., ¶¶ 84-86). In addition, a letter of 11 April 2001 from Mr. Mirza to NHA shows, according to Bayindir, that Mr. Mirza, in his capacity as consultant, was sympathetic towards and privy to the consideration of the various options by which Pakistan might save costs through action adverse to the interests of Bayindir, including the suggestion that the best course of action for Pakistan would be to terminate the Contract under clause 74.1, as invoking 63.1 was difficult to justify (Reply M., ¶¶ 107-111; CX-138).

1.2 Pakistan's position

212. The Respondent asserts that the allegation of conspiracy is without basis, and that it has been advanced by the Claimant to meet the more demanding requirements of a treaty breach, in what is in fact a contractual dispute:

> "In the presentation of its case, Bayindir has always been acutely aware that, even assuming in its favour that the Clause 63.1 notice was incorrectly issued, without more, with NHA acting on the basis of that notice in expelling Bayindir, the remedy for Bayindir lies under the Contract, in a challenge to a decision of the Engineer

> and ultimately arbitration pursuant to Clause 67. It is only if the notice was issued as part of a conspiracy, with the Engineer acting in bad faith with NHA and the Government of Pakistan, that a claim for breach of the Treaty could have any chance of success."
> (PHB [Pak.] ¶ 2.3)

213. In Pakistan's view Bayindir's claim rests upon the allegations that President Musharraf made a decision to expel Bayindir:

> "Bayindir's case on conspiracy ultimately turns upon the allegation that a decision to expel Bayindir was taken by the Chief Executive (President Musharraf) on 12 April 2001, and that this decision was then followed by the issue of a Clause 63.1 Certificate, which was allegedly issued in bad faith by the Engineer. That claim is simply inconsistent with the documentary (as well as oral) evidence. Bayindir has a high threshold to meet in terms of establishing the existence of a conspiracy. It has failed to meet that threshold."
> (PHB [Pak.] ¶ 2.4)

214. Pakistan further disputes Bayindir's assertion that the expulsion was decided for reasons unrelated to the performance of the Contract. It claims that the circumstances on which Bayindir relies are insufficient to establish the existence of a conspiracy and are rebutted by the evidence. In particular, the Respondent puts forward the following arguments.

215. First, Mr. Hayat's discussion paper of 14 October 2000 and the handwritten additions made by Mr. Shaikh only reflect internal discussions and cannot be interpreted as recording a decision or an instruction, and even less one aiming at the rejection of all EOT requests, whether valid or not (PHB [Pak.] ¶¶ 2.14-2.17). Moreover, the minutes of the interministerial meeting held on 7 November 2000 merely reflect the review of "an important national infrastructure project, subject to substantial delays, and also subject to particular criticisms from the World Bank and the Planning Commission" (PHB [Pak.] ¶ 2.20) and, in all events, the decision which ensued was that the project could continue.

216. Second, the Respondent argues that, contrary to Bayindir's allegations, the minutes of the milestone review of 19 March 2001 accurately reflect Pakistan's concern at Bayindir's poor performance of the Contract, which is further confirmed by the testimonies of General Javed and Mr. Bridger, and by the minutes of the Contract Progress Meeting held ten days later, on 29 March 2001 (PHB [Pak.] ¶¶ 2.35 and 2.39). Pakistan also points to Mr. Bridger's testimony that this meeting was a "turning

point" and that it was then that Mr. Bridger "lost patience with Bayindir" (PHB [Pak.] ¶ 2.35).

217. Third, with respect to the meeting with General Musharraf held on 12 April 2001 at the request of General Qazi, Pakistan argues that "[t]he reason why the involvement of President Musharraf was sought related to the particular sensitivities of Pakistan's diplomatic relations with Turkey" (PHB [Pak.] ¶ 2.48) and not because it was for General Musharraf to take the final decision on the continuation of the Project. Pakistan stresses that it was the Chairman of NHA who took the decision to expel Bayindir. For that, he formed his judgment not only on the basis of the legal opinion issued by Mr. Ebrahim on 23 April 2001, but also of the interim report of 7 April 2008 of the expert group constituted by the Chairman of NHA in coordination with the World Bank, as well as the letter to NHA of 11 April 2001 from Mr. Mirza, acting in his capacity as consultant.

218. Fourth, regarding Bayindir's allegations of bad faith on the part of the Engineer and the Engineer's Representative, Pakistan advances several arguments.

219. With respect to the treatment of the requests for extension, Mr. Shaikh explained that, in his handwritten notes on Mr. Hayat's discussion paper, by "requests for extension," he meant negotiated extensions such as the one under Addendum No. 9, and not extensions under the Contract, which were to be decided by the Engineer. Moreover, the fact that in early 2001 both the Engineer and NHA approved an extension of time for Bayindir in response to EOT 03 rules out Bayindir's allegation that a decision had been made to reject any request for extension (Rej. M., ¶ 2.15). As far as EOT 01 and EOT 02 are concerned, Mr. Bridger explained that they were not the subject of a formal determination by the Engineer because all the issues raised by these requests were agreed in Addendum No. 9 (Rej. M., ¶ 2.29). As for EOT 03, Pakistan argues that Bayindir was indeed provided with an opportunity to explain its position at a formal meeting (C-Mem. M., ¶ 2.127) and that the installation of traffic signs was not essential nor did it prevent the completion of the works (Rej. M., ¶¶ 2.34-2.39).

220. Further, Pakistan disputes having instructed the Engineer to issue a sub-clause 46.1 notice. The letter of 16 November 2000 referred to by Bayindir had nothing to do with

sub-clause 46.1. In fact, it demonstrates an instance in which the Engineer had ruled against NHA within the framework of sub-clause 67.1. In addition, Bayindir misinterprets Mr. Bridger's letter of 2 December 2000 allegedly acknowledging that equipment productivity was obstructed by the large proportion of confined working area. Contrary to Bayindir's interpretation, Mr. Bridger not only recommended an increase of 10 to 20% in equipment, but also noted the need for an increase in productivity because Bayindir was relying excessively on locally hired equipment which was sub-standard and unreliable and had even reduced the number of pieces of Bayindir-owned equipment between November 2000 and February 2001 (Rej. M., ¶¶ 2.52-2.55).

221. With respect to the steps that led to the issuance of the sub-clause 63.1(b)(ii) notice, Pakistan argues that a sub-clause 63.1(b)(ii) notice presupposes the issuance of a sub-clause 46.1 notice and that Bayindir's interpretation of the words "to proceed with the Works" in clause 63.1(b)(ii) is neither supported by the provisions of the Contract nor by the practical realities of managing a large construction project (Rej. M., ¶ 2.59). As for Mr. Mirza's letter to NHA of 11 April 2001, Pakistan stresses that this letter was written in Mr. Mirza's capacity as lead consultant to NHA rather than as Engineer, that Bayindir was fully aware that the PMC group was acting as consultants to NHA, that such double capacity is not uncommon and does not threaten impartiality, and that at no time did such letter say that proceeding under sub-clause 63.1(b)(ii) would not be justified. In addition, Pakistan refers to Mr. Mirza's supplemental witness statement confirming that the decision to issue a sub-clause 63.1(b)(ii) notice was not taken as a result of any pressure from NHA (Rej. M., ¶ 2.66). Pakistan also notes in relation to request for extension EOT 04, that it was not received until the Engineer issued the sub-clause 63.1(b)(ii) certification, and that such request had therefore no bearing on the Engineer's determination.

222. Concerning Bayindir's allegation relating to the economic dependence of the Engineer's consultancy group, Pakistan argues in reply that ECIL, PMC's lead partner, does not depend upon any one agency and that employers such as NHA are autonomous. In addition, Pakistan argues that ECIL is involved in a substantial number of international projects and that the independence of the PMC group cannot

be assessed solely in the light of ECIL's position, to the extent that the group consists of 5 firms, including an American and an Australian one (Rej. M., ¶¶ 2.71-2.74).

1.3 Tribunal's determination

223. At the outset, the Tribunal recalls that the standard for proving a conspiracy involving a bad faith component is a demanding one.

224. The Claimant has referred to the award in *Waste Management v. Mexico*, which defines conspiracy as "a conscious combination of various agencies of government without justification to defeat the purposes of an investment agreement."[85] The Tribunal considers that this definition provides good guidance.

Mr. Nazal Shaikh's notes

225. In support of its allegation of conspiracy, the Claimant first points to the handwritten notes (in particular those in paragraph 9, alternatively numbered as paragraph 273) appearing at the end of Mr. Hayat's document dated 14 October 2000 (Exh. [Bay.] CX-140). At the hearing, Mr. Hayat described this document as a "discussion paper" (Tr. M., 28 May 2008, 148, 4). The "discussion paper" focuses on a critical assessment made by the World Bank of the M-1 Project and discusses the advantages and disadvantages of putting an end to the project. The document then proposes different courses of action. The last page of the document contains handwritten notes attributed to Mr. Nazar Shaikh, the then Secretary of Communications, which read in paragraph 9 (or 273) as follows:

> "As for M-1 project, we should wait for any default by the contractor and then terminate the project. They are likely to default in Burhan Section. NHA should ensure not to default in any way and also not entertain requests for extension."
> (Exh. [Bay.] CX-140)

226. While the Claimant's interpretation of these notes is *prima facie* understandable, the witness testimonies did not support the thesis that the notes evidence a conspiracy. At the hearing, Mr. Hayat recognized that there were internal divergences regarding the desirability of the M-1 Project, which were discussed in his paper:

> "I think that some perspective is necessary. This Project is being viewed by many players as not a very good Project to have, and the discussion would not have

85 *Waste Management v. Mexico*, *supra* footnote 65, ¶ 138.

> prolonged for as long as it did if it were being implemented quickly, but it was just ridden with slow movement and difficulties, and was being, therefore, repeatedly questioned. So, my view was that it was worth considering, because some players think that it is a bad Project, to look at how this can be rationalised or reduced or stopped, or whatever. That was my view. It was not a view to – it was nothing more than that, and it was – and this was really a response to the World Bank's assertion that this is not a good Project."
> (Tr. M., 28 May 2008, 152-153, 12-25, 1).

227. The Tribunal does not see in such divergences, which are not an unusual occurrence among administrations, evidence of a conspiracy. More importantly, the course of action proposed in the handwritten notes cannot be viewed as reflecting either a final decision or an instruction imposed on the Engineer. Indeed, Mr. Hayat testified as follows:

> "[I]f I may add, you see, this is an internal note, and it was not a decision, it was my opinion, and it was not communicated to the NHA, I repeat, it was not communicated to the NHA as a decision at all. So this really – it was just for our internal consumption. How it got out and came in the hands of people who were not authorized to look, that is a different question."
> (Tr. M., 28 May 2008, 249-250, 21-25, 1-4)

228. This conclusion is corroborated by the testimony of the former Minister of Communications, General Qazi. The latter acknowledged that there were divergent views among the different divisions of the Pakistani government concerned with the Project. He stressed that Mr. Hayat's discussion paper had no impact on the discussions held during the meeting of 7 November 2000, at which the course of action described in paragraph 9 of the discussion paper would have allegedly been endorsed:

> "This report was not discussed, because there were people from finance, there were people from planning, and they were all expressing their views about the Project, and they were asking me to take a decision, and I recorded my decision, and my decision was; we will go ahead with the Project, and we will not take – we will not make use of further loan from the Turkish Exim Bank, which was, extremely expensive, because we would be able to fund the Project with our own money, and I said, 'Make sure that the Project is completed on time and nobody defaults', and I expressed some – also caution about not compromising with the safety [...]."
> (Tr. M., 28 May 2008, 298, 7-19).

229. The minutes of the meeting held on 7 November 2000 further confirm this conclusion. In effect, they record that the Minister of Communications decided *inter alia* that "[w]ork on the project especially the two sections Islamabad-Burhan and Rashakai-Charsadda may continue" (Exh. [Bay.] CX-201, ¶ 5(i)).

Milestone review meeting of 19 March 2001

230. As a further circumstance, Bayindir claims that the milestone review meeting of 19 March 2001 was pre-orchestrated as part of the conspiracy. It relies on the note signed by the Chairman of NHA dated 18 March 2001 (Exh. [Bay.] CX-38), which discusses the strategy to be followed during the meeting of 19 March 2001 in connection with a request for extension submitted by Bayindir. The note summarizes the strategy by referring to the "slippages in progress," NHA's "stance to abide by our part of the Contract" and its contractual remedies:

> "5. [...] the undersigned will work on the following strategy with M/s Bayindir during the meeting scheduled for tomorrow:-
>
> a. The Engineer will highlight the slippages in progress despite provision of all facilities including prompt payments by NHA. This will be in line with our committed stance to abide by our part of the Contract Agreement.
> b. The main grounds for Bayindir's extension are based on late availability of construction site which, being untrue, will be strongly contested both by the Engineer and NHA with facts and figures and photographs. The grant of extension of 27 days will not be announced but will be made contingent upon a commitment by M/s Bayindir to put their act together and increase the progress substantially.
> c. M/s Bayindir will be appropriately reminded of the rights and remedies available to NHA in the event of non-fulfilment of their contractual obligations, to which I have alluded in para. 3.
>
> (Exh. [Bay.] CX-38, para. 5)

231. On the basis of the other elements in the record, the Tribunal reaches a different understanding of this note from the Claimant. In reality, the Respondent had serious concerns about Bayindir's performance. Paragraph 1 of the note records that despite "numerous notices and reminders, both verbally and in writing [...] the pace of work did not pick up despite the scheduled completion date of priority sections by 23rd March 2001 drawing closer" (Exh. [Bay.] CX-38, par. 1). Paragraph 2 adds that "M/s Bayinder, as per their past practice, instead of gearing up their work, approached the Turkish Embassy" (Exh. [Bay.] CX-38, par. 2). These concerns are corroborated by the testimonies of General Javed and Mr. Bridger. At the hearing, General Javed testified in this connection that:

> "[...] we were paying them the state-of-the-arts rates, and one expected to see a good quality of equipment. [...], their machine mix was wrong. They didn't have the right equipment to do the job. Also, the sequencing was wrong. They didn't have a good work cycle worked out, which meant that they were wasting their time with their equipment."
>
> (Tr. M., 29 May 2008, 14-16)

232. Mr. Bridger, the Engineer's Representative, also stressed Bayindir's poor performance:

> "I think by and large, the people in this room should understand that delays – there was a very large area of this Project that I think we are talking about, around about 35 kilometres on Part 1, by and large the Contractor was way behind without any cause of delay from external influences."
> (Tr. M., 29 May 2008, 189, 6-12)

233. While the Tribunal found the statements of these witnesses credible, it remained unconvinced by the Claimant's representatives. Mr. Jilani, Bayindir's area manager, who was most directly concerned with the development of the M-1 Project stated that after 1999 issues of equipment and mobilisation were reported directly to Mr. Sadiq Can "because he is, by profession, a Mechanical Engineer, so that is how the construction was being managed" (Tr. M., 27 May 2008, 24, 3-7). As for Mr. Can, who was serving at the time as President of the Bayindir Construction Company, his testimony left the overall impression that the project was not being handled professionally:

> "Q: Your Project Manager, Mr. Yildirim, would he provide reports back to Ankara and to Bayindir to Head Office about how the progress on the job was going, what resources might be needed, what equipment, staffing levels, issues like that related to a large Project, would he communicate with Head Office, or send periodic reports to that effect?
> A: Yes, We used to talk to him periodically. Sometimes it was every week, sometimes I personally went to Pakistan, and I stayed there for a week or ten days, and we were working on site with him. It was not in the form of written reports, but we were in constant contact."
> (Tr. M., 27 May 2008, 253-254, 15-25, 1-3)

234. The same impression arose from the examination of Mr. Jilani, Bayindir's area manager, who was very hesitant when asked about basic aspects of the Project's management, for instance whether he had signed Addendum No. 9 in April 2000, which surprised the Tribunal knowing the importance of that document (Tr. M., 27 May 2008, 60, 9-22).

235. The existence of real concerns over the performance of Bayindir is reinforced by the minutes of the milestone review meeting (Exh. [Pak.] RB-68) and of the contract progress meeting No. 32 held on 29 March 2001 (Exh. [Bay.] CX-153). For all these reasons, the Tribunal concludes that the evidence adduced by the Claimant does not support the allegation that the milestone review meeting of 19 March 2001 was pre-orchestrated as part of the conspiracy.

Meeting of 12 April 2001

236. As an additional element of conspiracy, Bayindir asserts that the decision to terminate the Contract was taken by General Musharraf at the meeting held on 12 April 2001, while presented as having been made by the Chairman of NHA at a later time. It is true that there is evidence of the involvement of high officials of the Pakistani government, including General Musharraf, in the assessment and follow up of the Project. General Qazi, the Minister of Communications, confirmed this fact on cross-examination:

> "Q: You said a moment ago, if I am not mistaken, that if Bayindir would default, the National Highway Council would decide whether to follow the contractual terms or not. Do you mean that a decision to terminate the Contract would have to be taken bit (sic) National Highway Council?
> A: No, sir. That would be taken by the NHA. NHA is the contracting party. But National Highway Council would only come in with regard to the matter of Turkey being involved, you know, as I said, it weighed very heavily on us, because previously once the Contract was terminated by a previous Government, the Government of Turkey intervened. They did not do so this time, but still, that was on our mind, and in any case, NHA council had to be kept informed about the happenings, because that is the overall policy-making body. So if Bayindir default, the NHA counsel had to be informed. The Chairman of the council had to be told, and then whatever action there to be taken, whether it is termination, whether it is extension, whether it is this, that, that is the job of the National Highway Authority. That is not my job, or the Chief Executive's job, or anybody else's job.
> [...]
> (Tr. M., 28 May 2008, 315-319).

237. This appears unsurprising if not normal for a project of major economic importance for the development of the country. It is certainly not an indication of a conspiracy to put an end to the Contract without justification.

238. In fact, there is no direct evidence on record demonstrating that it was General Musharraf who took the decision to terminate the Contract. There are no minutes of the meeting of 12 April 2001, no other writings nor witness evidence. To the contrary, General Qazi testified plausibly that General's Musharraf's involvement was limited to the potential diplomatic repercussions of significant actions involving the M-1 Project. This is consistent with the testimony of the then Secretary of Finance of Pakistan, Mr. Afzal (Tr. M., 28 May 2008, 35, 6-11).

239. At the hearing, Bayindir argued that in the absence of direct evidence of the fact that General Musharraf had taken "the political decision [...] to get rid of Bayindir" (Tr. M., 4

June 2008, 107, 14-15), such a conclusion could nevertheless be reached on the basis of indirect evidence as "the whole series of facts, linked together, lead logically to that single and inevitable conclusion" (Tr. M., 4 June 2008, 107, 15-17). The Tribunal cannot follow Bayindir. It does not consider that the series of facts identified by the Claimant and just discussed is sufficient to establish conspiracy.

Engineer's role in conspiracy

240. The Claimant's argument necessarily entails, not just that the Engineer and the Engineer's Representative failed in their duties under the Contract, but that they were in fact part of the conspiracy, and this is what the Claimant does allege. It questions the conduct of the Engineer and the Engineer's Representative in connection with the treatment of Bayindir's requests for extension, the issuance of a sub-clause 46.1 notice, and the issuance of a sub-clause 63.1(b)(ii) notice. Although these are contractual questions, the Tribunal will review them to the extent relevant for the assessment of a breach of the Treaty.

241. The Engineer is appointed by the Employer (Part I – General Conditions – sub-clause 1.1(iv)). For certain matters, he must obtain the Employer's specific approval before exercising his authority (Part I – General Conditions – sub-clause 2.1(b)). For others, he is to exercise his discretion. In so doing, he must act "impartially within the terms of the Contract and having regard to all the circumstances" (Part I – General Conditions – sub-clause 2(6)). The "Engineer's Representative" is appointed by and responsible to the Engineer. He carries out the duties and exercises the authority delegated to him by the Engineer (Part I – General Conditions – sub-clause 2.2).

242. Sub-clause 44.1 of the Contract provides the reasons and procedure for time extensions:

> "In the event of:
> (a) the amount or nature of extra or additional work, or
> (b) any cause of delay referred to in these Conditions, or
> (c) exceptionally adverse climatic conditions, or
> (d) any delay, impediment or prevention by the Employer, or
> (e) other special circumstances which may occur, other than through a default of or breach of contract by the Contractor or for which he is responsible,
> being such as fairly to entitle the Contractor to an extension of the Time for Completion of the Works, or any Section or part thereof, the Engineer shall, after due consultation with the Employer and the Contractor, determine the amount of

> such extension and shall notify the Contractor accordingly, with a copy to the Employer."
> (Exh. [Bay.] C-10)

243. The Engineer or his Representative are required to obtain the written approval of the Employer before deciding an extension of time under clause 44 above (Part II – Conditions of Particular Applications – sub-clause 2.1(e)). By contrast, the issuance of notices under sub-clauses 46.1 and 63.1(b)(ii) are not subject to prior approval of the Employer.

244. The Engineer's contractual status and the provisions governing requests for extension being defined, the Tribunal first turns to EOT 03. At the hearing, the Claimant focused on a number of additional works eliminated and added to its schedule, allegedly to push it into default. It also claimed that the Engineer's Representative had failed to investigate and take into account the obstruction by landowners, which would have entitled the Claimant to a time extension.

245. The chronology with respect to EOT 03 is the following. On 15 January 2001, Bayindir requested an extension on the ground of additional works and difficulties of access to the site because of obstruction by land owners. On 22 February 2001, the Engineer sent his evaluation report on EOT 03 to the Employer recommending *inter alia* an extension of time of 49 days for the completion of Part I, Islamabad to Burhan Section, out of 208 days requested (Exh. [Pak.] CM-88)]. By letter of 15 March 2001, the Engineer's Representative informed Bayindir that EOT 03 had been evaluated and forwarded to the Employer for approval. He drew Bayindir's attention to the fact that, notwithstanding its request for extension, Bayindir's rate of progress had remained "well below the Contract requirements" and it had therefore "failed to comply with the requirements [of sub-clause 46.1]" (Exh. [Pak.] RB-58). On 17 March 2001, the Engineer's Representative revised the recommendation for time extension previously made and recommended an extension of 27 days for Part I, on the basis of further discussions with the Engineer and of the consideration of the course of action that Bayindir could follow (Exh. [Pak.] CM-96). On 2 April 2001, NHA approved the extension recommended by the Engineer (Exh. [Pak.] CM-100), which the Engineer's Representative communicated to Bayindir by letter of 3 April 2001 (Exh. [Pak.] CM-101).

246. This sequence suggests that the examination by the Engineer and the Engineer's Representative of EOT 03 followed the procedure set forth in sub-clause 44.1 of the Contract. It is true that the reduction in the days recommended for extension from 49 to 27 days may appear surprising. Yet, Mr. Bridger gave the following contemporaneous explanation:

> "Following consultation on the Extension of Time Claim with NHA and the Contractor and now having had further discussions with the Engineer, it is considered that some minor changes are warranted only to the Part I time extension consideration.
> In Section 3.10 – Delays in Approval and Revision of Drawings, I note: (a) in previous reference to the 4 cell culvert to be constructed under the Lunda Cut Flyover, I now consider that it would have been possible to construct the Flyover approach fill with only a pipe culvert installed initially and the 4-cell culvert constructed later. This would remove the 4-cell culvert from any consideration in the Extension of Time Claim. (b) the time for completing the rock excavation would be 21 days rather than 28 days; this better reflects the Contractor's approved rate of construction progress for this work. (c) that the main carriageway of the Motorway could be opened to traffic once the Underpass at Km 32+510 has been completed, and backfilled, the motorway pavement has been completed, the Flyover bridge girders launched over the pavement and the deck slab formwork fixed into position over the main carriageways."
> (Exh. [Pak.] CM-96).

247. At the hearing, the Claimant challenged the explanation just quoted. Addressing some of the obstacles that Bayindir had alleged in support of its request for time extension, Mr. Bridger stressed that:

> "I think that by and large, the people in this room should understand that delays – there was a very large area of this Project that I think we are talking about, around about 35 kilometers on Part 1, by and large the Contractor was way behind without any cause of delay from external influences."
> (Tr. M., 29 May 2008, 189, 6-12)

248. Dealing specifically with the reduction of the extension eventually granted to Bayindir, he added:

> "By reverting to the Clause 14 programme production figures for rock excavation, which I must say, in all of this Extension of Time analysis, we probably started off being maybe a little on the generous side with the Contractor, but in discussions it became obvious with NHA and the Contractor, it became obvious that we could have tightened up on things, and this is certainly one of the outcomes. After sending my letter to the Engineer, he didn't want to be caught out with another change, and we discussed what was possible with the Clause 14 programme production rates, and that is why this change came about."
> (Tr. M., 29 May 2008, 204-205, 24-25, 1-11)

249. Whatever the actual number of extension days to which Bayindir was entitled, the facts just reviewed do not warrant a conclusion that the Engineer or Engineer's

Representative acted partially or conspired with the Employer or the Respondent. This conclusion is confirmed by the observation that between November 2000 and July 2001, five out of ten decisions of the Engineer were in favour of Bayindir, and that three of these prompted the Employer to file notices to commence arbitration (PHB [Pak.] ¶ 6.25; Exh. [Pak.] CM-19 to CM-21, CM-24 to CM-26, CM-29 to CM-31, CM-33, CM-37 and CM-38).

250. This conclusion is more generally supported by Mr. Bridger's oral examination. He left the impression of a serious professional, who may well have been irritated at times by Bayindir's slow progress and other deficiencies, but who was perfectly aware of his duties as the Engineer's Representative under the Contract. This said, it is true that the Tribunal did not have the benefit of Mr. Mirza's testimony at the hearing. Yet, the record shows that Mr. Mirza considerably relied upon Mr. Bridger who was the one exercising the duties and authority of the Engineer. This was certainly so with respect to the matters reviewed here.

251. The same considerations hold true for the other acts of the Engineer and the Engineer's Representative which Bayindir challenges. Specifically, the Parties disagreed on a number of issues relating to the issuance of the notices under sub-clauses 46.1 and 63.1(b)(ii), particularly whether the completion dates for the Priority Sections under Addendum No. 9 were binding; whether expulsion was available as a remedy even after the imposition of liquidated damages under sub-clause 47.3 of the Contract (as amended by Addendum No. 6); whether a sub-clause 46.1 notice could be issued pending a request for extension of time; whether the content of the sub-clause 46.1 notice was specific enough for the Contractor to understand that it referred to the completion dates of the Priority Sections; whether the issuance of a sub-clause 63.1(b)(ii) after a sub-clause 46.1 notice presupposes an almost complete stoppage of the works.

252. In particular, the Parties have put forward competing interpretations of the meaning of sub-clauses 46.1 and 63.1(b)(ii), which are the main contractual bases for the expulsion of Bayindir. The notice under sub-clause 46.1 is indeed a precursor of the notice under sub-clause 63.1(b)(ii), which in turn provides the basis for the expulsion of the contractor. Yet, the Tribunal finds that the issuance of the notices under these sub-

clauses was based on a reasonable interpretation of the Contract, as evidenced by the written (Bridger's WS, ¶¶ 72-73, 95-102; Bridger's supplemental WS, ¶¶ 48-71, 98-115) and oral testimony of Mr. Bridger (Tr. M., 29 May 2008, 194-201). On cross-examination, Mr. Bridger noted *inter alia* that:

> "Q: Mr. Bridger, is the purpose of Clause 46.1, of a Notice under Clause 46.1 to encourage the Contractor to expedite progress in order to bring the delayed Project back on schedule?
> A: That is, strictly speaking, the purpose of it. I think even if it is not absolutely possible to bring it back on schedule, I think a reasonable client would be happy to see efforts being made that would bring it back towards the schedule, and I think the whole idea was to gear this Project up so that it wasn't going to be falling behind the way it was falling behind.
> Q: So a reasonable Contractor (sic) [client] would be happy to see that efforts were being made to bring it behind schedule, and to bring it on schedule?
> A: Substantial efforts, and real efforts. Not just bringing in equipment that didn't have the capacity to achieve the production levels, you know, we saw a lot of increases in equipment after that Notice was served, but the productivity fell, despite the increase in numbers of items of equipment."
> (Tr. M., 29 May 2008, 192-193, 12-25, 1-8).

253. Mr. Bridger's understanding of the purpose of a sub-clause 46.1 notice was confirmed by the Claimant's expert witness Mr. Pickavance, according to whom "the purpose of Clause 46.1 is to draw the Contractor's attention to the fact that he is not proceeding quickly enough in order to complete on time, and it is a precursor to the operation of Clause 63(b)(ii) in certain circumstances" (Tr. M., 30 May 2008, 221, 10-16). Mr. Pickavance opined however that the content of the notice was not precise enough, as it did not specify which works needed to be accelerated. According to Mr. Pickavance, "the Contractor has to tell the Engineer what he is going to do to put it right, but he cannot tell him what he's going to do to put it right unless he knows what it is that is wrong" (Tr. M., 30 May 2008, 221, 21-24). The experts produced by the Respondent, Prof. Uff and Mr. Chapman, were not of the same opinion. For them, "[t]he nature of the thing is to tell the Contractor he's going too slowly. It then requires him to take steps which the Engineer has to approve" (Tr. M., 30 May 2008, 222, 10-13) and "[w]hat would normally happen in the circumstance would be there would be a meeting after the receipt of a letter like this, so that the Contractor could be made clear at a meeting of the particular points where he needs to put more effort in" (Tr. M., 30 May 2008, 223, 13-18).

254. This discussion is particularly relevant when it comes to assessing Bayindir's reaction to the sub-clause 46.1 notice. Mr. Bridger's view was that Bayindir failed to proceed

with the works and that the issuance of a sub-clause 63.1(b)(ii) notice was thus justified. Asked in cross-examination why he had not proceeded as in early 2000, when before issuing such a notice he had alerted Bayindir, Mr. Bridger answered that in April 2001 the situation was different:

> "A: [...] We had been through a lot of processes up to that point, including this opportunity for dialogue, and so it was a different situation then.
> Q: A different situation where, in your assessment, a dialogue would have been counterproductive?
> A: The dialogue had taken place the second time because with extensive dialogue at the time of addendum number 9, and concessions had been made with respect to the Mobilization Advance, retrieval of the Mobilization Advance by incremental monthly payments, quite significant changes had been made to that [...]."
> (Tr. M., 29 May 2008, 226-227)

255. Bayindir's progress following the sub-clause 46.1 notice and whether it justified a sub-clause 63.1(b)(ii) notice was debated by the experts. Mr. Pickavance stated that the failure to proceed within the meaning of sub-clause 63.1(b)(ii) must be interpreted strictly (Tr. M., 30 May 2008, 160, 16-22) and confirmed the interpretation given in paragraph 7.58 of his report, namely that: "the only way in which a Contractor could be found to not have 'proceeded with the works' in accordance with 63.1(b)(ii) would be if the Contractor substantially reduced its labour to a point where there is either no progress, or the progress is de minimis" (Tr. M., 30 May 2008, 161-162, 18-25, 1-2). The Tribunal is not persuaded by this interpretation, which would not make much sense in practice, or in the words of Prof. Uff:

> "I have construed the words of the Contract in order to make what is sometimes called 'Business common sense', which always appeals to English judges and Arbitrators. It seems to me to construe the clause as Mr. Pickavance and the Claimant suggests doesn't make any sense because it would suggest that the sequence of events is that the Contractor is going too slowly, a Clause 46 Notice is served with the intention of speeding him up, but you can only act on that Notice by terminating if he actually stops altogether. That doesn't seem to be a likely sequence of events. It seems obvious to me that the clause is intended to refer to a failure to comply with the Clause 46 Notice, and I believe you can arrive at that conclusion within the words of the clause, but in any event, I suggest that the clause at the very lowest should be construed as failing to proceed with the works in accordance with the general requirements of the Contract, particularly Clause 41.1, that expressly requires the Contractor to proceed with due expedition and without delay, irrespective of whether a Clause 46 Notice has been served."
> (Tr. M., 30 May 2008, 167-168)

256. On the basis of the foregoing considerations, the Tribunal has no hesitation in ruling out a finding of conspiracy. Such a finding can in no circumstances derive solely from a divergence of views on the interpretation of certain provisions of the Contract. As to

the other factual allegations made by the Claimant in this connection, as has been shown, they are not sufficient either.

257. The additional argument advanced by Bayindir that PMC was economically dependent upon Pakistan does not change this conclusion. The fact that ECIL, the lead partner of PMC, may have worked extensively with the Pakistani government does not necessarily entail that the PMC group overall or Mr. Mirza himself were economically dependent upon Pakistan. And even if such dependence were proved, it would be insufficient to establish that the Engineer acted in bad faith. As for the alleged subservience shown in the correspondence, particularly in Mr. Mirza's letters to NHA dated 19 September 2002 (Exh. [Pak.] CM-162) and 11 April 2001 (Exh. [Bay.] CX-138), the Tribunal finds nothing in these letters suggesting bad faith on the part of Mr. Mirza. To the contrary, in his letters, Mr. Mirza specified whether he was acting in his capacity as Engineer or as consultant to NHA, thereby making it clear that he was well aware of the different roles he was playing in the context of the Contract. That the combination of these sometimes conflicting roles in one and the same person can be problematic is well-known to anyone familiar with construction contracts. But that is a different question. What matters here is that there is no concrete evidence of bias which could potentially lead to a finding of treaty breach.

258. The Tribunal thus concludes that the existence of a conspiracy to expel Bayindir for reasons unrelated to the latter's contract performance is not established. This conclusion does not preclude the possibility of an expulsion for other reasons which in and of themselves might be grounds for a treaty breach.

2. Reasons underlying the expulsion of Bayindir

2.1 Bayindir's position

259. Bayindir submits in essence that its expulsion was motivated by grounds unrelated to its performance of the Contract and, more specifically, by the following three "sovereign reasons": "to serve Pakistan's changing political imperatives, to save money in a time of acute financial difficulty, and to favour local contractors" (PHB [Bay.] ¶ 34).

260. First, regarding the changing political priorities, Bayindir argues that the Project was constantly subject to shifts in the political winds, political pressures, and the "tit-for-tat" referred to by Mr. Afzal that came with the changes in the Pakistani government (PHB [Bay.] ¶ 35). More specifically, Bayindir contends that the impact of a change of government must be assessed in light of the precedents before the revival of the Contract in 1997 (Reply M., ¶ 124), in particular the divergent positions of Prime Minister Nawaz Sharif, who was favourable to the Project, and Prime Minister Benazir Bhutto, who opposed it as a tactic to "befool the public" and "gain cheap publicity" (Exh. [Bay.] CX-16; PHB [Bay.] ¶ 37) and terminated the Contract. Moreover, Bayindir also alleges that the government of General Musharraf, which came to power in October 1999, took an aggressive stance against the Project "in the light of Pakistan's financial problems necessitating a change in policy" (Reply M., ¶¶ 129 and 132). Bayindir refers, in particular, to the answer of NHA to a question by the National Assembly of Pakistan, in which it admitted that projects, including M-1, were delayed due to changes in priorities of the subsequent governments and financial constraints (Reply M., ¶ 210; Exh. [Bay.] CX-230).

261. Second, in connection with Pakistan's financial difficulties, Bayindir alleges, that as a result of the nuclear tests in May 1998 and of General Musharraf's coup in October 1999, financial institutions were unwilling to extend credit to Pakistan (Reply M., ¶ 129; Exh. [Bay.] CX-168; PHB [Bay.] ¶ 42). Moreover, when General Musharraf came to power, he imposed a policy of fiscal discipline (Tr. M., 4 June 2008, 9, 10-5), which led to a reassessment of the Project to take into account the funding problems. To support this allegation, Bayindir relies primarily on a document entitled "Talking Points for the Prime Minister" intended for the meeting with Bayindir's Chairman on 12 October 1999 (Exh. [Bay.] CX-170-B) and to the recommendations of a committee, established by the Musharraf government in November 1999, that the M-1 Project be reduced from six to four lanes (Exh. [Bay.] CX-169). This recommendation was later approved by General Musharraf (Exh. [Bay.] CX-170-A; Tr. M., 28 May 2008, 30, 8-11). In Bayindir's submission, these documents show that with the advent of General Musharraf's government the Project came under increased scrutiny not because of a deficient performance on the part of Bayindir, but because of the financial constraints experienced by Pakistan.

262. Bayindir further argues that the Respondent's financial situation deteriorated in the year 2000. Referring to the oral testimonies of Mr. Wall, then World Bank country Director for Pakistan, and of Mr. Afzal, then Pakistan's Secretary of Finance, Bayindir points out that in the summer of 2000 Pakistan was facing a balance of payment crisis and actively seeking to conclude a standby agreement with the IMF (PHB [Bay.] ¶ 42). At the same time, Bayindir refers to the "liquidity crunch" that NHA experienced by the fall of 2000 and the lack of funds to cover the promissory notes that were coming due on the M-1 Project, a situation which prompted the Ministry of Communications to seek further funds from the Ministry of Finance (PHB [Bay.] ¶ 41).

263. Bayindir links the financial difficulties to its expulsion by referring to the following sequence of events. The standby agreement which was eventually reached in November 2000 specified revenue and expenditure targets. Being unable to meet those targets, Pakistan announced in April 2001 a revised budget in which funds available for the Public Sector Development Programme (PSDP) were substantially reduced. This reduction had an adverse impact on NHA's budgetary situation, which Bayindir describes as follows:

> "NHA received funding, including the funding for the M-1 Project, through the PSDP, and, as Mr. Afzal stated in no uncertain terms, NHA was expected to live within its PSDP allocation. As of April 11, 2001, the Secretary General of Finance was advised that NHA had Rs. 2.86 billion PSDP funds remaining for all NHA projects. Under the revised PSDP budget, however, NHA was facing a budget reduction of Rs. 3.1 billion, which would effectively place NHA in a deficit situation. However, in addition to NHA's projected remaining funds of Rs. 2.86 billion, NHA anticipated a release of Rs. 1.5 billion which had already been allocated specifically "to meet the liability of M/s Bayindir" [...] Unless NHA could avoid using the Rs. 1.5 billion release to satisfy Pakistan's obligations to Bayindir, the projected Rs. 3.1 billion PSDP budget cut would exceed NHA's remaining Rs. 2.86 billion PSDP allowance. Bayindir was owed Rs. 1.5 billion and more on account of IPC 20, IPC 21, and IPA 22. But the solution was simple enough [...] [Pakistan] stopped work on the M-1 Project, a low priority project under the Musharraf Government, and it stopped payments to Bayindir, freeing up the Rs. 1.5 billion for NHA's other PSDP project."
> (PHB [Bay.] ¶¶ 43-44)

264. In Bayindir's contention the M-1 Project was chosen as a target because it had come under severe criticism from the World Bank and the Expert Group convened by the Respondent and financed by a grant from the Japanese government administered by the World Bank (PHB [Bay.] ¶¶ 45-46) to the effect that the M-1 Project was financially unviable and that termination would result in a saving of costs (Reply M., ¶¶ 207-209; Exh. [Bay.] CX-139). It thereby strengthened the internal opposition within the

Pakistani government against the continuation of the Project. Further, according to a note prepared by NHA for the Finance Minister on 6 January 2000, the M-1 Project was specified to be a low priority project (Reply M., ¶ 151; Exh. [Bay.] CX-196).

265. It was allegedly in this context that the then Minister of Communications, General Qazi, requested a meeting with General Musharraf "to get his decision on [the] future of the M-1 project" (PHB [Bay.] ¶ 47), which was held on 12 April 2001. Bayindir emphasizes in this respect that

> "It is evident from the face of this memorandum requesting the meeting that the need for General Musharraf's intervention was not driven by contractual concerns or Project delays – the focus, as ever, was on the financial difficulties that Bayindir's M-1 Project posed for Pakistan and NHA."
> (PHB [Bay.] ¶ 47)

266. Bayindir claims that the decision to end the Project and expel it was taken by General Musharraf. It summarizes its general argument with respect to the financial reasons underlying its expulsion as follows:

> "with no funding available and an expensive, financially unviable project on its hands, the Government decided to sacrifice Bayindir in the name of sovereign financial discipline."
> (PHB [Bay.] ¶ 48)

267. Third, with respect to the alleged favouritism to the benefit of local contractors, Bayindir contends that its expulsion not only solved Pakistan's funding difficulties but also allowed the M-1 Project to proceed

> "because Pakistan could save money and still complete the M-1 motorway by engaging local contractors in Bayindir's stead. Even with the savings that Pakistan would reap, the local contractors stood to benefit from taking over the M-1 Project from Bayindir and were eager to do so. And indeed, local contractors were waiting in the wings, ready to take over the Project."
> (PHB [Bay.] ¶ 49)

268. More specifically, Bayindir points out that the completion of the Project by influential local contractors was recommended by NHA's advisors and was decided prior to the expulsion as evidenced by a number of documents and statements of NHA officials (Reply M., ¶¶ 214, 217, 219; Exh. [Bay.] CX-96, CX-139, CX-206, CX-224). According to Bayindir, Mr. Kamal Nasir Khan, the Deputy Managing Director of Saadullah Khan & Brothers (SKB), and a consortium of local contractors exerted pressure on Mr. Cörtük, Bayindir's Chairman, to assign the Project to them (Reply M., ¶ 216; Exh. [Bay.] CX-235). Eventually, the award of the Project to Pakistan Motorway Contractors Joint

Venture (PMC-JV), a local consortium led by SKB, was the result of a corrupt tender process, evidencing NHA's real motives for expelling Bayindir, namely saving cost and favouring influential local contractors (Reply M., ¶¶ 218-219). For Bayindir, NHA was in fact directly involved in the creation of PMC-JV, as evidenced by contemporaneous press reports (Exh. [Bay.] CX-106) as well as by a letter from the Vigilance Wing describing PMC-JV as "the Consortium which was constituted by concerned NHA officials through negotiations with concerned firms mainly SKB" (Exh. [Bay.] CX-236-A), and as confirmed by the oral testimony of Mr. Nasir Khan (PHB [Bay.] ¶ 52).

269. In Bayindir's submission, it is for these three reasons that it was expelled and not because of its performance under the Contract. At the hearing, Bayindir noted that the documents reviewed in this regard make little or no mention of performance problems (Tr. M., 4 June 2008, 6, 12-19).

270. Bayindir acknowledges that there were delays in the completion of the Project for reasons that are disputed. It adds that even if those delays were attributable to Bayindir, Pakistan's response was "grossly disproportionate to whatever problems existed on the Project" (PHB [Bay.] ¶ 60) and was "all the more egregious when viewed in light of Pakistan’s and NHA's own culpability for the delays on the Project" (PHB [Bay.] ¶ 66) stemming mainly from Pakistan's failure to acquire and properly transfer land to Bayindir and from the assignment of additional work to Bayindir which was not contemplated when the Priority Sections deadlines were set in Addendum No. 9 (PHB [Bay.] ¶ 75).

271. In any case, Bayindir stresses that any delays or other problems relating to contractual performance were not the reason that moved the Pakistani government to take the decision to expel Bayindir. Such decision was instead the expression of governmental interference with the Contract.

2.2 Pakistan's position

272. As a general matter, it is Pakistan's case that it was truly committed to the Project and that the change of the Project's scope and completion dates was not due to its financial constraints but to Bayindir's failure to arrange a foreign currency loan and to the latter's poor contractual performance (Rej. M., ¶ 3.53).

273. The Respondent replies to Bayindir's allegations relating to the shifts in political winds that events pre-dating the entry into force of the Treaty on 3 September 1997 are not covered by the protections afforded by the Treaty and lie outside the jurisdiction of the Tribunal (C-Mem. M., ¶ 4.8). Moreover, the Pakistani government which came to power in October 1999 wished to continue the Project and retain Bayindir as the Contractor (Rej. M., ¶ 3.3). More specifically, Pakistan argues that:

> "The evidence shows that the decision to expel was made by NHA, acting on its own following the issuance of a Clause 63.1 Certification by the Engineer, subsequent to 12 April 2001, albeit with the high level approval that – so far as concerns the general diplomatic fallout – it could act in accordance with the terms of the Contract. This has two important consequences. First, and most obviously, Bayindir's case of conspiracy fails. Secondly, the case comes down to the exercise by NHA of a contractual right, divorced from interference by the State. The fact that President Musharraf might have, but did not, discourage NHA from exercising its contractual rights because of broader diplomatic reasons in no way constitutes relevant interference."
> (PHB [Pak.] ¶¶ 2.76-2.78)

In addition, Pakistan notes that General Musharraf was diplomatically and personally fond of Turkey and appreciated the fact that the Project was in the hands of a Turkish contractor.

274. In connection with Bayindir's allegations about Pakistan's financial constraints and balance of payment crisis, Pakistan notes that the "Talking Points for the Prime Minister" referred to by Bayindir do not support the Claimant's allegations. Quite to the contrary, this document shows that Bayindir had difficulties sourcing credit in the international market (Rej. M., ¶ 3.26). According to Pakistan, the contemporaneous record shows that it was Bayindir's inability to arrange the foreign exchange component of the loan that caused the financing and the scope of the Project to be revisited. As a result of Bayindir's failure to arrange the foreign currency loan, Pakistan had indeed to finance the Project itself. The position of NHA's legal advisor at the time, Mr. Farrukh Qureshi (now Bayindir's counsel), was that "[Bayindir's] letter dated 23.10.99 tantamounts to a repudiation of contract entitling NHA to accept such repudiation and terminate the contract should it consider to do so" (Exh. [Pak.] CM-52). Instead, NHA and Pakistan opted against termination and for negotiation (Rej. M., ¶ 3.28).

275. Pakistan further alleges that the very fact that Addendum No. 9 was concluded in early 2000, at a time when Pakistan was facing serious financial concerns, disproves

Bayindir's assertion that its expulsion in 2001 was motivated by financial considerations, as Pakistan's financial position at that time was more secure. NHA did not give in to the opposition from Pakistan's Planning Division or to the advice from the World Bank. It rather maintained its view that the Project should be completed by the Contractor, as evidenced by the conclusion of Addendum No. 9, which was highly favourable to Bayindir (Rej. M., ¶¶ 3.55 - 3.65). Nothing in the minutes of the 7 November 2000 meeting chaired by the Minister of Communications in any way supports the proposition that a decision was taken to discontinue the Project owing to financial constraints. In fact, it was decided that the Project might continue (PHB [Pak.] ¶ 3.2). If Pakistan nevertheless remained cautious, this was because of Bayindir's past poor performance. Similarly, General Javed testified that he made no mention of financial constraints in his presentation to the Chief Executive on 23 February 2001, and that his reference in this presentation to Bayindir's high rates was only to illustrate the incentive that Bayindir should have had to make progress swiftly (PHB [Pak.] ¶ 3.2).

276. In addition, Pakistan stresses that, contrary to Bayindir's contention, the budget available to NHA for the Project was not restricted to the PSDP allocation. NHA could rely upon another budgetary stream, the current budget, which was many times larger than the PSDP and could have been employed for the Project. NHA was provided with funds from the PSDP for the express purpose of meeting its liabilities to Bayindir for the period from April to June 2001. The provision would have covered payments not only in respect of IPCs 20 and 21, but also IPA 22. NHA did not pay IPCs 20 and 21 because, under the Contract, these IPCs were not to be paid until the final accounting at the end of the Project's Defects Liability Period (PHB [Pak.] ¶ 3.2). It took this decision on the basis of legal advice, which was subsequently confirmed by a decision of the Engineer, and, in this arbitration, further supported by the expert testimony of Mr. Chapman.

277. Pakistan argues that, in any case, Bayindir's allegation that the M-1 Project was not a priority is unsupported by the evidence on record. The note on which Bayindir relies in this regard states that priority should be given to ongoing projects which included M-1. It then concludes that the balance of the Turk-Exim Bank loan was sufficient for the current financial year and that "efforts would be made to remain within the budgetary allocations, as far as the Rupee portion was concerned" (Rej. M., ¶¶ 3.40-3.41).

278. Further, Pakistan submits that it did not anticipate any savings from the expulsion of Bayindir. Quite on the contrary, it advised NHA that the latter would probably not gain financially from an expulsion and that there was likely to be a substantial windfall to Bayindir at the end of the Defects Liability Period (Rej. M., ¶¶ 3.126 - 3.127 and 3.136 - 3.140).

279. Pakistan also rebuts Bayindir's third allegation pursuant to which the expulsion was effected to favour local contractors. It replies that neither the government nor NHA had any contacts with SKB before the expulsion (Rej. M., ¶¶ 3.153, 3.171 - 3.173), that it is not established that the decision to complete the works with local contractors preceded the one to expel Bayindir (Rej. M., ¶¶ 3.152, 3.164 - 3.170), that any suggestion of collusion is disproved by the fact that NHA's attempts to continue parts of the works with local contractors were stopped by the very contractors with whom it is supposed to have colluded (Rej. M., ¶ 3.154). Finally, Pakistan notes that the completion of the works with Bayindir's subcontractors was in any event a natural course of action expressly permitted under sub-clause 63.1 of the Contract.

280. More generally, for Pakistan it was Bayindir's poor performance under the Contract that led to the expulsion (PHB [Pak.] ¶¶ 6.56 – 6.62). Bayindir's progress was slow from the start and the financial resources it invested in the Project were inadequate (Exh. [Pak.] CM-47). General Javed referred in his statement to the minutes of the Contract Progress Meeting No. 18 for December 1999, showing that Bayindir was experiencing a lack of cash flow, which was adversely affecting its progress. Contrary to Bayindir's contention, the delays cannot be explained by the unavailability of the land. Indeed, most of the land had been properly handed over, except for an encumbered stretch of 4 kms that was *de minimis* given the overall lack of progress of Bayindir (Rej. M., ¶¶ 3.16-3.17). Moreover, the Chairman of Bayindir, Mr. Kamuran Cörtük, testified in response to a question from the Turkish Parliamentary Committee investigating the purchase of the television station Genc TV in November 1998, that 30 to 40 million dollars originating from Pakistan had been used for this acquisition (Rej. M., ¶ 3.9). In Pakistan's submission, Bayindir was itself undergoing a "credit crunch" that caused it to be constantly under-resourced, to fail to acquire adequate equipment, and to display a chronic inability to pay its subcontractors in spite of NHA's regular and prompt payment of IPCs.

2.3 Tribunal's determination

281. To assess the merits of these allegations, the Tribunal will focus on two issues: first, whether the Claimant was expelled for reasons unrelated to its performance (2.3.1); second, whether the Claimant's contractual performance had an impact on the Respondent's acts allegedly in breach of the Treaty (2.3.2).

2.3.1. Expulsion unrelated to Contract performance?

282. To answer the first issue about the reasons unrelated to performance, the Tribunal will consider whether the evidence supports the existence of political shifts (2.3.1.1), of financial difficulties (2.3.1.2), and of attempts to favour local contractors (2.3.1.3).

2.3.1.1. Political shifts

283. In its post-hearing brief, the Claimant relied on the oral testimony of Mr. Afzal to claim that it had been the victim of "political pressures" and "tit-for-tat" political dynamics between Prime Minister Nawaz Sharif and, his successor, Prime Minister Benazir Bhutto. Whereas Mr. Sharif had fully supported the Project, Ms. Bhutto had not, irrespective of Bayindir's performance. However, these events occurred prior to the entry into force of the Treaty on 3 September 1997 and the disputes arising from them have been settled (see section IV(A)(c) *supra*). These events are thus not susceptible of founding a treaty breach in these proceedings. They can merely be taken into account for a better understanding of the relevant facts.

284. With respect to the period following the entry into force of the Treaty, Bayindir argues that a further political shift occurred in October 1999 with the advent of the government of General Musharraf. The new government is said to have taken an aggressive stance against the Project. The Tribunal is, however, unpersuaded by the evidence put forward by the Claimant. The answer provided by NHA to a question of the National Assembly of Pakistan (Exh. [Bay.] CX-230), upon which the Claimant relies, does not show an "aggressive stance." While it indeed refers to delays due to changes in policy, it also mentions that "with prudent handling" most of the "sick projects" including M-1 "are now on track" (Exh. [Bay.] CX-230).

285. Asked in cross-examination when Bayindir started to perceive the alleged hostility of the new government, Mr. Jilani, Bayindir's area manager, gave inconclusive answers. He was unable to put a date on some of the assertions he made in his written statement. To a question seeking to elicit what time period he intended to cover when writing that "the correspondence that Bayindir started to receive from the NHA and the Engineer clearly revealed to me that efforts were being made to find an excuse to take the Project away from Bayindir," he replied "a very wide period" from the 1999 takeover of Pakistan by General Musharraf to December 2000 when the sub-clause 46.1 notice was received (Tr. M., 27 May 2008, 31, 19-25).

286. This answer omits the crucial fact that during that time span Bayindir was confirmed in its position of Contractor by the conclusion of Addendum No. 9. The Addendum No. 9 provided *inter alia* for a revised completion date, the reduction of the Project from six to four lanes, a rescheduling of the recovery of the Mobilisation Advance, the settlement of foreign currency payments in Pakistani rupees at the conversion rate of the date of payment, the deletion of certain works, the immediate resumption of work by Bayindir, and the handover of remaining land by NHA within a set deadline (Exh. [Bay.] C-18). The conclusion of Addendum No. 9 can hardly be seen as an "attempt to take the Project away from Bayindir" nor as an indication of an adverse political shift constituting a breach of fair and equitable treatment.

287. In this context, the Tribunal also notes General Qazi's testimony according to which Pakistan's diplomatic relations and General Musharraf's personal contacts with Turkey had a positive rather than an adverse effect on Bayindir's position (Tr. M., 28 May 2008, 313-314).

2.3.1.2. Financial difficulties

288. The evidence, including the testimony of Mr. Afzal, at the time Pakistan's Secretary of Finance, and of Mr. Wall, at the time World Bank Country Director for Pakistan, shows that Pakistan was indeed undergoing financial difficulties when General Musharraf came to power. Mr. Afzal confirmed that "the ratings suffered a shattering blow after the nuclear tests of May 1998" and "continued to be precarious" (Tr. M., 28 May 2008, 111, 11-13 and 17), and that General Musharraf's accession to power adversely affected Pakistan's access to international institutional lending (Tr. M., 28 May 2008,

56, 17-24). This evidence was corroborated by Mr. Wall, who mentioned that Pakistan faced a balance of payment crisis in the year 2000 (Tr. M., 30 May 2008, 131, 4-5).

289. In essence, Bayindir argues that these difficulties led to a reduction of the scope of the Project, while Pakistan replies that it was Bayindir's inability to arrange the foreign exchange component of the loan which led to a review of the Project's scope and finance mechanism. It is undisputed that Bayindir was not able to raise a foreign currency loan. It is disputed, however, whether Bayindir was under an obligation to do so or under a mere duty to exert best efforts. In reality, this dispute ultimately does not matter. On the facts, it cannot be denied that financial considerations played an important role in the review of the Project. But the difficulties were resolved and the Project continued.

290. The content of Addendum No. 9 concluded in 2000 leaves no doubt in this respect. Its preamble emphasizes the reason for the review:

> "WHEREAS Bayindir has informed NHA through its letter reference No. IPM/OK/NHA/292 dated October 23, 1999 that Bayindir is unable to arrange further Foreign Currency Credit for the construction of Islamabad – Peshawar Motorway Project in terms of the Agreement for The Revival of Contract Agreement for the Construction of The Islamabad – Peshawar Motorway dated 3 July 1997.
> AND WHEREAS NHA has agreed to arrange the remaining funding for the Project and has resultantly reduced the work and extended the Completion Date in view of the non-availability of the said Foreign Currency Credit."
> (Exh. [Bay.] C-18).

The Tribunal concludes that the solution reached in the form of Addendum No. 9 evidences the Respondent's willingness to continue with the Project, and not the reverse.

291. Bayindir's further argument about the influence of the World Bank's negative assessment of the viability of the Project does not appear better founded. The World Bank's opinion does not seem to have had much impact on Pakistan's decision-making processes. As noted at hearing by Mr. Afzal on cross-examination, it was seen as a mere suggestion, and often disregarded:

> "You see, look, the point I am making a little different. I am making two points. One is that the World Bank's view on the viability of the Project, even continuation at that stage, was something that they had been consistent with, ever since the inception of the Project, so incidentally was the Planning Commission. Maybe they changed it at the very end. All I am saying is that these were in the form of

> suggestions, and in my original letter, if I recall, I cited two or three cases, but let me just specify those. There was the Chashma nuclear power programme which we had assisted with the assistance of the Chinese Government in 1991, 1992, and was, you know, consistently opposed by the World Bank, right through, and this was, by the way, in the time of the policy loans. We went ahead with it, and incidentally today everybody thinks, well, we did a good job [...]. Then there was this Lady Health Workers programme, which was started in Ms. Bhutto's Government time [...] Now, when it was started, the World Bank thought, because, unfortunately, Ms. Bhutto's Government had acquired a bad reputation for, you know, giving employment where it was undeserved, even in schools, they thought this was another programme which was just there to recruit people and give jobs. In fact, it is today continuing with about 100,000 workers. We have had several assessments, including that by third parties like the Oxford Policy Management Group, and they think it is one of the most successful public health programmes in the region. So, you know, this sort of advice would come and go, and we would have a healthy exchange."
> (Tr. M., 28th May 2008, 64-65, 2-25, 1-18) [testimony of Mr Wall].

292. Bayindir also seeks to establish that the Respondent's financial situation further deteriorated throughout the year 2000 and that by the fall of 2000 NHA was facing a "liquidity crunch." It argues that the reduction of NHA's PSDP allocation prompted NHA to seek an exit strategy from the M-1 Project, which was draining a large portion of its resources and had come under severe criticism from the World Bank and parts of the Pakistani government. The Claimant thus seeks to establish a causal link between Pakistan's financial difficulties and the decision to expel it.

293. As the record stands, such a link is not established. Pakistan contends that NHA had at its disposal another budget stream larger than the PSDP. At the hearing, Mr. Afzal confirmed that "the national highways authorities, as I said, would get its budget allocation through two different streams. One is the PSDP, and one is the current budget" (Tr. M., 28 May 2008, 41, 13-16). He restated so in cross-examination:

> "Q: Right. What I am trying to understand is whether you are suggesting that the M-1 Project was funded within or outside the PSDP or both?
> A: Both."
> (Tr. M., 28 May 2008, 44, 5-8).

This testimony is corroborated, as the Respondent pointed out, by a letter from NHA to Bayindir of 17 July 2000 (Exh. [Bay.] CX-251), which suggests the existence of funds in addition to those stemming from the PSDP allocation for the financial year 2000-2001.

294. To counter this evidence, Bayindir refers to a note for the Finance Minister dated 6 January 2000, which in part reads as follows:

> "[o]n the subject of prioritization of NHA's Development Program the Finance Minister observed that first priority should be assigned to the completion of ongoing projects and within ongoing projects higher priority should be assigned to N-5 projects and then to rehabilitation/reconstruction of National Highway Network other than N-5."
> (Exh. [Bay.] CX-196).

295. There is nothing in this note suggesting that the M-1 Project was not a priority. Quite to the contrary, the priority goes to "completion of ongoing projects," which would appear to cover the M-1 Project. The M-1 Project is then discussed in more detail, but the note concludes merely that a decision from the Finance Minister is requested so that the proposals made by Bayindir (including the payment of the foreign exchange portion in cash in equivalent Pakistan rupees) can be turned into an agreement. In this context, one should note that the fact that the Project may have been viewed as a priority is in line with the country's diplomatic and General Musharraf's personal ties with Turkey (Tr. M., 28 May 2008, 313-314).

296. For these reasons, the Tribunal comes to the conclusion that the financial situation referred to by the Claimant cannot be considered a decisive cause of Bayindir's expulsion.

2.3.1.3. Local contractors

297. The same reasoning applies to Bayindir's allegation that the purpose of its expulsion was to save resources and complete the Project at lesser cost with local contractors. While it is plausible that NHA and the government considered ways of cutting costs, it is not established that this consideration triggered the expulsion of Bayindir and the decision to continue the Project with local contractors.

298. Bayindir refers to a number of documents allegedly demonstrating the intent to favour local contractors. These documents include a letter from the Vigilance Wing, press reports, and a memorandum of understanding signed by NHA with the local contractors before the launch of the tender procedure. Bayindir also relies on the testimony of Mr. Nasir Khan, all to sustain that, prior to the expulsion of Bayindir, NHA had undertaken the constitution of a consortium of local contractors to take over the Project. Bayindir claims that such conduct evidences the real motives underlying its expulsion.

299. On the basis of the documents to which the Claimant mainly refers (Exh. [Bay.] CX-96, CX-106, CX-139, CX-206, CX-224, CX-235, CX-236-A), the Tribunal agrees that NHA and the government had in mind the possibility of completing the Project with local contractors. However, this conclusion does not necessarily entail that they preferred to do so, or, even if they did, that the decision to expel Bayindir resulted from such preference. Absent any indication on record to these effects, the Tribunal cannot deem these facts established.

300. In reaching this conclusion, the Tribunal has taken into account that the record does not support Bayindir's allegation of corruption in the tendering process. Moreover, it appears to the Tribunal that any employer facing the unpleasant prospect of having to terminate a construction contract before completion would by necessity seek to identify alternative solutions. Envisaging the use of Bayindir's subcontractors to continue the works was certainly a sensible alternative. Indeed, it goes without saying that it makes more sense to try to retain the subcontractors who have already worked on the project rather than to resort to newcomers. These circumstances cannot be viewed as an indication that Pakistan's motivation for the termination was to favour local contractors and save costs.

2.3.2. Bayindir's performance

301. The foregoing conclusions are supported by a review of Bayindir's perfomance. In essence, the Claimant submits that the internal documentation of NHA and the government contained no or little mention of deficient performance on its part, while Pakistan’s financial problems received far more attention. It adds that, even if its performance had not been satisfactory, expulsion was a disproportionate remedy, which is additional proof that the motivation lay elsewhere. In response, the Respondent refers extensively to contemporaneous documentation, mainly monthly progress reports and correspondence, to establish Bayindir's poor contractual performance (Tr. M., 26 May 2008, 189-236, 240-273; see also PHB [Pak.] ¶¶ 3.78 – 3.96, 3.99 – 3.106, 6.56 – 6.62).

302. As a threshold matter, the Tribunal notes that there can be no objection against relying on monthly progress reports and correspondence issued by the Engineer or its Representative, as the latter were not shown to be biased or acting in collusion with

NHA and the government. It also notes that Mr. Sadik Can, President of Bayindir Construction Company, testified that, together with reports on expenses, monthly progress reports were the main written sources regarding Bayindir's project management (Tr. M., 27 May 2009, 254-255, 22-25, 1-2).

303. The Tribunal stresses that in assessing this evidence it has taken into account the arguments advanced by the Parties in connection with the evidentiary weight of Mr. Mirza's testimony as well as the fact that Mr. Mirza was not available to appear at the hearing for cross-examination. Due to the confidential nature of the reasons alleged for Mr. Mirza's non-appearance, the positions of the Parties cannot be restated in this Award. However, the Tribunal has carefully reviewed all circumstances and concluded that, because the Claimant had no opportunity to cross-examine Mr. Mirza, the latter's written evidence could only be considered if corroborated by other evidence in the record.

304. The record substantiates the Respondent's negative assessment of Bayindir's contractual performance. Already immediately after the conclusion of Addendum No. 9, there is evidence that Bayindir's performance, particularly the level of re-mobilization and funds committed, was insufficient in the opinion of the Engineer's Representative (Exh. [Pak.] CM-65, CM-66). There is further evidence of this fact in the monthly progress reports for September and October 2000 (Exh. [Pak.] CM-8, CM-9) and in a letter from the Engineer to Bayindir of 7 October 2000 (Exh. [Pak.] CM-73).

305. It is true that the press release of the site visit of General Qazi on 12 September 2000, to which Bayindir refers (Exh. [Bay.] CX-31), states that the Minister of Communications had "expressed satisfaction over the pace of work." Yet, that press release is insufficient to establish the satisfactory performance of Bayindir or rebut strong evidence to the contrary. Government releases are often couched in prudent or diplomatic terms. More specifically, this release contains another passage to which General Qazi referred in his examination (Tr. M., 28 May 2008, 292, 16-20) and which states that "[the Minister] directed the experts to further gear up the pace of work on the project so that it could be completed at the earliest" (Exh. [Bay.] CX-31). In his oral testimony, General Qazi confirmed that, after his visit to the site, he was not satisfied with Bayindir's pace of work:

> "Based on what I had seen before the briefing, because first, we made the visit. We made the round. Then we came to the place which was – they called it, 'Camp office', and over there the briefing was given on the charts, and all. I had already visited the site. You had seen the work that was going on, and frankly, I was a bit disappointed to see that the number of machines deployed were too less, and the outfieldwork and the carting of the earth was mostly being done by donkeys, so I said, 'How can you meet the targets by such a slow-moving actions that are going on?' And I was told that, 'Well, these are the local subcontractors, and we are – 'we have deployed machines and we will deploy more machines', and they are working on other parts of the roads, that is why you could not see them. So I said, 'But all the same, I am not satisfied, the way the work is going on, because when I drove beyond the road after which I was ruled (sic) [told] to go, then I could see that large portions there was nobody working, and then they said, 'Well, we have divided up the road and people would be working on those portions also', so overall, my impression, as I carried, was not very happy one. I was a bit unhappy with the pace of work that I saw, and the amount of machines deployed that I saw, and then when the briefing was given, I was told by Bayindir that they would be able to meet the target, which was two asks (sic) [weeks] by March 2001, and the complete road by December. So, I had very serious doubts, and then the Engineer gave his assessment, and he pointed out that with the amount of work, the percentage of work they had done so far, there was no way they would be able to meet the target unless they undertook some extraordinary measures and deployed more resources and machines. So, I, at that time, told the Bayindir representative, a gentleman called Jilani, Mr. Jilani, I told him, I said, 'Listen, you better deploy more machines and bring in more resources so that you can meet the targets, because we want to make this motorway, and we want you to finish the work on time', which he promised that he would do."
> (Tr. M., 28 May 2008, 289-291).

306. Similar concerns were expressed later by General Javed, the Chairman of NHA, on the occasion of a visit to the site on 25 November 2000. These concerns are recorded in his notes, which the Engineer forwarded to Bayindir on 5 December 2000 (Exh. [Pak.] RB-43). General Javed confirmed his doubts in oral testimony:

> "The first remark that I made to the Bayindir people was that I have yet to have a critical analysis of your output, and I haven't seen any of the Engineer's reports, but they said that the critical activity appears to be the earthwork. The earthwork was the most critical activity, and I distinctly remember having told them that, 'Critical activity for you is the earthwork, unless you put your act together you will have no hope in hell to complete this section come 23rd of March'. So, certainly, this is absolutely right. They were far behind the schedule, at that point in time, with respect to the other areas, also, but earthwork, amongst the order of the works is probably the first one [...]."
> (Tr. M., 29 May 2008, 112, 5-21).

307. None of Bayindir's witnesses were examined on these facts, whereas Mr. Bridger's testimony confirmed that Bayindir's performance remained unsatisfactory in the months preceding the issuance of the sub-clause 46.1 notice at the beginning of December 2000 (Bridger's WS, ¶¶ 62 – 73; Tr. M., 29 May 2008, 189, 2-12). Referring to his

remarks in the November 2000 monthly progress reports, Mr. Bridger testified that earthwork quantities on Parts 1 and 5 combined were 45% less than the November target and that Part 1 had fallen significantly behind schedule (Bridger's WS, ¶ 71). By the end of November, Messrs. Bridger and Mirza considered that Bayindir's performance was such that they needed to issue the sub-clause 46.1 notice "before it became too late for BCI to have the opportunity to bring the Project back on program" (Bridger's WS, ¶ 72).[86]

308. After the issuance of the sub-clause 46.1 notice on 2 December 2000, Bayindir's progress remained unsatisfactory, as is evidenced by a letter from Mr. Bridger to Bayindir of 11 December 2000 (Exh. [Pak.] CM-79), and by the December 2000 monthly progress report (Exh. [Pak.] CM-11). Mr. Finn followed up with several reminders in January 2001 (Exh. [Pak.] CM-83, CM-84, CM-86). The monthly progress reports for January, February and March 2001 also show that Bayindir's progress was insufficient (Exh. [Pak.] CM-12, CM-13, CM-14). Mr. Bridger explained at the hearing that productivity decreased although Bayindir had added equipment (Tr. M., 29 May 2008, 193, 2-8).

309. Bayindir submits that, in assessing its performance over these months, the Engineer and his Representative improperly disregarded the fact that progress was being hindered by reasons attributable to the Respondent. This issue has been partly addressed in paragraphs 245-250 *supra*. Asked at the hearing about his assessment of the obstacles allegedly excusing the delays, Mr. Bridger gave the following answer:

> "Q: So they invited you to a joint inspection, you and a representative of the Employer. Bayindir witnesses have testified that you never accepted the invitation.
> A: That is absolutely right. I didn't.
> Q: You did not?
> A: I did not, but I inspected this site twice myself, once before the meeting of 19th of March, and once just before I sent out my letter [...] I went through the site with my Resident Engineers, I declined to go through with Bayindir because I didn't want the coercion – I didn't want to be pressured by Bayindir. I believe I knew exactly what Mr. Jilani said on the meeting of the 19th of March, and it was absolutely incorrect. The assertions he was making about what I had seen on site, and I did not want to go on site with them and be pressured in any way. [...]
> Q [THE PRESIDENT]: Well, can I just ask; what did you mean by being pressured by Bayindir? Would they otherwise pressure you?

---

86 *See* also Mr. Bridger's statement referred to earlier that: "by and large the Contractor was way behind without any cause of delay from external influences" (Tr. M., 29 May 2008, 189, 10-12).

> A: I think they held a view that was contrary to what the actual circumstances were. They were obviously not going to back down from it, and to travel with them over 150 kilometres one way, and then back the other way 100 kilometres to my office, that is 250 kilometres, sitting with Bayindir telling me that black is white, I didn't enjoy the thought of that, so I didn't travel with them. [...]
> Q [THE PRESIDENT]: So the relationship was a difficult one?
> A: At that stage, after the 19th of March meeting it was. Up until then I had had very good relations with Bayindir. I was probably generous in the way I administered the Contract towards Bayindir because I believe that if the Contractor is treated fairly, and he gets his due payments, it is going to expedite the Contract. I had very good relations with all the – all three Project Managers, but after this 19th of March meeting, things became quite acrimonious with Bayindir, and I was going to be absolutely independent of them in every way possible.
> Q [THE PRESIDENT]: So the turning point was the 19th of March meeting?
> A: Oh, I believe that was a turning point, major turning point, yes."
> (Tr. M., 29 May 2008, 215-218)

310. At that 19 March 2001 meeting, the Employer and the Engineer's Representative had indeed expressed their concerns about Bayindir's unsatisfactory progress (Tr. M, 29 May 2008, 216, 3-8). The minutes of the meeting show that presentations were made by Mr. Bridger (pointing to Bayindir's deficient performance despite several reminders) and by Mr. Jilani (regarding the progress on the site). The minutes record that the Chairman of NHA intervened several times during Mr. Jilani's presentation to express concern about Bayindir's progress (Exh. [Pak.] CM-97).

311. Bayindir has sought to show that the minutes do not reflect the discussions held at the meeting, but to no avail. Mr. Jilani's testimony on this point at the hearing was unconvincing. Although he confirmed that the 19 March 2001 meeting was regarded as an important meeting, he stated that neither he nor Mr. Can, who attended for Bayindir, took any notes "because [the] Engineer was prepared, taking, I guess, the notes. We were not taking notes" (Tr. M., 27 May 2008, 67, 16-18). Moreover, he was unable to point to any evidence that he had asked Mr. Bridger for the draft minutes (Tr. M., 27 May 2008, 68, 12-16). Mr. Can's testimony was hardly more convincing. Asked whether he was aware of a letter sent by Mr. Bridger to Bayindir's project manager one week after the 19 March meeting, stating that the list of obstructions presented by Mr. Jilani at the meeting was obsolete (Exh. [Pak.] RB-67), Mr. Can was unable to answer whether Bayindir had replied or not, later noting that he was not involved in daily correspondence (Tr. M., 27 May 2008, 260-262).

312. Pakistan also relies on a letter that Mr. Bridger sent to Bayindir on 16 February 2001, noting that the value of the equipment permanently imported by Bayindir was well below Bayindir's commitment (Exh. [Pak.] CM-91). Mr. Bridger recalled that, at a meeting held on 21 March 2001, Mr. Jilani informed him that Bayindir would "never bring in the rest of that equipment" (Bridger's WS, ¶ 78). In his Supplemental Witness Statement, Mr. Bridger testified that he had found this statement "quite shocking" (Bridger's Supplemental WS, ¶ 110), which he confirmed orally (Tr. M., 29 May 2008, 259, 5-18):

> "Well, I think the very misguided view that Mr. Jilani gave of the obstructions, and the progress, certainly I was very disappointed in, and in fact, so much so that I made a point of convening a meeting with Mr. Jilani and others very soon after that March 19th meeting to discuss the importation of plant to get the Project really moving again, and it was in that meeting, I think it might have been just two days after the presentation on the 19th, that I was absolutely flabbergasted that there was no intention by Bayindir to bring in plant that I understood was due to come in accordance with a 1998 agreement with NHA, and I just thought it was trickery taken to the Nth degree."
> (Tr. M., 29 May 2008, 259, 5-18)

The oral testimony of Mr. Jilani appeared to confirm Mr. Bridger's statement that Bayindir did not intend to bring in additional equipment. Asked in redirect examination whether the equipment that Bayindir had on site was insufficient, Mr. Jilani gave a long answer to the effect that Bayindir was not contractually required to bring in more equipment (Tr. M., 27 May 2008, 81-85).

313. Additional criticism was voiced both by the Engineer's Representative and by the Employer shortly before the issuance of the sub-clause 63.1(b)(ii) notice on 19 April 2001. On 14 April 2001, Mr. Bridger in particular reminded Bayindir that:

> "According to any assessment, your rate of progress has remained well below the Contract requirements and you have failed to comply with our notice issued to you under Clause 46.1."
> (Exh. [Pak.] RB-69)

314. Accordingly, the facts are such that NHA's concerns about Bayindir's performance must be deemed founded, with the result that NHA was entitled to consider termination. Under these circumstances, the Tribunal can see no basis for finding a breach of the applicable FET standard.

315. In the light of the foregoing conclusion, the Tribunal will dispense with reviewing whether one or more of the three reasons invoked by the Claimant are capable of grounding an allegation of governmental interference with the Contract.

(iii) Did Pakistan exert illegitimate pressure or coercion on Bayindir?

1. Bayindir's position

316. It is Bayindir's case that it was expelled from the site under threat by armed soldiers who had surrounded the site on 24 April 2001 and prevented Bayindir's personnel from entering their offices or removing records (Mem. M., ¶ 179). Bayindir emphasizes that the time and manner in which the notice of expulsion was served upon Bayindir was deliberately planned so as to prevent Bayindir from seeking assistance or advice from its head office, or the Turkish Embassy in Islamabad, or legal counsel (Mem. M., ¶ 102). In this regard, Bayindir quotes from *Pope & Talbot v. Canada*[87] and argues that a "confrontational and aggressive" regulatory review may breach fair and equitable treatment:

> "The relations between the SLD and the Investment during 1999 were more like combat than cooperative regulation, and the Tribunal finds that the SLD bears the overwhelming responsibility for this state of affairs. It is not for the Tribunal to discern the motivations behind the attitude of the SLD; however the end result for the Investment was being subjected to threats, denied its reasonable requests for pertinent information, required to incur unnecessary expense and disruption in meeting SLD's requests for information, forced to expend legal fees and probably suffer loss of reputation in government circles.[...] In its totality, the SLD's treatment of the Investment during 1999 in relation to the verification review process is nothing less than a denial of the fair treatment required by NAFTA Article 1105, and the Tribunal finds Canada liable to the Investor for the resultant damages."[88]

317. Bayindir opposes Pakistan's allegation that the security problems on site were caused by unpaid subcontractors. It asserts that it had paid its subcontractors for the works performed until the end of December 2000 and that non-payment for works performed thereafter was due to NHA's failure to settle outstanding IPCs. According to Bayindir, the Chairman of NHA, in a press conference of 23 April 2001, upon the expulsion of

---

87 *Pope & Talbot Inc v. The Government of Canada* NAFTA Arbitration (UNCITRAL Rules), Award of 10 April 2001 (hereafter, *Pope & Talbot v. Canada*).

88 *Id.*, ¶ 181, quoted in Mem. M., ¶ 181.

Bayindir, assured Bayindir's subcontractors that their interests would be protected (Exh. [Bay.] CX-93). However, upon a request by Bayindir that its subcontractors be paid by NHA directly out of the certified amounts payable to Bayindir, the Engineer issued an allegedly biased decision under sub-clause 67.1, rejecting direct payment. Thus, Pakistan refused to pay Bayindir's subcontractors and directed the subcontractors to approach Bayindir for payment, which the latter did with the result that Bayindir's personnel was threatened and felt extremely insecure.

318. Moreover, Bayindir alleges that the Respondent deployed the FWO, a unit of the army, on the site. Thus, as a result of Pakistan's acts and omissions, Bayindir's expatriate personnel was compelled to leave Pakistan without securing its assets and property (Reply M., ¶¶ 242 - 243, Exh. [Pak.] CM-61, Exh. [Bay.] CX-158, CX-159).

319. Bayindir further claims that it was entitled under the Contract to seek a decision under sub-clause 67.1, followed by final adjudication by an arbitral tribunal. While such remedy was being pursued, the Respondent could not lawfully take over the site (Mem. M., ¶ 104). Bayindir has also mentioned that recourse to arbitration by the Respondent may constitute an act of coercion in breach of the FET standard as characterized in *Tecmed* (Mem. M., ¶ 183).

2. Pakistan's position

320. Pakistan's position is that the expulsion was carried out in accordance with the Contract. In particular, there was no intimidation of Bayindir's personnel. Neither was there any contemporaneous complaint by Bayindir, not even with respect to NHA's decision to use FWO personnel to secure the site and protect the equipment left by Bayindir (C.-Mem M., ¶ 4.42). Pakistan further argues that coercion as such, i.e. irrespective of any unlawful conduct, cannot give rise to an actionable breach of the FET standard (C.-Mem. M., ¶ 4.43).

321. In Pakistan's view, Bayindir's allegation of forcible expulsion comprises two elements (i) alleged coercive acts and threats by Pakistani armed soldiers; and (ii) alleged confiscation of records. In Pakistan's submission, Bayindir has failed to prove these elements. Bayindir relies heavily on Mr. Sadik Can's witness statement, who, as noted by Pakistan, was not in a position to recall what happened at the time of expulsion

because he had left the site on 25 April 2001, two days after receipt of the expulsion notice, and therefore was not present when the actual expulsion took place on 7 May 2001. Apart from Mr. Can's testimony, Bayindir has failed to substantiate its allegations. In particular, no complaints were raised at the time by any of Bayindir's representatives about coercion, threats or mistreatment at the hands of Pakistan.

322. According to Pakistan, security concerns that existed on site after Bayindir's expulsion had nothing to do with Pakistani armed soldiers, but were due to Bayindir's failure to pay its employees and subcontractors (PHB [Pak.] ¶¶ 4.1-4.3). NHA's response in arranging extra police protection and the FWO's presence were necessary to protect the site, including the equipment and Bayindir's personnel during the handing over of the Project to NHA (Rej. M. ¶¶ 3.91 – 3.124). In this connection, Pakistan notes that payment to subcontractors was the sole responsibility of Bayindir, as there was no privity of contract between NHA and Bayindir's subcontractors. In issuing the directions ruling out direct payment by NHA, the Engineer acted in conformity with his duties (Rej. M., ¶¶ 2.68-2.70).

323. Pakistan also notes that Bayindir points to no authority supporting that a State entity's recourse to an arbitration mechanism agreed in a contract can be considered as an act of coercion (C.-Mem. M., ¶ 4.44).

3. Tribunal's determination

324. The main evidentiary source of Bayindir's allegation is the witness statement of Mr. Sadik Can, President of Bayindir Construction Company (Exh. [Bay.] CX-65). The Tribunal must therefore assess Mr. Can's testimony and weigh it in the light of the other evidence in the record.

325. In his written statement, Mr. Can mentioned that in the evening of 23 April 2001, he was handed a letter which required Bayindir to vacate the site within 14 days and was urged to acknowledge receipt of this letter, which he did under protest. He further testified that he "noticed some soldiers of the Pakistani Army who were carrying guns and had taken positions at the gates and were also seen walking on the site" and that "[t]he presence of soldiers resulted in a panic amongst [his] staff who felt that they may be taken into custody or subjected to physical abuse" (Can's WS, ¶¶ 6-7). Mr. Can

added that the office site was locked, that the entrance was guarded by an armed soldier, and that he and his staff were only allowed to enter the office by the soldier who had the key, and that they were prevented from removing or copying any files. Mr. Can left Pakistan shortly thereafter reaching Turkey on 25 April 2001 (Can's WS, ¶ 9). At the hearing, he declared that:

> "On the evening of the 23rd, once we received the Notice, we were obviously – we found ourselves obviously in a very tight corner. The people at the site and I sat down. We thought about what we could do. Meanwhile, while we were talking, we realised that there were uniformed and armed soldiers on site. When we saw the soldiers we said, 'Okay, this is very serious'. We felt we needed to secure our offices on site. We also felt we needed to secure ourselves. This was something we were not quite familiar with. We had been in Pakistan for four to five years until then, and until then we had our own security forces that maintained security. This is a security force composed of professionals. We saw soldiers, and obviously this caused further unrest. Everyone, including myself, was scared. I was obviously leading the Project so I had to calm my colleagues down. I tried to calm them down. My colleagues and I said that we need to take our personal belongings and important valuables from the offices. We went to our offices but we were unable to access the offices. The soldiers came to us and they said that we cannot take anything out of the offices."
> (Tr. M., 27 May 2008, 247-248, 3-25, 1).

326. This account sounds quite dramatic. The fear and unrest among Bayindir's personnel is easily understandable and cannot be taken lightly. Yet, upon a closer review of the specific facts, the situation loses much of its drama. In reality, there are no indications that Bayindir's staff were threatened or subjected to physical violence by conduct attributable to the Respondent. To the contrary, the Respondent took steps to maintain order on the site and to protect Bayindir's staff from potential harm by the unpaid local workers hired by Bayindir. In fact, the main threat against Bayindir's personnel emanated from unpaid local workers and was handled by means of a non-fighting unit of the Pakistani army, the two, usually deployed for such tasks.

327. At the hearing, counsel for the Respondent asked Mr. Can several times whether he could point to any specific security complaint by Bayindir's staff in Pakistan. Mr. Can's answer was that he did not know (Tr. M., 27 May 2008, 268, 7-25, 272-273, 24-25, 1-9). Mr. Bridger's testimony reports the absence of security concerns. He had "not heard mention of any violence or rough tactics being used by anyone from NHA or from FWO" in his discussions with local staff (Bridger's WS, ¶ 108). Mr. Bridger further testified that he held a meeting with the Employer and Bayindir after the expulsion notice was served, and advised them of the steps that had to be taken for the orderly

expulsion of Bayindir (Bridger's WS, ¶ 104). He then confirmed the main content of this meeting in a letter of 24 April 2001 (Exh. [Pak.] CM-127). As noted by the Respondent, the letter makes no mention of any complaints regarding harassment or coercion by armed forces. With respect to security, it merely states that Bayindir was responsible for the security of the site for a period of two weeks.

328. Mr. Bridger also recalled that after the issuance of the notice of expulsion

> "large gatherings of angry people unpaid by BCI took place at the Burhan Camp and at BCI's offices in Islamabad. These crowds wanted to be paid before BCI left Pakistan. I remember that on one occasion the BCI Project Manager was trapped in his office on site by a mob of people [...] I understand that he was extricated through the efforts of NHA without being harmed."
> (Bridger's WS, ¶ 106).

329. This view of the situation immediately after expulsion is confirmed by a letter of 26 April 2001 from Askari Guards (PVT) Ltd., the security firm which Bayindir had hired to secure the site. That letter states that "the contractors and employees who have not been paid their dues are likely to react violently" and that the situation may require "special assistance [...] from law enforcing agencies" (Exh. [Pak.] R-24). This view was reinforced by the oral testimony of General Javed, who declared that:

> "The Escri(?) [Askari] Guards were already there, and I have seen it somewhere on the record that the Escri [Askari] Guard had written a letter to Bayindir that, 'Unless you supplement our resources, get outside help, additional help, we cannot guarantee the safety of your people', but before such a letter, I was conscious that here are nearly 70 or 75 plus Turkish staff, and they would be in jeopardy if we didn't try to save their life and property. The reason was that the – there was a lot of restlessness amongst the low level employees and the low level-one-concerns-type people, and most of them happened to be from the turbulent tribal areas of Pakistan, the Burhans who usually get very angry, et cetera, and can resort to any level of violence when their wages for the last six months are not paid, so I thought it was my responsibility to make sure that the process of expulsion and other related post-expulsion and post-termination events take place in a most organized manner."
> (Tr. M., 29 May 2008, 142-143, 24-25, 1-18).

330. At the hearing, Mr. Sadik Can did not offer any alternative explanation (Tr. M., 27 May 2008, 263-265). Asked whether he was aware of the warning contained in the letter from Askari Guards, Mr. Can stated "No. I was not aware of it, and I did not infer from Article 3 that additional support would be needed. I read in paragraph 3 that difficulties may arise because of unpaid salaries" (Tr. M., 27 May 2008, 264, 5-8). Bayindir contends that NHA should have paid its subcontractors out of the certified amounts

payable to Bayindir instead of directing these subcontractors to Bayindir. However, the Claimant has not established that NHA actually sought to turn the subcontractors against Bayindir in order to coerce the latter, nor has it demonstrated that NHA was responsible for paying Bayindir's subcontractors.

331. The expulsion was effected on 7 May 2001, at a time when Mr. Can was no longer in Pakistan. Mr. Bridger was not on site either when the Employer took over. The operation was reportedly performed by FWO on behalf of the Employer. According to the testimonies of Mr. Bridger and General Javed, the FWO is the construction and engineering unit of Pakistan's army and was used to secure and protect the equipment and material left on the site (Bridger's WS, ¶ 107; Tr. M., 29 May 2008, 143, 20-25). General Javed testified that there were approximately twenty to twenty-five men of the FWO, in addition to the guards hired by Bayindir, and that the FWO were deployed "because they are familiar with the job, and they had a number of contracts from NHA also" (Tr. M., 29 May 2008, 143-144, 25-2). General Javed further explained that "when this happened, not one person was even scratched, not a pin was stolen, and there was absolute order when the expulsion process took place" (Tr. M., 29 May 2008, 144, 5-8).

332. Thereafter, in response to a letter from Mr. Bridger of 7 May 2001, Bayindir identified the personnel which would carry out the joint measurement of the remaining permanent works, temporary works, and preparation of inventories as required by the Contract (Exh. [Pak.] CM-136). On this occasion, Bayindir raised no complaints as to any mistreatment of personnel by NHA's security staff. The letter only stated that "Bayindir Security shall work in parallel with NHA's additional security arrangements until complete handing/taking over of the Project takes place" (Exh. [Pak.] CM-136). The same day, Mr. Bridger answered Bayindir's letter stressing that "[u]nder the Contract it is only appropriate to have Bayindir Security personnel on hand as observers" (Exh. [Pak.] CM-137).

333. The minutes of the first joint measurement and inventory meeting, held on 10 May 2001, at which three representatives of Bayindir were present, do not record any complaints about harassment or coercion either (Exh. [Pak.] CM-138). At a meeting held the following day, Bayindir expressed the concern that the FWO may have a

conflict of interest in the measurement and inventory process and stressed its preference for engaging some other independent organisation with the necessary expertise (Exh. [Pak.] CM-141). No complaints about mistreatment were raised in this context either. By letter of 15 May 2001, Mr. Bridger advised Bayindir that an independent organisation, Jaffer Brothers (Pvt.) Ltd., had been nominated to conduct the joint inventory (Exh. [Pak.] CM-142).

334. By contrast, Bayindir did raise complaints on 16 May 2001 with respect to the taking over by NHA of the sites, offices, workshops and stores at the Burhan and Bara Banda camps, noting that "[p]olice was mobilized at all end and entry points and thus all the camps and sites were sealed on the same day" (Exh. [Pak.] CM-143). On 21 May 2001, Bayindir also complained about a one day shutdown of electricity that had taken place at its residential block on 17 May 2001; it added that such actions were "contrary to the agreement to speed up the inventorization and other important activities" (Exh. [Pak.] CM-144). Mr. Bridger replied on 24 May 2001 that he did not condone such actions, but that NHA had "the legal right to take over any or all parts of the site that they wish" and that, upon raising the matter, he had been assured that the process would be completed in a "professional manner" (Exh. [Pak.] CM-145). Two days later, Mr. Bridger wrote that access to offices and stores had been restricted for one or two days at the beginning of the inventory period, and that the issue relating to the removal of some of Bayindir's records had been solved amicably (Exh. [Pak.] RB-105).

335. Regarding Bayindir's access to files more generally, Mr. Bridger testified that records were kept "under a dual lock system requiring attendance for access by both NHA and BCI" (Bridger's supplemental WS, ¶ 122) and that, although there were tensions between the parties, he was generally able to achieve cooperation. He did not recall "ever being made aware of any occasion where BCI had been unable to resolve problems of access to any records at the Project Site Offices, when such access was necessary for the supply of information to NHA" (Bridger's supplemental WS, ¶ 123).

336. On the basis of the foregoing considerations, the Tribunal concludes that the evidence does not support Bayindir's allegation of coercion. There is no evidence showing that Bayindir was harassed or coerced by conduct of NHA or of its subcontractors attributable to the Respondent. Nor is there any evidence showing that NHA or the

Respondent failed to act when it appeared necessary to prevent harm to Bayindir's personnel. Quite to the contrary, the few instances in which Bayindir raised complaints about the treatment of its personnel appear to have been swiftly addressed and would in any event not be capable as such of sustaining a breach of the FET standard.

337. Finally, the Tribunal is also unpersuaded by the Claimant's allegation that the recourse to arbitration under the Contract constitutes an exercise of coercion or undue pressure. Bayindir has not provided any explanation, nor any authority to this effect. It appears obvious to the Tribunal that, as a rule, a party's initiation of arbitration as provided in a contract cannot constitute a treaty breach.

(iv) Was Bayindir deprived of due process and/or procedural fairness?

1. Bayindir's position

338. It is Bayindir's claim that it was denied its right to be heard and was treated in a non transparent manner because all the decisions affecting its investment were taken at the highest level without it being heard (Mem. M., ¶ 190; Reply M., ¶ 297). Bayindir relies on *Metalclad v. Mexico*,[89] *Middle East Cement v. Egypt*,[90] *Tecmed v. Mexico,*[91] and *Waste Management v. Mexico*.[92] In Bayindir's submission, these awards hold that the absence of a fair procedure or the existence of serious procedural shortcomings may constitute violations of fair and equitable treatment.

339. In Bayindir's submission, delays and disputes are common in large construction projects. Thus, Pakistan should have worked in good faith towards a resolution as required by the FET standard and held in *Saluka v. Czech Republic*.[93] Instead, Pakistan "exercised a destructive option to which it was not even contractually entitled – expulsion" (PHB [Bay.] ¶ 65).

---

[89] *Metalclad v. Mexico, supra* footnote 64.

[90] *Middle East Cement Shipping and Handling Co. S.A. v. Arab Republic of Egypt* (ICSID Case No. ARB/99/6) (hereafter*, Middle East Cement v. Egypt*), Award of 12 April 2002.

[91] *Tecmed v. Mexico*, *supra* footnote 52.

[92] *Waste Management v. Mexico, supra* footnote 65.

[93] *Saluka v. Czech Republic, supra* footnote 54.

340. In any case, Bayindir emphasizes that the dispute resolution provisions of the Contract are irrelevant, as the present claims are brought under the Treaty and are therefore distinct from contract claims.

2. Pakistan's position

341. For Pakistan, Bayindir's contentions assume some form of administrative or analogous proceedings where due process requirements apply. However, this case does not involve any such proceedings. Rather, Bayindir failed to perform under the Contract, which resulted in discussions at various levels as to the consequences of that breach (C.-Mem. M., ¶ 4.45).

342. Moreover, Bayindir had the opportunity and did in fact meet and make representations to high level governmental officials at the main junctures when the Project was in crisis. Such representations were taken into account in NHA's final decision to expel Bayindir (C.-Mem. M., ¶¶ 4.47 – 4.48).

3. Tribunal's determination

343. The Tribunal must determine whether the due process requirements that could be derived from the applicable FET standard cover situations such as the present one, in which procedural fairness was allegedly denied because the Claimant was not part of the internal decision-making of the administration concerning the management of the Contract. If so, the Tribunal must then assess whether the Claimant was in fact denied procedural fairness.

344. The Tribunal agrees with the arbitral decisions holding that a denial of due process or procedural fairness may amount to a breach of the FET standard.[94] This does not

---

[94] *See*, for instance*, S.D. Myers, Inc. v. Government of Canada*, NAFTA Arbitration (UNCITRAL Rules), Partial Award of 13 November 2000 (hereafter, *S.D. Myers v. Canada*); *Mondev v. United States, supra* footnote60; *ADF v. United States, supra* footnote 61, *Loewen Group v. United States*, *supra* footnote 76, *Middle East Cement v. Egypt, supra* footnote 90.

mean, however, that such guarantees are available in any given situation. As noted in *Waste Management*, to which the Claimant refers, whilst the fair and equitable treatment standard may be infringed by conduct amounting to "a complete lack of transparency and candour in an administrative process," such standard largely depends upon and must be adapted to the circumstances of each specific case.[95] The decisions which address this issue, generally do so in the context of judicial or administrative proceedings. Such was, for instance, the case in *Metalclad* and *Tecmed*. As for *Middle East Cement*, the procedural fairness requirement was applied to seizure and auction procedures, which can also be deemed administrative in nature.

345. The nature of the present issue is different. It deals with the internal decisions of NHA and the government regarding the management of the Contract. Public administrations are regularly involved in managing different types of contracts and act, in this regard, in a manner which is not fundamentally different from that in which a private corporation handles its contractual relationships. Such internal processes may include decisions required to perform contractual obligations, such as planning and releasing budgetary allocations or carrying out performance reviews. The Tribunal is aware that, in certain respects, public and private contracting are not subject to the same requirements. A typical example is the tendering processes related to public procurement contracts.

346. This said, the Tribunal considers that, under the present circumstances, the decision of NHA, in consultation with the government, to resort to certain contractual remedies and the related preparatory discussions and assessments were not as such subject to procedural requirements other than those contractually agreed. In this connection, the Tribunal has concluded, in paragraphs 240-258 and 281-314 *supra*, that the main contractual mechanisms which eventually led to the expulsion of Bayindir (particularly the issuance of notices under sub-clauses 46.1 and 63.1(b)(ii)) had not been used in a manner that amounts to a breach of the Treaty. In particular, there is no evidence that the Engineer or the Engineer's Representative were biased and deprived Bayindir of procedural safeguards.

347. More importantly, even assuming for the sake of the analysis that due process and procedural fairness govern the internal processes underlying the exercise of

contractual rights, the record shows that Bayindir was indeed given the opportunity to present its position on numerous occasions throughout the relevant period. In this regard, the Respondent has pointed to the following instances: representations to a committee formed by the Ministry of Communications (14/12/99) (Exh. [Pak.] CM-174); representations to a meeting chaired by the Secretary of Communications (19/01/00) (Exh. [Pak.] CM-175); discussions among Bayindir's President and the Chairman of NHA, the Secretary General of Finance, the Secretary of Communications, and the Engineer (09/02/00) (Exh. [Pak.] CM-176); letter from Bayindir's Chairman to President Musharraf acknowledging that several meetings had taken place between Bayindir and NHA, the Ministry of Communications, and the Ministry of Finance (26/02/00) (Exh. [Pak.] CM-177); shortly thereafter invitation of the Turkish Ambassador to Pakistan by the Chairman of NHA to participate in a meeting between the parties, which later led to the signature of Addendum No. 9 (Exh. [Pak.] CM-178); meeting between the Turkish Ambassador and the Chairman of NHA (19//12/00) (Exh. [Pak.] CM-182, CM-183); letter from the Minister of Communications to the Turkish Ambassador to inform him of Bayindir's defective performance (20/02/01) (Exh. [Pak.] CM-179); letters from the President of Bayindir to the Turkish Ambassador referring to a previous meeting with the Chairman of NHA and Minister of Communications and requesting him to arrange another meeting (26/02/01) (Exh. [Pak.] CM-180), which was done (Exh. [Pak.] CM-181, CM-182); meeting attended by representatives of the Ministries of Communications, of Finance, and Foreign affairs, as well as by a Senior Diplomat from the Turkish Embassy, the parties and the Engineer (19/03/01) (Exh. [Pak.] CM-97).

348. In summary, the Tribunal concludes that Bayindir was not denied due process or procedural fairness primarily because these requirements did not apply in the present context. Secondarily, assuming – *quod non* – that they applied, the record shows that Bayindir was in fact afforded a number of opportunities to present its position during the relevant time period.

e. Conduct following the expulsion

1. Bayindir's position

349. Bayindir alleges that after the expulsion Pakistan failed to proceed to the evaluation of the works completed pursuant to sub-clause 63.2 of the Contract or to certify IPAs 22

and 23. In Bayindir's submission, Pakistan slashed IPAs 22 and 23 to a fraction of their original value and failed to pay IPCs 20 and 21, which had been certified by the Engineer and were due and payable to the Claimant in March 2001, namely before its expulsion. Moreover, the Respondent refused to certify an extension of time granted by the Engineer (EOT 04) and claimed some US$ 1 billion in the Pakistani arbitration.

2. Pakistan's position

350. It is Pakistan's argument that Bayindir retains residual rights under clause 63 of the Contract (Tr. M., 4 June 2008, 128, 6-10). In particular, NHA did not pay IPCs 20 and 21 because these IPCs were not payable under the Contract until the final accounting at the end of the Project's Defects Liability Period (PHB [Pak.] ¶ 3.2). NHA's participation in the measuring up exercise following Bayindir's expulsion evidences its intention to comply with the final accounting provision. In any case, Bayindir has not established that NHA did not intend to apply sub-clause 63.3 at the end of the Defects Liability Period (Rej. M., ¶ 3.128).

3. Tribunal's determination

351. It was not until its post-hearing submission that the Claimant clearly identified that the "conduct following the expulsion" allegedly in breach of the FET standard consisted of "unfair and inequitable" actions in connection with the handling of IPA 23 (PHB [Bay.] ¶ 86), the lack of certification and payment of IPA 22 (PHB [Bay.] ¶ 87), and "Pakistan's self-serving and litigation-motivated reductions to the values of both IPA 22 and IPA 23" (PHB [Bay.] ¶ 88). These acts are said to be unfair and inequitable because they do not comply with the Contract and, more fundamentally, because they reflect the intention of the Respondent not to abide by clause 63 and therefore deprive Bayindir of any remaining contractual rights.

352. It is recalled that the task of the Tribunal is not to exercise jurisdiction over contractual matters but to assess whether the alleged conduct is established and, if so, whether it amounts to a breach of the Treaty.

353. It is undisputed that NHA did not pay IPCs 20 and 21. It also arises from the record that IPAs 22 and 23 have not been certified, that they have been reduced over time, and that NHA has not approved the extension of time calculated by the Engineer in response to EOT 04 (Exh. [Pak.] RB-84). The Claimant has further stressed that the Engineer and its Representative did not certify the works as required under sub-clause 63.2 of the Contract within the context of the final settlement of accounts contemplated under sub-clause 63.3 of the Contract. In his oral testimony, Mr. Bridger stated that he did not recall whether he or the Engineer had issued such certification (Tr. M., 29 May 2008, 237, 7-14).

354. The Parties provide conflicting interpretations of whether or not such conduct was in breach of the Contract. The Respondent notes, inter alia, that:

> "once it was established that there was no immediate right to payment due to the issuance of the expulsion notice, the urgency of preparing the IPCs was removed, i.e. the question of what sums were owing to Bayindir was postponed until the time of the final measure up pursuant to Clause 63.3 of the Contract."
> (PHB [Pak.] ¶ 7.25)

355. The Claimant argues that a number of steps had to be followed for the process of final settlement of accounts to be completed, and that NHA and the Engineer or the Engineer's Representative failed to take some of these steps, which amounted to a breach of the Contract. It seeks to infer from these facts the existence of an intent to deprive it in an unfair and inequitable manner of any residual rights it may have under sub-clause 63.3 of the Contract.

356. In light of the evidence, the Tribunal is not convinced by Bayindir's allegation for several reasons. First, the Respondent's expert Mr. Chapman has provided a reasonable contractual explanation of NHA's acts in respect of the treatment of IPCs 20 and 21:

> "Sub-Clause 63.3 provides that upon expulsion the Employer's obligation to pay monies to the Contractor is suspended until the expiration of the Defects Liability Period at the earliest. This means that all payments to the Contractor are instantly frozen. No further certification need be undertaken by the Engineer in respect of Interim Payment Applications (whether submitted before of (sic) after the expulsion) and any certificates issued to the Employer by the Engineer in respect of payments due to the Contractor are not to be paid."
> (Chapman's WS, ¶ 42)

The Claimant's expert Mr. Pickavance offered no specific alternative interpretation of the Contract to counter this.

357. Second, the evidence discussed in paragraphs 332-335 *supra* shows that NHA did in fact engage in a measurement and inventory process as required by sub-clause 63.2 of the Contract. In that context, it took account of Bayindir's concerns about FWO's bias (Exh. [Pak.] CM-141) with the result that an independent organization was put in charge of the joint inventory (Exh. [Pak.] CM-142). That organization reportedly completed its task on 13 May 2003 (Exh. [Pak.] R-68).

358. Third, Mr. Bridger has testified that, despite some tensions, a good level of cooperation was generally achieved, and that he did not recall "ever being made aware of any occasion where BCI had been unable to resolve problems of access to any records at the Project Site Offices, when such access was necessary for the supply of information to NHA" (Bridger's supplemental WS, ¶ 123).

359. In these circumstances, the Tribunal cannot conclude that the acts identified by Bayindir amount to a breach of the Treaty.

f. Attempted encashment of the Mobilisation Advance Guarantees

1. Bayindir's position

360. Bayindir submits that Pakistan inequitably and unfairly ruined the Bayindir Group by calling the Mobilisation Advance Guarantees without a contractual basis, the contractual justifications put forward by Pakistan (analogy with sub-clause 60.8 of the Contract as well as paragraph 3 of sub-clause 60.8 in Addendum No. 6) being ill-founded. Indeed, according to Bayindir, sub-clause 60.8 had been contractually superseded twice.[96]

---

96 In June 1999, this mechanism was replaced with a rollover system if the amount of a given month's Mobilisation Advance deduction exceeded the amount due to Bayindir under a particular IPC, the difference due to Pakistan would be carried forward and deducted from the next IPC. Second, in Addendum No. 9, the fixed Mobilisation Advance repayment schedule was replaced by a percentage deduction from each IPC, as a result of which the Mobilisation Advance deduction would always be a percentage of Bayindir's IPC payment, and could never exceed the IPC payment due to Bayindir.

361. Bayindir also stresses that the Respondent's alleged contractual justifications are new, as the argument that the Mobilisation Advance was only allowed to be used for the purchase of permanently imported equipment, implying that Pakistan was entitled to recover any amounts spent on mobilization with temporarily imported equipment, was advanced for the first time at the hearing. Furthermore, this argument was said not to take into account that sub-clause 60.8 in Addendum No. 6 provides that there would be no bank guarantee for the 20% Mobilisation Advance which was to be utilized for the purchase of plant and equipment. In addition, the link between plant and equipment and the Mobilisation Advance was later superseded. The Over-Riding Conditions of Contract provided that the Mobilisation Advance – increased to 30% – would be secured by letters of guarantee from a bank and from Bayindir. This provision was then further modified by NHA's Letter of Acceptance, which confirmed that the Mobilisation Advance would amount to 30%, the full amount being secured by a bank guarantee (PHB [Bay.] ¶¶ 95-106).

362. It is Bayindir's further submission that the attempt to encash the guarantees not only lacked a contractual basis but was also unfair, if not even in bad faith. In support, Bayindir refers to NHA's request of 7 April 2001 that Bayindir renew the Mobilisation Advance Guarantees expiring on 9 May 2001. This request came shortly before Bayindir's expulsion and only days after the Ministries of Communications and Finance had decided, unbeknownst to Bayindir, to halt all payments for the Project and to request a decision on the future of the Project from General Musharraf.

363. In addition, Bayindir asserts that the encashment would unjustly enrich Pakistan to the extent that Bayindir left behind the product of the Mobilisation Advance on the site, and brought about the complete collapse of the Bayindir Group given the circumstances surrounding the attempted encashment, the magnitude of the bank guarantees and the fact that these were provided by a consortium consisting of all of the major Turkish banks, thus cutting off Bayindir's access to credit and financing.

364. Finally, Bayindir notes that Pakistan sought to encash the guarantees at their full face value, without first deducting the value of repayments due under IPCs 20 and 21.

2. Pakistan's position

365. In substance, Pakistan asserts that the call on the Mobilisation Advance Guarantees was made in accordance with the Contract. The position of the Respondent is supported by the expert testimony of Mr. Chapman (Chapman's WS, ¶ 50; Chapman's Supplemental WS, ¶¶ 60-64). According to the latter's evidence, the call complied with sub-clause 60.8 and any benefits accruing to the Employer from it would be taken into account in the final accounts. As a result, any allegation of bad faith would be doomed to fail.

366. The Respondent also contends that Bayindir did not spend the Mobilisation Advance as contractually required. It refers to Bayindir's financial difficulties and argues that a substantial part of the Mobilisation Advance Guarantee (US$ 35 million) was likely used for purposes unrelated to the M-1 Project, as suggested by the testimony of Mr. Körtük, Chairman of Bayindir Holding Company, before a Turkish Parliamentary Committee set up to investigate the sale of Turkbank (PHB [Pak.] ¶¶ 3.107 – 3.121).

3. Tribunal's determination

367. It is common ground that NHA sought to encash the Mobilisation Advance Guarantees. As discussed in section IV(A)(b) supra, this conduct can be attributed to the Respondent, which the latter did not dispute. The Tribunal must thus determine whether the attempted encashment of the Mobilisation Advance Guarantees constitutes a breach of FET.

368. The Parties disagree on whether the attempted encashment of the Mobilisation Advance Guarantees was in conformity with the Contract. The main point of disagreement is whether sub-clause 60.8 of the Contract provides a basis for the encashment.

369. Sub-clause 60.8 entitles the Employer to call the guarantees to the extent the amount due by Bayindir as reimbursement of the Mobilisation Advance exceeds the amount due to Bayindir for work done. The mechanism for the recovery of advance payments was amended twice. First, on 24 June 1999 (Exh. [Bay.] C-16) to the effect that "[t]he recovery/deduction of the advance payment shall be made from every IPC irrespective of its value beginning from the IPC of May 1999 onward. In the event that the value of any monthly deduction/recovery exceeds the amount of any particular IPC, the

difference in amount will be carried forward and adjusted from the next IPC and so on" (Exh. [Bay.] C-16). Second, in Article 3 of Addendum No. 9, which replaced the fixed repayment schedule with a percentage deduction from each IPC (Exh. [Bay.] C-18).

370. Bayindir submits that, as a result of these two amendments, the content of sub-clause 60.8 became inoperative and that the repayment of the Mobilisation Advance should in any event have been frozen until final settlement (PHB [Bay.] ¶ 102). Pakistan responds by reference to the first expert report of Mr. Chapman according to whom:

> "In the situation where a contractor is expelled before the advance payments have been recovered in full (and thus the APG is extant) I would expect the Employer to make a call on the bond in order to recover as much of the advance payment as possible. Clause 60.8 of the Contract provides that the Contractor is obliged to repay amounts of mobilisation payments in excess of monies certified within seven days of demand and if not paid the Employer shall be empowered to call in sufficient of the APG to cover this balance. The APG is security for a loan and once the Contractor is expelled, no further payments from which the loan repayments are to be deducted will be made. Accordingly, I believe the right under Clause 60.8 to demand recovery of the loan crystallises once expulsion occurs."
> (Chapman's WS, ¶ 50)

371. In his additional report, Mr. Chapman added the following:

> "The Mobilisation Bond is 'on demand' and its execution is not dependent upon proof of fault by the Contractor nor is the operation of this bond deferred until the time of the Final Statement. The provision of on demand bonds is an onerous obligation placed on a contractor but one that has been found necessary within the construction industry to avoid the bondsman (or an arbitrator or the court) being required to determine liability for breach of performance by the Contractor which, with a resistant contractor, could take a considerable time. However, it is accepted that the Employer is not to use its right to demand payment without due cause and an implied term to this effect is recognised. That said, as long as the Employer has a genuine belief that the advance payment is not to be repaid in accordance with the terms of the Contract and that the Contractor is unable to complete its obligations under the Contract, I consider that a call on the Mobilisation Bond is justified."
> (Chapman's Supplemental WS, ¶ 63)

The Claimant's expert Mr. Pickavance offered no specific alternative interpretation of the Contract to counter this.

372. The Respondent further argues that Bayindir improperly spent the Mobilisation Advance on temporarily imported equipment as well as on matters unrelated to the M-1 Project. In this latter regard, it referred to a statement of Mr. Cörtük, Chairman of Bayindir Holding Company, before a Turkish Parliamentary Committee set up to

investigate the sale of Turkbank. In response to a question regarding the source of the funds used by Bayindir to acquire a TV station, Genc TV station, Mr. Cörtük stated:

> "We are a group (of Companies) having a monthly turnover of 70-80 million dollars. Namely if we obtain the loans or resources from other places, for instance in those days – if I remember this correctly exactly-we, in fact, obtained the money amounted to 30-40,000,000 dollars from Pakistan." (Annex 24 to WS of Dr. Birsel, submitted with Resp RP).

373. Under these circumstances, the Tribunal can see no Treaty breach. The Parties have divergent views about the interpretation and application of subclause 60.8 of the Contract. Pakistan puts forward an interpretation that is reasonable and is supported by expert evidence. Even if such interpretation were not to prevail in a contract arbitration, the related conduct would not rise to the level of a violation of the Treaty standards.

374. This said, relying on the sequence of events, the Claimant alleges bad faith on the part of Pakistan. If this allegation were founded, it would be capable of changing the conclusion just reached. Specifically, Bayindir claims that the request for the renewal of the Mobilisation Advance Guarantees, which were to expire on 9 April 2001, was made on 7 April 2001, that is:

> "shortly before Bayindir's expulsion, and only days after the Ministries of Communications and Finance had decided, unbeknownst to Bayindir, to halt all funds for the Project and request General Musharraf's decision on the future of the Project."
> (PHB [Bay.] ¶ 97)

The Claimant further observes that "a mere three weeks" after Bayindir renewed the guarantees in full, Pakistan sought to encash them.

375. The Claimant seeks to infer bad faith from its reading of the chronology. There is, however, no evidence showing bad faith. Even if it were established that Pakistan requested the renewal for the sole purpose of calling the guarantees shortly thereafter, this fact would not suffice in and of itself to demonstrate bad faith. Indeed, as a general matter, it would rather appear as good contract management to renew guarantees when they are about to expire and the liabilities secured by such guarantees are still likely to materialize. This was precisely so here. The Respondent contends that it tried to collect on the Mobilisation Advance Guarantees in order to recover as much of the advance payment as possible, Bayindir having failed to mobilize the contractually

required equipment on site. The discussion of the evidence in paragraphs 308-314 *supra*, shows that, even after the issuance of the sub-clause 46.1 notice in December 2000, Bayindir did not bring the adequate equipment to the site. This point was in particular stressed by Mr. Bridger at the hearing.

> "Q: So a reasonable Contractor (sic) [client] would be happy to see that efforts were being made to bring it behind schedule, and to bring it on schedule?
> A: Substantial efforts, and real efforts. Not just bringing in equipment that didn't have the capacity to achieve the production levels, you know, we saw a lot of increases in equipment after that Notice was served, but the productivity fell, despite the increase in numbers of items of equipment."
> (Tr. M., 29th May 2008, 192-193, 24-25, 1-8).

376. On these facts, Bayindir has not met its burden of proving bad faith. This is the more so as the standard of proof is a demanding one for this purpose.

377. For the sake of completeness, the Tribunal adds that a breach of FET requires conduct in the exercise of sovereign powers. This requirement is not met in the present situation in which the attempt to call on the guarantees appears as the act of an ordinary contract partner which was carried out on foreign territory, i.e. in Turkey, in accordance with Turkish legal procedures.

378. Finally, the arguments about the impact of the attempted encashment on the viability of the Bayindir Group and Pakistan's unjust enrichment do not change the earlier conclusions. First, the monies have not been cashed and thus the proposition of an enrichment is difficult to follow. Second, any adverse consequences of the attempted encashment on Bayindir's standing and viability, however unfortunate, are part of the business risk that any contractor assumes when entering into a contract for a major project with substantial financial exposure. This would only be different if the host state had breached a treaty protection, which is not the case here.

379. In view of the foregoing considerations, the Tribunal concludes that the applicable FET standard has not been breached.

g. Respondent's acts taken together

380. It remains for the Tribunal to review whether the Respondent's acts taken together constitute a breach of the FET standard. It is true that Bayindir does not specifically

claim that a breach of treaty could arise from the overall effect of all of Pakistan's actions. Yet, the Tribunal deems it appropriate to examine this issue as well.

381. On the basis of the evidence discussed in the preceding sections, the Tribunal has denied the existence of treaty breaches with respect to each of the Respondent's acts taken separately. Assuming for the sake of this analysis that a cumulation of non-breaches can in theory result in a breach, this is certainly not the position here. Even added up, the conduct of the Respondent does not amount to a Treaty breach. It might give rise to contract liability, but that is a different issue on which this Tribunal makes no assessment.

C. NATIONAL TREATMENT AND MFN STANDARDS

382. Bayindir claims a violation of the national treatment and most favoured nation (MFN) standards embodied in Article II(2) of the Treaty. It incriminates specific acts. The Tribunal will thus organize its discussion by reference to each of those acts first with respect to national treatment (b) and then to MFN (c). Before doing so, it will identify the applicable standards (a). At the end, it will consider whether all the acts of the Respondent taken together could amount to Treaty breaches (d).

a. Applicable standards

1. Bayindir's position

383. The Claimant invokes Article II(2) of the Treaty as the basis for its claim. It refers to *SD Myers*,[97] *Feldman v. Mexico*,[98] *Occidental v. Ecuador*[99] and *Lauder v. Czech Republic*[100] to support the argument that the test of discrimination is an objective one, which focuses on a measure's practical effect rather than on the Respondent's intent to discriminate. It also relies on these authorities to assert that there is no requirement that the differential treatment be motivated by foreign nationality and that the sole facts of discrimination and foreign nationality are sufficient (Mem. M., ¶ 206).

---

97 *S.D. Myers v. Canada*, *supra* footnote 94, ¶¶ 238-257.

98 *Marvin Roy Feldman Karpa v. United Mexican States* (ICSID Case No. ARB(AF)/99/1) (hereafter, *Feldman v. Mexico*), Award of 16 December 2002, ¶¶ 154-188.

99 *Occidental v. Ecuador*, *supra* footnote 80.

100 *Lauder v. Czech Republic*, *supra* footnote 65.

384. As to the facts relevant to a finding of discrimination, the Claimant recalls the Tribunal's Decision on Jurisdiction:

> "The fact remains that, taken together, Bayindir's allegations in respect of the selective tender, and that the expulsion was due to Pakistan's decision to favour a local contractor, and that the local contractor was awarded longer completion time-limits, if proven, are clearly capable of founding a MFN claim."[101]

2. Pakistan's position

385. Pakistan submits that Bayindir's claim under Article II(2) requires a showing of intent, since Bayindir alleges that its expulsion from the Project was designed to benefit a pre-determined group of local contractors, which "design" necessarily comprises intent. In Pakistan's view, Bayindir's reliance on the decision in *SD Myers* is therefore irrelevant, as that case "merely suggests that protectionist intent on its own (i.e. without a practical effect) is insufficient for a finding of breach of Article 1102 NAFTA" (C.-Mem. M., ¶ 4.58).

3. Tribunal's determination

386. It is common ground that Bayindir's claim must be assessed under Article II(2) of the Treaty, which reads as follows:

> "Each Party shall accord to these investments, once established, treatment no less favourable than that accorded in similar situations to investments of its investors or to investments of investors of any third country, whichever is the most favourable."

387. Article II(2) thus covers both national treatment and MFN obligations. Its purpose is to provide a level playing field between foreign and local investors as well as between foreign investors from different countries.[102]

388. As noted in the Decision on Jurisdiction, the Tribunal considers that the scope of the national treatment and MFN clauses in Article II(2) is not limited to regulatory treatment.[103] It may also apply to the manner in which a State concludes an investment contract and/or exercises its rights thereunder. Indeed, the Tribunal stressed that:

---

101 Decision on Jurisdiction, ¶ 223.

102 Noah Rubins & N. Stephan Kinsella, *International Investment, Political Risk and Dispute Resolution – A Practitioner's Guide* (2005), pp. 225-226.

103 *See* Decision on Jurisdiction, ¶¶ 205-206, 213.

> "[t]he mere fact that Bayindir had always been subject to exactly the same legal and regulatory framework as everybody else in Pakistan does not necessarily mean that it was actually treated in the same way as local (or third countries) investors."[104]

389. To decide whether Pakistan has breached Article II(2), the Tribunal must first assess whether Bayindir was in a "similar situation" to that of other investors. The inquiry into the similar situation is fact specific.[105] In line with *Occidental v. Ecuador*,[106] *Methanex*,[107] and *Thunderbird*,[108] the Tribunal considers that the national treatment clause in Article II(2) must be interpreted in an autonomous manner independently from trade law considerations.

390. If the requirement of a similar situation is met, the Tribunal must further inquire whether Bayindir was granted less favourable treatment than other investors. This raises the question whether the test is subjective or objective, i.e. whether an intent to discriminate is required or whether a showing of discrimination of an investor who happens to be a foreigner is sufficient. The Tribunal considers that the second solution is the correct one. This arises from the wording of Article II(2) quoted above. It is also in line with the rationale of the protection as was emphasized in *Feldman v. Mexico,*[109] to which the Claimant referred:

> "It is clear that the concept of national treatment as embodied in NAFTA and similar agreements is designed to prevent discrimination on the basis of nationality, or "by reason of nationality." […] However, it is not self-evident […] that any departure from national treatment must be *explicitly* shown to be a result of the investor's nationality. There is no such language in Article 1102. Rather, Article 1102 by its terms suggests that it is sufficient to show less favorable treatment for the foreign investor than for domestic investors in like circumstances.
>
> […]

---

[104] *Id.*, ¶ 206.

[105] *Pope & Talbot v. Canada*, *supra* footnote 87, ¶ 75; *see* also *S.D. Myers v. Canada*, *supra* footnote 94, ¶ 244.

[106] *Occidental v. Ecuador, supra* footnote 80, ¶¶ 174-176.

[107] *Methanex Corporation v. United States of America*, NAFTA Arbitration (UNCITRAL Rules), Award of 3 August 2005, ¶¶ 35, 37.

[108] *Thunderbird v. Mexico*, supra footnote 59, ¶¶ 176-178.

[109] *Feldman v. Mexico*, *supra* footnote 98, ¶¶ 181 and 183. *See* also *Pope & Talbot v. Canada,* footnote 87*,* in which the tribunal presumed that discriminatory treatment of foreign investors in like circumstances would be in violation of Article 1102, "unless they have a reasonable nexus to rational government policies that (1) do not distinguish, on their face or *de facto*, between foreign-owned and domestic companies, and (2) do not otherwise unduly undermine the investment liberalizing objectives of NAFTA" (¶ 78).

> [R]equiring a foreign investor to prove that discrimination is based on his nationality could be an insurmountable burden to the Claimant, as that information may only be available to the government. […]. If Article 1102 violations are limited to those where there is explicit (presumably de jure) discrimination against foreigners, e.g., through a law that treats foreign investors and domestic investors differently, it would greatly limit the effectiveness of the national treatment concept in protecting foreign investors."

b. National treatment

391. It is Bayindir's contention that it was expelled for reasons of cost and local favouritism, as evidenced by the selective tender that followed its expulsion. The Claimant also asserts that PMC-JV, the local contractors retained, were treated more favourably, in particular with respect to the construction schedule.

392. In paragraphs 297-300 *supra*, the Tribunal has already discussed Bayindir's allegation that the expulsion was due to Pakistan's intent to favour local contractors. In the present section, the Tribunal will review whether Bayindir was indeed accorded treatment less favourable than the local contractors in breach of the national treatment standard.

1. Bayindir's position

393. In Bayindir's submission, "the PMC-JV Contract forms a near perfect comparator against which to judge Pakistan's treatment of Bayindir" (Tr. M., 26 May 2008, 125, 15-17). Bayindir further asserts that it is objectively established that the Respondent accorded more favourable time schedules to PMC-JV and reacted more leniently to PMC-JV's unsatisfactory performance. Specifically, Bayindir alleges that

> "PMC-JV was granted much more time to do the remaining work on the M-1 than Bayindir had been granted for the entire motorway, and when PMC-JV fell far behind even in this generous schedule, PMC-JV was allowed to continue on the Project. This is in stark contrast to the treatment Bayindir received, and in stark contradiction to Pakistan's claims that Bayindir had to be expelled out of concern for the timely completely [sic] of the M-1 Project." (Tr. M., 26 May 2008, 125-126)

394. In support of its allegation of less favourable treatment, the Claimant refers to the following facts: PMC-JV was granted 1460 days to complete the remainder of the M-1 Project, whereas Bayindir had been granted only 730 days in 1993 and 1095 days in 1997 to complete the entire motorway; in March 2001, Bayindir had been granted only

27 additional days to complete the two Priority Sections, whereas PMC-JV was granted 18 months to complete the remaining portion of the two Priority Sections, now for six lanes; PMC-JV was permitted seven reviews of its work schedule, yet failed to achieve the construction targets it proposed, whereas, as of the date of its expulsion from the Project, Bayindir had completed 90% of the work on the two Priority Sections on the areas which were free from obstructions; PMC-JV was not expelled for far more significant delays than Bayindir ever experienced, even though PMC-JV's performance was worryingly behind schedule, its progress very slow, and several sub-clause 46.1 notices had been issued. Bayindir adds that differences in performance between itself and PMC-JV must be appraised taking into account that Bayindir had to prepare the site, while PMC-JV started work on a site already prepared and developed by Bayindir.

395. In its post-hearing brief, Bayindir further referred to a series of acts such as the alleged expropriation of Bayindir's contractual rights and the attempted encashment of the Mobilisation Advance Guarantees (see paragraphs 349 and 360-364 *supra*) as discriminatory and in breach of the Treaty. However, Bayindir did not specify the manner in which these series of acts breached the national treatment/MFN clauses.

2. Pakistan's position

396. Pakistan maintains that the expulsion was lawful and later developments therefore irrelevant. It also denies that Bayindir's residual investment was in a "similar situation" to the investment of the local contractors (C.-Mem. M., ¶ 4.51). It adds that there is no room for a discrimination claim such as the one raised by Bayindir in a purely contractual context (Tr. M., 26 May 2008, 293-294).

397. To demonstrate that the investments were not in "similar situations," Pakistan points to differences in the financial terms;[110] the level of experience and expertise;[111] the scope of work;[112] and in the commitment of the two entities to progressing with the works after

---

[110] In particular, Pakistan notes that PMC-JV received no mobilisation advance and did not benefit, as Bayindir, from having a foreign exchange component of its payments being settled by NHA in rupees at highly favourable exchange rates.

[111] Unlike Bayindir, PMC-JV was a consortium of diverse local Pakistani contractors with no equivalent experience on projects of the magnitude of M-1.

[112] In July 2003, shortly after the contract with PMC-JV had been signed, the scope of works was converted back to a six-lane motorway, and works also involved repair and rectification of works performed by Bayindir.

being issued sub-clause 46.1 notices.[113] Pakistan further notes that the position of NHA had changed as a result of Bayindir's expulsion, because NHA could neither avail itself of the large Mobilisation Advance given to Bayindir nor collect on the guarantees, and had to pay over Rs. 1 billion in order to alleviate the problem of Bayindir's sub-contractors. Under such different circumstances, Pakistan argues that NHA was fully justified in establishing new completion dates and, more generally, that it was justified in treating the two situations differently (PHB [Pak.] ¶¶ 5.53-5.99).

398. Pakistan finally insists that it was normal practice that the works be completed by a group of Bayindir's sub-contractors:

> "[t]heir bid was lower, they were already on site, and it is what Bayindir wanted. These kinds of facts differentiate the present case from past cases of discrimination. It was also in Bayindir's interest under Clause 63.3 of the Contract that the cheapest option for a new contractor be chosen."
> (PHB [Pak.] ¶ 5.2).

3. Tribunal's determination

399. The Tribunal will first determine whether Bayindir's investment was in a "similar situation." If so, it will then assess whether Bayindir's investment was accorded less favourable treatment than PMC-JV and whether the difference in treatment was justified.

400. In respect of the first requirement, the Tribunal must start by determining whether there is a relevant comparator to be used for the assessment of NHA's treatment of Bayindir and PMC-JV. In its Decision on Jurisdiction, the Tribunal did not rule out that the contracts with PMC-JV and Bayindir may be similar, as they both related to the same project.[114] The Tribunal must now go further and look at the terms and circumstances of the contractual relationships between, on the one hand, NHA and Bayindir, and, on the other hand, NHA and PMC-JV.

401. The Respondent has argued that, after its expulsion, Bayindir retained only residual rights under sub-clause 63.3 of the Contract and, therefore, Bayindir's contractual situation was not comparable to that of the local contractors who took over the Project.

---

[113] In particular, Pakistan notes that, unlike Bayindir, PMC-JV had no prior history of shutting down the works when it was faced with sub-clause 46.1 notices.

[114] Decision on Jurisdiction, ¶ 216.

The Tribunal is unpersuaded by this argument, which seems to assume that two situations can only be "similar" if they are contemporaneous.

402. Turning to the terms and circumstances of the two contractual relationships, Pakistan raises a number of differences especially in the financial terms; the constitution of the two entities; their level of experience and expertise; the scope of work; and the commitment of the two entities to progressing with the works after receiving a sub-clause 46.1 notice. In contrast, Bayindir focuses on the identity of business sector and project. The Claimant is right that the project and business sectors are the same. This may be relevant in a trade law context. Under a free-standing test, however, such as the one applied here, that degree of identity does not suffice to displace the differences between the two contractual relationships.

403. The Claimant does not seriously dispute the existence of divergences in the financial terms. The contract between NHA and PMC-JV did not involve a foreign currency component. This difference must not be underestimated. The history of the dispute between the Parties over the availability of foreign currency for the continuation of the Contract illustrates this point. Indeed, as the Claimant emphasizes in its opening statement at the hearing (Tr. M., 26 May 2008, 16-29), the foreign currency issue was one of the main reasons why by the end of 1999 "Bayindir had nearly stopped work in the Project" (Tr. M., 26 May 2008, 27, 6-7). The dispute was then resolved by the conclusion of Addendum No. 9 in which Bayindir accepted payment in rupees for half of the Contract price. It is disputed whether Addendum No. 9 was more favourable to the Claimant or for the Respondent. What is clear is the role played by the foreign currency component.

404. Not surprisingly, the lack of a foreign currency component in the new contract price discouraged foreign contractors from participating in the tender, a fact acknowledged by the Claimant (Reply M., ¶ 219). Furthermore, the minutes of an NHA meeting held on 13 November 2002, regarding *inter alia* the award of the balance works of the M-1 Project (Exh. [Bay.] CX-99) confirm the importance of the foreign currency issue. In paragraph 24.1 of this document it is stated indeed that: "keeping in view the past unpleasant experience in M-1 project as also some other projects, it was made

absolutely clear to all the prospective bidders at the pre-qualification stage that no payment in foreign currency would be allowed" (Exh. [Bay.] CX-99).

405. Another difference in financial terms relates to the mobilization advance. The Claimant does not seriously contest that, unlike Bayindir, PMC-JV did not benefit from a large mobilisation advance. Under the terms of the Contract, Bayindir was to benefit from a Mobilisation Advance of 30% of the value of the Contract price, which was to be paid half in rupees and half in dollars. By contrast, the mobilisation advance contemplated in Part II of the conditions of contract between NHA and PMC-JV was far lower and paid exclusively in rupees (Exh. [Bay.] CX-240A).

406. One might think of explaining the differences in advance payments by reference to the equipment which Bayindir left on site. That explanation would be ill founded. The evidence shows that such equipment was not fit for use (Exh. [Pak.] CM-170). Mr. Nasir Khan, confirmed this point:

> "Even though NHA had done an excellent job in preserving the equipment, machinery and plant left behind by Bayindir (including the dump trucks, motor graders, asphalt plants and crushing plants), the fact is that a large quantity of the equipment, machinery and plant was old, in bad condition and in some cases just not functioning."
> (Nasir Khan's WS, ¶ 36)

407. Asked on cross-examination about a presentation made by Colonel Azim in November 2002 to the NHA Executive Board (Exh. [Bay.] CX-224) stating that "the 300 pieces of Plant and Equipment have been parked in two camps and kept in perfect working conditions through regular maintenance by NHA's field staff," Mr. Nasir Khan confirmed his earlier testimony that the maintenance was good, but the plant was bad. He added that with the plant that was handed over PMC-JV "would not have been able to complete the project until today."[115]

[115] Quoting the passage in full: "the maintenance and, I mean, the owning of the machine was in a very professional way, but it cannot change the status of the plant. Like, if – I mean, just I will give you an example, there was two small plant installed, one was installed at end of NWFP province, a camp which is called Barabanda – there were two camps. One was Burhan and one was Barabunda. One was in Punjab and one was in NWFP. The Punjab plant was definitely – they brought it second-hand. Used. Very used plant. [...] That plant, when we took over, we never were able to get it – capacity even 10%, so then we installed another small part in replacement of that plant because that plant was not able to produce the production, the same was with the crushing plant, and the same was with batching plants, because when we assess the condition, and the capacity of plant and equipment, which was there, that according to that plant and

408. Likewise, the record confirms the existence and relevance of other differences in particular regarding the scope of work and the contractors' expertise and experience.

409. The scope of works was different to the extent the Contract as amended by Addendum No. 9 provided for four lanes and the contract with PMC-JV six. Mr. Nasir Khan explained the change in the following terms:

> "this Contract was four-lane motorway and it was converted into six-lane after the award. Now, what happened was that there was some job done by Bayindir, and then we immediately start our job and we have done some job. Once it was converted to six lane, so we have to redo a lot of work. Now, that redoing a lot of work, it is not taken into consideration that that was a major factor of affecting our physical progress [...] So, we took considerable time and definetely method of doing this, because usually we don't do this on ongoing Project."
> (Tr. M., 30 May 2009, 93-94)

410. The expertise and experience of the contractors constitutes another difference. Bayindir benefited from considerable experience in handling large projects, while PMC-JV did not. This difference which was reflected in the higher rates charged by Bayindir, played a role in the expectations that NHA formed with respect to each contractor. So testified General Javed:

> "The expectation that I had [from Bayindir], when I understood the Project was, that there would be a reasonable number of such high-tech equipment and machinery, because remember, we were paying them the state-of-the-art rates, and one expected to see a good quality of equipment."
> (Tr. M., 29 May 2008, 14-15, 25, 1-5)

411. As a result, the Tribunal comes to the conclusion that the two contractual relationships are too different for Bayindir and the local contractors to be deemed in "similar situations." Consequently, the first requirement for a breach of the national treatment clause embodied in Article II(2) of the Treaty is not met. It thus makes no sense to pursue the analysis of the other requirements.

c. MFN

1. Bayindir's position

---

equipment with you was handed over to us by NHA, we would not have been able to complete the Project until today, and maybe, maybe a year more, so then we supplement with new plant and equipment, with additional plant and equipment, and the plant and equipment was not able to produce efficiently, with just abandoned that plant, and it is still abandoned today."(Tr. M., 30 May 2008, 63-64).

412. In support of its claim under this heading, Bayindir refers to a press report of 17 September 2004 (Exh. [Bay.] CX-119) in which Pakistan's Minister of Communications stated that out of 35, only six projects of NHA had been completed in time during the years 1999 to 2003, the remaining 29 projects having been delayed for several years. In spite of these delays and of the use of the FIDIC form of contract for allegedly all of these other projects, only two other clause 63 notices were issued, and no contractor other than Bayindir was expelled (Tr. M., 26 May 2008, 97-98). In its Memorial on the merits, Bayindir referred more specifically to the M-2, Islamabad-Murree Dual Carriageway, and to the M-3 projects to contend that the treatment of Bayindir, when compared to the contractors in these other projects, was unfavourable and thus discriminatory.

2. Pakistan's position

413. Pakistan understands the Decision on Jurisdiction as denying jurisdiction over this head of claim. For the event this understanding would prove incorrect, Pakistan contends that Bayindir has not established that, as noted by the Tribunal in the Decision on Jurisdiction, an objectively different situation is the result of unequal treatment rather than of the existence of reasons to treat the two situations differently (R. Rej., ¶ 4.3). The Respondent argues that Bayindir has failed to provide the information relevant to the contracts with which it seeks to compare its situation, including information on the contract terms, performance, and reasons for the delays (C.-Mem. M., ¶¶ 4.63, 4.66).

414. The Respondent also objects that NHA was under no obligation to grant identical contract terms to different investors, because "[t]he protections of investment treaties do not extend to insuring investors against the potentially adverse effects, or the less than optimal nature, of the terms that they agree to in their investment contracts" (C.-Mem. M., ¶ 4.67).

3. Tribunal's determination

415. At the outset, the Tribunal notes that Pakistan misinterprets the Decision on Jurisdiction. That decision merely noted that Pakistan's objection pursuant to which "[o]ther projects must be examined on their merits and in the light of the factual and contractual context" (Reply J., ¶ 4.96) could *prima facie* apply to Bayindir's contention

that it was the only contractor expelled in 29 out of 35 projects which suffered delays as a result of problems similar to those faced by M-1.[116] Bayindir's contention was not discarded and remained to be substantiated in the merits phase.

416. The Tribunal must thus review whether the Claimant has substantiated its allegation of breach of the MFN clause. For this purpose, it must start assessing the similarity of the situations to be compared. As with national treatment, such similarity must be examined at the level of the contractual terms and circumstances.

417. The Tribunal is in no position to proceed to any meaningful comparison between the different situations at issue. To do so it would have needed sufficiently specific data on the terms and the performance of the different contracts involved. It is true that Bayindir, which carries the burden of proof, requested the production of several categories of documents in connection with its allegation of less favourable treatment than other foreign investors. In Procedural Order No. 4 of 27 November 2006, the Tribunal granted some requests and denied others as insufficiently substantiated.

418. That said, the evidence on record is clearly insufficient to support this claim. This is so even if one were to assume that the press report of 17 September 2004 is entirely accurate. In effect, that report referred to 29 out of 35 projects of NHA not being completed on time during the five preceding years (Exh. [Bay.] CX-119). Beyond this statement, it also mentions that "delay occurred due to multifarious reasons including revision in scope of work, change in design parameters, delay in release of funds, land acquisition and removal and relocation of utilities" and "action [was being] taken against the contractors in case the delay occur due to shortcomings on their part." Hence, this report is of no assistance to Bayindir. Moreover, the unproven allegation that all contracts are FIDIC-based is not very helpful either. Supposing it were right, it would still not provide any data on terms that are essential to a meaningful comparison, such as payment, funding, or completion periods.

419. The Tribunal is aware that it was not easy for the Claimant to discharge its burden of proof on this claim. A shift of such burden, if at all permissible, would, however, have

---

[116] Decision on Jurisdiction, ¶ 216.

required a higher degree of substantiation on the part of the Claimant, at least by reference to one potential comparator.

420. Consequently, the Tribunal finds that one of the necessary requirements of a breach of Article II(2), the similarity of the situations, is not met, which rules out a breach of the MFN standard.

d. The Respondent's acts taken together

421. Bayindir further claims that the acts attributable to the Respondent taken together constitute a breach of the national treatment and MFN standards.

422. Regardless of whether the cumulation of non-breaches may result in a breach, such a conclusion would in any event be precluded here by the lack of similar situations in the context of both the national treatment and MFN claims. Lacking similarity, even taken together, the acts at issue cannot found a breach of these standards.

423. For all the foregoing reasons, the Tribunal holds that the Respondent has not breached the national treatment and MFN clauses contained in Article II(2) of the Treaty.

D. EXPROPRIATION

424. Bayindir has claimed that Pakistan breached Article III(1) of the Treaty by expropriating its contractual rights, its plant and equipment, and the Mobilisation Advance Guarantees (Mem. on Merits, ¶ 222).

425. After determining the applicable standard for a finding of expropriation (a), the Tribunal will discuss in sequence the alleged expropriation of Bayindir's contractual rights (b), plant and equipment (c), and Mobilisation Advance Guarantees (d). The Tribunal will further discuss whether all the acts referred to by Bayindir taken together may amount to an expropriation (e).

a. Applicable standard

1. Bayindir's position

426. Bayindir contends that Article III(1) of the Treaty adopts a broad definition of expropriation including any interference with an investor's property that deprives such investor of the use or value of that property, whether such interference is direct or indirect, in the context of nationalization or otherwise, insofar as the measure has an effect similar to expropriation or nationalization (Mem. M., ¶¶ 215, 217).

427. In Bayindir's submission, the definition does not cover tangible property alone, such as plant and equipment, but also contractual rights. In this regard, Bayindir refers to *Vivendi II*,[117] which stated that "[t]here can be no doubt that contractual rights are capable of being expropriated" (Tr. M., 4 June 2008, 103, 7-13). On the basis of this and other authorities, namely the *Chorzów Factory* case,[118] as well as the *Orinoco*[119] and *Shufeldt*[120] arbitrations, Bayindir further argues that an expropriation of contractual rights may arise in contexts other than nationalization measures (Tr. M., 4 June 2008, 102-103).

428. With reference to *Vivendi II*[121] and *Siemens v. Argentina*,[122] Bayindir stresses that expropriation may occur when a government "terminates a Contract for wilful, discriminatory, or policy reasons" (Tr. M., 4 June 2008, 103, 16-18) and that "where a State's breach of contractual rights does not consist of 'simple commercial acts' a finding of expropriation is warranted" (Tr. M., 4 June 2008, 104, 2-5). Based on the decision of the Iran-US Claims Tribunal in *SeaCo*,[123] Bayindir argues that it suffices to show that contract rights were breached and that such breach was the result of government directives in order to prove an expropriation of contract rights (Mem. M., ¶ 221).

---

117 *Vivendi II*, *supra* footnote 30, ¶ 7.5.4.

118 *Factory at Chorzów (Germany v. Poland)*, Judgment (Merits), 13 September 1928, PCIJ *Series A*, No. 17 (1928).

119 *Orinoco Steamship Company Case*, Award of 25 October 1910, The Hague Court Reports, *1st series*, 1916, p. 228; 11 UNRIAA 227.

120 *Shufeldt Claim* (U.S. v. Guatemala), Award of 24 July 1930, 2 UNRIAA 1079.

121 *Vivendi v. Argentina II*, *supra* footnote 30.

122 *Siemens v. Argentina*, supra footnote 58, ¶¶ 271-272.

123 *SeaCo Inc v. Islamic Republic of Iran* (hereafter *SeaCo v. Iran*), Award of 25 June 1992, Case No 260, Iran-US CTR 28 (1996):198.

429. The Claimant also asserts that an expropriation may take place "when the effect of the action is deprivation of property regardless of the intent" (Tr. M., 4 June 2008, 105, 6-9). It emphasizes, however, that intent matters in this case, among other reasons, because "discriminatory action is a strong indication that the action is expropriatory" (Tr. M., 4 June 2008, 105, 11-12). In support, it refers to *Eureko v. Poland*[124] to claim that a government's discriminatory termination of contractual rights may constitute expropriation.

430. With reference to the decision in *Wena Hotels v. Egypt*,[125] it also notes that "forcible eviction of an investor is a strong indication of an expropriation" (Mem. M., ¶ 237).

2. Pakistan's position

431. In substance, Pakistan's argument is that there can be no expropriation of a party's contractual rights when such party is treated in accordance with the contract (Tr. M., 26 May 2008, 306-307).

432. Pakistan further asserts that, even in the event of a breach of contract, such breach would not be sufficient to establish an expropriation (Tr. M., 26 May 2008, 307-308). It refers to *Azinian v. Mexico*, according to which:

> "Labelling is, however, no substitute for analysis. The words 'confiscatory', 'destroy contractual rights as an asset', or 'repudiation' may serve as a way to describe breaches which are to be treated as extraordinary, and therefore as acts of expropriation, but they certainly do not indicate on what basis the critical distinction between expropriation and an ordinary breach of contract is to be made. The egregiousness of any breach is in the eye of the beholder – and that is not satisfactory for present purposes."[126]

433. Pakistan also points to certain reasons in *Waste Management*, which read as follows:

> "The Tribunal concludes that it is one thing to expropriate a right under a contract and another to fail to comply with the contract. Non-compliance by a government with contractual obligations is not the same thing as, or equivalent or tantamount to, an expropriation. In the present case the Claimant did not lose its contractual rights, which it was free to pursue before the contractually

---

124 *Eureko v. Poland, supra* footnote 55, ¶¶ 242-243.

125 *Wena Hotels v. Egypt*, supra footnote 18.

126 *Robert Azinian and Others v. United Mexican States* (ICSID Case No. ARB(AF)/97/2), Award of 1 November 1999, ¶ 90. The Respondent further refers to Prof. Ian Brownlie's Principles of Public International Law, who states that: "the general view is that a breach of contract (as opposed to its confiscatory annulment) does not create State responsibility on the international plane." Ian Brownlie, *Principles of Public International Law*, 6th edition, 2003, pp. 522-523.

> chosen forum. The law of breach of contract is not secreted in the interstices of Article 1110 of NAFTA. Rather it is necessary to show an effective repudiation of the right, unredressed by any remedies available to the Claimant, which has the effect of preventing its exercise entirely or to a substantial extent."[127]

434. In this respect, the Respondent underlines that the cases which have dealt with a taking of contract rights, such as *Aminoil*,[128] *Texaco Calasiatic v. Libya*,[129] *BP v. Libya*,[130] *LIAMCO v. Libya*,[131] *Aramco v. Saudi Arabia*,[132] and *Sapphire*,[133] all concerned the "abrogation of the Contract by a State that was engaging in a policy of nationalisation" (Tr. M., 26 May 2008, 308, 20-21) and cannot be transposed to the present circumstances.

435. Similarly, Bayindir's reference to *Wena*[134] and *SeaCo*[135] is said to be inapposite as the facts of such cases have nothing in common with those of the present one.

436. With respect to *Wena*, the Respondent considers that forcible eviction of an investor as such is not a strong indication of expropriation, as "an investor may remain on a site unlawfully, and it may be perfectly lawful to evict, using force as appropriate" (C.-Mem. M., ¶ 4.76). Whether the use of force may be an indication of an expropriation depends upon the circumstances.

437. As to the *SeaCo* case, the Respondent stresses that it concerned a situation of alleged expropriation by a State of a lease agreement between two third parties having no relation to the State. It opposes Bayindir's interpretation of this decision as contrary to

---

127 *Waste Management v. Mexico, supra* footnote 65, ¶ 175.

128 *Kuwait v. Aminoil*, *supra* footnote 79.

129 *Texaco Overseas Petroleum Company (Topco) and California Asiatic (Calasiatic) Oil Company v. Government of the Libyan Arab Republic*, Award of 19 January 1977, 17 ILM 1978, p. 1.

130 *BP Exploration Co (Libya) Ltd v. The Government of the Libyan Arab Republic*, Award of 10 October 1973, 53 ILR 297.

131 *Libyan American Oil Company (Liamco) v. Libya*, Award of 12 April 1977, 20 ILM 1.

132 *Arabian American Oil Company (Aramco) v. Saudi Arabia,* Award of 23 August 1958, 27 ILR 117.

133 *Sapphire International Petroleum Ltd. v. National Iranian Oil Co.*, Award of 15 March 1963, 35 ILR 136.

134 *Wena Hotels v. Egypt, supra* footnote 18.

135 *SeaCo v. Iran, supra* footnote 124.

the Decision on Jurisdiction, in which the Tribunal stated with reference to *Impregilo v. Pakistan*:[136]

> "[O]nly measures taken by Pakistan in the exercise of its sovereign power ('puissance publique'), and not decisions taken in the implementation or performance of the Contracts, may be considered as measures having an effect equivalent to expropriation."[137]

438. If a showing of breach of contract resulting from governmental directives were sufficient to constitute expropriation, then any "governmental act would by definition be one of *puissance publique*" (C.-Mem. M., ¶ 4.77), a proposition that Pakistan considers unfounded. More specifically, Pakistan argues that:

> "[I]n circumstances where (i) a State entity enters into a contract, (ii) that contract was negotiated between the investor, the State entity and given governmental departments and (iii) those governmental departments remain involved in monitoring the performance of the contract, indeed, their input is actively sought by the investor, it would not in any event be an act of puissance publique for the governmental departments to recommend or even direct that the contract should be terminated because of the investor's breach. Such a recommendation or decision would constitute nothing more than a decision taken in the implementation or performance of the given contract."
> (C.-Mem. M., ¶ 4.77)

439. Finally, Pakistan contends that a finding of expropriation generally requires, in addition to the loss of the investment, arbitrary conduct or an intentional deprivation on the part of the State (C.-Mem. M., ¶ 4.79; Rej. M., ¶ 4.49).

3. Tribunal's determination

440. The basis for the assessment of Bayindir's expropriation claim is Article III(1) of the Treaty, which reads as follows:

> "Investments shall not be expropriated, nationalized or subject, directly or indirectly, to measures of similar effects except for a public purpose, in a non-discriminatory manner, upon payment of prompt, adequate and effective compensation, and in accordance with due process of law and the general principles of treatment provided for in Article II of this Agreement."

441. The Tribunal concurs with the Claimant when it asserts that Article III(1) adopts a broad concept of expropriation, potentially applicable not only to tangible property but also to contractual and other rights, even outside the context of a nationalization.

---

136 *Impregilo v. Pakistan*, *supra* footnote 26, ¶ 281.

137 Decision on Jurisdiction, ¶ 257.

442. The first step in assessing the existence of an expropriation is to identify the assets allegedly expropriated. In the present case, the assets identified by the Claimant, namely its contractual rights, plant and equipment, and the Mobilisation Advance Guarantees, are within the scope of Article III(1) of the Treaty, and may potentially be subject to an interference amounting to expropriation.

443. Having identified the assets, the next step is to identify the allegedly expropriatory conduct. As stated in the Decision on Jurisdiction, expropriation may arise out of a simple interference by the host State in the investor's rights with the effect of depriving the investor of its investment.[138] A critical issue in this regard concerns the intensity or the effect of such conduct with respect to the investor's property. The Tribunal concurs with *Tecmed*, *CMS*,[139] and *Telenor*,[140] that an expropriation might occur even if the title to the property is not affected, depending on the level of deprivation of the owner[141]:

> "[I]t is understood that the measures adopted by a State, whether regulatory or not, are an indirect *de facto* expropriation if they are irreversible and permanent and if the assets or rights subject to such measure have been affected in such a way that "…any form of exploitation thereof…" has disappeared; i.e. the economic value of the use, enjoyment or disposition of the assets or rights affected by the administrative action or decision have been neutralized or destroyed. Under international law, the owner is also deprived of property where the use or enjoyment of benefits related thereto is exacted or interfered with to a similar extent, even where legal ownership over the assets in question is not affected, and so long as the deprivation is not temporary. The government's intention is less important than the effects of the measures on the owner of the assets or on the benefits arising from such assets affected by the measures; and the form of the deprivation measure is less important than its actual effects. To determine whether such an expropriation has taken place, the Arbitral Tribunal should not:
> [...] restrict itself to evaluating whether a formal dispossession or expropriation took place, but should look beyond mere appearances and establish the real situation behind the situation that was denounced."[142]

444. The third step in this inquiry consists in examining whether the alleged interference with the property or the rights of the investor has been made in the State's exercise of its

[138] Decision on Jurisdiction, ¶ 255.

[139] *CMS v. Argentina*, *supra* footnote 77, ¶ 260-264.

[140] *Telenor Mobile Communications AS v. Republic of Hungary* (ICSID Case No. ARB/04/15), Award of 13 September 2006.

[141] *Starrett Housing Corp. v. The Government of the Islamic Republic of Iran*, Interlocutory Award of 19 December 1983, 4 Iran-US CTR 122; *Tippetts, Abbett, McCarthy, Stratton v. TAMS-AFFA Consulting Engineers of Iran*, Award of 22 June 1984, 6 Iran-US CTR 219.

[142] *Tecmed v. Mexico, supra* footnote [53], ¶ 116.

sovereign powers. As noted for instance in *Impregilo v. Pakistan* cited in lieu of others, such as *Siemens v. Argentina*,[143] or *RFCC v. Morocco*[144]:

> "[O]nly measures taken by Pakistan in the exercise of its sovereign power (*"puissance publique"),* and not decisions taken in the implementation or performance of the Contracts, may be considered as measures having an effect equivalent to expropriation."[145]

445. In the present case, the Claimant has suggested that a breach of the Contract as a result of governmental directives would suffice for a finding of expropriation. The Tribunal disagrees. First, not every contract breach deprives an investor of the substance of its investment. Second, even where it does and the breach stems from a governmental directive, it would not necessarily follow that the contractual breach is the result of a sovereign act, as a directive of the State may be given in the framework of the contract.

446. The fourth step in assessing the existence of an expropriation in breach of the Treaty is the analysis of the conditions specified in Article III(1), namely (i) the lack of a public purpose, (ii) discrimination, (iii) the absence of payment of prompt, adequate and effective compensation, and (iv) a breach of "due process of law and the general principles of treatment provided for in Article II of this Agreement."

b. Contractual rights

1. Bayindir's position

447. Bayindir submits that Pakistan expropriated the investment indirectly in a clandestine manner under the pretext of exercising contractual rights, in order to give effect to a governmental change in policy towards Bayindir. In Bayindir's submission, Pakistan acted in an arbitrary and discriminatory manner with the intention of permanently depriving it of its contractual rights. More specifically, through its forcible expulsion pursuant to the notice of 23 April 2001, it was deprived of the benefits it expected to derive from the Contract as well as from payment for works executed until the expulsion.

---

143 *Siemens v. Argentina*, *supra* footnote 59, ¶ 253.

144 *RFCC v. Morocco*, *supra* footnote 32, ¶¶ 65-69, 85-89.

145 *Impregilo v. Pakistan*, *supra* footnote 26, ¶ 281.

448. Pakistan's argument that Bayindir keeps a residual right to a final settlement of accounts as such does not prevent a finding of expropriation, as was recognized in *Wena Hotels v. Egypt*, *SPP v. Egypt* and *Middle East Cement v. Egypt* (Reply M., ¶¶ 320-325).

449. In any event, the Respondent's conduct after the expulsion leaves no doubt on its intention not to give effect to the final settlement of accounts under the Contract and, therefore, to permanently deprive Bayindir of its contractual rights. Indeed, according to Bayindir, Pakistan's interpretation of sub-clause 63.3 of the Contract is untenable, as it was well understood from the beginning that Bayindir's expulsion would result in substantial savings and would in any event require Bayindir to wait seven to eight years (until works are completed by the local contractors) for a settlement and probably, at this time, a dispute might arise regarding the amounts of the settlement. Thus, sub-clause 63.3 cannot be relied upon by Pakistan to justify the absence of a prompt and adequate compensation, in accordance with the BIT (Reply M., ¶¶ 42-45).

450. Moreover, according to Bayindir, sub-clause 63.3 of the Contract does not apply to amounts already certified by the Engineer on the date of expulsion, but only to works that the Contractor was in the process of performing. Thus, there was no justification for withholding payment under payment certificates Nos. 20 and 21 (Reply M., ¶¶ 48). Furthermore, Bayindir argues that several acts attributable to the Respondent which were accomplished after the expulsion (see paragraph 349 *supra*) show that there was no intention on the part of the Respondent to give effect to sub-clause 63.3 of the Contract.

451. Bayindir further submits that the decision to expel Bayindir was the result of governmental directives given by General Musharraf himself and based *inter alia* on national policy and compliance with World Bank recommendations. In addition, Pakistan acted in the exercise of its sovereign powers when it complied with the directives and served the notice of expulsion upon Bayindir, and used the Pakistani Army to ensure that Bayindir left the site.

2. Pakistan's position

452. Pakistan submits that the expulsion of Bayindir pursuant to the Contract cannot be considered expropriatory of Bayindir's contractual rights, as such rights are limited by the Contract itself.

453. Moreover, even if there had been a breach of the Contract, such breach would not amount to expropriation. In Pakistan's submission, a finding of expropriation would require proof of an improper motive for the expulsion (C.-Mem. M., ¶ 4.80). It would also require a showing of deprivation, which is not the case given the rights which Bayindir keeps under sub-clause 63.3 of the Contract.

454. Pakistan also disputes that the expulsion was an act of "*puissance publique*" rather than one carried out in the performance of the Contract. More specifically, it asserts that:

> "[I]n circumstances where (i) a State entity enters into a contract, (ii) that contract was negotiated between the investor, the State entity and given governmental departments and (iii) those governmental departments remain involved in monitoring the performance of the contract, indeed, their input is actively sought by the investor, it would not in any event be an act of puissance publique for the governmental departments to recommend or even direct that the contract should be terminated because of the investor's breach. Such a recommendation or decision would constitute nothing more than a decision taken in the implementation or performance of the given contract." (C.-Mem. M., ¶ 4.77)

455. Pakistan also notes that Bayindir's complaints about the threat of force is neither established nor an indicator on its own of an unlawful measure, as it may be perfectly lawful to evict an investor who remains on site unlawfully.

3. Tribunal's determination

456. Following the steps of the analysis set forth above (see paragraphs 442 *et seq. supra*), the Tribunal starts by observing that the assets allegedly subject to expropriation are Bayindir's rights under the Contract, including those relating to the payment for works completed. Such rights have an economic value and can potentially be expropriated.

457. As a second step, the Tribunal finds that the measures through which Pakistan allegedly deprived Bayindir's contractual rights of their economic value are in essence the notice of expulsion and the taking over of the site.

458. Third, the Tribunal must review whether Pakistan has interfered with Bayindir's contractual rights to an extent amounting to a deprivation of the economic substance of such rights. In this regard, the fact that Bayindir was expelled is obviously not enough. As rightly pointed out by the Respondent, if the expulsion was lawful under the Contract, then there would be no taking of or interference with Bayindir's rights. Moreover, even if the expulsion was conducted in breach of the Contract, that would not as such be enough for a finding of expropriation under the Treaty. Bayindir submits that its expulsion was contrary to the terms of the Contract as well as in breach of the Treaty. While not a contract judge, the Tribunal must review those facts related to contract interpretation and performance and here particularly related to the exercise of certain contractual remedies to the extent necessary to rule on the Treaty claim. In this regard, the Tribunal has already discussed at length in paragraphs 240-256 and 351-359 *supra* that there is a reasonable interpretation of the Contract according to which the mechanisms leading to Bayindir's expulsion as well as those regarding measures subsequent to the expulsion were used in conformity with the Contract. On the basis of such considerations, the Tribunal concluded that there was no breach of the applicable FET standard. For the same reasons, the Tribunal cannot accept that there is a breach of the treaty provision on expropriation.

459. The critical element for a finding of expropriation is the economic effect of the measure rather than the intent underlying it. This is so even though Bayindir's claim focuses on the Respondent's improper intent. The Tribunal has in any event already found that the record does not show an intent on the part of Pakistan to permanently deprive Bayindir of its residual contractual rights (see paragraphs 351-359 *supra*).

460. Bayindir's contractual rights are defined by the terms of the Contract. To establish an expropriation of its rights as a result of NHA's exercise of its own contractual rights, Bayindir must start by proving that its contractual rights were not limited by NHA's contractual rights or that NHA took an action that, although allegedly based on the Contract's terms, was in fact clearly in breach of such terms. Absent such proof, there can be no deprivation of the economic substance of Bayindir's rights, as the scope of such rights is limited by NHA's own rights under the Contract. The foregoing analysis of the Contract (see in particular paragraphs 240-258, 301-314, 331-335, 346-347,

351-359, and 367-376 *supra*) shows that Bayindir has not succeeded in adducing proof of these facts.

461. In addition, even if the expulsion violated the Contract and deprived Bayindir of the economic substance of its contract rights, a finding of expropriation would only be founded if the acts at issue were sovereign acts. The evidence does not point in this direction. To the contrary, it shows that Pakistan can reasonably justify the expulsion by Bayindir's poor performance (*see* paragraphs 301-315 *supra*) with the consequence that the expulsion must be seen in the framework of the contractual relationship, not as an exercise of sovereign power. This conclusion is not contradicted by the close involvement of the Pakistani government in the M-1 Project. As noted in section IV(A)(b) *supra*, governmental involvement is not necessarily equivalent to the exercise of sovereign power when it is grounded on legitimate contractual considerations.

462. For the foregoing reasons, the Tribunal concludes that Pakistan has not expropriated Bayindir's contractual rights in breach of Article III(1) of the Treaty.

c. Machinery, plant, equipment, material, spare parts and office inventory

1. Bayindir's position

463. Bayindir claims that, following its expulsion from the site, Pakistan's armed forces confiscated its machinery, plant, equipment, material, spare parts and office inventory. It argues that such confiscation occurred despite the fact that it disputed the sub-clause 63.1 certificate and the notice of expulsion. It adds that no contractual provision required Bayindir to raise a separate dispute in connection with the expropriation of its assets under sub-clause 63.2 of the Contract.

464. More specifically, Bayindir considers that, since the certification under sub-clause 63.1(b)(ii) was invalid, all acts carried out on this basis were unlawful and were equivalent to an expropriation of its assets.

465. In Bayindir's submission, the expropriation of its tangible property occurred without prompt and adequate compensation, and in a discriminatory manner through an act of *puissance publique*. Bayindir further contends that the record shows that Pakistan does not intend to repay Bayindir for its confiscated property.

2. Pakistan's position

466. In substance, Pakistan's position is that the actions of NHA were entirely justified under the Contract. It refers to sub-clause 6.2 of the Overriding Conditions of Contract attached to Addendum No. 6 and sub-clause 63.1 of the Contract to support its allegation that Bayindir had agreed that all permanently imported equipment would eventually become property of NHA and that "given that NHA had issued a valid notice [under sub-clause 63.1] it was expressly entitled to use the Contractor's Equipment, Plant, Temporary Works and materials" (C.-Mem. M., ¶ 4.83).

467. Pakistan further argues that Bayindir "never questioned the retention of its Equipment, Plant, Temporary Works and materials on Site after it was expelled in May 2001" (C.-Mem. M., ¶ 4.84) and participated in the measuring up and inventory process carried out pursuant to sub-clause 63.2 of the Contract.

468. Finally, the Respondent contends that NHA's acts were not undertaken in the exercise of sovereign powers.

3. Tribunal's determination

469. The Tribunal’s reasoning on this head of the expropriation claim is in line with the considerations set forth in connection with the claim for the expropriation of the contract rights. It is true that this claim deals with tangible as opposed to intangible property and that the controversial measures consist in the seizure and confiscation as opposed to the notice of expulsion and the taking over of the site. These differences have no bearing, however, on the assessment of the existence of an expropriation.

470. With respect to the contractual matters relevant for the assessment of a breach of the Treaty, the Tribunal set out in paragraphs 240-256 and 351-359 *supra* that there is a reasonable interpretation of the Contract under which the mechanisms leading to Bayindir's expulsion as well as those regarding subsequent measures were used in conformity with the Contract.

471. Moreover, the Respondent has offered a reasonable contract basis for the seizure and use of Bayindir's property left on the site, with reference to sub-clause 6.2 of the

Overriding Conditions of Contract attached to Addendum No. 6 and sub-clause 63.1 of the Contract. Indeed, sub-clause 6.2, as subsequently amended, provides that:

> "The Contractor shall be allowed to import construction machinery, equipments and related spare parts to be incorporated into and used for the Work without all taxes and duties (custom duty, surcharge [...] and others) payable to customs department on the condition that all such equipments, machinery and spares shall be transferred without cost to the Employer after the completion of the Work on an as is where is basis."
> (Exh. [Pak.] C-3)

This provision must be read together with sub-clause 63.1, as modified by the Conditions of Contract – Part II, which provides that:

> "[T]hen the Employer may, after giving fourteen day's notice to the Contractor, enter upon the Site and expel the Contractor therefrom without thereby voiding the Contract, or releasing the Contractor from any of his obligations or liabilities under the Contract, or affecting the rights and powers conferred on the Employer or the Engineer by the Contract, and may himself complete the Works or may employ any other contractor to complete the Works. The Employer or such other contractor may use for such completion so much of the Contractor's Equipment, Plant, Temporary Works and materials, which have been deemed to be reserved exclusively for the execution of the Works, under the provisions of the Contract, as he or they may think proper, and the Employer may, at any time, sell any of the said Contractor's Equipment, Temporary Works and unused Plant and materials and apply the proceeds of sale in or towards the satisfaction of any sums due or which may become due to him from the Contractor under the Contract."
> (Exh. [Bay.] C-11)

472. Furthermore, the record evidences that the measurement and inventory process took place in relatively good conditions (see paragraphs 331-336 *supra*). NHA took account of the concerns then expressed by Bayindir, that the FWO may be biased (Exh. [Pak.] CM-141), resulting in the nomination of the independent organization in charge of conducting the joint inventory (Exh. [Pak.] CM-142), which reportedly completed its task on 13 May 2003 (Exh. [Pak.] R-68).

473. In any event, even if a taking of Bayindir's machinery, plant, equipment, material, spare parts, and office inventory in breach of the Contract could be established, such action would not amount to a deprivation of the economic substance of Bayindir's remaining investment.

474. Finally, even if one were to reach a contrary conclusion, it would still be necessary to demonstrate that the conduct under review was effected in the exercise of sovereign

power. For the reasons explained above, the Tribunal does not regard this requirement as met (see paragraph 461 *supra*).

475. For the foregoing reasons, the Tribunal concludes that Pakistan has not expropriated Bayindir's property left on the site in breach of Article III(1) of the Treaty.

d. Mobilisation Advance Guarantees

1. Bayindir's position

476. Bayindir argues in substance that through a series of acts attributable to the Respondent which are set forth above and relate to the call of the Mobilisation Advance Guarantees (see paragraphs 360-364 *supra*), the Respondent expropriated the amounts covered by these guarantees. In Bayindir's submission, the guarantees fall within the definition of 'investment' of the Treaty, as the Tribunal noted in the Decision on Jurisdiction (Reply M., ¶ 331).

477. Moreover, the Claimant argues that its reputation and creditworthiness were destroyed by the call on the guarantees, which caused the destruction of its value as a company (Tr. M., 26 May 2008, 127-128).

2. Pakistan's position

478. Pakistan submits that this claim had not been raised at the time of the jurisdictional phase, and that the Tribunal thus lacks jurisdiction over it. In connection with jurisdiction, it argues that "Bayindir has never suggested that the mobilisation advance guarantees themselves constitute an investment falling within Article I(2) of the Treaty, and they would not correctly be characterized as such" (C.-Mem. M., ¶ 4.87).

479. On the merits, Pakistan objects that the acts under review were in conformity with the Contract (see paragraphs 365-366 *supra*). It also counters that the Mobilisation Advance Guarantees constitute contracts between the Turkish banks and NHA. Thus, the Contract, on the one hand, and the Mobilisation Advance Guarantees, on the other, are between different parties and are juridically distinct (C.-Mem. M., ¶ 4.85).

480. Pakistan further contends that the guarantees remain in effect, albeit in abeyance and that there has been no payment under the guarantees, with the result that no expropriation can have occurred (C.-Mem. M., ¶ 4.88).

3. *Tribunal's determination*

481. At the outset, the Tribunal notes that it does not consider that Bayindir's claim for expropriation of the Mobilisation Advance Guarantees is a new claim. In its Decision on Jurisdiction, it held that it had jurisdiction over Bayindir's claims for breach of the Treaty, including for the alleged expropriation of Bayindir's investment. Although Bayindir did not then clearly articulate the claim for the expropriation of the Mobilisation Advance Guarantees, the latter can be deemed to form part of the overall investment. Therefore, the Tribunal is of the opinion that this claim is within its jurisdiction as it was affirmed in the Decision on Jurisdiction.

482. The Tribunal has already discussed the acts alleged by the Claimant under this claim in connection with FET (see paragraphs 367-379 *supra*) and concluded that they did not amount to a breach of the FET standard. The reasons which prevailed on FET apply *mutatis mutandis* to the present head of claim. In essence, the Tribunal found that Pakistan's contractual explanation was reasonable enough to disprove Bayindir's allegations in connection with the misuse of the terms of the Contract. Even if such breach could be established, this would not suffice for a finding of expropriation. There is no evidence that such actions were undertaken in bad faith or for sovereign reasons, particularly taking into consideration that the attempts to encash the Mobilisation Advance Guarantees were conducted in accordance with the legal procedures of another State within that State's territory. Moreover, the monies have not been cashed. As to the adverse consequences of the attempted encashment on Bayindir's standing and viability, however unfortunate, they are part of the business risk that any contractor assumes when entering into a contract for a major project with substantial financial exposure. Investment treaties are not meant to protect against business risks.

483. On this basis, the Tribunal concludes that the attempted encashment of the Mobilisation Advance Guarantees does not amount to an expropriation in breach of Article III(1) of the Treaty.

e. Respondent's acts taken together

484. The question that remains is whether, despite the findings that the Claimant has failed to establish the existence of a breach of Article III(1) of the Treaty in the context of each of the specific acts so far considered, the evidence with respect to all the acts taken together may support the existence of a violation of the Treaty.

485. The Tribunal considers that the aggregation of the different components of Bayindir's expropriation claim cannot reverse its earlier findings. This is because such reasons for the Tribunal's conclusions in the preceding sections go well beyond the amounts of the alleged deprivation and concern, *inter alia*, the very characterization of the acts under review as neither constituting a deprivation nor sovereign acts.

486. For the foregoing reasons, the Tribunal finds that the Respondent has not breached Article III(1) of the Treaty.

E. PROVISIONAL MEASURES

487. The Tribunal deems it useful to recall that, pursuant to paragraph (ii) of the operative part of PO#1, the Tribunal ordered among others that:

> "Pakistan take whatever steps may be necessary to ensure that NHA does not enforce any final judgment it may obtain from the Turkish courts with regard to the Mobilisation Advance Guarantees. This recommendation remains in effect until: (a) an arbitral award declining jurisdiction is issued; or (b) an arbitral award is rendered on the merits; or (c)·any other order of the Tribunal amending the recommendations is issued; whichever comes first."
> (PO#1, at No. 78)

488. On 14 April 2008, the Tribunal then issued PO#11, in which it ordered that:

> "(i) Bayindir shall take whatever steps may be necessary and use its best endeavours to procure the withdrawal by Is Bank of its application dated 14 March 2007;
>
> (ii) In accordance with the rationale of the Tribunal's decision of 29 November 2004, Pakistan shall take whatever steps may be necessary to ensure that NHA does not enforce any final judgment it may obtain from the Turkish courts with regard to the encashment of interest on the Mobilisation Advance Guarantees;
>
> (iii) The foregoing directions remain in effect until (a) an arbitral award is rendered on the merits; or (b)·they are amended or revoked by order of the Tribunal; [... .]"

(PO#11, at No. 41)

489. As provided in the operative parts of both PO#1 and PO#11, these measures were to remain in effect until the issuance of an award on the merits. For the avoidance of doubt, the Tribunal confirms that the measures recommended in PO#1 and PO#11 will cease to be in effect as of the date of the notification of the present Award. The Tribunal also notes, in connection with the subsequent dispute over the potential impact of Is Bank's application dated 14 March 2007 on NHA's recovery of default interest on part of the Mobilisation Advance Guarantees, that it is for NHA to seek redress before a competent forum and under the proper law of such guarantees.

F. COSTS

490. In the exercise of its discretion in matters of allocation of costs, the Tribunal finds it fair that the Parties bear the costs of the arbitration in equal shares and that each Party bears its own legal and other costs expended in connection with this arbitration. In reaching this decision, the Tribunal has pondered all the circumstances of the case, including in particular the withdrawal of the Contract claims, the outcome on jurisdiction in favour of Bayindir and on the merits in favour of Pakistan, the results achieved by each Party on provisional remedies, and the fact that Bayindir's treaty claims, even if they did not succeed on the merits, presented genuine issues which could legitimately be brought before an investment tribunal.

V. RELIEF

For the reasons set forth above, the Tribunal issues the following Award:

a. The Respondent has not breached the fair and equitable treatment standard applicable through the operation of Article II(2) of the Treaty;

b. The Respondent has not breached the national treatment and most favoured nation standards contained in Article II(2) of the Treaty;

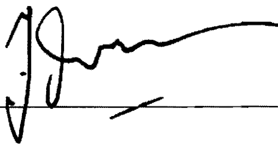
c. The Respondent has not expropriated the Claimant in breach of Article III(1) of the Treaty;

d. The measures recommended in PO#1 and PO#11 shall no longer be in effect as of the date of the notification of the present Award;

e. The Parties shall bear the costs of the arbitration in equal shares;

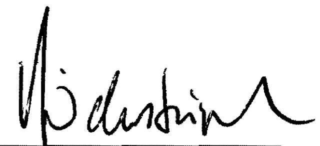
f. Each Party shall bear its own legal and other costs;

g. All other claims are dismissed.



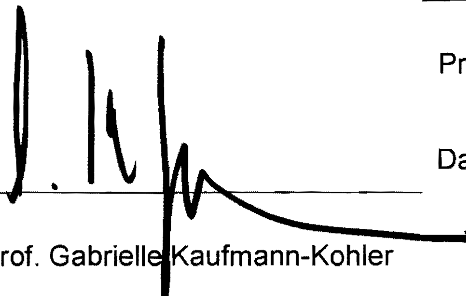
Sir Franklin Berman

Date: 20 August 2009



Prof. Karl-Heinz Böckstiegel

Date: 24 August 2009



Prof. Gabrielle Kaufmann-Kohler

Date: August 14, 2009

International Centre for Settlement of Investment Disputes

BAYINDIR INSAAT TURIZM TICARET VE SANAYI A.Ş.

CLAIMANT

v.

ISLAMIC REPUBLIC OF PAKISTAN

RESPONDENT

ICSID Case No. ARB/03/29

DECISION ON JURISDICTION

Rendered by an Arbitral Tribunal composed of:

Prof. Gabrielle Kaufmann-Kohler, President

Sir Franklin Berman, Arbitrator

Prof. Karl-Heinz Böckstiegel, Arbitrator

TABLE OF CONTENTS

TABLE OF ABBREVIATIONS 4

I. THE RELEVANT FACTS REGARDING THE ISSUE OF JURISDICTION 5

A. The parties **5**
a. The Claimant 5
b. The Respondent 6

B. Background facts **6**
a. The M1 Motorway Project 6
b. The origin of the present dispute 9
c. Related litigation 10
d. The BIT 12

II. PROCEDURAL HISTORY 12

A. Initial phase **12**

B. The written phase on jurisdiction **15**

C. The hearing on jurisdiction **17**

III. THE PARTIES' POSITIONS 18

A. Bayindir' position **18**

B. Pakistan's position **19**

IV. DISCUSSION 21

Introductory matters **21**
a. The relevance of previous ICSID decisions or awards 21
b. Uncontroversial matters 22
c. The law applicable to this Tribunal's jurisdiction and the relevant issues 23

A. Has Bayindir failed to comply with formal requirements preventing it to submit the present dispute (Article VII of the BIT)? **25**

B. Has Bayindir made an investment? **30**
a. Investment under Article I(2) of the BIT 30
aa. Bayindir's contribution in terms of know how, equipment and personnel 32
bb. Bayindir's financial contribution 32
cc. Conclusion 33

b. Investment under Article 25 of the ICSID Convention 33
aa. The object of the contract 34
bb. The so-called “Salini Test” 35

C. Are Bayindir’s Treaty Claims in reality Contract Claims? 37
a. Bayindir’s Treaty Claims 38
b. The difference between Treaty Claims and Contract Claims 40
c. The specific circumstances of the case 41
aa. The “ingredients” of Bayindir’s claims 42
bb. The quantum of Bayindir’s claims 42
d. Pakistan’s subsidiary arguments 45
aa. Abuse of Process 45
bb. Conflict of Conventions 46
e. The question of ‘puissance publique’ 48

D. Are Bayindir’s Treaty Claims sufficiently substantiated for jurisdictional purposes? 49
a. The relevant test 50
aa. The onus of establishing jurisdiction 50
bb. The relevant standard 51
b. Bayindir’s most favoured nation claim 53
aa. Expulsion for reasons of costs and local favouritism 55
bb. More favourable timetables were accorded to Pakistani contractors 56
cc. Selective tendering 58
c. Bayindir’s fair and equitable treatment claim 59
aa. Is there an obligation of equitable treatment? 60
bb. Alleged failure to provide a stable framework for Bayindir’s investment 61
cc. The allegedly unfair and inequitable expulsion 63
d. Bayindir’s expropriation claims 66
e. Conclusion 69

E. Should the Tribunal stay the current proceedings? 69

F. Costs 72

DECISION ON JURISDICTION 73

TABLE OF ABBREVIATIONS

Arbitration Rules	ICSID Rules of Procedure for Arbitration Proceedings
Bayindir	Bayindir Insaat Turizm Ticaret Ve Sanayi A.S. A.Ş.
BIT	Bilateral investment treaty; specifically "Agreement Between the Republic of Turkey and the Islamic Republic of Pakistan Concerning the Reciprocal Promotion and Protection of Investments" of 16 March 1995
1997 Contract	Agreement for the Revival of Contract Agreement for the Construction of Islamabad-Peshawar Motorway of 29 March 1997
C-Mem. J.	Bayindir's Counter-Memorial on Jurisdiction dated 31 March 2005
Contract	1993 Contract as revived by the1997 Contract
EOT	Extension of time
Exh. [Bay.] B	Bayindir's Exhibit [Request for arbitration]
Exh. [Bay.] CX	Bayindir's Exhibit (Documentary Evidence)
Exh. [Bay.] CLEX	Bayindir's Exhibit (Legal Materials)
Exh. [Pak.] C	Pakistan's Exhibit (Principal Contractual Documents) [Volume 2 of Mem. J.]
Exh. [Pak.] D	Pakistan's Exhibit (Documentary exhibits) [Volume 7 of Mem. J.]
Exh. [Pak.] L	Pakistan's Exhibit (Legal Materials) [Volume 3 to 6 of Mem. J.]
Exh. [Pak.] RL	Pakistan's Exhibit (Legal Materials) [Volume 3 to Reply.]
ICSID	International Centre for Settlement of Investment Disputes
ICSID Convention	Convention on the Settlement of Investment Disputes between States and Nationals of other States
M1 Project	Pakistan Islamabad-Peshawar Motorway
Mem. J.	Pakistan's Objections to Jurisdiction dated 31 December 2004
MFN	Most favoured nation clause
NHA	National Highway Authority of Pakistan
PMC JV	Pakistani Motorway Contractors Joint Venture
RA or Request	Bayindir's Request of Arbitration of 15 April 2002
Rejoinder J.	Bayindir's Rebuttal (on Jurisdiction) dated 17 June 2005
Reply J.	Pakistan's Reply on Bayindir's Counter-Memorial on Jurisdiction of 9 May 2005
Tr. P.	Transcript of the preliminary hearing
Tr. J. [page:line]	Transcript of the hearing on jurisdiction

I. THE RELEVANT FACTS REGARDING THE ISSUE OF JURISDICTION

1. This Chapter summarizes the factual background of this arbitration in so far as it is necessary to rule on the Respondent's objections to jurisdiction.

A. THE PARTIES

a. The Claimant

2. The Claimant, Bayindir Insaat Turizm Ticaret Ve Sanayi A.S. A.Ş. ("Bayindir") is a company incorporated and existing under the laws of the Republic of Turkey. Its principal office is situated at Tunus Caddesi No. 24, Kavaklidere, Ankara, Turkey.

3. The Claimant is part of the Bayindir group of companies. It is engaged in the business of construction of motorways and other larger infrastructure projects in Turkey and abroad.

4. The Claimant was initially represented in this arbitration by

- Dr. Michael Bühler and Mr. Jonathan Eades; JONES DAY; 120, Rue du Faubourg Saint Honoré; 75008 Paris; France, and
- Mr. Farrukh Karim Qureshi; WALKER MARTINEAU SALEEM; 40-B, Street 30, Sector F-8/1; Islamabad; Pakistan.

5. On 1st July 2005, Claimant informed the ICSID Secretariat that it had retained new counsel and that it would be represented by

- Prof. Emmanuel Gaillard; SHEARMAN & STERLING LLP; 114, avenue des Champs-Elysées; 75008 Paris; France, and
- Mr. John Savage; SHEARMAN & STERLING LLP; 6 Battery Road, #25-03; 049909 Singapore, Singapore.

6. On 14 July 2005, Prof. Gaillard and Mr. Savage advised the ICSID Secretariat that SHEARMAN & STERLING LLP had ceased to represent the Claimant with immediate effect.

7. On 18 July 2005, Claimant informed the ICSID Secretariat that it had retained new counsel and would be represented at the jurisdictional hearing by Mr. Farrukh Karim Qureshi and

- Mr. Gavan Griffith, QC; ESSEX COURT CHAMBERS; 24 Lincoln's Inn Fields; London WC2A 3EG; United Kingdom.

b. The Respondent

8. The Respondent is the Islamic Republic of Pakistan ("Pakistan").

9. The Respondent is represented in this arbitration by

- The Hon. Makhdoom Ali Khan; Attorney General for Pakistan; Supreme Court Building; Islamabad; Pakistan, and
- Mr. V. V. Veeder QC, Prof. Christopher Greenwood CMG, QC and Mr. Samuel Wordsworth; ESSEX COURT CHAMBERS; 24 Lincoln's Inn Fields; London WC2A 3EG; United Kingdom, and
- Mr. Rodman R. Bundy and Ms. Loretta Malintoppi; EVERSHEDS Avocats à la Cour de Paris; 8, Place d'Iéna; 75116 Paris; France,
- Mr. Iftikharuddin Riaz; Bhandari; Nagvi & Riaz; 5 Miccop Centre; 1 Mozang Road; Lahore; Pakistan, who replaced Mr. Umar Atta Bandial, UMAR BANDIAL & ASSOCIATES, Lower Ground Floor, LDA Plaza Egerton Road; Lahore; Pakistan; and
- Mr. Khurram M. Hashmi; Barrister-at-Law; 24 Mezzanine Floor, Beverley Centre, Blue Area, Islamabad, Pakistan.

B. BACKGROUND FACTS

a. The M1 Motorway Project

10. The National Highway Authority ("NHA") is a public corporation established by the Pakistani Act No XI (National Highway Authority Act) of 1991 to assume responsibility for the planning, development, operation and maintenance of Pakistan's national highways and strategic roads. Although controlled by the Government of Pakistan, NHA is a body corporate in Pakistan with the right to sue and to be sued in its own name (Section 3(2) National Highway Authority Act 1991).

11. Among other projects, NHA has planned the construction of a six-lane motorway and ancillary works known as the "Pakistan Islamabad-Peshawar Motorway" (the "M1 Project").

12. In 1993, NHA and Bayindir entered into an agreement for the construction of the M1 Project (the "1993 Contract") (Exh. [Pak.] C-1). The 1993 Contract was a two page

agreement incorporating, *inter alia*, Addenda No.1-9 (Exh. [Pak.] C-1), the Conditions of Contract - Part I and II (Exh. [Pak.] C-4), General Specifications, Special Provisions and Addenda to General Specifications, Drawings, Priced Bill of Quantities (BOQ), as well as the Bid and Appendices "A to M". In particular, it bears noting that:

(i) Part I incorporated the FIDIC General Conditions of Contract for Works of Civil Engineering Construction (1987 edition).

(ii) Part II, entitled "Conditions of Particular Applications", incorporated the amendments and supplements to Part I as negotiated by the Parties.

13. Disputes arose in connection with the 1993 Contract, which NHA and Bayindir resolved in 1997. As part of their settlement, on 29 March 1997 the parties executed a Memorandum of Agreement "with the objective of reviving The Contract Agreement dated 18 March 1993" (Exh. [Pak.] C-5). Under Clause 8 of this Memorandum of Agreement, the Parties agreed "to apply to the arbitration tribunal in the appropriate manner to seek the decision of the tribunal on only the issue of the quantum of expenses incurred by Bayindir as specified in Bayindir's claim for expenses only"[1].

14. On 3 July 1997, the Parties entered into a new contract, the "Agreement for the Revival of Contract Agreement for the Construction of Islamabad-Peshawar Motorway" (the "1997 Contract") (Exh. [Pak.] C-6). The 1997 Contract incorporated the 1993 Contract "in its entirety" with some "overriding conditions" agreed by the parties in the Memorandum of Agreement signed on 29 March 1997.

15. For the sake of simplicity, the Tribunal will simply use the term "Clause of the Contract" to mean the relevant clause of the (FIDIC) General Conditions of Contract (Conditions of Contract – Part I incorporated in the 1993 agreement), as possibly supplemented by the Conditions of Particular Applications (Conditions of Contract – Part II incorporated in the 1993 agreement), as revived and possibly amended by the 1997 Contract. The Tribunal will refer to the (revived) contractual relationship between the parties as the "Contract".

16. The Contract is governed by the laws of Pakistan.

---

[1] By an arbitral award of 30 June 1999, Bayindir was ordered to pay USD 12,909,935 to NHA but was declared entitled to retain USD 10,721,595 of the advance payment made under the Contract in 1993 (Exh. [Pak.] L-27).

17. It was a term of the Contract that NHA would pay to Bayindir 30% of the Contract price as an advance payment (the "Mobilisation Advance"). Thereafter, NHA paid to Bayindir an amount of USD 159,080,845 as Mobilisation Advance (namely two separate amounts of USD 96,645,563.50 and PKR 2,523,009,751.70[2]).

18. It was a further term of the Contract that Bayindir would provide a bank guarantee equivalent to the amount of the Mobilisation Advance. On 9 January 1998, a consortium of Turkish banks (comprising Türkiye İş Bankasi A.Ş., Türkiye Vakiflar Bankasi T.A.O., Türkiye Halk Bankasi A.Ş., Finansbank A.Ş., DenizbanktheA.Ş. and Kentbank A.S., which subrogated its rights to Bayindirbank A.Ş.) issued two guarantees on behalf of Bayindir to secure the Mobilisation Advance in accordance with the Contract (the "Mobilisation Advance Guarantees"). Consistent with the Contract, the Mobilisation Advance Guarantees were payable to NHA "on his first demand without whatsoever right of objection on [the Bank's] part and without his first claim[ing] to the Contractor". The amounts of the Mobilisation Advance Guarantees were to decrease, as interim payments were made for work in progress[3].

19. The performance of the Contract was to be supervised by an Engineer.

20. The Contracts set forth a multi-tier mechanism for "Settlement of Disputes", which may be sketched as follows:

- Any "matter in dispute shall, in the first place, be referred in writing to the Engineer" (67.1(1) of the Contract).
- Either of the parties dissatisfied with any decision of the Engineer[4] "may give notice to the other party of his intention to commence arbitration" (67.1(3) of the Contract).
- The parties "shall attempt to settle such dispute amicably" and, unless the parties otherwise agree, arbitration cannot be commenced on or after the fifty-sixth day after the day on which notice of intention to commence arbitration was given.
- The dispute shall then be "finally settled under the rules and provisions of the Arbitration Act 1940 as amended or any statutory modification or re-enactment thereof for the time being in force".

---

[2] The parties seem to agree on a relevant exchange rate of 40.41 PKR to 1 USD.

[3] The final terms of the reimbursement were set in Addendum No. 09 (see *infra* No. 23; Exh. [Bay.] CX-12 at 3).

[4] The same applies "if the Engineer fails to give notice of his decision on or before the eighty-fourth day after the day on which he received the reference".

b. The origin of the present dispute

21. On 3 June 1998, the Engineer issued the order to proceed to the construction with original completion dates foreseen on 31 July 2000.[5]

22. Between September 1999 and 20 April 2001, Bayindir submitted several claims regarding payment and four claims for extension of time (EOT) invoking different omissions on the part of Pakistan (in particular delays in the construction work resulting from late hand over of the land by Pakistan and/or NHA[6]).

23. The first two EOT claims (EOT/01 and EOT/02) were settled by agreement among the parties during a meeting held on 18 February 2000. This agreement[7] led to the execution of Addendum No. 9 of 17 April 2000 to the Contract, which set out, among other things, that "the revised Contract Completion Date shall be 31st December 2002" and that "NHA will hand over the remaining land as expeditiously as possible but not later than 4 months from the signing" of Addendum No. 9. The detailed schedule attached to Addendum No. 9 provided that two priority sections had to be completed before 23 March 2003 (the Priority Sections).

24. Asserting primarily that NHA failed "to give the Possession of Site as per Addendum No. 9", on 15 January 2001 Bayindir submitted its third EOT claim (EOT/03) for completion of the two "Priority Sections" by October 2001 (Exh. [Bay.] B-15). On 3 April 2001 the Engineer's representative granted Bayindir a limited extension of time of twenty-seven and ten days respectively (Exh. [Bay.] B-17).

---

5 See 1997 Contract. This date was extended till 31 December 2002 though Addendum No. 9 dated 17 April 2000 (see *infra* No. 23-24).

6 During the same period, Bayindir also issued several claims for delay in the settlement of Bayindir's monthly progress payments (interim payment certificates).

7 Under the agreement reached during the meeting of 18 February 2000, it was decided, inter alia, that "December 2002 as the new completion date for the Project with about one year advance completion of two sections from Islamabad to Burhan and Indus to Mardan" (Exh. [Bay.] B13). Among other new conditions that were not contemplated by the agreement of 18 February 2000, Addendum No. 9 provided that Bayindir had to "complete the two Priority Sections mentioned therein by 23 March 2001". It is Bayindir's contention that it accepted this new demand by NHA "[a]s a result of the pressure, coercion and duress exercised by Pakistan" (RA p. 5 ¶ 13).

25. By letter of 6 April 2001 Bayindir disputed this extension of time (Exh. [Bay.] B-18) and referred the matter to the Engineer for his decision under Clause 67.1 of the Contract reiterating its entitlement to an extension under EOT/03.[8]

26. On 19 April 2001 NHA informed Bayindir that liquidated damages would be imposed on Bayindir for late completion of the two Priority Sections with effect from 20 April 2001; that is, the end of the limited extension granted on 3 April 2001 (Exh. [Bay.] B-20).

27. The same day, Bayindir wrote to NHA to refer the decision to impose liquidated damages to the Engineer pursuant to Clause 67.1, in particular on the ground that EOT/03 was "still pending with the Engineer for decision" (Exh. [Bay.] B-25).

28. On 20 April 2001, Bayindir wrote to NHA to inform that it had been unable to complete the Priority Sections "due to reasons beyond [its] control" and requested that "the procedure [that is the submission of EOT/03 to the Engineer for decision under Clause 67.1] be allowed to follow to determine [its] entitlement for Time extension" (Exh. [Bay.] B-21).

29. On 23 April 2001 – before the engineer issued its determination – NHA served a "Notice of Termination of Contract" upon Bayindir requiring the latter to hand over possession of the site within 14 days (Exhibit [Bay.] B-26). Thereafter, the Pakistani army surrounded the site and Bayindir's personnel were evacuated.

30. On 23 December 2002 NHA concluded a contract for the "Completion of Balance Works of Islamabad – Peshawar Motorway (M-1) Project with "M/s Pakistan Motorway Contractors Joint Venture (PMC JV)" providing for a completion term of 1460 days (Exh. [Bay.] CX29).

c. Related litigation

31. From January to July 2001, Bayindir served several Notices of Intention to Commence Arbitration pursuant to Clause 67.1 of the Contract. The matters were not settled but the arbitration was not pursued.[9]

---

[8] The Engineer rendered its decision on EOT/03 on 28 June 2001 granting an extension of time until 19 and 1st April respectively.

32. On 30 April 2001, Bayindir filed a constitutional challenge against the notice of termination served by NHA before the Lahore High Court (Exh. [Pak.] D-15). On 7 May 2001, the Lahore High Court dismissed Bayindir's constitutional challenge on the ground that the Contract contained an arbitration clause (Exh. [Pak.] D-16, in particular pp. 17-18)[10].

33. Between 2001 and early 2003, NHA raised a series of claims against Bayindir and served a notice of arbitration. On 31 March 2003, NHA sought Bayindir's concurrence in the appointment of a sole arbitrator. On 10 April 2003, Bayindir informed NHA that it had already submitted the matter to ICSID jurisdiction and requested to await the decision on Bayindir's request for ICSID Arbitration (Exh. [Pak.] D-23).

34. On 5 January 2004, NHA applied for the appointment of an arbitrator in Pakistan under section 20 of the Arbitration Act 1940. On 28 May 2004, the Court of Civil Judge in Islamabad appointed Mr. Justice (Retd.) Afzal Lone as arbitrator. The court subsequently upheld an objection of NHA (claiming that Mr. Lone was too closely linked with the previous government of Pakistan; that is the government that decided the revival of the contract in 1997) and appointed Mr. Justice (Retd.) Zahid. Following a request by Pakistan, NHA moved for an extension of time limits in such a manner that the arbitration would not proceed prior to this Tribunal's decision on jurisdiction (see *infra* No. 45).

35. In the meantime, on 24 April 2001, NHA called for payment under the Mobilisation Advance Guarantees of approximately USD 100,000,000. Bayindir then obtained an order from the Turkish courts enjoining the Banks from paying. This injunction was lifted on 12 September 2003. Execution proceedings against the Banks, to which Bayindir is not a party, are currently stayed following this Tribunal's Procedural Order N° 1 (PO#1) that Pakistan take steps to ensure that NHA does not enforce any final judgment it may obtain from the Turkish courts with regard to the Mobilisation Advance Guarantees (see *infra* No. 46).

---

9 With specific regard to a claim introduced on 7 September 2001 concerning escalation payment, Bayindir filed an application under Section 20 of the 1940 Arbitration Act for the appointment of an arbitrator on 19 April 2001 (Exh. [Pak.] D-13). The application was dismissed as premature (failing notice under Clause 67.4 of the Contract) on 24 March 2003 (Exh. [Pak.] D-17). An appeal against this decision was dismissed as withdrawn (Exh. [Pak.] D-19).

10 An appeal against this decision was dismissed as withdrawn by the Supreme Court of Pakistan on 16 November 2003.

d. The BIT

36. The present proceedings are based on the "Agreement Between the Republic of Turkey and the Islamic Republic of Pakistan Concerning the Reciprocal Promotion and Protection of Investments" of 16 March 1995 (the “BIT”), which entered into force on 3 September 1997.

37. Article VII of the BIT contains a dispute settlement provision with respect to investments between one of the parties and an investor of the other party (see *infra* N° 80).

II. PROCEDURAL HISTORY

A. INITIAL PHASE

38. On 15 April 2002, Bayindir submitted a Request for Arbitration (the “Request” or “RA”) to the International Centre for the Settlement of Investment Disputes (“ICSID” or the “Centre”), accompanied by 15 exhibits (Exh. [Bay.] B-1 to B-15). In its Request Bayindir invoked the provisions of the BIT and sought the following relief:

    (i) payment of outstanding Interim Payment Certificates US$62,514,554.00;

    (ii) payment of additional financial claims related to the Works completed by Bayindir provisionally quantified as US$27,000.000.00;

    (iii) reimbursement of all costs incurred in anticipation of completing the Project by Bayindir US$19,071,449.00;

    (iv) payment against all fixed and movable assets expropriated by Pakistan US$43,050,619.00;

    (v) compensation for mobilisation and demobilisation costs US$7,444,854.00;

    (vi) compensation for profits lost through Pakistan’s unlawful acts and omissions provisionally quantified as US$107,154,634.00;

    (vii) compensation for damage to Bayindir's reputation resulting from Pakistan's unlawful acts and omissions provisionally quantified as US$150,000,000.00;

    (vii) […] compensation and costs on account of the following items:

        (i) the reimbursement of all costs incurred by Bayindir in pursuing the resolution of the claims brought in this arbitration, including but not limited to the fees and/or expenses of the arbitrators, ICSID, legal counsel, experts and Bayindir's own experts and staff;

        (ii) compounded interest on all amounts awarded at an appropriate rate or rates and over an appropriate period or periods;

        (iii) compensation for opportunities lost as a direct result of Pakistan's unlawful acts and omissions;

(iv) compensation for losses and damages suffered by Bayindir in Turkey as a direct consequence of Pakistan's unlawful acts and omissions;

(v) any other relief that the Arbitral Tribunal may deem fit and appropriate in the circumstances of this case.

(RA, ¶¶ 39-40)

39. On 16 April 2002, the Centre, in accordance with Rule 5 of the ICSID Rules of Procedure for the Institution of Conciliation and Arbitration Proceedings (the "Institution Rules"), acknowledged receipt and transmitted a copy of the RA to Pakistan and to the Pakistani Embassy in Washington D.C.

40. After a long and extensive exchange of correspondence between Bayindir[11], Pakistan[12], NHA[13] and the Centre, on 1 December 2003, the Secretary-General of the Centre registered Bayindir's RA, pursuant to Article 36(3) of the Convention on the Settlement of Investment Disputes between States and Nationals of other States (the "ICSID Convention" or "the Convention"). On the same date, the Secretary-General, in accordance with Institution Rule 7, notified the parties of the registration of the request and invited them to proceed, as soon as possible, to constitute an Arbitral Tribunal.

41. In the absence of agreement between the parties, on 6 February 2004, Bayindir elected to submit the arbitration to a panel of three arbitrators, as provided in Article 37(2)(b) of the ICSID Convention and appointed Prof. Karl-Heinz Böckstiegel, a national of

---

11 In particular, on 10 February 2003, Bayindir supplemented its RA by the submission of a Volume III.

12 In particular, on 23 May 2002, the republic of Pakistan stated that "[t]he nomination of Secretary Communication by [Bayindir] is without any relevance to the terms of Contract. In view of provisions of Contract Agreement and various guarantees given by [Bayindir] to NHA for faithful performance of [Bayindir]'s obligations and against Mobilization Advance; NHA is the party to the Contract and not the Secretary Communication. The alleged dispute is manifestly outside the jurisdiction of the Centre, pursuant to sub-para 1 Article 25, sub-para 3 of Article 36, sub-para 1(b) of Rule 6 of INSTITUTION RULE of the Centre. The contents of the requests by [Bayindir] are in contravention to Rule 2 of the INSTITUTION RULE of the Centre" (Pakistan's submission of 23 May 2002). The Government of Pakistan further "requested that all future communication and notices if required, regarding the subject issue, are to be sent to the [NHA]" (Pakistan's submission of 19 February 2003).

13 In particular, on 22 August 2003, NHA submitted its "Observation and Reply to ICSID" with reference to Bayindir's RA. In its submission NHA concluded that "[t]he documented statements as given in this submission provide further material to conclude the fact that *Bayindir had never been an Investor neither* the dispute referred to *ICSID has any bearing with the relevant provision of BIT*. Therefore, the 'Request for Arbitration' submitted by Bayindir to ICSID is void of merits at its own account and manifestly *beyond the jurisdiction of ICSID. Therefore, the Secretary General is requested to refuse the registration of Bayindir's 'Request for Arbitration'* pursuant to Article 36(3) and institution Rule 6(1)(b) of the Convention" (NHA's submission of 22 August 2003, p. 2, emphasis in the original).

Germany. On 26 February 2004, Pakistan appointed Sir Franklin Berman, a national of the United Kingdom, as arbitrator. On 27 April 2004, the parties agreed to appoint Prof. Gabrielle Kaufmann-Kohler, a national of Switzerland, as the President of the Tribunal.

42. On 15 June 2004, the Secretary-General of ICSID, in accordance with Rule 6(1) of the ICSID Rules of Procedure for Arbitration Proceedings (Arbitration Rules), notified the parties that all three arbitrators had accepted their appointments and that the Tribunal was therefore deemed to be constituted and the proceedings to have begun on that date. The same letter informed the parties that Mr. José-Antonio Rivas, Counsel, ICSID, would serve as Secretary of the Tribunal[14].

43. On 20 July 2004, Bayindir submitted a Request for Provisional Measures, seeking in substance recommendations by the Tribunal that the Respondent stay all proceedings pending before the Courts of Pakistan and Turkey. On 27 August 2004, Pakistan filed its Response to Claimant's Request for Provisional Measures.

44. The Arbitral Tribunal held a first hearing on 24 September 2004, at the offices of the World Bank in Paris. At the outset of the preliminary hearing, the parties expressed agreement that the Tribunal had been properly constituted (Arbitration Rule 6) and stated that they had no objections in this respect. The parties further agreed on a set of procedural rules to apply to the present proceedings. The preliminary hearing was tape-recorded, a *verbatim* transcript was taken and later distributed to the parties (Tr. P.).

45. During the course of the preliminary hearing, the parties' counsel also presented oral arguments on Bayindir's request for provisional measures. At the end of the preliminary hearing, Bayindir withdrew its request seeking a stay of the arbitration pending in Pakistan between NHA and Bayindir before the sole arbitrator, Mr. Justice (Retd.) Zahid,[15] as a result of an offer by Pakistan to request NHA to move for an extension of the time limits fixed in the latter in such a manner that the Pakistani arbitration would

---

[14] In the course of the Proceedings, Mr. Rivas was replaced by Ms. Martina Polasek, Counsel, ICSID, on 11 May 2005.

[15] As amended at the hearing, this request reads as follows: "1. The Parties immediately take all steps required to obtain a temporary stay of all proceedings brought under the Pakistan Arbitration Act 1940 and pending before the Courts of Pakistan and/or before an arbitrator" (Bayindir's amended Request for provisional measures submitted at the hearing on 24 September 2004).

not proceed before this Tribunal rendered its decision on jurisdiction (Tr. P. 153:17–155:25).

46. On 29 November 2004, the Tribunal rendered its Decision on Claimant's Request for provisional measures (PO#1), which reads as follows:

> Having reviewed the Claimant's and the Respondent's written submissions and having heard oral argument, the Tribunal issues the following order:
>
> (i) The Tribunal acknowledges that Bayindir withdrew the request seeking a stay of the Pakistani arbitration as a result of an offer of Pakistan to request NHA to move for an extension of time limits in such a manner that that arbitration will not proceed prior to this Tribunal's decision on jurisdiction.
>
> (ii) The Tribunal recommends that Pakistan take whatever steps may be necessary to ensure that NHA does not enforce any final judgment it may obtain from the Turkish courts with regard to the Mobilisation Advance Guarantees. This recommendation remains in effect until: (a) an arbitral award declining jurisdiction is issued; or (b) an arbitral award is rendered on the merits; or (c)·any other order of the Tribunal amending the recommendations is issued; whichever comes first.
>
> (iii) The Tribunal dismisses Pakistan's request to recommend, as a matter of principle, that Bayindir should provide security for Pakistan's costs.
>
> (iv) The Tribunal will rule on the costs of this application in its decision on jurisdiction or, if it asserts jurisdiction, in its decision on the merits of the dispute.
>
> (PO#1, at No. 78)

47. As a threshold matter in the Tribunal's decision on provisional measures, the Tribunal emphasized that the reasons contained in that decision were "without prejudice to a later decision of this Tribunal on Pakistan's objection to the jurisdiction of the Tribunal" (PO#1, at No. 40).

B. THE WRITTEN PHASE ON JURISDICTION

48. In accordance with the timetable agreed during the preliminary hearing, on 31 December 2004, Pakistan submitted its Memorial on jurisdictional objections (Mem. J.) accompanied by one volume of contractual documents (Annexes C-1 to C-13), four volumes of legal materials (Annexes L-1 to L-43) and one volume of Documentary Exhibits (Exhibits 1 to 35). Pakistan did not append any witness statement or expert opinion.

49. In accordance with the timetable agreed during the preliminary hearing, on 31 March 2005, Bayindir submitted its Counter-Memorial on jurisdiction (C-Mem. J.) accompanied

by one volume of documentary evidence (CX 79 to CX 124) and five volumes of legal materials (Exhibits CLEX 18 to CLEX 55). Bayindir did not append any written witness statement or expert opinion.

50. In accordance with the timetable agreed during the preliminary hearing, on 9 May 2005, Pakistan submitted its Reply to Claimant's Counter-Memorial on jurisdiction (Reply J.) accompanied by one volume of documentary exhibits (Exhibits R-1 to R-74) and one volume of legal materials (Exhibits RL-1 to RL-22).

51. Within the extension of time allowed by the Tribunal, on 17 June 2005, Bayindir submitted its Rejoinder on Jurisdiction (Rejoinder J.) accompanied by one volume of documentary exhibits (Exhibits CX 125 to CX 156)[16] and one volume of legal materials (Exhibits CLEX 56 to CLEX 61).

52. On 5 July 2005, pursuant to Article 19 of the ICSID Arbitration Rules, the Tribunal invited Pakistan to file a written response limited to the new factual allegations contained in ¶¶ 101 to 104 of Claimant's Rejoinder on Jurisdiction on or before 15 July 2005.

53. On 7 July 2005, the Tribunal held a preparatory telephone conference to organize the hearing on jurisdiction for which the dates of 25 and 27 July 2005 had previously been retained. None of the parties having submitted witness statements or expert opinions, it was agreed that the hearing on jurisdiction would be limited to oral arguments.

54. On 11 July 2005, the Secretary of the Tribunal informed the parties that the jurisdictional hearing would be held on 25, 26 and 27 July 2005 and transmitted the agenda for the hearing.

---

[16] At the outset of the hearing on jurisdiction, Pakistan pointed out that some of these exhibits – namely Exh. [Bay]CX127, an internal letter dated 4 November 2000; Exh. [Bay]CX131, an internal letter dated 2 May 2001; Exh.[Bay]CX145, an internal letter of June 2001; Exh. [Bay]CX146, an internal letter dated May 200; Exh. [Bay]CX151, an internal letter of April 2001; Exh. [Bay]CX152, a confidential letter from the World Bank dated 26 May 2000 to the Government of Pakistan; Exh. [Bay]CX153, a confidential letter from the World Bank to the Government of Pakistan dated 5 June 2000 – constituted "confidential and privileged legal materials which have apparently been taken from the files of the Government of Pakistan" (Tr. J., 18:3-16). Pakistan did not however object to their production in this arbitration (see *infra* No 248).

55. On 22 July 2005, Mr Bundy wrote to the Tribunal to inform it that Pakistan had ratified the New York Convention and attached the ratification instrument dated 9 June, deposited with the Secretary-General of the United Nations on 14 July. Mr. Bundy's letter also informed the Tribunal that Pakistan had enacted the New York Convention in the form of the Recognition of Enforcement of Arbitration Agreements and Foreign Arbitral Awards Ordinance of 2005, which came into force with retroactive effect on 14 July 2005[17].

C. THE HEARING ON JURISDICTION

56. The Arbitral Tribunal held the hearing on jurisdiction from 25 July 2005, starting at 11:00 am to 26 July ending at 4:15 pm, at the Salons des Arts et Metiers, 9 bis avenue d'Iena, Paris. In addition to the Members of the Tribunal[18], and the Secretary, the following persons attended the jurisdictional hearing:

(i) On behalf of Bayindir:

- Mr. Gavan Griffith QC, Essex Court Chambers
- Mr. Farrukh Karim Qureshi; Walker Martineau Saleem
- Mr. Sadik Can; Bayindir Insaat Turizm Ticaret Ve Sanayi AS
- Mr. Zafer Baysal; Bayindir Insaat Turizm Ticaret Ve Sanayi AS
- Ms. Gokce Cicek BIcioglu
- Ms. Nudrat Ejaz Piracha

(ii) On behalf of Pakistan:

- Mr. Aftab Rashid; Ministry of Communications of Pakistan
- Mr. Raja Nowsherwan Sultan; NHA
- Lt. Col. (Ret'd.) Muhammad Azim; Consultant, NHA
- Mr. Iftikharuddin Riaz; Bhandari, Naqvi & Riaz
- Prof. Christopher Greenwood, CMG, QC; Essex Court Chambers
- Mr. V.V. Veeder, QC; Essex Court Chambers
- Mr. Samuel Wordsworth; Essex Court Chambers
- Mr. Rodman R. Bundy; Eversheds

---

17 At the hearing on jurisdiction, the Tribunal granted Pakistan's formal application to introduce these legal materials into the file (Tr. J., 17:30-32).

18 With the agreement of the parties, Dr. Antonio Rigozzi, an attorney practising in the law firm of the President of the Tribunal, attended the hearing.

- Ms. Loretta Malintoppi; Eversheds
- Mr. Charles Claypoole; Eversheds
- Ms. Cheryl Dunn; Eversheds
- Ms. Victoria Forman Hardy; Eversheds
- Mr. Nicholas Minogue; Eversheds

57. During the jurisdictional hearing, Messrs. Veeder, Greenwood, Wordsworth and Bundy addressed the Tribunal on behalf of Pakistan and Mr. Griffith addressed the Tribunal on behalf of Bayindir.

58. The jurisdictional hearing was tape-recorded, a *verbatim* transcript was taken and later distributed to the parties (Tr. J.). It ended earlier than scheduled, both parties having fully presented their arguments and agreeing to such change of schedule.

* * *

59. It was agreed at the close of the jurisdictional hearing that the Tribunal would issue a reasoned decision on the preliminary questions of jurisdiction and admissibility. If the decision were negative, the Tribunal would render an award terminating the arbitration; if the decision were affirmative, the Tribunal would render a decision asserting jurisdiction and issue an order with directions for the continuation of the procedure pursuant to Arbitration Rule 41(4).

60. The Tribunal has deliberated and thoroughly considered the parties' written submissions on the question of jurisdiction and the oral arguments delivered in the course of the jurisdictional hearing. Before reaching a conclusion on the question of jurisdiction, the present decision summarizes (III) and discusses (IV) the position of the parties.

III. THE PARTIES' POSITIONS

A. BAYINDIR'S POSITION

61. In its written and oral submissions, Bayindir advanced the following four main contentions:

(i) Bayindir made an "investment" under both the BIT and the ICSID Convention;

(ii) Bayindir has *prima facie* claims against Pakistan for breaches of the BIT, namely for breaches of the treaty provisions on national and most favoured nation treatment, fair and equitable treatment and expropriation without compensation (hereinafter generally referred to as "Treaty Claims");

(iii) The Treaty Claims are distinct and autonomous claims which Bayindir can assert against NHA (and or Pakistan) independently from those claims which arise out of the Contract (hereinafter generally referred to as Bayindir's "Contract Claims").

(iv) Finally, as an independent argument, Bayindir claims that the Tribunal also has jurisdiction over the Contract Claims.

62. On the basis of these contentions, Bayindir requested the Tribunal to decide:

> [t]hat this Tribunal has jurisdiction to hear the claims for breach of the BIT, but in addition also claims that would be only contractual in nature. The requirements for this Tribunal to exercise its jurisdiction under the BIT over the Parties and over Bayindir's claim have been satisfied.
>
> (C-Mem. J., p. 88, ¶ 312)

63. At the outset of the jurisdictional hearing, Bayindir withdrew its independent argument that the Tribunal has jurisdiction also over the Contract Claims:

> [I]t appears to us that our claim for treaty breaches is so strongly expressed that it is not necessary for us to turn to alternative and fall-back mechanisms to pursue our claims by asserting as we did in Part VI of our counter memorial that even if there is no treaty BIT breaches made out nonetheless we can make a freestanding contract claims as the basis of our jurisdiction under ICSID and under the BIT.
>
> (Tr. J., 7:12-19)

64. Accordingly, Bayindir resiles from pressing purely contractual claims (Tr. J., 60:2-4).

B. PAKISTAN'S POSITION

65. In its written and oral submissions, Pakistan advanced the following six main arguments:

(i) Bayindir has not made an investment within article I(2) of the BIT or Article 25 of the ICSID Convention.

(ii) The basis of Bayindir's claims is alleged breach of the Contract. The Contract is governed by the law of Pakistan and, pursuant to the law of Pakistan, the Employer (NHA) is a separate legal person, distinct from Pakistan. The Tribunal has no jurisdiction in respect of alleged breaches of the Contract as such breaches are not attributable to Pakistan.

(iii) The Contract Claims are inadmissible in the light of the agreement of the Employer and the Contractor to refer their disputes to arbitration, and the proceedings should be stayed pending resolution of the contractual dispute by arbitration.

(iv) To the extent that Bayindir's claims are based on an alleged breach of the BIT, i.e., to the extent that they are Treaty Claims, they are entirely artificial and advanced solely for purposes of expediency.

(v) Since Bayindir's Treaty Claims are dependent upon the claims for breach of the Contract that have to be settled in another forum, the Tribunal cannot exercise jurisdiction over the Treaty Claims, at least until that other forum has reached a conclusion with regard to the alleged breach of the Contract.

(vi) Insofar as Bayindir's Treaty Claims are distinct from the alleged breach of the Contract, these allegations "have no colourable basis" and are insufficient for this Tribunal to assert jurisdiction.

66. In reliance on these arguments, Pakistan invites the Tribunal:

> [t]o declare that it has no jurisdiction in respect of the whole of Bayindir's claim, and that the claim is accordingly to be dismissed. Insofar as the Tribunal considers that the claim is not to be dismissed in its entirety for want of jurisdiction, Pakistan invites the Tribunal to make alternative declarations to reflect restrictions on its jurisdiction and/or on the admissibility of Bayindir's claims, namely:
>
> a. That it has no jurisdiction in respect of Bayindir's allegations of breach of the Contract, alternatively that such claims are inadmissible before this Tribunal;
>
> b. That, insofar as the Tribunal has jurisdiction to determine Bayindir's claims characterised as breaches of the BIT, such claims should not be heard pending resolution of the disputes pursuant to the Arbitration Agreement in the Contract.
>
> (Mem. J., p. 2)

67. Following Bayindir's above-mentioned change of position at the outset of the jurisdictional hearing, on 16 August 2005 Pakistan requested the Tribunal to:

> [d]eal with the issues of principle and apportionment relating to costs in its award/decision, including the wasted costs due to Bayindir's late change in position, and to award the Government of Pakistan its costs and expenses incurred as a result of these proceedings.[19]

68. On 26 August 2005, Bayindir submitted in response "that the issue of costs should be a matter for submission after the award on objections to jurisdiction"[20].

---

[19] See letter of Mr. Bundy to the Secretary of the Tribunal of 16 August 2005.

[20] See letter of Mr. Farrukh Karim Qureshi to the Secretary of the Tribunal of 26 August 2005.

69. On 29 August 2005, "in the light of the above[-mentioned change in Bayindir's position], Pakistan request[ed] the Tribunal's permission to withdraw its offer to request NHA to move for an extension of the time limits in the Pakistani arbitration so that this does not proceed prior to a decision on jurisdiction in the present case" (see *supra* N° 46).

70. On 20 September 2005, Bayindir opposed such request, asked that it "be declined and taken up for consideration after the decision on jurisdiction and upon consulting the parties on opportunity to make written and oral submissions."

71. In support of their position on jurisdiction, both parties have relied on rules of international law, decisions of courts and arbitral tribunals, and opinion of learned authors. In the course of the following discussion, the Tribunal will review the law pleaded by the parties and its applicability to the facts of the present case. The Tribunal adds that while Part III of this decision summarizes the main arguments of the parties, other arguments were made and considered by the Tribunal, and will be referred to in Part IV to the extent the Tribunal considers them relevant.

IV. DISCUSSION

INTRODUCTORY MATTERS

72. Before turning to the actual issues, the Tribunal wishes to address certain preliminary matters, i.e., the relevance of previous ICSID decisions (a), some uncontroversial matters (b), the law applicable to the Tribunal's jurisdiction and the relevant issues for determination (c).

a. The relevance of previous ICSID decisions or awards

73. In support of their position, both parties relied extensively on previous ICSID decisions or awards, either to conclude that the same solution should be adopted in the present case or in an effort to explain why this Tribunal should depart from that solution.

74. In particular, part of the parties' oral and written submissions was devoted to discussing the relevance, the scope and the 'appropriateness' of the recent decision on jurisdiction

in the arbitration between Impregilo S.p.A. and the Islamic Republic of Pakistan (hereinafter the *Impregilo* case)[21].

75. For instance[22], in its Rejoinder on jurisdiction, Bayindir submitted:

> As a final point, Bayindir again submits that this Tribunal is not bound to follow the decisions of other investment Tribunals deciding different cases on the basis of similar, yet distinctly worded treaties. Nevertheless, this Tribunal will be asked in the Rebuttal to carefully consider the very recent decision of *Impregilo v. Pakistan*. Contrary to the Reply, rather than assisting Pakistan, the *Impregilo* decision actually exposes several of the major flaws in Pakistan's arguments, as shall be hereafter discussed.
>
> (Rejoinder J., p. 3, ¶ 9)

76. The Tribunal agrees that it is not bound by earlier decisions[23], but will certainly carefully consider such decisions whenever appropriate.

b. Uncontroversial matters

77. There is no dispute as to the jurisdiction of this Tribunal to decide the jurisdictional challenges brought by Pakistan (Article 41 of the ICSID Convention).

78. Pakistan's jurisdictional objections are related to the nature of the dispute and to the legal characterization of the claims. In other words, Pakistan contests the jurisdiction of the tribunal *ratione materiae*. Pakistan raises no jurisdictional objection *ratione personae* or *temporis*[24].

---

21 *Impregilo S.p.A. v. Islamic Republic of Pakistan,* ICSID Case No. ARB/03/3, Decision on Jurisdiction, 22 April 2005, ¶ 108; available at http://www.worldbank.org/icsid/cases/impregilo-decision.pdf (Exh. [Pak]RL-1 = Exh. [Bay]CLEX 57).

22 Pakistan expressed a similar view for instance as regards the most favoured nation clause of Article II(2) of the BIT. After having relied upon *Siemens v. Argentina* [*infra* Fn. 80] to contend that "[p]ursuant to its ordinary meaning, the more favourable protection that Bayindir seeks falls outside the scope of Article II(2) of the 1995 Treaty", Pakistan felt compelled to add the following: "The Tribunal is not, of course, bound by the decisions of previous ICSID tribunals on the extent of most favoured nations provisions in other treaties. However, if necessary, Pakistan will submit that, in the absence of express wording, it would be wrong to find that the rights of an investor under a most favoured nation provision could extend to benefiting either from an agreement to arbitrate where there was no such agreement" (Mem. J., p. 65, ¶ 5.9).

23 *AES Corporation v. the Argentine Republic*, ICSID Case No. ARB/02/17, Decision on jurisdiction of 13 July 2005, ¶¶ 30-32; available at http://www.investmentclaims.com/decisions/AES-Argentina_Jurisdiction.pdf.

24 Inasmuch as they involve objective requirements, these conditions shall be analysed by the Tribunal *motu propio* (see SCHREUER, *The ICSID Convention: A Commentary*, Cambridge (UK), 2001, para. 4-45 ad Article 41, pp. 535-536). The Tribunal notes that the Parties to the dispute are a State (Pakistan), and a Turkish company (Bayindir) and that both Pakistan and Turkey are Contracting States within the meaning of Article 25(1) of the ICSID Convention.

c. The law applicable to this Tribunal's jurisdiction and the relevant issues

79. This Tribunal's jurisdiction *ratione materiae* depends in the first instance upon the requirements of the BIT and of the ICSID Convention.

80. Article VII of the BIT contains the following dispute settlement clause:

> 1. Disputes between one of the Parties and an investor of the other Party, in connection with his investment, shall be notified in writing, including a detailed information, by the investor to the recipient Party of the investment. As far as possible, the investor and the concerned Party shall endeavour to settle the disputes by consultations and negotiations in good faith.
> 2. If these disputes cannot be settled in this way within six months following the date of the written notification mentioned in paragraph 1, the dispute can be submitted, as the investor may choose, to:
>
>   (a) the International Centre for Settlement of Investment Disputes (ICSID) set up by the 'Convention on Settlement of Investment Disputes Between States and nationals of other States'; [in case both Parties become signatories of this Convention]
>
>   (b) an ad hoc court of arbitration laid down under the Arbitration Rules of Procedure of the United Nations Commission for International Law (UNCITRAL), [in case both Parties are members of UN]
>
>   (c) the Court of Arbitration of the Paris International Chamber of Commerce,
>
>   provided that, if the investor concerned has brought the dispute before the courts of justice of the Party that is a party to the dispute and a final award has not been rendered within one year.

81. 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.

82. The Tribunal notes that Pakistan has not objected to its jurisdiction on the ground that the dispute is not legal or that it does not involve a Contracting State and a national of another Contracting State.

83. In order to establish the jurisdiction of this Tribunal under Article 25 of the ICSID Convention, Bayindir relies upon (1) the consent of Pakistan to arbitration as contained in the BIT combined with (2) its own consent as contained in the Request for arbitration. As the tribunal held in *Impregilo*, according to a now "well established practice, it is clear that the coincidence of these two forms of consent can constitute 'consent in

writing' within the meaning of Article 25(1) of the ICSID Convention […] if the dispute falls within the scope of the BIT."[25] This is not disputed by Pakistan.

84. Pakistan has objected to the jurisdiction of the Tribunal and/or to the admissibility of Bayindir's claim.

85. Pakistan's objection to jurisdiction is based on the following grounds:

(i) Bayindir has not made an investment within Article I(2) of the BIT or Article 25 of the ICSID Convention.

(ii) There are no freestanding treaty breaches capable of being alleged by Bayindir.

(iii) Insofar as there are alleged breaches of the Treaty distinct from the alleged breaches of the Contract, these allegations "have no colourable basis", i.e., they are not "sustainable".

86. Pakistan's objection to the admissibility of the claim is based on the following grounds:

(i) To exercise jurisdiction would raise a potential conflict between two very important treaties, the 1958 New York Convention and the 1965 Washington Convention.

(ii) Insofar as there are alleged breaches of the Treaty distinct from the alleged breaches of the Contract, Bayindir is barred from raising them as it has previously characterized these breaches as contractual.

(iii) Insofar as there are alleged breaches of the Treaty distinct from the alleged breaches of the Contract, the ICSID proceedings should be stayed pending the resolution of the contractual dispute by arbitration.

(iv) Bayindir has failed to comply with the formal requirements of Article VII of the BIT.

87. The Tribunal will examine Pakistan's objections in turn, without distinguishing between objections to the jurisdiction of the Tribunal and objections to the admissibility of the claims[26]. For the sake of logic, the Tribunal will begin with Pakistan's objection that Bayindir has failed to comply with the pre-conditions to arbitration in Articles VII(1) and (2) and that, accordingly, Bayindir is not entitled to submit any dispute to arbitration under Article VII(2) of the 1995 Treaty.

---

[25] *Impregilo v. Pakistan* [*supra* No. 74], ¶ 108.

[26] *Consortium Groupement L.E.S.I. - DIPENTA v. République Algérienne Démocratique et Populaire*, Award of 27 December 2004, ¶ 2 (Exh. [Bay]CLEX 57); available at http://www.worldbank.org/icsid/cases/lesi-sentence-fr.pdf.

A. HAS BAYINDIR FAILED TO COMPLY WITH FORMAL REQUIREMENTS PREVENTING IT TO SUBMIT THE PRESENT DISPUTE (ARTICLE VII OF THE BIT)?

88. Pakistan's first, "fundamental and principled objection" is that Bayindir did not satisfy the "prerequisites for jurisdiction" set forth in Article VII of the BIT (Tr. J., 73:17-26). More specifically, Pakistan contends that Bayindir has failed to give notice of any claim for alleged breaches of the BIT and/or to negotiate in respect of such a claim as provided by Article VII of the BIT "and that, accordingly, Bayindir is not entitled to submit any dispute to arbitration under Article VII(2) of the 1995 Treaty" (Mem. J., p. 67, ¶ 5.10).

89. In its relevant part, Article VII of the BIT provides that the investor can submit disputes to arbitration only "if these disputes cannot be settled in this way within six months following the date of the written notification" of the dispute. It further specifies that:

> Disputes between one of the Parties and an investor of the other Party, in connection with his investment, shall be notified in writing, including a detailed information, by the investor to the recipient Party of the investment. As far as possible, the investor and the concerned Party shall endeavour to settle these disputes by consultations and negotiations in good faith.

90. Bayindir contends that it has complied with the requirement of notice under Article VII of the BIT by disputing the validity of various decisions of the Engineer (RA, p. 7, ¶ 21) and, by serving the Government of Pakistan with the "Constitutional Petition" on 26 April 2001 (Exh.[Bay.]CX 35, referred to in C-Mem. J., p. 51, ¶ 178). In substance, Bayindir admits that this notice could be framed "more perfectly", but contends that it "effectively g[a]ve notice" (Tr. J., 180:1 *et seq.*).

91. As shown at the jurisdictional hearing by Pakistan (Tr. J., 42:13 *et seq.*), the notices referred to in Bayindir's RA were purely contractual notices to the Engineer with a view to commencing arbitration under clause 67.1 of the Contract and cannot be assimilated to a notice under Article VII(2) of the BIT[27].

92. As regards the Constitutional Petition, it is Bayindir's contention that it "provided 20 pages of detailed information concerning the dispute between Bayindir and Pakistan" (C-Mem. J., p. 51, ¶ 179). More specifically, Bayindir points out that in the Constitutional

---

[27] The Tribunal notes that Bayindir seems to abandon the argument that it complied with the requirement of notice by disputing the validity of various decisions of the Engineer (Tr. J., 180:13-18).

Petition it complained that it had been treated "unilaterally, arbitrarily and illegally […] without […] due process of law" and that the expulsion "appears to have been taken under the dictates of [the Government of Pakistan] for ulterior motives" (C-Mem. J., p. 51, ¶ 180 referring to Exh. [Bay.] CX-35, p. 19 at xv).

93. Pakistan did not address this contention in its Reply. At the hearing on jurisdiction, it adopted the following position:

> But it is an interesting question in theory whether a constitutional petition in the courts of a state is capable of amounting to the necessary notification as a prelude to a good faith attempt to settle a dispute by negotiation. But this is a constitutional petition that does not refer to the BIT. It could not remotely be described as a notification in writing of a dispute under the BIT accompanied by the appropriate detailed information.
>
> (Tr. J., p. 71:25-33)

94. Although it is true that – unlike other treaties and in particular NAFTA – "[t]here is no requirement in the BIT that such written notice refer either to the BIT or BIT breaches" (C-Mem. J., p. 51, ¶180), the fact remains that the Constitutional Petition was not filed in view of a dispute under the Treaty. Moreover, as correctly pointed out by Pakistan, the Constitutional Petition could hardly rely on the BIT since the BIT itself is not part of the law of Pakistan (Tr. J., 216.15-16 referring (implicitly) to Tr. J., 192:3-5).

95. This being said, the Tribunal does not need to make a definitive ruling on the 'theoretical' question of whether a constitutional petition in the courts of a State may serve as a notice under a BIT. Nor does the Tribunal need to rule on the more practical question whether, in Bayindir's terms, "when one looks closely at the constitutional petition one can spell out" the necessary information required under Article 7 of the BIT (Tr. J., 182:13-16) or, more generally, whether these requirements constitute "a necessary ingredient of the notice provision" (Tr. J., 182:20-21). In the Tribunal's view, the requirement of notice contained in Article VII of the BIT should not be interpreted as a precondition to jurisdiction.

96. Determining the real meaning of Article VII of the BIT is a matter of interpretation. Pursuant to the general principles of interpretation set forth in Article 31 of the Vienna Convention on the Law of Treaties, and consistently with the practice of previous ICSID

tribunals dealing with notice provisions[28], this Tribunal considers that the real meaning of Article VII of the BIT is to be determined in the light of the object and purpose of that provision.

97. The parties made extensive submissions on what the correct interpretation of Article VII of the BIT should be:

(i) In Pakistan's view, the notice requirement constitutes a "carefully crafted" limitation of the consent given by the parties to the BIT offering the foreign investor a direct right of recourse to international arbitration against the defendant state (Tr. J., 72:3-12). Hence, Article VII is a mandatory provision and the parties have a "real obligation" to endeavour to settle their dispute within the six months periods (Tr. J., 213:16 *et seq.*). Accordingly the notice requirement is to be interpreted as a precondition to the jurisdiction of the Tribunal, which if it is not met, bars the non-complying party from commencing arbitration: it is not only a procedural matter, "it does go to jurisdiction" (Tr. J., 71:37–72:2).

(ii) According to Bayindir, the purpose of the notice requirement is "to allow the possibility of an agreed settlement before formal proceedings" (Tr. J., 184:15-17) "in a way rather of exhortation than compulsion for the parties to see whether they can resolve the dispute by negotiations" (Tr. J., 186:21-23). Accordingly, "[t]hese provisions should be regarded as ones that do not disable the next level in the process" (Tr. J., 186:38-187:1[29]). In other words, the non fulfilment of the notice requirement should "not b[e] regarded as a bar" (Tr. J., 188:3) to the Tribunal's jurisdiction.

98. The Tribunal notes that Pakistan has not denied that the main purpose of Article VII of the BIT is to provide for the possibility of a settlement of the dispute. In the Tribunal's view, the purpose of the notice requirement is to allow negotiations between the parties which may lead to a settlement. Significantly, Article VII(2) does not read, if these disputes "are not settled" within six months but "cannot be settled" within six months, which wording implies an expectation that attempts at settlement are made. Faced with a similar situation, the tribunal in *Salini v. Morocco* refused to adopt a formalistic

---

[28] See, for instance, *L.E.S.I. v. Algeria* [*supra* Fn. 26], ¶ 32. In *L.E.S.I. v. Algeria* the tribunal considered the purpose of the notice provision to hold that one could not require that the notice contains more than the general framework of the claim: *"Il n'est nulle part exigé que cette requête comprenne d'autres éléments, qui seraient de toute façon étrangers au but poursuivi par la règle"* (see *L.E.S.I. v. Algeria* [*supra* Fn. 26], ¶ 32(iii)).

[29] Referring to *SGS v. Pakistan* [*infra* Fn. 32], specifically ¶ 184 quoted hereinafter at No. 99.

approach and stated that an attempt to reach amicable settlement implies merely "the existence of grounds for complaint and the desire to resolve these matters out-of court"[30].

99. Pakistan itself admits that the notice requirement cannot constitute a prerequisite for jurisdiction when the necessary "steps […] are impossible to take in the circumstances of the case" (Tr. J., 72:20-24). In the specific setting of investment arbitration, international tribunals tend to rely on the non-absolute character of notice requirements to conclude that waiting period requirements do not constitute jurisdictional provisions but merely procedural rules that must be satisfied by the Claimant[31]:

> Compliance with such a requirement is, accordingly, not seen as amounting to a condition precedent for the vesting of jurisdiction.[32]

100. The Tribunal agrees with the view that the notice requirement does not constitute a prerequisite to jurisdiction. Contrary to Pakistan's position, the non-fulfilment of this requirement is not "fatal to the case of the claimant" (Tr. J., 222:34). As Bayindir pointed out, to require a formal notice would simply mean that Bayindir would have to file a new request for arbitration and restart the whole proceeding, which would be to no-one's advantage (Tr. J., 184:18 *et seq.*).

101. The Tribunal is reinforced in this conclusion by the undisputed fact that on 4 April 2002, Bayindir notified the Government of Pakistan that it was compelled to commence ICSID arbitration regarding the "serious disputes in connection with the investments made by Bayindir" given that its efforts to negotiate had "failed to bear fruit" (Exh. [Bay.] B-40). Pakistan did not respond to this letter by pointing to the requirement of notice and the obligation to endeavour to reach a settlement contained in Article VII of the BIT. Similarly, in its first response to Bayindir's RA, Pakistan did not rely on Article VII of the BIT but heavily insisted on the fact that Bayindir "had already filed three (3) suits in the

---

30 *Salini Costruttori S.p.A. and Italstrade S.p.A. v. Kingdom of Morocco*, ICSID Case No. ARB/00/4, Decision on Jurisdiction of 23 July 2001, ¶ 20 as translated in 42 ILM 609 (2003); (Exh. [Pak]L-6 = Exh. [Bay]CLEX 15); also available at http://www.worldbank.org/icsid/cases/salini-decision.pdf.

31 *Ronald S. Lauder v. The Czech Republic*, UNCITRAL Final Award, 3 September 2001, ¶ 187 (Exh. [Bay]CLEX 30); available at http://www.mfcr.cz/cps/rde/xbcr/mfcr/FinalAward_pdf.pdf.

32 *SGS Société Générale de Surveillance SA v. Islamic Republic of Pakistan*, ICSID Case No. ARB/01/13, Decision on Jurisdiction of 6 August 2003, ¶ 184 (Exh. [Bay]CLEX 9 = Exh. [Pak]L-7), 42 ILM 1290 (2003); also available at http://www.investmentclaims.com/decisions/SGS-Pakistan-Jurisdiction-6Aug2003.pdf.

courts of law in Pakistan"[33]. It was the ICSID Secretariat, on 14 June 2002, which raised the issue asking Bayindir to provide further information and documentation regarding "the fulfilment of the condition set forth at the beginning of Article VII(2) […] as it appears that the first notice mentioning the BIT was made on April 4, 2002"[34]. Two weeks later, on 28 June 2002, Pakistan wrote to the Centre to challenge its jurisdiction without making any mention of the requirements of Article VII of the BIT[35].

102. The Tribunal further notes that Pakistan made no proposal to engage in negotiations with Bayindir following Bayindir's notification of 4 April 2002, which made an explicit reference to the failure of the efforts to negotiate. In the Tribunal's view, if Pakistan had been willing to engage in negotiations with Bayindir, in the spirit of Article VII of the BIT, it would have had many opportunities to do so during the six months following the notification of 4 April 2002[36]. Along the lines of the award rendered in *Lauder v. The Czech Republic*, the Tribunal is prepared to find that preventing the commencement of the arbitration proceedings until six months after the 4 April 2002 notification would, in the circumstances of this case, amount to an unnecessary, overly formalistic approach which would not serve to protect any legitimate interests of the Parties[37] and hold "that the six-month waiting period in [the BIT] does not preclude it from having jurisdiction in the present proceedings"[38].

103. As a result of this conclusion, the Tribunal will not discuss Bayindir's additional argument pursuant to which it would be entitled to disregard the notice requirement of Article VII of the BIT by virtue of the operation of the most favoured nation clause contained in Article II(2) of the BIT.

---

33 Letter of Pakistan to the Centre of 23 May 2002.

34 Letter of the Centre to Bayindir of 14 June 2002.

35 Letter of Pakistan to the Centre of 28 June 2002. In fact, Pakistan invoked Article VII of the BIT for the first time in a letter of the Attorney General of 22 December 2003 requesting the Centre to recall the decision to register the RA. [Following the Centre's letter of 14 June 2002, on 8 July 2002 NHA filed an unsolicited response referring for the first time to Article VII of the BIT noting that "no mention of the BIT was ever made by Bayindir 'the Contractor' in their correspondence regarding amicable settlement of disputes" and emphasizing that Bayindir letter of 4 April was addressed to Pakistan, "and not to NHA". It was only in the beginning of 2003 that NHA relied for the first time on Article VII of the BIT (see letter of NHA to the Centre of 2 January 2003).]

36 The Tribunal notes that in *Impregilo*, "immediately after the registration of Impregilo's first request for arbitration by ICSID, negotiations took place between the Parties on the initiative of the Pakistan Minister of Finance" (*Impregilo v. Pakistan* [*supra* No. 74], ¶ 44).

37 *Lauder v. Czech Republic* [*supra* Fn. 31], ¶¶ 189-190.

38 *Lauder v. Czech Republic* [*supra* Fn. 31], ¶ 191.

B. HAS BAYINDIR MADE AN INVESTMENT?

104. Pakistan's first objection to jurisdiction is based on the alleged lack of an investment within the meaning of Article I(2) of the BIT (a) and Article 25 of the ICSID Convention (b) (Mem. J., p. 1 at (iv)).

a. Investment under Article I(2) of the BIT

105. It is common ground between the parties that the Tribunal's jurisdiction is contingent upon Bayindir having made an investment within the meaning of the BIT. Article I(2) of the BIT defines investment as follows:

> The term "investment", in conformity with the hosting Party's laws and regulations, shall include every kind of asset, in particular, but not exclusively:
>
> (a) Shares, stocks or any other form of participation in companies
>
> (b) returns reinvested, claims to money or any other rights to legitimate performance having financial value related to an investment,
>
> (c) moveable and immoveable property, as well as any other rights in rem such as mortgages, liens, pledges and any other similar rights,
>
> (d) […]
>
> (e) business concessions conferred by law, or by contract, including concessions to search for, cultivate, extract or exploit natural resources on the territory of each Party as defined hereinafter.

106. The parties first disagree on the meaning of the phrase "in conformity with the hosting Party's laws and regulations" following the "investment" in Article I(2). On the one hand, Bayindir argues that the requirement of conformity is meant "to exclude investments that have been made in violation of local law from the treaty's protection" and has no bearing on the definition of the term investment itself (C-Mem. J., p. 20). By contrast, Pakistan contends that this phrase limits the definition of investment under the BIT to "investment within the laws and regulations of Pakistan" (Mem J., p. 10 ¶ 2.6).

107. Pakistan further asserts that Bayindir has obtained the authorisation by the Pakistan Board of Investment to engage in the construction work upon an express representation that it was not making an investment (Mem. J., p. 11-13), so that "there has been no investment for the purposes of the laws and regulations of Pakistan as required by Article I(2)" of the BIT (Mem. J., p. 14, ¶ 2.12).

108. For the purpose of deciding on its jurisdiction, the Tribunal does not need to determine the exact legal significance of Bayindir's statements before the Pakistan Board of

Investment (as well as Pakistan's own statements that Bayindir did actually invest in Pakistan[39]). In and of itself the representation that Bayindir was not making an investment given for the purposes of obtaining an authorisation by the Board of Investment does not mean that the activity of Bayindir does not qualify as an investment under Pakistani laws. Moreover, Pakistan does not set forth any domestic laws or regulations providing for a specific definition of investment.

109. In any event, the Tribunal cannot see any reason to depart from the decision of the tribunal in *Salini v. Morocco* holding that "this provision [i.e., the requirement of conformity with local laws] refers to the validity of the investment and not to its definition"[40]. The mere fact that in *Salini* the phrase "in accordance with" qualified the words "assets invested" and not the term "investment" is not a sufficient basis to distinguish *Salini*, contrary to Pakistan's suggestion (Mem. J., p. 10, Fn. 17). Indeed, the *Salini* holding refers explicitly to the "investment" and not to the "assets invested".

110. Since Pakistan does not contend that Bayindir's purported investment actually violates Pakistani laws and regulations, the Tribunal considers that the reference to the "hosting Party's laws and regulations" in Article I(2) of the Treaty could not in any case oust the Tribunal's jurisdiction in the present case.

111. Accordingly, the question boils down to whether Bayindir made an investment within the meaning of Article I(2) of the BIT. Before listing a non exhaustive series of examples, Article I(2) provides as a general definition that investment "shall include every kind of assets".

112. Quoting a publication by the United Nations Conference on Trade and Development (UNCTAD)[41], Bayindir contends that the indication "that investment includes 'every kind

---

39 See the instances cited by Bayindir in C-Mem. J., pp. 25-26, ¶ 85.

40 *Salini v. Morocco* [*supra* No. 98], ¶ 46. Neither the fact that the regularity-validity of the investment under the host state law is specifically dealt with in another provision of the Treaty (namely Article II(1) and (2)) nor the fact that in *Salini* the provision qualified the words 'assets invested' and not 'the term investment', provides sufficient grounds to depart from the *Salini* reasoning.

41 United National Conference On Trade And Development, Scope and Definition, UNCTAD Series on issues in international investment agreements (1999) (Exh. [Bay] CLEX 47); available at http://www.unctad.org/en/docs/psiteiitd11v2.en.pdf. In the relevant passage of this paper, UNCTAD refers to Article 1(3) of the ASEAN Agreement for the Promotion and Protection of

of asset' suggest[s] that the term embraces everything of economic value, virtually without limitation" (C-Mem. J., p. 17, ¶ 57).

113. The Tribunal agrees with Bayindir that the general definition of investment of Article I(2) of the Treaty is very broad. On a comparative basis, it has been suggested that the reference to "every kind of asset" is "[p]ossibly the broadest" among similar general definitions contained in BITs[42].

114. Bayindir submits that its contributions in terms of know-how, equipment and personnel (aa) and financing (bb) qualify as a Treaty investment under this broad definition.

aa. Bayindir's contribution in terms of know-how, equipment and personnel

115. Bayindir alleges that it has trained approximately 63 engineers, and provided significant equipment and personnel to the Motorway.

116. On the facts of the case, this cannot be seriously disputed. Bayindir's contribution in terms of know how, equipment and personnel clearly has an economic value and falls within the meaning of "every kind of asset" according to Article I(2) of the BIT.

117. Indeed, Pakistan's objections concern mainly the purely financial contribution of Bayindir.

bb. Bayindir's financial contribution

118. According to Pakistan, Bayindir did not make any significant injections of funds that could be considered as an investment. Referring to Clause 60.8 of the Contract's Conditions of Particular Application (as amended by Addenda Nos. 6 and 8 [of 1993]) and to Clause 3 of Addendum No. 9 of 17 April 2000, Pakistan relies upon the following considerations:

> [Bayindir] received almost one-third of the Contract price up front, which more than adequately covered mobilisation costs. In this respect, it is recalled that as of April 2001, Bayindir had retained approximately $100 million of the

---

Investment, according to which, exactly as in the BIT at hand, the term investment shall mean "every kind of asset".

42 N. RUBINS, The Notion of 'Investment' in International Investment Arbitration, in: N. Horn (ed), Arbitrating Foreign Disputes, The Hague, 2004, p. 292.

> mobilisation advance. At the same time, the risk engaged was minimal because Bayindir had received such a substantial mobilisation advance, which it was to retain (proportionally reduced) until the end of the Contract (Mem. J., pp. 15-16).

119. The very fact that a part of the price is paid in advance has in and of itself no bearing on the existence of a financial contribution. In any event, Pakistan's contention overlooks the fact that Bayindir provided bank guarantees equivalent to the amount of the Mobilisation Advance payable to NHA "on his first demand without whatsoever right of objection on our part and without his first claim[ing] to the Contractor" (see *supra* No. 18). Specifically, Pakistan did not dispute Bayindir's allegation that it "has incurred bank commission charges in excess of USD 11 million" (C-Mem. J., p. 19 ¶ 33).

120. Under these circumstances, the Tribunal concludes that Bayindir made a substantial financial contribution to the Project.

cc. Conclusion

121. Considering Bayindir's contribution both in terms of know how, equipment and personnel and in terms of injection of funds, the Tribunal considers that Bayindir did contribute "assets" within the meaning of the general definition of investment set forth in Article I(2) of the BIT.

b. Investment under Article 25 of the ICSID Convention

122. It is common ground between the parties that the jurisdiction of the Tribunal is further contingent upon the existence of an "investment" within the meaning of Article 25 of the ICSID Convention (be it as an independent requirement or as a specification of the concept of investment under the BIT).

123. Article 25 of the ICSID Convention provides the following:

> 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.

124. The Tribunal notes that Bayindir claims that Pakistan has breached various rights conferred on it by the BIT with respect to its investment. Hence, the current dispute is a dispute with Pakistan, as required by Article 25(1) of the ICSID Convention.

125. Pakistan did not contest that the current dispute is a "legal dispute" within the meaning of Article 25(1) of the ICSID Convention[43]. Irrespective of the possible nexus between Bayindir's claims under the BIT and the issues to be determined under the underlying Contract, the fact remains that the present dispute is clearly legal in nature as it concerns, in the words of the Report of the Executive Directors of the World Bank on the Convention, "the existence or scope of [Bayindir's] legal rights" and the nature and extent of the relief to be granted to Bayindir as a result of Pakistan's violation of those legal rights[44].

126. Whether the rights asserted by Bayindir in the end are found to exist must await the proceedings on the merits. Subject to determining whether Bayindir made an investment within the meaning of Article 25 of the ICSID Convention, which will be discussed below, the Tribunal holds that the assertion of said rights has given rise to a dispute that comes within the jurisdiction of the Centre as set out in Article 25(1) of the ICSID Convention.

aa. The object of the contract

127. First of all, Pakistan objects that, in the absence of express wording, a straightforward highway construction contract does not constitute an investment under within Article 25 of the ICSID Convention (Mem. J., p. 8 referring to SCHREUER, *op. cit.* [supra Fn. 24], p. 139, footnote 158).

128. The Tribunal is unpersuaded by this objection. The construction of a highway is more than construction in the traditional sense. As noted by the tribunal in *Aucoven*, the construction of a highway, "which implies substantial resources during significant

---

43 In fact, Pakistan disputes the characterization of the legal dispute (see, for instance, Tr. J. 207:7-17: "We do not conceal the fact that there is a real dispute between Bayindir and NHA about this, there is not question about that at all. But it is not a dispute about breach of treaty; it is a dispute about whether the exercise of a contractual power was justified under this term of the contract, or whether instead the contracting party should have acted under a different contractual provision and on payment of compensation. With the very greatest respect to Bayindir and its representatives, there is no way of turning that into a claim for breach of treaty").

44 Report of the Executive Directors on the Convention on the Settlement of Investment Disputes Between States and Nationals of Other States; International Bank for Reconstruction and Development, March 18, 1965, ¶ 26; available at http://www.worldbank.org/icsid/basicdoc/partB-section05.htm#03.

periods of time, clearly qualifies as an investment in the sense of Article 25 of the ICSID Convention"[45].

129. The Tribunal is reinforced in this conclusion by the fact, referred to by Bayindir, that in the recent *Impregilo* case, which regarded a similar dispute concerning the construction of a dam, Pakistan did not challenge the existence of an investment under Article 25 of the ICSID Convention.[46]

bb. The so-called "Salini Test"

130. Both parties relied upon previous decisions by ICSID Tribunals to define the notion of investment under Article 25 of the ICSID Convention and in particular upon the decision in *Salini v. Morocco*[47]. The Tribunal in *Salini* held that the notion of investment presupposes the following elements: (a) a contribution, (b) a certain duration over which the project is implemented, (c) sharing of the operational risks, and (d) a contribution to the host State's development, being understood that these elements may be closely interrelated, should be examined in their totality,[48] and will normally depend on the circumstances of each case[49]. In the following paragraphs the Tribunal will examine these conditions in turn.

131. Firstly, to qualify as an investment, the project in question must constitute a substantial commitment on the side of the investor. In the case at hand, it cannot be seriously contested that Bayindir made a significant contribution, both in terms of know how, equipment and personnel and in financial terms (see *supra* Nos. 115 *et seq.*).

132. Secondly, to qualify as an investment, the project in question must have a certain duration. The element of duration is the paramount factor which distinguishes investments within the scope of the ICSID Convention and ordinary commercial

---

45 *Autopista Concesionada de Venezuela v. Venezuela*, ICSID Case No. ARB/00/5, Decision on Jurisdiction, 27 September 2001, ¶ 101 (Exh. [Bay]CLEX 14); also available at http://www.worldbank.org/icsid/cases/decjuris.pdf.

46 See *Impregilo v. Pakistan* [*supra* No. 74], ¶ 111(a).

47 *Salini v. Morocco* [*supra* No. 98], *passim*.

48 *Id.* See also *L.E.S.I. v. Algeria* [*supra* Fn. 26], ¶ 13 (iv).

49 *Joy Mining Machinery Limited v. The Arab Republic of Egypt*, ICSID Case No. ARB/03/11, Decision on jurisdiction of 6 August 2004, ¶ 53 *in fine* (Exh. [Pak]L-11); available at http://www.worldbank.org/icsid/cases/joy-mining-award.pdf.

transactions. When denying the qualification of investment to an ordinary sales contract (even if complex), the Tribunal in *Joy Mining* expressly distinguished *Salini v. Morocco* on the ground that "[i]n that case, however, a major project for the construction of a highway was involved and this indeed required not only heavy capital investment but also services and other long-term commitments."[50]

133. Bayindir points out that the Contract had an initial duration of three years followed by a defect liability period of one year and a maintenance period of four years against payment. It is further undisputed that the project had been underway for three years and that Bayindir was granted a contractual extension of an additional twelve months. Contracts over similar periods of time have been considered to satisfy the duration test for an investment[51]. Since Pakistan has not contended that the project was not sufficiently extended in time to qualify as an investment, the Tribunal considers that this requirement is met. More generally, as mentioned by the tribunal in *L.E.S.I. v. Algeria*, one cannot place the bar very high, as (a) experience shows – and a preliminary assessment of the facts of the case seem to confirm – that this kind of project more often than not requires time extensions, and (b) the duration of the contractor's guarantee should also be taken into account[52].

134. Thirdly, to qualify as an investment, the project should not only provide profit but also imply an element of risk. Pakistan's argument in this respect is that "the risk engaged was minimal because Bayindir had received such a substantial mobilisation advance, which it was to retain (proportionally reduced) until the end of the Contract" (Mem. J., ¶ 2.19, p. 16).

135. Bayindir contested this argument, *inter alia*, on the ground that it had placed itself at considerable risk by securing first demand bank guarantees, and by opening itself to the danger of an unlawful call on the guarantees. More generally (C-Mem. J., ¶ 41, p. 13). Bayindir relied on the following passage of the *Salini* decision:

---

50 *Joy Mining v. Egypt* [*supra* Fn. 49], ¶ 62.

51 *Salini v. Morocco* [*supra* No. 98], ¶¶ 54-55, citing D. CARREAU *et al.*, Droit International Economique, pp. 558-78 (3d ed., 1990); C.H. SCHREUER, Commentary on the ICSID Convention (1996) 11 ICSID Rev - FILJ 318 et seq).

52 *L.E.S.I. v. Algeria* [*supra* Fn. 26], ¶ 14(ii) *in fine*: *"On ne peut de toute façon pas se montrer excessivement rigoureux tant l'expérience apprend que des objets du genre de celui qui est en cause justifient souvent des prolongations, sans parler de la durée de la garantie."*

> It does not matter in this respect that these risks were freely taken. It also does not matter that the remuneration of the Contractor was not linked to the exploitation of the completed work. A construction that stretches out over many years, for which the total cost cannot be established with certainty in advance, creates an obvious risk for the Contractor.[53]

136. The Tribunal cannot agree with Pakistan's objection. Besides the inherent risk in long-term contracts, the Tribunal considers that the very existence of a defect liability period of one year and of a maintenance period of four years against payment, creates an obvious risk for Bayindir. Under these circumstances, the Tribunal is of the opinion that Bayindir's participation in the risks of the operation was significant.

137. Lastly, relying on the preamble of the ICSID Convention, ICSID tribunals generally consider that, to qualify as an investment, the project must represent a significant contribution to the host State's development[54]. In other words, investment should be significant to the State's development. As stated by the tribunal in *L.E.S.I*, often this condition is already included in the three classical conditions set out in the 'Salini test'[55]. In any event, in the present case, Pakistan did not challenge the numerous declarations of its own authorities emphasising the importance of the road infrastructure for the development of the country[56].

138. For all the foregoing reasons, the Tribunal concludes that Bayindir made an investment both under Article I(2) of the BIT and Article 25 of the ICSID Convention. Accordingly, Pakistan's jurisdictional challenge that there is no investment fails.

C. ARE BAYINDIR'S TREATY CLAIMS IN REALITY CONTRACT CLAIMS?

139. It is Pakistan's "primary submission" (Tr. J., 209:36) that "Bayindir's (treaty) claims, however skilfully repackaged, are inextricably bound up with the Contract" (Reply J., p. 3 ¶ 2.2) and that "the only rights which Bayindir claims have been violated are rights which it asserts are derived from the Contract" (Reply J., p. 21, ¶ 2.44). In other words, regardless of how they have been formulated in this arbitration, Bayindir's Treaty

53 *Salini v. Morocco* [*supra* No. 98], ¶ 56 referred to in C-Mem. J.

54 The significance of the contribution, an element that was not contemplated in *Salini*, was added in *Joy Mining v. Egypt* [*supra* Fn. 49], ¶ 53.

55 *L.E.S.I. v. Algeria* [*supra* Fn. 26], ¶ 13(iv) *in fine*.

56 See for instance CX 122 referred to in C-Mem. J. p. 14 ¶ 46.

Claims "are in reality contract claims […] and thus beyond the scope of this tribunal's jurisdiction" (Tr. J., 45:24-27).

140. In response, Bayindir relies on the above-mentioned 'precedent' in the *Impregilo* case, in which Pakistan was unsuccessful with this very same argument to object to jurisdiction[57]. As pointed out by Bayindir, the tribunal in *Impregilo* held, *inter alia*, as follows:

> The fact that Article 9 of the BIT does not endow the Tribunal with jurisdiction to consider Impregilo's Contract Claims does not imply that the Tribunal has no jurisdiction to consider Treaty Claims against Pakistan which at the same time could constitute breaches of the Contracts. [58]

141. And the tribunal added:

> [C]ontrary to Pakistan's approach in this case, the fact that a breach may give rise to a contract claim does not mean that it cannot also – and separately – give rise to a treaty claim.[59]

142. In substance Bayindir contends that it has laid out in some detail its claims for the breach of four separate BIT provisions and has thus, in the words of the *Impregilo* tribunal, properly stated a claim "that the alleged damages were a consequence of the behaviour of the Host State acting in breach of the obligations it had assumed under the treaty" (Rejoinder J., pp. 18-19, ¶ 57[60]). Before discussing in more detail the difference between Treaty Claims and Contract Claims (b) under the specific circumstances of the case (c) and Pakistan's subsidiary arguments in this respect (d), it is useful to recall the actual formulation of Bayindir's Treaty Claims (a).

a. Bayindir's Treaty Claims

143. In its RA, Bayindir submitted that Pakistan's conduct in connection with the project constituted:

> [b]latant violation of its obligations to Bayindir under the BIT. In particular, Pakistan has allegedly:
>
> - failed to promote and protect Bayindir's investment in violation of Article II of the BIT;

---

57 In *Impregilo*, Pakistan submitted that "the Treaty Claims [t]here c[ould] not be separated from the Contract Claims and that, consequently, such claims fall outside the scope of the BIT and this Tribunal has no jurisdiction over them" (see *Impregilo v. Pakistan* [*supra* No. 74], ¶ 77).

58 *Impregilo v. Pakistan* [*supra* No. 74], ¶ 219.

59 *Impregilo v. Pakistan* [*supra* No. 74], ¶ 258.

60 Referring to the wording of *Impregilo v. Pakistan* [*supra* No. 74], ¶ 260.

- failed to ensure the fair and equitable treatment of Bayindir's investment, in violation of Article II (2) of the BIT;
- taken measures of expropriation, or measures having the same nature or the same effect, against Bayindir's investment in violation of Article III (1) of the BIT.

(RA, p. 11 ¶ 36-*37*)

144. In its Counter-Memorial on Jurisdiction, Bayindir expanded on the alleged violation of Article II (2) of the BIT explaining that this provision contained an obligation of both national and most favoured nation treatment. Bayindir's Treaty Claims are of three types:

(i) claims for violation of Pakistan's obligation to ensure fair and equitable treatment (based on the BIT's preamble and indirectly on Article II(2) of the BIT);

(ii) claims for violations of Pakistan's obligation to accord most favoured nation treatment (based directly on Article II(2) of the BIT);

(iii) claims for expropriation (based directly on Article III(1) of the BIT).

145. At the jurisdictional hearing Bayindir summarized its case in the following terms:

> We assert that we entered bona fide a substantial contract for the construction of a motorway, the contract having been entered with the NHA, in terms which undoubtedly as it seems to be common ground, would provide a profitable contractual enterprise for us as a substantial contractor to provide a result which in the circumstances was at a tender price some 30 per cent less than any other tender for this substantial project. We expected no more than to be treated fairly and without discrimination as we executed our contract pursuant to the arrangements which we made with the NHA. Our complaint is that for reasons external to our contractual performance it became convenient to the Respondent, the Republic of Pakistan, acting in its own behalf and also, we say, through its emanation, NHA, to terminate their contractual arrangement before the completion of the project.
>
> (Tr. J., 126:16:32)

146. There can be no dispute that these claims are directly stated by reference to Pakistan's obligations under the BIT. In and of themselves, assuming *pro tem* that they may be sustained on the facts, Bayindir's Treaty Claims fall within the scope of the BIT. This being so, the following aspects are, however, disputed:

(a) whether Bayindir's Treaty Claims are in reality Contract Claims or, in other words whether there is any "credible self-standing Treaty Claim" (Mem. J., p. 5 ¶1.7);

(b) whether Bayindir's Treaty Claims are sufficiently substantiated;

(c) whether the actions about which Bayindir's complains were taken in the exercise of *puissance publique*.

147. Pakistan summarized its objections to the Tribunal's jurisdiction to hear Bayindir's Treaty Claims as follows:

> Bayindir's claims for breach of the treaty are claims that its rights under the Contract have been interfered with or abrogated. It follows that in the present case (and it is not suggested that this will invariably be the case whenever there is a combination of contract and treaty claims in an investment dispute), if the claims for breach of contract are unsuccessful, because it is determined that Bayindir did not possess the rights which it claims or (which amounts to the same thing) that abrogation of those rights was contractually justified, then the treaty claims must also fail.
>
> (Reply J., p. 18, ¶ 2.39)

b. The difference between Treaty Claims and Contract Claims

148. As a preliminary matter, the Tribunal notes that Pakistan accepts that "treaty claims are juridically distinct from claims for breach of contract, even where they arise out of the same facts" (Reply J., p. 18, ¶ 2.38). The Tribunal considers that this principle is now well established[61]. The ad hoc committee in *Vivendi v. Argentina* described this "conceptual separation"[62] as follows:

> A particular investment dispute may at the same time involve issues of the interpretation and application of the BIT's standards and questions of contract.[63]
>
> Whether there has been a breach of the BIT and whether there has been a breach of contract are different questions. Each of these claims will be determined by reference to its own proper or applicable law in the case of the BIT, by international law, in the case of the Concession Contract, by the proper law of the contract.[64]

149. The *Vivendi* ad hoc Committee went on to state:

> [W]here "the fundamental basis of the claim" is a treaty laying down an independent standard by which the conduct of the parties is to be judged, the

---

[61] See, for instance, *Siemens v. Argentina* [*infra* Fn. 80], ¶ 180; *AES Corp. v. Argentina* [supra No. 76], ¶¶ 90 *et seq*.

[62] B. CREMADES and D.J.A CAIRNS, Contract and Treaty Claims and Choice of Forum in Foreign Investment Disputes, in: T. Weiler (Ed) International investment law and arbitration: leading cases from the ICSID, NAFTA, bilateral treaties and customary international law, London, 2005, p. 331.

[63] *Compañia de Aguas del Aconquija SA and Vivendi Universal (formerly Compagnie Générale des Eaux) v. Argentine Republic*, Decision of Annulment, 3 July 2002, ¶ 60 (Exh. [Pak]L-5 = Exh. [Bay]CLEX16); ICSID Review (2004), vol. 19, No. 1, 41 ILM 1135 (2002), also available at http://www.worldbank.org/icsid/cases/vivendi_annul.pdf

[64] *Ibid.*, ¶ 96.

> existence of an exclusive jurisdiction clause [or, for present purpose, an arbitration clause[65]] in a contract between the claimant and the respondent state or one of its subdivisions cannot operate as a bar to the application of the treaty standard.[66]

And:

> In a case where the essential basis of a claim brought before an international tribunal is a breach of contract, the tribunal will give effect to any valid choice of forum clause in the contract.

150. In the present case, it is undisputed that the 1997 Contract contains a dispute settlement clause providing for arbitration under the 1940 Arbitration Act of Pakistan.

151. As a matter of principle, this arbitration clause is irrelevant for the purpose of the jurisdiction of this Tribunal over the Treaty Claims[67]. However, following the withdrawal of the Contract Claims, Pakistan argues that, under the particular circumstances of this case, "to use the language of the award in the *Vivendi* Annulment case, the essential basis of [Bayindir's] claims is purely contractual" (Tr. J., 45:22-26).

c. The specific circumstances of the case

152. On Pakistan's case, the Treaty Claims are purely contractual as they:

> [c]oncern [aa.] the interpretation and application of contract provisions, to what extent and whether the contract was breached by either NHA or Bayindir, whether and to what extent the engineer's decisions as to which Bayindir's claims are ultimately directed were justified and [bb.] how any claim should be quantified under the contract's provisions".
>
> (Tr. J., 45:22-26).

153. In other words, the Treaty Claims are in reality contract claims (over which the Tribunal does not have jurisdiction) because (aa) their 'ingredients' are essentially contractual which is confirmed by the fact that (bb) the amount of the Treaty Claims corresponds to the amount of the Contract Claims.

---

65 See, for instance 90-91.

66 *Vivendi v. Argentina* [*supra* No. 148], ¶ 101. See also *Impregilo v. Pakistan* [*supra* No. 74], ¶ 225.

67 See also *Camuzzi International S.A. v. Argentine Republic*, ICSID Case No. ARB/03/2, Decision on Jurisdiction of 11 May 2005, available at http://www.worldbank.org/icsid/cases/camuzzi-en.pdf, ¶ 89, where the tribunal seems to limit the relevance of the contractual forum only to "purely contractual questions having no effect on the provisions of the Treaty".

aa. The "ingredients" of Bayindir's claims

154. In substance, Pakistan's case is that the Treaty Claims are in reality dependent upon the existence of a breach of contract:

> The right not to be the victim of unfair and inequitable treatment, the right not to be the victim of expropriation, are both rights that are tied to specific substantive rights of an investor, and one has to ask what has been interfered inequitably or unfairly; what has been taken in an expropriation? […] it is logically and juridically essential to establish that Bayindir has the rights under the contract that it claims to have before it will even be possible to determine whether those rights have been the subject of expropriation.
>
> (Tr. J., 85:3-8; 85:30-34).

155. Bayindir acknowledges that its case arises out of the contractual relationship but insists on the fact that its claims rest on breaches of the BIT:

> [I]t is difficult to contemplate, although one can postulate, a situation for breach of a BIT obligation that would not be some underlying contractual situation supporting the circumstances that have given rise to the claim for a breach of the treaty obligation. So the fact that one can identify a particular contractual relationship is a usual, one would say almost inevitable, precursor to any aspect of a claim arising from the breach of a BIT obligation.
>
> (Tr. J., 126:7-15)

156. On the expropriation claim in particular, Pakistan further argues that:

> Bayindir's expropriation claim, what it now terms an expropriation claim, as well as all of its claims which are based on its expulsion from the site, can only be assessed in the light of the contract's terms and taking into account their actual application in fact, including an assessment of whether Bayindir was responsible for insufficient progress on the works, the actions and decision of the engineer and the contractually based qualification of any amounts potentially owing to Bayindir for work performed or for its fixed and moveable assets on the site under the contract, and those are all quintessentially contractual matters as to which Pakistan respectfully submits this tribunal has no jurisdiction.
>
> (Tr. J., 52:20-33)

157. The Tribunal is however of the opinion that the fact that a State may be exercising a contractual right or remedy does not of itself exclude the possibility of a treaty breach (see also *infra* Nos. 180 *et seq.*).

bb. The quantum of Bayindir's claims

158. According to Pakistan, "the most striking indication [of the intrinsically contractual nature of the Treaty Claims] is that the amount claimed in the present proceedings (US $416,236,110) is exactly the same as that claimed by Bayindir in the proceedings it has

initiated in Pakistan under the contractual provisions for arbitration" (Mem. J, p. 40, ¶ 4.1) or in other words:

> [T]he amount of Bayindir's claim quantified in its request for arbitration is precisely to the dollar the same amount that Bayindir claim to the Engineer under clause 53 of the contract. In and of itself that is a test to the fact that the underlying basis for Bayindir's claims must be contractual.
>
> (Tr. J. 47:17-23)

159. Bayindir's position is that, following the abandonment of the Contract Claims, "the issue of what would have happened under the contract, which is not by definition before the tribunal, is irrelevant"; since Bayindir is pursuing exclusively "treaty breach[es], all these problems about damages fall away" (Tr. J., 146:14-22).

160. As Bayindir's original Treaty and Contract Claims clearly arose out of the same set of facts, it is not surprising that at the stage of the RA Bayindir articulated damages by reference to the Contract. In the current situation, following the abandonment of its Contract Claims, Bayindir is required to articulate the damage exclusively by reference to the Treaty. In Bayindir's counsel's terms:

> [O]ur complaint is a completely different complaint under a treaty, which has its own measures of compensations. Once you get to that point we say that you levitate yourself out of contract issues and come to the issue of if there is a breach amounting to expropriation, what is the compensation.
>
> (Tr. J., 146:5-10)

161. At the jurisdictional hearing, Bayindir recognized that it has "not yet articulated" the requested amount of compensation (Tr. J., 147:23-24) and qualified the articulation "by reference to the issues about contract claims" as merely "a convenient reference point" (Tr. J., 145:16-17). Referring to the principles set out by the Permanent Court of International Justice in the 1928 *Chorzów Factory* case, Bayindir contends that reparation must as far as possible wipe out all the consequences of the illegal act and re-establish the situation which in all possibility would have existed if that act had not been committed. According to Bayindir, if it concludes that Pakistan breached the BIT, the Tribunal will have to address the question of compensation according to these principles. In Bayindir's view, "it does not involve working through the contractual provisions" (Tr. J. 143:7-8; see also Tr. J., 168:16-19), the "obvious elements of compensation" being:

> [o]ne loss of profit, which we say we can measure exactly here because of the price at which the contract was let out to other contractors as well as in other ways. We have the element, we say, of destruction of our corporate business because of the hardship imposed by reason of this expulsion. We have the

> issues, we say, of recouping unrecouped expenditure including amounts which had not even been certified. We do not claim them because they have been certified here; we just claim the set amounts we have spent and which are entitled to be recouped as part of our losses. Fifthly, we would say that we would be entitled to have appropriate orders indemnifying us completely against a call up of these guarantees of 71.6 million and 1.87 billion rupees and other customs and guarantees which even recently have been called up to put us in the position we would have been if there had not been, for the purpose of this argument, undoubted treaty breaches amounting to reparation.
>
> (Tr. J. 144:28-145:8)

162. In and of itself, "Bayindir's contemporaneous characterisation and pursuit of those claims under the contract dispute resolution mechanism" (see. Tr. J., 54:18-21) – which was described as "a self evident fact" by Bayindir (Tr. J., 63:35-38; 64:1-10) – does not mean that Bayindir's current Treaty Claims are in reality Contract Claims.

163. In support of its case that the Treaty Claims are in reality Contract Claims, Pakistan puts much weight on "[t]he fact that it is admitted by Bayindir that if they are completely successful in the ICSID proceedings that will wipe out the totality of their contractual claim" (Tr. J., 83:27-30).

164. Indeed, when abandoning its Contract Claims, Bayindir expressed the following views:

> [W]e are pursuing our remedies on the basis that there is a treaty breach. If, as we expect, we are successful in establishing liability with respect to that matter, we would expect that our relief as claimed would provide complete relief for us with respect to all matters arising out of the agreements made with respect to the freeway. That would mean that there would be no outstanding issues to be resolved.
>
> (Tr. J., 12:11-19)

165. Moreover, as will be discussed below, at the jurisdictional hearing Bayindir further submitted that the Contract Claims are in any event time barred under Pakistani law. One may ask whether, under these circumstances, Bayindir's re-articulation of the claims and of the possible measure of compensation is legitimate. This is a question that the Tribunal will address more generally when discussing Pakistan's argument that Bayindir's procedural behaviour constitutes qualified "abuse of process" (cf. *infra* Nos. 169 *et seq.*). For the present purpose, the Tribunal must assess its jurisdiction on the basis of the record as it stands. The fact remains that Bayindir is asserting Treaty Claims and a newly articulated request for compensation, which may include "an appropriate sum for compensation" (Tr. J., 147:33-38).

166. Under these circumstances, the Tribunal holds that the present case is not a case where the essential basis of the claims is purely contractual. Hence, there is no reason to depart from the principle of the independence of treaty claims and contract claims as it was expressed by the ad hoc Committee in *Vivendi*.

167. In conclusion, the Tribunal considers that when the investor has a right under both the contract and the treaty, it has a self-standing right to pursue the remedy accorded by the treaty. The very fact that the amount claimed under the treaty is the same as the amount that could be claimed (or was claimed) under the contract does not affect such self-standing right.

d. Pakistan's subsidiary arguments

168. Having concluded that the Treaty Claims are independent from the Contract Claims, the Tribunal will now review Pakistan's two subsidiary objections to its jurisdiction to hear the Treaty Claims, that is (aa) abuse of process and (bb) conflict of conventions.

aa. Abuse of Process

169. At the jurisdictional hearing, Pakistan qualified Bayindir's articulation of claims as an "abuse of process […] under international law with the BIT and the ICSID convention" (Tr. J., 34:4-32). In particular, Pakistan insisted on the following circumstances:

> [R]eally almost up until the last minute before this dramatic request for arbitration in the Spring of 2002 to ICSID, Bayindir treated all its complaints against NHA as contractual complaints. There is not a hint of any complaint under any BIT against Pakistan.
>
> (Tr. J., 34:5-10)
>
> Bayindir [became] unhappy with the dispute resolution mechanism it voluntarily agreed with when it signed the contract and which was an essential part of the bargain between NHA and Bayindir, and wants to re-write the contract and effectively substitute this Tribunal for the Tribunal that it hitherto recognised was the competent Tribunal.
>
> (Tr. J., 65:35-66:3)

170. Pakistan asserts that there is an "inherent power and duty for an international Tribunal to guard against this kind of abuse of process, and that that has had jurisdictional or at least preliminary objections significance" (Tr. J., 83:37-84:2).

171. In the Tribunal's opinion, one should distinguish between Bayindir's tactical choice to abandon the Contract Claims at the outset of the jurisdictional hearing and Bayindir's fundamental choice to pursue the Treaty Claims. It is evident that Bayindir's initial choice to raise Contract Claims and its late withdrawal of these Claims may have engendered a significant amount of useless work for both the Tribunal and Pakistan. Whether Bayindir's late abandonment of the Contract Claims should have an incidence on the allocation of costs will be addressed below (cf. *infra* Nos. 276 *et seq.*).

172. The same can be said of Bayindir's contention that, on the basis of the "relevant limitation periods under the law of Pakistan, there are no contract claims being maintained by the claimant in arbitration or in legal proceedings in Pakistan nor is there a possibility that any contract claims could be maintained because they are out of time" (Tr. J., 229:7-11). If the Tribunal can only regret that this submission was made at the very end of the jurisdictional hearing, this does not make Bayindir's pursuit of the Treaty Claims abusive.

173. Hence, the Tribunal dismisses Pakistan's challenge to its jurisdiction to the extent it is based on an alleged abuse of process.

bb. Conflict of Conventions

174. At the hearing on jurisdiction, Pakistan put forward a new argument: Pakistan's recent ratification of the 1958 New York Convention which brings with it "Pakistan's obligations to respect and to enforce a private arbitration agreement" under Article II of the New York Convention (Tr. J., 28:31-32). Pakistan relies on a "potential conflict between […] the 1958 New York Convention and the 1965 Washington Convention" and argues that "the New York Convention both historically and because of its specialist terms should be preferred to the Washington Convention" (Tr. J., 28:34-29:8). It is Pakistan's submission that the Tribunal should avoid "creat[ing] a situation where by thwarting the private arbitral process [it] induce[s] a breach of Pakistan's treaty obligations both to Turkey and to all other ratifiers of the New York Convention" (Tr. J., 29:11-15).

175. The Tribunal cannot conceal its surprise at the raising of this argument, which it considers devoid of merit. Along the lines of the *Impregilo* decision as quoted by Pakistan itself, the Tribunal considers that, as the current proceedings are not

concerned with the Contract Claims, the issue of "the impact (if any) of competing arbitration agreements, including all questions as to the viability of such provisions, does not arise" (*Impregilo v. Pakistan* [*supra* No. 74], ¶ 85 referred to in Tr. J., 118:9-119:15)[68].

176. In any event, Pakistan's point regarding a potential conflict of conventions might only arise if an ICSID tribunal were to order a state to disregard a local arbitration agreement, contrary to Article II of the New York Convention which obliges states to "recognise an agreement in writing under which the parties undertake to submit to arbitration all or any differences which have arisen or which may arise between them" (see Tr. J., 117:18-21).

177. It is true that, at a time when this arbitration was still concerned with the Contract Claims, Bayindir applied to obtain preliminary measures in order to stay the Islamabad arbitration. It then withdrew its request as a result of an offer by Pakistan to request NHA to move for an extension of time limits in such a manner that that arbitration would not proceed prior to this Tribunal's decision on jurisdiction (see PO#1, p. 23). It has always been the common understanding that Pakistan agreed to this measure in a "spirit of co-operation" (Tr. J., 116:4) and there is no question that Pakistan will not be bound by its commitment following the Tribunal's decision on jurisdiction. In any event, the mere stay of the arbitration would not under any circumstances amount to a non-recognition of the arbitration agreement in violation of Article II of the New York Convention.

178. Moreover, Pakistan's ratification of the New York Convention in the course of the present proceedings cannot have any bearing on the jurisdiction of the Tribunal in the present case. The contrary would entail, amongst other things, that a unilateral act by the respondent to an arbitral proceeding could retrospectively affect (to the respondent's own benefit) the arbitral tribunal's jurisdiction which, according to the long-established jurisprudence of international tribunals of all kinds, is fixed as of the time the proceedings are commenced, and is not subject to *ex post facto* alteration[69].

68 This Tribunal is aware that a conflict of convention argument was put forward by Pakistan in *Impregilo*, but is unable to find any endorsement of such argument in the *Impregilo* Tribunal's brief remark just quoted.

69 Again, the Tribunal notes that Pakistan put forward a similar argument in *Impregilo*. However, it observes that, contrary to the present one, *Impregilo* was a case in which the allegedly

179. As a result, the Tribunal cannot see any merit in Pakistan's argument regarding the potential conflict of conventions.

e. The question of 'puissance publique'

180. Having held that a contractual breach may give rise to a separate treaty claim, the tribunal in *Impregilo* added that:

> [o]nly the State in the exercise of its sovereign authority ("*puissance publique*"), and not as a contracting party, may breach the obligations assumed under the BIT. In other words, the investment protection treaty only provides a remedy to the investor where the investor proves that the alleged damages were a consequence of the behaviour of the Host State acting in breach of the obligations it had assumed under the treaty. [70]

181. On Pakistan's case, almost all of the allegations which make up Bayindir's claim for breach of treaty (whether relating to claims of discriminatory treatment, unfair and inequitable treatment, or expropriation) concern the conduct of NHA, which was contractual and not sovereign in character. Moreover, Pakistan contends that

> [e]ven if the possibility that some small part of NHA's actions could potentially be characterised as sovereign, the fact that the overwhelming majority are self-evidently acts of a contractual character demonstrates the essentially contractual nature of the claim and the futility of this Tribunal proceeding until the contractual forum has examined all of the contractual claims and pronounced upon them.
>
> (Reply J., p. 21, ¶ 2.43)

182. Bayindir's argues that the record shows the exercise of sovereign power, i.e., a decision "from the top down", in which "the element of national interest […] was the driving force for the result of our expulsion and expropriation of our contract" (Tr. J., 170:9-23)[71].

183. In the Tribunal's view, the test of *'puissance publique'* would be relevant only if Bayindir was relying upon a contractual breach (by NHA) in order to assert a breach of the BIT.[72]

---

contradictory treaty obligations (BIT versus Geneva Convention) were already binding on both states well before the arbitral proceedings were brought.

70 *Impregilo v. Pakistan* [*supra* No. 74], ¶ 85.

71 Similarly, the Tribunal does not have to decide on Bayindir's argument that the tribunal in "*RFCC v. Morocco*, which *Impregilo* cites, discussed "puissance publique" only in the context of fair and equitable treatment and expropriation claims before it, while it did not apply the test to the national treatment and MFN claims" (Reply J., p. 17, ¶ 54 referring to *Consortium RFCC v. Royaume du Maroc*, ICSID N° ARB/00/6, Award of 22 December 2003, ¶¶ 52-53 (Exh. [Pak]L-8 = Exh. [Bay]CLEX 59); available at http://www.worldbank.org/icsid/cases/rfcc-award.pdf).

72 The Tribunal notes that this view is not contrary to *Impregilo* and *RFCC*. The tribunal in *Impregilo* referred to the concept of *'puissance publique'* in respect of the question whether a "breach of an investment contract can be regarded as a breach of a BIT" (*Impregilo v. Pakistan* [*supra* No. 74], ¶¶ 259-260). Similarly, *RFCC v. Morocco* (cited by the tribunal in *Impregilo*) was concerned with

In the present case, Bayindir has abandoned the Contract Claims and pursues exclusively Treaty Claims. When an investor invokes a breach of a BIT by the host State (not itself party to the investment contract), the alleged treaty violation is by definition an act of *'puissance publique'*. The question whether the actions alleged in this case actually amount to sovereign acts of this kind by the State is however a question to be resolved on the merits.

184. Hence, at this stage the real question is whether the Treaty Claims are sufficiently substantiated for jurisdictional purposes or, in Pakistan's words, whether they have a "colourable basis".

D. ARE BAYINDIR'S TREATY CLAIMS SUFFICIENTLY SUBSTANTIATED FOR JURISDICTIONAL PURPOSES?

185. Significantly, Pakistan itself assimilates the issue whether the Treaty Claims are in reality Contract Claims to the question whether the Treaty Claims are in fact sufficiently substantiated for jurisdictional purposes:

> So a Tribunal that is not the Tribunal chosen under the contract should not be hearing this case, we say, unless it really is a treaty claim that is confronting it and not a contract claim dressed up to look like something on breach of treaty.
>
> The Impregilo case at paragraph 254 of the award makes very much this point […]. Having quoted both Oil Platforms and the arbitration award in SGS/Philippines […], at paragraph 254 the Tribunal goes on in these terms. "The present Tribunal is in full agreement with the approach evident in this jurisprudence. It reflects two complementary concerns. To ensure that courts and Tribunals are not flooded with claims which have no chance of success or may even be of an abusive nature […] and equally to ensure that in considering issues of jurisdiction courts and Tribunals do not go into the merits of cases without sufficient prior debate."
>
> (Tr. J., 81:33-82:15)

---

the questions of whether (i) the alleged contract breach could constitute an unfair and inequitable treatment under the BIT, and (ii) the alleged bad performance of the contract could amount to interference tantamount to expropriation. *RFCC v. Morocco*, [*supra* Fn. 71]: *"L'Etat, ou son émanation, peuvent s'être comportés comme des cocontractants ordinaires ayant une divergence d'approche, en fait ou en droit, avec l'investisseur. Pour que la violation alléguée du contrat constitue un traitement injuste ou inéquitable au sens de l'Accord bilatéral, il faut qu'elle résulte d'un comportement exorbitant de celui qu'un contractant ordinaire pourrait adopter."* (¶ 51). And further: *"Or un Etat cocontractant n' « interfère » pas, mais « exécute » un contrat. S'il peut mal exécuter ledit contrat cela ne sera pas sanctionné par les dispositions du traité relatives à l'expropriation ou à la nationalisation à moins qu'il ne soit prouvé que l'Etat ou son émanation soit sorti(e) de son rôle de simple cocontractant(e) pour prendre le rôle bien spécifique de Puissance Publique"* (*Ibid*, ¶ 65 ; see also ¶ 69).

186. To answer the question whether the Treaty Claims are sufficiently substantiated for jurisdictional purposes, the Tribunal will first define the relevant standard (a). It will then apply it to the different Treaty Claims, i.e., the most favoured nation (MFN) claim (b), the fair and equal treatment claim (c) and the expropriation claim (d).

a. The relevant test

187. According to Pakistan, Bayindir cannot merely allege breach of the BIT with a view to establishing the Tribunal's jurisdiction. Referring to previous decisions by international tribunals, Pakistan submits that:

> [i]t is for the Tribunal to interpret each provision of the BIT relied upon (Articles II (1) and (2), III(1)), and to see whether on the facts alleged that provision could be breached.
>
> (Mem. J., p. 6, ¶ 1.9)

188. Pakistan accepts that the Tribunal need not determine whether Bayindir's allegations of breach are well-founded, but maintains that "some broad consideration of the facts may be appropriate". Specifically, Pakistan contends that:

> Bayindir can only rely on allegations of fact (i) that are credible, (ii) where such allegations could give rise to a breach of the BIT, (iii) taking into account the views expressed by Pakistan on such allegations.
>
> (Mem. J., p. 6, ¶ 1.10)

189. Bayindir seems[73] to accept that it has the burden (aa.) to demonstrate that the Tribunal has jurisdiction (C-Mem. J., p. 3, ¶ 6). As to the standard of proof (bb.), Bayindir seems[74] to accept that in the jurisdictional phase of this arbitration it has to establish that "the claims it pleads are sustainable on a *prima facie* basis" (C-Mem. J., p. 3, ¶ 6).

aa. The onus of establishing jurisdiction

190. In accordance with accepted international (and general national) practice, a party bears the burden of proving the facts it asserts. In *Impregilo*, the tribunal took it for granted

---

73 At the hearing, Bayindir expressed the following view: "Now, it is put that there is an onus on us to establish jurisdiction. We say that is not so. We say that the onus is on Pakistan to establish there is no jurisdiction but in the context that we have been firstly in our request for arbitration expressed a tenable basis for putting a claim" (Tr. J., 138:38-140:5).

74 At the hearing, Bayindir expressed the following view: "We do not have to establish in our submission a *prima facie* case, but we say whatever is the test we comfortably clear it" (Tr. J., 151:24-26).

that the Claimant had to satisfy "the burden of proof required at the jurisdictional phase" and make "the *prima facie* showing of Treaty breaches required by ICSID Tribunals".[75]

191. At the jurisdictional hearing, Bayindir declared that it did not accept this passage of the *Impregilo* decision (Tr. J., 13:34-36). Upon a specific request for clarification by the Tribunal, Bayindir expressed the following view:

> [I]t is necessary for this objection to be successful to the Republic of Pakistan to say on this preliminary documentation that even if [Bayindir] establish the matters and the characterisation of those matters which [it asserts], it becomes untenable to make out [the Treaty] breach.
>
> (Tr. J., 156:24-30)

192. In the Tribunal's understanding, this approach does not alter the fact that, as conceded in Bayindir's written submissions, Bayindir has the burden of demonstrating that its claims fall within the Tribunal's jurisdiction.

bb. The relevant standard

193. In their written submissions, the parties formulated the test which the Tribunal is to apply in determining jurisdictional disputes in various ways. They made extensive reference to decisions of the International Court of Justice, ICSID tribunals and other international tribunals. The gap between their positions appeared to narrow down through that written process and, at the jurisdictional hearing, counsel for both parties accepted the following test stated by the tribunal in *Impregilo* (Tr. J., 157:13 *et seq.* [Bayindir]; 198:31 *et seq.* [Pakistan]):

> [T]he Tribunal has considered whether the facts as alleged by the Claimant in this case, *if* established, are capable of coming within those provisions of the BIT which have been invoked.[76]

194. The tribunal in *Impregilo* went on to explain that, applying the approach set out above, the tribunal has to determine whether the "Treaty Claims fall within the scope of the BIT, assuming *pro tem* that they may be sustained on the facts"[77]. In other words, the

---

75 *Impregilo v. Pakistan* [*supra* No. 74], ¶ 79.

76 *Impregilo v. Pakistan* [*supra* No. 74], ¶ 254, emphasis in the original

77 *Impregilo v. Pakistan* [*supra* No. 74], ¶ 263. In this respect, the Tribunal agrees with the observation in *United Parcel Service v. Government of Canada* that "the reference to the facts alleged being 'capable' of constituting a violation of the invoked obligations, as opposed to their 'falling within' the provisions, may be of little or no consequence. (*United Parcel Service v. Government of Canada* (NAFTA), Decision on Jurisdiction, 22 November 200, ¶ 36; available at http://www.investmentclaims.com/decisions/UPS-Canada-Jurisdiction-22Nov2002.pdf.)

Tribunal should be satisfied that, if the facts or the contentions alleged by Bayindir are ultimately proven true, they would be capable of constituting a violation of the BIT.

195. The Tribunal notes that the approach has been followed by several international arbitration tribunals deciding jurisdictional objections by a respondent state against a claimant investor, including *Methanex v. USA*, *SGS v. Philippines*[78], *Salini v. Jordan*[79], *Siemens v. Argentina*[80] and *Plama v. Bulgaria*[81]. In the last of these cases, the tribunal held that "if on the facts alleged by the Claimant, the Respondent's actions might violate the [BIT], then the Tribunal has jurisdiction to determine exactly what the facts are and see whether they do sustain a violation of that Treaty"[82]. Likewise, the tribunal in *Impregilo* considered that "it must not make findings on the merits of those claims, which have yet to be argued, but rather must satisfy itself that it has jurisdiction over the dispute, as presented by the Claimant"[83].

196. The Tribunal is in agreement with this approach, which strikes a helpful balance between the need "to ensure that courts and tribunals are not flooded with claims which have no chance of success or may even be of an abusive nature" on the one side, and the necessity "to ensure that, in considering issues of jurisdiction, courts and tribunals do not go into the merits of cases without sufficient prior debate" on the other.

197. Accordingly, the Tribunal's first task is to determine the meaning and scope of the provisions which Bayindir invokes as conferring jurisdiction and to assess whether the facts alleged by Bayindir fall within those provisions or are capable, if proved, of

---

78 *Société Générale de Surveillance S.A. v. Republic of the Philippines*, ICSID Case No. ARB/02/6, Decision on Jurisdiction of 29 January 2004, ¶ 29 (Exh. [Pak]L-9); available at http://www.worldbank.org/icsid/cases/SGSvPhil-final.pdf.

79 *Salini Costruttori S.p.A and Italstrade S.p.A v. The Hashemite Kingdom of Jordan*, ICSID Case No. ARB/02/13, Award of 15 November 2004, ¶¶ 31 *et seq*. (Exh. [Pak]L-12); also available at http://www.worldbank.org/icsid/cases/salini-decision.pdf.

80 *Siemens A.G. v. The Argentine Republic*, ICSID Case No. ARB/02/8, Decision on Jurisdiction of 3 August 2004 (Exh. [Pak]L-10); available at http://www.asil.org/ilib/Siemens_Argentina.pdf, ¶ 180: "The Tribunal simply has to be satisfied that, if the Claimant's allegations would be proven correct, then the Tribunal has jurisdiction to consider them."

81 *Plama Consortium Limited v. The Republic of Bulgaria*, ICSID Case No. ARB/03/24, Decision on Jurisdiction of 8 February 2005, ¶ 119; available at http://www.worldbank.org/icsid/cases/plama-decision.pdf.

82 *Plama v. Bulgaria* [*supra* Fn. 81], ¶ 132.

83 *Impregilo v. Pakistan* [*supra* No. 74], ¶ 237.

constituting breaches of the obligations they refer to[84]. In performing this task, the Tribunal will apply a *prima facie* standard, both to the determination of the meaning and scope of the BIT provisions and to the assessment whether the facts alleged may constitute breaches. If the result is affirmative, jurisdiction will be established, but the existence of breaches will remain to be litigated on the merits.

198. Before applying this approach to each specific claim which Bayindir bases on the BIT, the Tribunal notes that at the jurisdictional hearing Bayindir submitted that Pakistan should have waited until the memorial on the merits before raising its jurisdictional objections (Tr. J., 141:4-5), which "of itself lowers the bar for [Bayindir] to clear" (Tr. J., 151:24-28).

199. It is true that under ICSID Arbitration Rule 41, Pakistan could have waited to raise its objections on jurisdiction until its counter-memorial. However, this Rule also provides that jurisdictional objections "shall be made as early as possible". Moreover, as Pakistan mentioned, Bayindir has explicitly accepted the way in which these proceedings have been organised (Tr. J., 197:32-198:2). The reason for the exchange of pleadings on jurisdiction prior to the memorial on the merits was to clear the question of jurisdiction at an early stage. Bayindir knew the challenges brought forward by Pakistan and had three opportunities to respond. At the first opportunity, Bayindir submitted "that this Tribunal should consider whether the claims it pleads in the jurisdictional phase of this arbitration are sustainable on *a prima facie* basis" (C-Mem. J., p. 3, ¶ 6).

200. The Tribunal therefore sees no reason to "lower the bar for [Bayindir] to clear" and thus will apply the standard defined in paragraph 197 above.

b. Bayindir's most favoured nation claim

201. Article II (2) of the BIT states:

> Each Party shall accord to these investments, once established, treatment no less favourable than that accorded in similar situations to investments of its

[84] Contrary to the tribunal in *L.E.S.I.*, this Tribunal will not simply verify that the Claimant invokes treaty breaches (see *L.E.S.I. v. Algeria* [*supra* Fn. 26], ¶ 25.4. The Tribunal observes that a similar approach was adopted by the Tribunal in Consortium *RFCC v. Royaume du Maroc*, Decision on jurisdiction, ¶¶ 70-71; available at http://www.investmentclaims.com/decisions/-Consortium-Morocco-Jurisdiction-16Jul2001.pdf).

> investors or to investments of investors of any third country, which ever is the most favourable.

202. It is Bayindir's contention that its investment was not given treatment equivalent to the best treatment accorded to a comparable Pakistani or third country investment. Specifically, Bayindir alleged that (aa) it was expelled allegedly to save costs and for reasons of local favouritism, considering in particular that (bb) far more favourable timetables were accorded to Pakistani and other foreign contractors and that (cc) these other contractors were not expelled even though they were behind schedule far more than Bayindir.

203. Pakistan opposes this claim arguing (i) that Bayindir has not pleaded the MFN claim in its RA, (ii) that Bayindir's contentions do not amount to "an MFN national treatment type claim", and (iii) that Bayindir has "not show[n] enough to get this tribunal across the threshold to establish a *prima facie* breach" (Tr. J., 100:11-24).

204. As a preliminary matter, the Tribunal observes that the fact that the most favoured nation claim was first brought forward only in Bayindir's C-Mem. J. is not relevant *per se*.

205. Pakistan further contends that MFN claims "are predominantly about regulatory action where a local investor or a foreign investor is offered better treatment, i.e., a more preferable regulatory treatment than the foreign investor", which is clearly not the case of Bayindir (Tr. J., 100:24-30). In other words, the obligation arising out of the most favourable treatment clause concerns "regulatory protection not the exercise of discretion where no legal obligation exists", in particular in contractual matters:

> The periods for the completion of the project and the employer's remedies for a failure to complete on time, just like questions of remuneration, are matters that fall within the scope of a given construction contract. […] The fact that NHA may not have terminated contracts in other cases is wholly irrelevant.
>
> (Tr. J. 96:11-22)

206. The Tribunal disagrees. The mere fact that Bayindir had always been subject to exactly the same legal and regulatory framework as everybody else in Pakistan does not necessarily mean that it was actually treated in the same way as local (or third countries) investors. In other words, as is evident from the broad wording of Article II(2)

of the BIT, the treatment the investor is offered under the MFN clause is not limited to "regulatory treatment"[85].

207. Hence, the Tribunal will verify whether the facts alleged by Bayindir fall within this broad wording of the MFN clause or would be capable if proved of constituting breaches asserted. In the following paragraphs, the Tribunal will discuss this point in respect of each of Bayindir's contentions referred to above (cf. *supra* No. 202).

aa. Expulsion for reasons of costs and local favouritism

208. In support of its allegation that it was expelled for reasons of costs and local favouritism, Bayindir relies primarily on three articles published by the Pakistani newspaper "*Dawn*":

- A first article – published on 26 April 2002, that is three days after Bayindir's expulsion – quoting a spokesman for the NHA saying that "the project will now be completed by the Pakistani construction companies [...] by December 31, 2002" (Exh. [Bay.] CX 101).
- A second article, published on 7 May 2001, observing that the contract put the country in a "difficult position in respect to foreign reserves" and suggesting that the Prime Minister at the time of the revival of the contract "took personal interest to ensure the execution of the project" (Exh. [Bay.] CX 98).
- A third article, published on 17 June 2001, quoting information from "official sources" that "Islamabad is hoping to save several hundred million dollars by executing the Islamabad-Peshawar motorway (M-1) project through local construction firms" (Exh. [Bay.] CX 99).

209. According to Pakistan, these allegations are "false and unsubstantiated" (Reply J., p. 70, ¶ 4.94). Pakistan did not indicate why and to what extent the information reported in the press was not true but merely insisted on the fact that these press reports do not constitute a sufficient basis to substantiate Bayindir's allegation for the purposes of jurisdiction. Relying on the decisions of the International Court of Justice in the

[85] See also the developments regarding the scope of the obligation of fair and equitable treatment (see *infra* NNo. 240-240).

Hostages case[86] and in *Nicaragua*[87], Pakistan affirms that international courts and tribunals invariably treat such press reports with great caution and accept them merely as corroborative evidence.

210. This Tribunal notes that the decisions cited in both the *Hostages* and *Nicaragua* cases were concerned with decisions *on the merits*, to which the corresponding standard of proof therefore applied. The position is obviously different where, as here, the tribunal is merely applying a *prima facie* standard for the purpose of determining whether it has jurisdiction.

211. Accordingly, irrespective of the evidentiary weight of these press reports on the merits, the Tribunal considers that they constitute a sufficient basis for the purpose of establishing jurisdiction. Additional elements support this *prima fa*cie basis. Indeed, in connection with the Constitutional Petition, Pakistan submitted that the 1997 Contract was a "bonanza" for Bayindir and was "highly favorable to the petitioner and against the [...] economic and social interests of Pakistan" (Exh. [Bay.] CX 30). Moreover, Bayindir's alleged expulsion appears to have been decided after reports by the World Bank indicating that the most economic course of action would be to stop the M1 Project (see *infra* No. 247). Whatever the weight that they may carry when the Parties will have fully briefed the merits and presented their evidence, at this preliminary stage these elements are a sufficient basis to establish jurisdiction.

bb. More favourable timetables were accorded to Pakistani contractors

212. Bayindir alleges that Pakistan breached the MFN clause because it awarded PMC JV, the local contractor that replaced Bayindir, a four-year extra 'time and space', while it was itself expelled having requested an EOT for a much shorter period. It also argues that, although the project is still not terminated, the local contractor remains in place and continues to benefit from Pakistan's leniency as to delays.

---

86 *United States Diplomatic and Consular Staff in Tehran (United States of America v. Iran)*, Judgment of 24 May 1980; ICJ Reports 1980, p. 3, 10 (Exh. [Pak]RL-2).

87 *Military and Paramilitary Activities in and against Nicaragua (Nicaragua v. United States of America)*, Judgment on the Merits of 27 June 1986; ICJ Reports 1986, p. 14, 40 (Exh. [Pak]RL-3).

213. Having concluded that the MFN clause is not limited to regulatory treatment (see *supra* Nos. 205-206), it is clear that awarding an extended timetable to the local investor can fall within Article II(2) of the BIT.

214. Pakistan objects that:

> [t]he periods for the completion of the project and the employer's remedies for a failure to complete on time, just like questions of remuneration, are matters that fall within the scope of a given construction contract. They are not matters of a treaty.
>
> (Tr. J., 96:11 *et seq.*)

215. The Tribunal can certainly agree with the first sentence. However, the very fact that these questions are governed by specific contractual provisions does not necessarily mean that they have no relevance in the framework of a treaty claim. One cannot seriously dispute that a State can discriminate against an investor by the manner in which it concludes an investment contract and/or exercises the rights thereunder. Any other interpretation would consider treaty and contract claims as mutually exclusive, which would be at odds with the well-established principles deriving from the distinction between treaty and contract claims as discussed above (see *supra* Nos. 148 *et seq.*).

216. Pakistan's main contention in this respect is that Bayindir's claim is "untenable", in particular because "[o]ther projects must be examined on their merits and in the light of their factual and contractual context" (Reply J., p. 71, ¶ 4.96). *Prima facie*, this argument may well apply to Bayindir's contention that it was the only contractor expelled when 29 out of 35 projects were delayed as a result of problems very similar to those faced at M-1, (see in particular the projects listed in C-Mem. J., pp. 34-37, ¶¶ 116 *et seq.*), but not to the contract with PMC JV, which relates to the very same project from which Bayindir was expelled. Indeed, and this is not disputed by Pakistan, PMC JV was awarded the contract for the remaining works on the M-1 Project with a four year (1460 days) completion deadline (Exh. [Bay.] CX 29).

217. Moreover, the memorandum of understanding between NHA and PMC JV provided that the time of completion would be "agreed between the parties depending upon the situation of NHA cashflow" (Exh. [Bay.] CX 132). The mere allegation that NHA's financial difficulties were due to the fact that it "has already paid up to date Bayindir insofar as the works on the project, and has already paid to Bayindir the very, very

substantial advance mobilisation payment" (Tr. J. 98:28-35) does not appear to explain the difference in treatment with respect to the completion deadlines.

218. Failing an explanation or particular insight about the reasons for the extended timetable agreed with PMC JV, Bayindir's allegation of discrimination with respect to the construction schedules cannot be considered as untenable under the applicable *prima facie* standard.

cc. Selective tendering

219. Bayindir further contends that Pakistan did not follow a bid procedure to replace it for the completion of the remaining works. Relying on several press reports, Bayindir submits that it was only after the memorandum of understanding had been signed with PMC JV that Pakistan organized a "selective tendering" (limited to two governmental organizations) as a later stage "cover-up" (C-Mem. J., p. 46, ¶¶ 159-160).

220. Again Pakistan does not contest that a selective tendering in favor of local contractors could constitute a violation of the MFN clause. What Pakistan disputes is the alleged irregularity of the process. In particular the parties disagree on the interpretation of the NHA Minutes of Meeting of 13 November 2002, during which NHA's Vigilance Wing stated:

> PMC-JV was the Consortium which was constituted by concerned NHA officials through negotiations with concerned firms mainly SKB and this aspect was reported by us at that time. Now through the process of manipulation as reported by insiders the contract is being awarded to the same.
>
> (Ex. [Pak.] 70)

221. Pointing out that the Executive Board of NHA did not question the remarkable assertion that PMC JV was actually "constituted by concerned NHA officials", Bayindir submits that the wording "at that time" proves that Pakistan already intended to bring in the local consortium led by SKB, *prior to* Bayindir's expulsion (Rejoinder J., p. 27, ¶¶ 87-88). At the jurisdictional hearing, Pakistan strongly challenged Bayindir's reliance on "these minutes to show that NHA had already organised a replacement consortium of local contractors prior to Bayindir's expulsion from the site in April 2001" (Tr. J. 97:26-31).

222. It would be both premature and inappropriate for the Tribunal to express any views as to the regularity of the tendering process on these (and other) materials. Whatever their

weight on the merits, it is clear that NHA informed the press immediately following the expulsion of Bayindir that a local consortium would complete the works. Under these circumstances, Bayindir's allegations as to the openness of the tendering cannot be deemed untenable for jurisdictional purposes.

223. The fact remains that, taken together, Bayindir's allegations in respect of the selective tender, and that the expulsion was due to Pakistan's decision to favor a local contractor, and that the local contractor was awarded longer completion time-limits, if proven, are clearly capable of founding a MFN claim[88].

224. As a final matter, and irrespective of the circumstances of the case, the Tribunal wishes to emphasize that it is generally difficult to prove that an objectively different situation is the result of unequal treatment rather than of the existence of reasons to treat the two situations differently. At this preliminary stage this reinforces the Tribunal in its conclusion that it has jurisdiction to hear Bayindir's most favored nation claims on the merits.

c. Bayindir's fair and equitable treatment claim

225. In its RA, Bayindir asserted that "Pakistan failed to promote and protect Bayindir's investment in violation of Article II of the BIT [and] failed to ensure the fair and equitable treatment of Bayindir's investment, in violation of Article II (2) of the BIT (RA, p. 11, ¶ 37). In summary, Bayindir's fair and equitable treatment claim is based on Pakistan's alleged "failure to provide a stable framework for Bayindir's investment" (C-Mem. J., pp. 41-43, ¶¶ 140 *et seq.*) and on the alleged fact that "Pakistan's expulsion of Bayindir was unfair and inequitable" (C-Mem. J., pp. 43-47, ¶¶ 150 *et seq.*).

226. Pakistan's case is that there is no obligation of equitable treatment in the BIT and, even if there were, there would be no violation of fair and equal treatment.

---

88 At the hearing Bayindir noted that "[i]t is an aggregation of matters which we say if not answered form a basis for the Tribunal to make inferences" (Tr. J., 150:19-21); "that is information to the Tribunal which has not been denied and possibly when we get to the merits we can require some document to establish that" (Tr. J., 156:12-15).

aa. Is there an obligation of equitable treatment?

227. In its objections to jurisdiction, Pakistan pointed out that Article II (2) contains no requirement of fair and equitable treatment:

> Bayindir is presumably seeking to rely upon some form of argument based on the most favoured nation provisions of Article II(2). If that is the case, then, first one would have expected that argument to have been pleaded in the Request and particulars given. Secondly, in the absence of such particulars, all that is before the Tribunal is the reliance on a provision of the BIT which on its terms plainly does not impose the duties invoked by Bayindir.
>
> (Mem. J., p. 58, ¶ 4.53)

228. Bayindir expanded on the legal basis of the equitable treatment claim in its Counter-Memorial on Jurisdiction:

> The applicability of a fair and equitable treatment obligation to Bayindir's investment arises out of both the BIT preamble and the most favored nation clause.
>
> (C-Mem. J., p. 38, ¶ 129)

229. The preamble describes the objectives which Turkey and Pakistan pursued in entering into the BIT as follows:

> The Islamic Republic of Pakistan […] and the Republic of Turkey […] agre[e] that fair and equitable treatment of investment is desirable in order to maintain a stable framework for investment and maximum effective utilization of economic resources.

230. Despite the use of the verb “agree”, it is doubtful that, in the absence of a specific provision in the BIT itself, the sole text of the preamble constitutes a sufficient basis for a self-standing fair and equitable treatment obligation under the BIT. It remains however for the Tribunal to consider whether, through the most favoured nation clause contained in Article II(2) of the BIT, Bayindir is entitled to rely on Pakistan’s obligation to act in a fair and equitable manner contained in other BITs concluded by Pakistan. Article II(2) of the BIT reads as follows:

> Each Party shall accord to these investments, once established, treatment no less favourable than that accorded in similar situations to investments of its investors or to investments of investors of any third country, which ever is the most favourable.

231. Neither in its Reply nor at the jurisdictional hearing, did Pakistan dispute Bayindir’s assertion that the investment treaties which Pakistan has concluded with France, the Netherlands, China, the United Kingdom, Australia, and Switzerland contains an explicit fair and equitable treatment clause (C-Mem. J., p. 38, ¶ 131-132).

232. Under these circumstances and for the purposes of assessing jurisdiction, the Tribunal considers, *prima facie*, that Pakistan is bound to treat investments of Turkish nationals "fairly and equitably."[89]

233. For the event that the Tribunal were to accept an obligation of fair and equitable treatment, Pakistan disputed that it violated it (Reply J., p. 70, ¶ 4.94):

> It was Bayindir's default under the Contract and not any alleged unfair or inequitable treatment on the part of the Government of Pakistan which led to Bayindir's withdrawal from the site.
>
> (Reply J., p. 67, ¶ 4.81)

234. The fact that an act is, or may be, in accordance with the Contract would not in and of itself rule out a treaty violation. The real question for present purposes is whether the facts alleged by Bayindir are capable of constituting a violation of Pakistan's obligation to treat Bayindir's investment fairly and equitably.

235. Accordingly, the Tribunal will review Bayindir's main allegation, namely that (i) Pakistan failed to provide a stable framework for Bayindir's investment and that (ii) Pakistan's expulsion of Bayindir was unfair and inequitable.

bb. Alleged failure to provide a stable framework for Bayindir's investment

236. In summary, Bayindir alleges that NHA was highly unstable for reasons of "lack of management continuity" as well as "malpractice and corruption" (C-Mem. J., p. 41, ¶ 143). More importantly, Bayindir contends that the government of Pakistan itself was unstable during the project:

> [E]ach time there was a change of government, Pakistan's attitude towards Bayindir's investment changed, commencing with the initial contract in 1993, its cancellation in 1994, the contract renewal in 1997, and finally the expulsion in 2001.
>
> (C-Mem. J., p. 42, ¶ 146)

237. The contents of the obligation to provide fair and equitable treatment were described in *Tecmed v. Mexico,* to which both Parties refer (see, for instance, C-Mem. J., p. 39, ¶

[89] As to the general possibility to "import" a fair and equitable treatment provision contained in another BIT, see, for instance *Pope & Talbot Inc. v. Government of Canada,* Decision of 10 April 2001, ¶¶ 111, 115.

134; Tr. J. 101:20 et seq.)[90]. Reasoning "in light of the good faith principle established by international law", the tribunal held that the concept of fair and equitable treatment obliges the State:

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

238. Pakistan does not dispute that it has an obligation to maintain a stable framework for investment, but it argues that governmental instability as such does not amount to a breach of the obligation to afford fair and equitable treatment (Tr. J., 102:9-21). The Tribunal agrees thus far, and endorses Pakistan's submission that "[a]n investor can never have an expectation that governments or government personnel would not change over the course of a given project" (Tr. J., 103:6-8). However, Bayindir claims that the changes in government had a direct influence upon Pakistan's conduct towards Bayindir's investment, which is a question that should clearly be decided on the merits.

239. The Tribunal considers that, in the light of the above-quoted terms of the BIT's preamble and for purposes of establishing jurisdiction, it cannot *prima facie* be ruled out that Pakistan's fair and equitable treatment obligation comprises an obligation to maintain a stable framework for investment.

240. It is true that Pakistan asserted that the obligation to afford fair and equitable treatment as expressed in *Tecmed v. Mexico*[91] relates to "changes to the regulatory framework in

---

[90] The Tribunal further notes that at the hearing this approach was implicitly endorsed also by Pakistan when declaring: "What matters so far as fair and equitable treatment is concerned is the actions of the government and whether there was an arbitrary refusal to grant a licence, or an arbitrary revocation of an existing permit" (Tr. J., 103:4-7).

which an investment has been made" and that "Bayindir can point to no equivalent regulatory changes in this case and of course there are none" (Tr. J., 102:7-9). However, the general definition of fair and equitable treatment in *Tecmed* refers not only to "all rules and regulations that will govern [the] investments" but also to "the goals of the relevant policies and administrative practices or directives"[92]. Hence, the fact that in *Tecmed* the change concerned a failure to renew a necessary operating permit does not rule out that a State can breach the 'stability limb' of its obligation through acts which do not concern the regulatory framework but more generally the State's policy towards investments.

241. Under these circumstances, the Tribunal considers that, if proven, Pakistan's alleged change in its general policy toward Bayindir's investment is capable of constituting a breach of Pakistan's obligations to accord fair and equitable treatment.

cc. The allegedly unfair and inequitable expulsion

242. Bayindir's "central allegation" (Rejoinder J., p. 20, ¶ 62) concerning the fair and equitable treatment claim is that the expulsion was motivated by "local favouritism" and that the alleged delays in completion were merely a pretext (C-Mem. J., p. 47, ¶ 164). In this respect, Bayindir's fair and equitable treatment claim coincides with its most favoured nation claim. Hence, the Tribunal refers to the discussion above (see *supra* Nos. 208 *et seq.*).

243. Besides the allegation of local favouritism, Bayindir contends that "[t]he circumstances of Bayindir's expulsion and the awarding of the contract to Pakistani contractors further indicates inequity and bad faith" (C-Mem. J., p. 45, ¶157) as the "actual motivation for ending Bayindir's employment [was] the World Bank's strong opposition to the Project" (Rejoinder J., p. 23, ¶ 73) and related "budgetary reasons" (Tr. J., 129:3-9):

> [T]here is enough to show that these elements of government action for a pre-determined result to get direct advantages both from the point of view we say of World Bank inputs and coercion, direct results for the Republic of Pakistan so far as saving money and its view of national interest is concerned. Real results for delay when it just did not have the money, particularly did not have US$, real

---

[91] *Técnicas Medioambientales, Tecmed S.A., v. The United Mexican States*, Case No. ARB (AF)/00/2, Award of 29 May 2003, ¶ 154; unofficial translation (Exh. CLEX 34); ICSID Review (2004), vol. 19, no. 1, also available at http://www.worldbank.org/icsid/cases/laudo-051903%20-English.pdf.

[92] *Tecmed v. Mexico* [supra No. 237], ¶ 154.

> results for its desire to establish local industry, real saving of over $100m on the contract price at a later date, and an attempt which is still being actively pursued to recover $104m of money from our guarantees that we will be responsible to fund the roadway.
>
> (Tr. J., 150:4-17)

244. In conjunction with the selective tender process discussed above, Bayindir further suggests that "it is now public knowledge that the award of Bayindir's investment to the Pakistani consortium was riddled with corruption" (C-Mem. J., p. 46, ¶157).

245. Pakistan does not contest that the expulsion could amount to a violation of fair and equitable treatment. It alleges, however, essentially that "any suggestion that Bayindir was expelled from the site at gunpoint in implementation of some Pakistan political or economic agenda is simply wrong" (Reply J., p. 68, ¶ 4.84). More specifically, it insists that (i) Bayindir's allegations are largely based on press reports, (ii) Bayindir's claim presupposes corruption on the part of Pakistan – which cannot be readily inferred by an international tribunal, and (iii) the delays were real and NHA had a right to expel Bayindir (Tr. J., 106:32-107:10).

246. Whether Bayindir's contested allegations are true or wrong, is a question for the merits. At this stage, the only relevant issue is whether it cannot be ruled out, at least *prima facie*, that the alleged unfair and inequitable expulsion is, if proven, capable of falling within the Scope of Pakistan's obligation to accord fair and equitable treatment.

247. With specific regard to the actual reasons for the alleged expulsion, Bayindir relies on two letters of the World Bank recommending that the Project to be stopped (letter dated 26 May 2000, (Exh. [Bay.] CX 152); letter dated of 5 June 2000, (Exh. [Bay.] CX 153)) and on two notes of the Ministry of Communication and Railways (note dated 4 November 2000) (Exh. [Bay.] CX 127); note dated 2 April 2001, (Exh. [Bay.] CX 151). The letters from the World Bank emphasized that the M1 Project was financially unattractive and considered that stopping it appeared to be the most economic course of action. The notes of the Ministry appear to show that, following these letters, the financial status of the contract was addressed "at the highest level".

248. At the outset of the hearing on jurisdiction, Pakistan pointed out that these documents constitute "confidential and privileged legal materials which have apparently been taken from the files of the Government of Pakistan" (Tr. J., 18:3-5) and reserved all its rights

in this regard (Tr. J., 17:21-24). Upon a specific request by Pakistan to clarify how these documents were obtained, Bayindir explained that these document "turned up in the files of the claimant being files removed on its expulsion from Pakistan" but had "no further capacity to explain how they got there" (Tr. J., 38:29-33). Insisting on the fact that the veracity of the documents was not at stake, Bayindir informed the Tribunal that in the event Pakistan should formally challenge these documents, it would reply "by making an application under rule 34.2 that the tribunal call upon the respondent to produce these documents" (Tr. J., 39:16-19). As already mentioned, Pakistan did not formally request the Tribunal to strike these documents from the record[93]. Hence, the Tribunal considers that the documents referred to in paragraph 247 above are part of the record in this arbitration.

249. On this basis, the Tribunal considers that Bayindir's claim does not appear *prima facie* untenable.

250. Having considered that the allegedly unfair motives of expulsion, if proven, are capable of founding a fair and equitable treatment claim under the BIT, the Tribunal concludes that it has jurisdiction to hear Bayindir's claims based on Pakistan's obligation to accord fair and equitable treatment to foreign investment.

251. Hence, there is no need for the Tribunal to discuss Bayindir's additional allegations of corruption at this stage. In any event, it bears noting that the question would not be – as erroneously suggested by Pakistan – whether the Tribunal is ready or not to infer corruption and/or conspiracy in the decision to expel Bayindir and to replace it with a local contractor (see Tr. J., 106:24-32). The question would simply be whether, assuming that corruption and/or conspiracy were proven, this would fall within the scope of the fair treatment guarantee.

252. As a final matter, the Tribunal notes that Bayindir's "concerns about the independency of the Pakistani judiciary" (Rejoinder J., p. 24, ¶ 78) and "its lack of confidence in receiving due process in Pakistan" (Rejoinder J., p. 25, ¶ 81) has become moot, insofar

[93] Later during the jurisdictional hearing, Pakistan's Counsel maintained the reservation over these documents and added: "they are obviously before the tribunal for what they are worth and we shall have to get instructions from the Government of Pakistan as to what our next steps should be" (Tr. J. 39:7-11). To this date, the Tribunal did not receive any request regarding these documents.

as the possible pursuit of the Contract Claims in the Pakistani arbitration is concerned. As to the allegation of lack of due process in respect of the Constitutional Petition (see for instance (Rejoinder J., p. 25, ¶ 81), the Tribunal finds that Bayindir cannot infer a breach of due process simply from NHA's Chairman writing to the Minister of Communication that "[o]ur legal counsel will defend the case and get [a favourable outcome] after appearing in Court" (Exh. [Bay.] CX 131). Moreover, as correctly pointed out by Pakistan, a claim based on failure of natural justice in judicial proceedings must take into account the system of justice as a whole, not only an individual decision in the course of proceedings (Tr. 108:13-19 referring to *Waste Management. v. Mexico*[94]). In the present case, there is no evidence whatsoever supporting, even on a *prima facie* basis, Bayindir's allegation that "the lack of independence of Pakistan's judiciary is notorious" (Rejoinder J., p. 24, ¶ 77).

d. Bayindir's expropriation claims

253. Article III (1) of the BIT states the following in connection with expropriation:

> Investments shall not be expropriated, nationalized or subject, directly or indirectly to measures of similar effects except for a public purpose, in a non-discriminatory manner, upon payment of prompt, adequate and effective compensation, and in accordance with due process of law and the general principles of treatment provided for in Article II of this Agreement.

254. Bayindir contends that the following actions of Pakistan constitute an expropriation within the meaning of Article III (1) of the BIT:

(i) Pakistan's expulsion of Bayindir from the site, enforced by armed units of the Frontier Works Organization, was "a large-scale taking of Bayindir's Motorway investment [including a right to payment for several months of Interim Payment Certificates and works in progress], for the purpose of transferring property and interests into government hands before being passed along to PMC N" (C-Mem. J., pp. 49-50, ¶ 173).

(ii) On the ground that Bayindir did not re-export equipment within the time limit set by the applicable Pakistani regulation, Pakistan's Customs services encashed bank guarantees issued by Standard Chartered Bank ("SCB") securing unpaid import customs duties on behalf of Bayindir (Rejoinder J., pp. 30-31, ¶ 101-102).

94 *Waste Management, Inc. v. The United Mexican States*, ICSID Case No. ARB(AF)/00/3, Award of 30 April 2004, ¶ 97 (Exh. [Pak]L-15 = Exh. [Bay]CLEX 54); available at http://www.investmentclaims.com/decisions/WasteMgmt-Mexico-2-FinalAward-30Apr2004.pdf.

255. It is not disputed that expropriation is not limited to *in rem* rights and may extend to contractual rights. More generally, the Tribunal considers that, in the absence of a specific definition in the BIT, expropriation can take place also where the measure is not technically a regulatory act. As it has been consistently held in investment cases, expropriation may arise out of a simple interference by the host State in the investor's rights with the effect of depriving the investor – totally or to a significant extent – of its investment (*RFCC v. Morocco*, [*supra* Fn. 71], ¶ 64)

256. Again, Pakistan's main contention is that the alleged taking of the investment was a mere contractual termination and that "there was no appropriation of rights or interests by the Government of Pakistan" (Reply J., p. 75, ¶ 4.108). At the jurisdictional hearing, Pakistan summarized its case as follows:

> [I]n terms of the taking of contractual rights, a party which maintains that its contractual partner has failed to perform its bargain and therefore purports to exercise its power to repudiate a contract or to terminate it is doing what any contractual party does. […] It is not acting in a sovereign capacity at all. It is quite different from something like the legislative abrogation of contractual rights which one had in Iran in 1980, which one found, for example, with the Libyan legislation abrogating concession contracts in the early 1970s.
>
> (Tr. J., 78:12-24)

257. It is common ground, as the tribunal in *Impregilo* explicitly held, "that only measures taken by Pakistan in the exercise of its sovereign power ("*puissance publique*"), and not decisions taken in the implementation or performance of the Contracts, may be considered as measures having an effect equivalent to expropriation"[95].

258. True it is that the tribunal in *Impregilo* considered that the claims based on 'unforeseen geological conditions' did "not enter within the purview [of the expropriation clause of the BIT]" and declined jurisdiction in this regard[96]. Geological conditions, let alone when unforeseen, are – by their very nature – not attributable to an act of State. Thus, the tribunal in *Impregilo* had no hesitation over excluding them from its jurisdiction[97]. It is clear that, in counsel for Pakistan's words, this kind of claim "would fail at the jurisdictional threshold" (Tr. J., 75:23-31).

---

95 *Impregilo v. Pakistan* [*supra* No. 74], ¶ 281 (referred to, for instance, in Tr. 75:23-31).

96 *Impregilo v. Pakistan* [*supra* No. 74], ¶ 282.

97 *Impregilo v. Pakistan* [*supra* No. 74], ¶ 283.

259. The situation is very different where, as in this case, a party invokes an action by the State, which may or may not have been taken in *puissance publique*. Unlike the case of geological conditions, it is difficult to rule out *puissance publique* upon a *prima facie* analysis at the jurisdictional stage. Significantly, the tribunal in *Impregilo* asserted jurisdiction over Impregilo's other claims based on "alleged breaches of contract" because it was not then in a position to decide whether or not these could be considered as breaches of Article 5 of the BIT [i.e., expropriation]"[98]. Similarly, the tribunal in *Siemens* considered that "the issue whether the breach of the Contract may or may not be an act of expropriation is a matter related to the merits of the dispute"[99]. Indeed, Pakistan's argument that "expropriation of contract rights […] goes beyond the exercise or purported exercise of contractual powers and capacities" relies on the *Waste Management* case (Tr. J., 202:16-33), which was an award *on the merits*[100].

260. In the present case, and without in any manner prejudging its eventual determination of the relevant facts, the Tribunal cannot rule out that there may have been a sufficient involvement by the State in the alleged taking of Bayindir's investment so as to amount to an expropriation under the BIT.

261. The Tribunal is reinforced in this conclusion by the unchallenged fact that Bayindir's equipment was retained on site following the expulsion. In the Tribunal's understanding,

---

98 *Impregilo v. Pakistan* [*supra* No. 74], ¶ 284. The tribunal concluded this passage noting that "only after a careful examination of those alleged breaches will the Tribunal be able to determine whether the behaviour of Pakistan went beyond that which an ordinary Contracting party could have adopted".

99 *Siemens v. Argentine* [*supra* Fn. 80], ¶ 182.

100 *Waste Management. v. Mexico* [*supra* Fn. 94], ¶ 174; in the relevant section the tribunal was dealing with the question "Was there conduct tantamount to an expropriation of Acaverde's contractual rights?". This Tribunal observes that this question was not dealt with in the Decision on Jurisdiction (see *Waste Management, Inc. v. Mexico* ICSID Case No. ARB(AF)/98/2, Decision on Jurisdiction of 2 June 2000; available at http://www.investmentclaims.com/decisions/WasteMgmt-Mexico-2-Jurisdiction-26Jun2002.pdf). For the sake of completeness, it is useful to observe that at the jurisdictional stage the tribunal held that "it is clear that one and the same measure may give rise to different types of claims in different courts or tribunals. Therefore, something that under Mexican legislation would constitute a series of breaches of contract expressed as non-payment of certain invoices, violation of exclusivity clauses in a concession agreement, etc., could, under the NAFTA, be interpreted as a lack of fair and equitable treatment of a foreign investment by a government (Article 1105 of NAFTA) or as measures constituting "expropriation" under Article 1110 of the NAFTA. In any case, it is not the mission of the Tribunal, at this stage of the proceedings, to make an in-depth analysis of alleged breaches of the NAFTA invoked by the Claimant, since that task, should it become necessary, belongs to an analysis of the merits of the question" (*ibid.*, ¶ 27(a)).

Bayindir's claim for taking of its investment includes the retention of the equipment. Pakistan objects that this retention was provided for in the Contract (Reply J., pp. 69-70, ¶¶ 487-491), including a mechanism for compensating Bayindir for the equipment:

> Any issue relating to amounts due to Bayindir for the value of such equipment, if any, shall be calculated and paid after the completion of the project in accordance with Clause 63.3 of the Conditions of Contract.
>
> (Reply J., p. 70, ¶ 4.91)

262. Here again, this argument neglects the principle of the possible coincidence of treaty and contract claims. Moreover, in the Tribunal's view, such a payment may qualify as "compensation" within the meaning of Article III of the BIT. Whether such compensation would be "prompt, adequate, and effective", which may render an expropriation of the equipment lawful under the BIT, is a question for the merits.

e. Conclusion

263. For all these reasons, the Tribunal concludes that it has jurisdiction over the Treaty Claims raised in these proceedings. The Tribunal emphasizes that this decision is not equivalent to joining the question of jurisdiction to the merits as contemplated by Rule 41(4) of the ICSID Arbitration Rules[101]. Rather, it holds that Bayindir's claims are capable of constituting a violation of the BIT. As it emphasized on several occasions, the threshold at the jurisdictional level, which implies a *prima facie* standard, is different from the standards which the Claimant will have to discharge on the merits to show an actual treaty breach.

E. SHOULD THE TRIBUNAL STAY THE CURRENT PROCEEDINGS?

264. Pakistan finally asserts that even if *quod non* the Tribunal would have jurisdiction to determine the Treaty Claims, because of their intrinsic contractual nature, the current proceedings for breach of treaty should be stayed until the arbitral tribunal provided in the Contract has determined the contractual issues.

265. This approach has been adopted in the much-debated *SGS v. Philippines* case. Faced with the situation where the Philippines' responsibility under the BIT – a matter which

[101] From this point of view, the Tribunal cannot share the approach adopted by the tribunal in *Impregilo v. Pakistan* [*supra* No. 74], ¶ 285.

did fall within its jurisdiction – was subject to ”the factual predicate of a determination” by the Regional Trial Court of the total amount owing by the respondent, the tribunal held that:

> [t]hat being so, justice would be best served if the Tribunal were to stay the present proceedings pending determination of the amount payable, either by agreement between the parties or by the Philippine courts in accordance with Article 12 of the CISS Agreement.[102]

266. The view that an ICSID tribunal has the power to stay proceedings pending the determination, by some other competent forum, of an issue relevant to its own decision, explicit in *SGS v. Philippines*, is also present, though impliedly, in the discussion in *SGS v. Pakistan*[103]. The Tribunal agrees with Pakistan's view that this "course of action […] would not involve a refusal to exercise jurisdiction (of the kind condemned by the ad hoc committee in the *Vivendi* Annulment decision)" (Reply J., p. 23, ¶ 2.49; see also Tr. J., 88:4-19).

267. Pakistan recognizes that its position was rejected by the tribunal in *Impregilo* (Reply J. p. 23, ¶ 2.50) where, "drawing upon the approach that was adopted in *SGS v. Philippines*[104], Pakistan submit[ed] that th[at] Tribunal should stay these proceedings, in order to allow the contractual dispute resolution mechanisms to take their course"[105].

268. In *Impregilo*, the tribunal held, *inter alia*, that:

> [w]hilst arguably justified in some situations, a stay of proceedings would be inappropriate here, for a number of reasons. Firstly, such a stay if anything, would confuse the essential distinction between the Treaty Claims and the Contract Claims as set out above. Since the two enquiries are fundamentally different (albeit with some overlap), it is not obvious that the contractual dispute resolution mechanisms in a case of this sort will be undermined in any substantial sense by the determination of separate and distinct Treaty Claims. Indeed, this is all the more so in a case such as the present, where (*unlike SGS v. Philippines*) the parties to these proceedings (Impregilo and Pakistan) are different from the parties to the contract arbitration proceedings (GBC and WAPDA).
>
> Further, if a stay was ordered, as Pakistan has sought, it is unclear for how long this should be maintained; what precise events might trigger its cessation; and what attitude this Tribunal ought then to take on a resumed hearing to any proceedings or findings that may have occurred in the interim in Lahore.[106]

---

102 *SGS v. Philippines* [*supra* Fn. 78], ¶¶ 174-175

103 *SGS v. Pakistan* [*supra* Fn. 32], ¶¶ 185-189.

104 *SGS v. Philippines* [*supra* Fn. 78].

105 *Impregilo v. Pakistan* [*supra* No. 74], ¶ 234.

106 *Impregilo v. Pakistan* [*supra* No. 74], ¶¶ 289-290

269. According to Pakistan, on the facts of the present case, there are compelling reasons for departing from the solution adopted by *Impregilo*. This allegedly "follows both from considerations of logic and a practical concern for the orderly settlement of disputes" (Reply J., p. 22, ¶ 2.48). As to the latter, Pakistan contends that the (contractual) arbitral tribunal sitting in Pakistan is already seized of the dispute between NHA and Bayindir and that (subject to a stay in these ICSID proceedings and to the latter tribunal's own decision on Bayindir's challenge to jurisdiction), it is obliged to proceed to the merits, regardless of extraneous factors.

270. In the Tribunal's view its jurisdiction under the BIT allows it – if this should prove necessary – to resolve any underlying contract issue as a preliminary question. Exactly like the arbitral tribunal sitting in Pakistan, this Tribunal should proceed with the merits of the case. This is an inevitable consequence of the principle of the distinct nature of treaty and contract claims. The Tribunal is aware that this system implies an intrinsic risk of contradictory decisions or double recovery. In this respect, in *Camuzzi v. Argentina* – a case where it was explicitly held that "the claim was […] founded on both the contract and the Treaty" – the tribunal noted that "this is an issue belonging to the merits of the dispute" and for which "international law and decisions offer numerous mechanisms for preventing the possibility of double recovery"[107].

271. In any event, accepting that it has discretion to order the stay of the present proceedings as requested by Pakistan, that discretion is to be exercised only if there are truly compelling reasons. In the present case, the Tribunal cannot see any compelling reason to stay the current arbitration.

272. The Tribunal is sympathetic towards the efforts of the tribunal in *SGS v. Philippines* "to give effect to the parties' contracts while respecting the general language of BIT dispute settlement provisions"[108]. However, to do so raises several practical difficulties. In particular, it may be very difficult to decide, at this preliminary stage, which contractual issues (if any) will have to be addressed by the Tribunal on the merits.

---

107 *Camuzzi v. Argentina* [*supra* Fn. 67], ¶ 89.

108 *SGS v. Philippines* [*supra* Fn. 78], ¶ 134.

273. Moreover, as a leading commentator recently put it, in practice the decision to stay the ICSID proceedings "results in the BIT tribunal having jurisdiction over an empty shell and depriving the BIT dispute resolution of any meaning"[109].

F. COSTS

274. In its Counter-Memorial, Bayindir made the following submission with respect to costs:

> Before both the courts in Pakistan and Turkey, the GOP has sought to benefit from the fact that Bayindir had seized ICSID, without revealing that it would be resisting ICSID's jurisdiction regarding Bayindir's claims. Under the circumstances, it would seem unfair that Bayindir should bear the costs of this first part of the proceedings. While Bayindir accepts that the Tribunal may wish to reserve its decision on costs until the Final Award, it submits that the costs for the jurisdictional phase of the arbitration should be borne by Pakistan.
>
> (C-Mem. J. p. 89 ¶ 314)

275. In a letter of its counsel dated 16 August 2005, Pakistan drew the Tribunal's attention to the waste of costs due to Bayindir's late abandonment of its Contract Claims and requested the following relief:

> [D]eal with the issues of principle and apportionment relating to costs in its award/decision, including the wasted costs due to Bayindir's late change in position, and to award the Government of Pakistan its costs and expenses incurred as a result of these proceedings.

276. At the jurisdictional hearing (Tr. J., 13:2-4), Pakistan noted that Bayindir's decision to abandon its Contract Claims in this arbitration after a double exchange of written submissions, has engendered a substantial waste of costs. It also submitted that a significant amount of preparation work in view of the jurisdictional hearing became redundant, not only for Pakistan but also for the members of the Tribunal.

277. When invited to respond, Bayindir submitted that "the issue of costs should be a matter for submission after the award on objections to jurisdiction" (letter of counsel dated 26 August 2005).

278. At this stage, the Tribunal takes due note of the parties' positions and requests with respect to costs. It decides, however, to deal with costs at the merits stage, which will allow it to make an overall assessment of costs. It will then also take into account the

---

109 E. GAILLARD, Investment treaty Arbitration and Jurisdiction Over Contract Claims – the SGS Cases Considered, in: T. Weiler (Ed) International investment law and arbitration: leading cases from the ICSID, NAFTA, Bilateral Treaties and Customary International Law, London, 2005, p. 334.

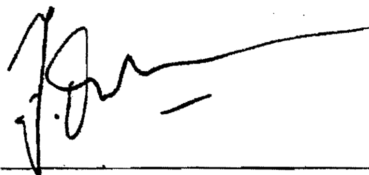
consequences of Bayindir's initial choice to raise both Treaty and Contract Claims and of its late decision to abandon the Contract Claims.

DECISION ON JURISDICTION

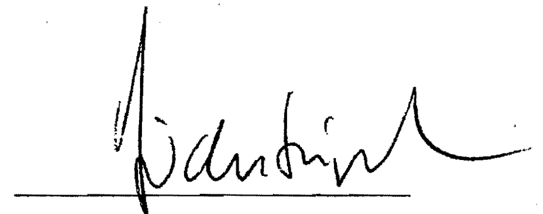
For the reasons set forth above, the Tribunal makes the following decision:

a) The Arbitral Tribunal has jurisdiction over the dispute submitted to it in this arbitration.
b) The Tribunal denies Respondent's application to suspend these proceedings.
c) The Tribunal will, accordingly, make the necessary order for the continuation of the proceedings on the merits.
d) The decision on costs is deferred to the second phase of the arbitration on the merits.

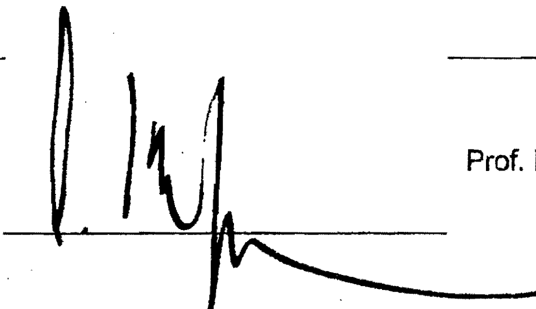
Done on 14 November 2005



Sir Franklin Berman



Prof. Karl-Heinz Böckstiegel



Prof. Gabrielle Kaufmann-Kohler

CLA-000068

S

THE ARBITRATION INSTITUTE OF
THE STOCKHOLM CHAMBER OF COMMERCE

Arbitral Award

Rendered in Stockholm, Sweden
On 22 September 2005

Claimants: Iurii Bogdanov, Republic of Moldova,
Agurdino-Invest Ltd, Republic of Moldova,
Agurdino-Chimia JSC, Republic of Moldova

Jointly represented by the counsels:

Chibac Isai, Chisinau, Republic of Moldova
Chetrusca Viorel, Chisinau, Republic of Moldova

Respondent: Republic of Moldova, its Government

Not represented

Arbitral Tribunal: Giuditta Cordero Moss, sole arbitrator

1. Introduction

1.1 *Institution of arbitral proceeding*

On 21 October 2004 the Claimants initiated against the Respondent an arbitration proceeding under the Rules of Arbitration of the Arbitration Institute of the Stockholm Chamber of Commerce, based on the Bilateral Investment Treaty entered into by and between the Republic of Moldova and the Russian Federation on 17 March 1998 (hereinafter referred to as the "BIT").

On 21 December 2004 the Arbitration Institute of the Stockholm Chamber of Commerce appointed Professor Giuditta Cordero Moss, Oslo, as sole arbitrator in the dispute.

The Respondent failed to effect payment of its share of the advanced costs provided for by the Arbitration Rules of the Arbitration Institute of the Stockholm Chamber of Commerce. Upon the request of the Claimants, the amount of the claim was reduced, so that the advanced costs already paid by the Claimants on their own behalf would be sufficient to cover the totality of the advanced costs, including also the Respondent's share.

On 30 March 2005 the Arbitration Institute of the Stockholm Chamber of Commerce referred the case to the Arbitral Tribunal. According to article 33 of the Arbitration Rules of the Arbitration Institute of the Stockholm Chamber of Commerce, the award is to be rendered not later than 30 September 2005.

1.2 *Short description of the case*

1.2.1 The Claimants

Iurii Bogdanov (hereinafter the "Foreign Investor" or the "Claimant"), a Russian citizen resident in the Republic of Moldova, established Agurdino-Invest Ltd, a wholly owned investment company in the Republic of Moldova (hereinafter the "Local Investment Company"). On 20 April 1999 the Local Investment Company entered into a contract with the Department of Privatization of the Republic of Moldova (the "Privatization Contract"), for the purchase of a majority shareholding in the capital of a company that later was re-named as Agurdino-Chimia JSC (hereinafter the "Privatized Company"). The Foreign Investor, the Local Investment Company and the Privatized Company are referred to hereinafter, jointly, as the "Claimants".

1.2.2 The Respondent

The Respondent is the Government of the Republic of Moldova.

1.2.3 The facts

The Privatization Contract provided among others, in section 5.5, that the Local Investment Company should transfer to the State certain assets of the Privatized Company (the "Transferred Assets"), in exchange of shares in companies owned by the State in other, not specified companies (the "Compensation Shares"). Such transfer of assets and compensation in state-owned shares is in accordance with a Governmental Regulation No 482 of 1998.

The Local Investment Company complied with all its obligations under the Privatization Contract, including also the obligation under section 5.5 about the Transferred Assets, following which the Privatized Company repeatedly requested compensation in Compensation Shares, in accordance with the Privatization Contract and the Regulation No 482 of 1998. The existence and the amount of the claim to compensation do not seem to be in dispute, since they have been acknowledged by the Department of Privatization in its letters dated 19 November 2003 and 10 May 2004. However, the due compensation has not yet taken place.

The first request of Compensation Shares made by the Privatized Company (dated 19 November 2001 and 17 October 2002) was rejected by the Department of Privatization (by letter dated 7 November 2002). The reason for rejecting the request was that the Privatized Company had requested shares that did not appear on a list of state-owned shares that are eligible as Compensation Shares (the "List of Eligible Compensation Shares"). The List of Eligible Compensation Shares contained only shares of companies in which the State owned less than 30% of the capital. Such criterion was based on an Order issued by the Department of Privatization on 17 December 2001, that introduced this restriction to the possibility to choose Compensation Shares.

The second request of Compensation Shares made by the Privatized Company (dated 31 July 2003) was also rejected by the Department of Privatization. The reason for rejecting the request was that the Privatized Company had requested shares that were removed from the List of Eligible Compensation Shares following a request by the Ministry of Agriculture and Food Industry on 30 October 2003.

The third request of Compensation Shares made by the Privatized Company (dated 12 November 2003) was again rejected by the Department of Privatization (by letter dated 19 November 2003). The reason for rejecting the request was that the State did not own a number of the requested shares that was sufficient to compensate the value of the Transferred Assets.

1.3 The relief sought by the Claimants and legal grounds

The Claimants affirm that the possibility to obtain a real compensation for the Transferred Assets is negatively affected by the Department of Privatization's application of its Order of 17 December 2001, containing the cap of 30% state

ownership for the companies whose shares may be included in the List of Eligible Compensation Shares. The cap was later, on 4 February 2003, further reduced to 25% state ownership, and codified into an amendment to the Governmental Regulation No 482 of 1998. The Claimants argue that the introduction of the cap limited the range of eligible Compensation Shares to shares that do not have any effective value.

The Claimants argue that the restriction contained in the Order of 17 December 2001 (and, a fortiori, the restriction contained in the 2003 amendment to the Regulation No 482 of 1998) are not applicable to the compensation of the Transferred Assets, the Order and the amendment having entered into force after the obligation to compensate arose under the Privatization Contract and after the transfer of the Transferred Assets was perfected. The Claimants invoke Moldovan law, including also article 43 of the Foreign Investment Act, protecting against retroactive application of legislation.

The violation of the principle of non-retroactivity is the only legal ground pleaded by the Claimants as basis for their request of relief in the Statement of Claim and the Additional Written Statement, and the legal sources invoked in this connection are the Foreign Investment Act and the Regulation No 482 of 1998, and the Act on entry into force of official acts N0 173-XIII of 1994. The Claimants list also, as applicable sources, the BIT and the Minsk Convention of 28 March 1997 on the Protection of the Rights of the Investor (signed by, i.a., the Republic of Moldova and the Russian Federation); however, in the Statement of Claim and the Additional Written Statement the Claimants fail to make any legal arguments or present any legal grounds in respect of these sources.

The Claimants request that the nominal value of the Transferred Assets, plus interests thereon, is compensated in money in lieu of Compensation Shares. The Claimants request, further, reimbursement of the moral damage allegedly caused by the Respondent's conduct. The legal basis that the Claimants invoke for their requests of relief is article 226 paragraph 2 of the Civil Code of the Republic of Moldova.

The Arbitral Tribunal asked both parties by notice dated 18 April 2005 to comment on the matter of jurisdiction of the Arbitral Tribunal. To such notice the Claimants answered in the letter dated 25 April 2005 supplementing the Statement of Claim, by making a generic reference to article 10 paragraph 2(b) of the BIT. The Respondent did not answer.

The Arbitral Tribunal asked both parties by notice dated 12 August 2005 to comment on whether the BIT is deemed violated by the Respondent's conduct, and to explain Moldovan law in respect of reimbursement of damages, including the admissibility of indirect and moral damages, the assessment of reimbursable damages, the payment of interests on overdue amounts. On 25 August 2005 the Arbitral Tribunal asked the parties to produce evidence that the BIT entered into force. To such notices the Claimants answered on 29 August 2005. The Claimant pleaded that article 6 of the BIT was violated by the Respondent's conduct; the Claimant introduced in the response to the Arbitral Tribunal's requests for clarification also new legal arguments and new evidence, which are inadmissible because they were presented too late in the proceeding. The Respondent did not answer.

1.4 Respondent in procedural default

The Respondent did not appoint a counsel to represent it in the proceeding and did not participate in the proceeding. The Respondent, however, was given the possibility to participate in the proceeding:

(i) all documents sent by the Arbitration Institute of the Stockholm Chamber of Commerce and by the Claimants to the Arbitral Tribunal appear to have been sent also to the Respondent,

(ii) all communication by the Arbitral Tribunal was notified to the Claimants and the Respondent in accordance with articles 20(5) and 12 of the Rules of Arbitration of the Arbitration Institute of the Stockholm Chamber of Commerce,

(iii) the Arbitral Tribunal emphasized in two written notices to both parties that the arbitral proceeding would continue and the award would be rendered even without the participation of the Respondent, in accordance with articles 10(5) and 28 of the Rules of Arbitration of the Arbitration Institute of the Stockholm Chamber of Commerce,

(iv) all time schedules decided by the arbitral tribunal were submitted to both parties, and both parties were given the possibility to comment upon them before the time schedules were finally decided,

(v) the time schedules decided by the Arbitral Tribunal throughout the proceeding provided for equal, successive terms for each of the Claimants and the Respondent to present their respective arguments and evidence, and the final time schedule permitted the Respondent a late participation in the proceeding, and

(vi) by notice in the Russian and in the English language, the Arbitral Tribunal offered the parties to decide the language of the Arbitration.

The foregoing shows that the Respondent was given the possibility to participate in the proceeding; failure by the Respondent to do so, therefore, cannot prevent the continuation and conclusion of the arbitral proceeding and the issuance of the present arbitral award, in accordance with articles 10(5) and 28 of the Rules of Arbitration of the Arbitration Institute of the Stockholm Chamber of Commerce.

On 15 September 2005 the Claimants transmitted to the Arbitral Tribunal copy of a Decision taken by the Government of the Republic of Moldova on 17 August 2005, No 83-d, requesting the Ministry of Economy and Commerce to examine the materials relating to an arbitral dispute pending before the Arbitration Institute of the Stockholm Chamber of Commerce between the company Agurdino-Invest Ltd and the company Agurdino-Chimia JSC, on one side, and the Republic of Moldova, on the other side. The Decision No 83-d by the Government of the Republic of Moldova is not a procedural act of the Respondent with relevance to the instant proceeding, since it was not addressed by the Respondent to the Arbitral Tribunal, it does not identify the instant dispute as its object, it does not contain any reply by the Respondent to the requests of the Arbitral Tribunal, nor any request by the Respondent to the Arbitral Tribunal or any information for the Arbitral Tribunal on the jurisdiction, the merits or the law applicable to the instant proceeding. Even if the Decision No 83-d was considered to have a relevance to the dispute, moreover, it would not be timely

because the last term that was given to the Respondent for presenting its Additional Written Statement was 8 July 2005.

The Decision No 83-d, therefore, does not prevent the Arbitral Tribunal from continuing the instant arbitral proceeding according to the time schedules resolved by the Arbitral Tribunal, agreed on by the Claimants and not objected to by the Respondent.

1.5 Waiting period for amicable settlement

In accordance with article 10(2) of the BIT, an arbitral proceeding may be initiated after an amicable settlement of the dispute has been attempted for a period of six months.

The Claimants notified the Respondent on 9 April 2004 of their proposal of amicable settlement, to be followed by the arbitral proceeding in case of failure to succeed.

The Respondent answered by letters dated 27 April 2004 and 12 August 2004, showing its readiness to effect the compensation sought by the Claimants on the basis of the List of Eligible Compensation Shares. However, the letters by the Respondent do not address the issue raised by the Claimants, i.e. the legitimacy of restricting the range of Compensation Shares to the List of Eligible Compensation Shares. On the basis of such letters, therefore, it does not seem that the attempt to reach an amicable settlement had a chance to be successful.

Therefore, it was admissible to start arbitral proceeding in accordance with article 10(2) of the BIT as from 9 October, 2004.

2. Jurisdiction

The Request for Arbitration presented by the Claimants is based on Article 10(2) of the BIT. Article 10(2) of the BIT contains a standing offer of arbitration by the host country, in this case the Republic of Moldova, that was accepted by the Claimant instituting the present arbitral proceeding. The arbitration agreement is thus perfected by the institution of the arbitral proceeding; this is generally considered as a sufficient basis for the jurisdiction of investment arbitration (PAULSSON, J., "Arbitration Without Privity", in 10 *ICSID Review—Foreign Investment Law Journal* 232 (1995))

Upon the Request of the Arbitral Tribunal to prove the entry into force of the BIT, the Claimant produced evidence that the BIT was ratified in the Republic of Moldova on 25 June 1998 and in the Russian Federation on 28 May 2001. The Respondent did not respond to the Arbitral Tribunal's request. An independent investigation carried out by the Arbitral Tribunal showed that the Russian Ministry of Foreign Affairs, being the last contracting party that ratified the BIT, sent to the other contracting party the notice confirming ratification on 18 July 2001. In accordance with its article 14,

therefore, the BIT entered into force upon receipt by the Moldovan Ministry of Foreign Affairs of the notice dated 18 July 2001.

To verify the scope of its jurisdictions, the Arbitral Tribunal makes the following observations:

2.1 Jurisdiction ratione materiae

Article 10(1) of the BIT extends the offer of arbitration to any disputes between a contracting state (in this case, the Republic of Moldova) and an investor of the other contracting state arising in connection with an investment. The language of article 10(1) permits to extend the jurisdiction of the Arbitral Tribunal to any dispute between qualified parties (on the question of which parties qualify see below, section 2.2), as long as it arises in connection with an investment as defined in the BIT, and irrespective of whether the dispute is based on an alleged breach of the BIT, an alleged breach of a contract between the parties, or other alleged breach of obligation (SCHREUER, C., "Investment Treaty Arbitration and Jurisdiction over Contract Claims – the Vivendi I Case Considered", in WEILER, T. (ed), *Leading Cases from the ICSID, NAFTA, Bilateral Treaties and Customary International Law*, 2005, p. 299, and ID., "Consent to Arbitration", *cit.*, pp. 9f.).

Article 1(2) of the BIT defines as "Investment" any kind of assets, including also shares, held by an entity of one contracting state in the territory of the other contracting state.

On the basis of the foregoing, the present dispute, regarding a contract for the acquisition of shares in the territory of a contracting state (in this case, the Republic of Moldova), falls within the scope of article 10(1) of the BIT and may be decided upon by the Arbitral Tribunal, as long as the parties to the dispute qualify under the BIT (see section 2.2 below).

The circumstance that disputes regarding privatization are excluded from arbitration under article 15 of the Minsk Convention does not affect the jurisdiction of the Arbitral Tribunal under the BIT, as article 21 of the Minsk Convention explicitly states that differing regulations contained in other international agreements (such as the BIT and its article 10(1) on arbitration) prevail over the regulation of the Minsk Convention.

2.2 Jurisdiction ratione personae

2.2.1 The Claimants

As described in section 1.2 above, three entities are involved on the side of the Claimants: (i) the Foreign Investor, (ii) the Local Investment Company, and (iii) the Privatized Company.

To verify whether the Claimants enjoy protection under the BIT, and consequently whether they are entitled to act as Claimants in the present arbitral proceeding, it is necessary to look at article 1(1) of the BIT, where the term "Investor" is defined. According to article 1(1), the following entities are considered as Investors under the BIT and enjoy treaty protection: (i) any individual having the nationality of one contracting state and making an investment in the territory of the other contracting state, and (ii) any legal entity constituted under the laws of one contracting state and making an investment in the territory of the other contracting state.

Not all the three Claimants, therefore, enjoy treaty protection under the BIT:

(i) The Foreign Investor meets the criteria set forth in article 1(1) of the BIT, because he is an individual having the nationality of the Russian Federation and making an investment in the Republic of Moldova. The Arbitral Tribunal underlines that in the practice of international investment arbitration it is generally accepted that protection under investment treaties (such as the BIT) is given to the shareholders of investment companies, even if the investment is actually carried out by a subsidiary constituted under the laws of the host country, such as, in this case, the Local Investment Company (SCHREUER, C., "Shareholder Protection in International Investment Law", in *Transnational Dispute Management* Volume 2 - Issue #03 June 2005, pp. 6ff. and ALEXANDROV, S.A., "The "Baby Boom" of Treaty-Based Arbitrations and the Jurisdiction of ICSID Tribunals: Shareholders as "Investors" and Jurisdiction *Ratione Temporis*", in 6 *The Journal of World Investment & Trade*, 2005, pp. 393ff.). The investment protected by the BIT, in other words, is not the investment made by the Local Investment Company in acquiring the shares of the Privatized Company, but the investment made by the Foreign Investor in establishing and funding the Local Investment Company;

(ii) The Local Investment Company does not meet the criteria set forth in article 1(1) of the BIT, because it is a company constituted under the laws of the country where the investment is made. The Local Investment Company is, admittedly, constituted under the laws of Moldova as a company with foreign investment, and subject to the Foreign Investment Act. This circumstance, however, is not sufficient to extend to the Local Investment Company the protection of the BIT, since the definition of "Investor" contained in article 1(1) may not be unilaterally modified by the internal legislation of one contracting state. To the extent that the Foreign Investment Act regards the Local Investment Company as a foreign investor and extends to it the protection granted in the Republic of Moldova to foreign investors, any violation of the guarantees enjoyed by foreign investors and affecting the Local Investment Company will be unlawful under Moldovan law. However, the Arbitral Tribunal's jurisdiction derived from the BIT is limited to unlawful conduct that has caused a damage to a party protected by the BIT, and the Local Investment Company does not enjoy treaty protection. The Arbitral Tribunal is aware that under certain circumstances international law recognises the criterion of foreign control, i.e. that the nationality of a company may be

determined on the basis of the nationality of the shareholders, and that therefore a company registered in the host country might qualify as a foreign investor, if the shareholders of that company are foreign. This criterion is applied on the basis of article 25(2)(b) of the Washington Convention of 1965 establishing the ICSID. Article 1(1) of the BIT, on the contrary, does not extend the definition of "Investor" with the help of the criterion of foreign control; the Arbitral Tribunal, therefore, does not deem the criterion of foreign control applicable to the Local Investment Company.

(iii) The Privatized Company does not meet the criteria set forth in article 1(1) of the BIT, because it is a company constituted under the laws of the same country where the investment is made.

The Arbitral Tribunal, therefore, accepts jurisdiction for claims presented by the Foreign Investor, but cannot accept jurisdiction for claims presented by the Local Investment Company or by the Privatized Company.

The Arbitral Tribunal observes, in this connection, that the Foreign Investor in the Request for Arbitration, the Statement of Claim and the remaining arbitral documentation is listed as a Claimant but appears as Claimant not in its own name, but in the name of the Local Investment Company and of the Privatized Company. The Arbitral Tribunal considers this presentation of the role of the Foreign Investor as the result of a clerical error: if the Foreign Investor did not act also in his own name, the request of awarding damages also to the Foreign Investor, contained in the Statement of Claim, would not make any sense. The Arbitral Tribunal, therefore, considers the claim presented by the Foreign Investor as presented both on behalf of the Foreign Investor himself and on behalf of the Local Investment Company and the Privatized Company. On the basis of the foregoing, the Arbitral Tribunal considers the claim presented on behalf of the Foreign Investor as admissible, whereas the claims presented on behalf of the other parties are not admitted due to lack of jurisdiction.

As a consequence of this decision of the Arbitral Tribunal regarding its jurisdiction, the request of relief made by the Claimants must be restricted to the Foreign Investor only, and cannot apply to the Local Investment Company and the Privatized Company.

The Arbitral Tribunal has the authority to make this correction to the relief sought by the Claimant in the Statement of Claim, because this correction does not introduce a new relief that was not sought by the Claimants, nor a legal source that was not mentioned as legal basis for the proceeding or a fact that was not pleaded in the proceeding; the correction simply recognizes one of the Claimants, the Foreign Investor, as the party entitled to the requested measures, and regards the requested relief, the payment of a sum of money, as indirect damage rather than as payment of the money equivalent in lieu of Compensation Shares (should the allegations made by the Claimant be accepted by the Arbitral Tribunal).

Under Swedish arbitration practice, which is applicable to this proceeding, it is established that the principle of iura novit curia applies; therefore, the Arbitral Tribunal, in applying the law, is not bound by the pleadings made by the parties, and

may by its own motion apply legal sources or legal qualifications that have not been pleaded by the parties. In respect of international arbitration taking place in Sweden, it is sometimes suggested that the principle iura novit curia applies, but the parties should be notified of new legal sources introduced by the arbitrator, so that they have the possibility to comment on them. Leaving aside the question of the necessity of following such suggestion on a general basis, the Arbitral Tribunal observes that, in the instant case, the Arbitral Tribunal does not introduce a new legal source: it applies the legal sources invoked by the Claimant in a way different from the way pleaded by the Claimant. Under Swedish arbitration law the right of the arbitrators to make their own legal qualifications is not limited, even if this results in imposing remedies different from those pleaded by the parties (HEUMAN, , L., "Arbitration Law of Sweden: Practice and Procedure", Stockholm, 2003, pp 610f.). Also in respect of international disputes arbitrated in Sweden it is recognised that arbitrators should be able to present legal arguments on a rationale that neither party has presented (HEUMAN, L., "Arbitration Law of Sweden: Practice and Procedure", *cit.*, p. 379). The Arbitral Tribunal, did, however, request both parties to comment on the matter of jurisdiction. The circumstance that the parties have not presented any arguments in this connection cannot prevent the tribunal from applying the law as it deems appropriate. This conclusion is confirmed by ICSID practice, see SCHREUER, C., "Three Generations of ICSID Annulment Proceedings", in GAILLARD, E., BANIFATEMI, Y. (eds.), *Annulment of ICSID Awards*, 2004, pp. 30f.

2.2.2 The Respondent

The Privatization Contract, which is the basis of the claim, was entered into by the Department of Privatization of the Republic of Moldova. In respect of the disputed compensation for the Transferred Assets, the Department of Privatization was authorized by Governmental Regulation No 482 of 1998 to carry out the compensation procedure. The Department of Privatization is, therefore, a central Governmental body of the Republic of Moldova, delegated by Governmental regulations to carry out state functions, and the effects of its conduct may be attributed to the State. It is generally recognised, in international law, that States are responsible for acts of their bodies or agencies that carry out State functions (See Article 4 of the ILC Articles on State Responsibility, and CRAWFORD, J, "The International Law Commission's Articles on State Responsibility", Cambridge 2003, p. 94). The State of the Republic of Moldova is, therefore, the correct respondent.

This is indirectly confirmed by the letters dated 27 April 2004 and 12 August 2004, by which the Respondent answered the Claimants' notification of their proposal of amicable settlement, to be followed by the arbitral proceeding in case of failure to succeed. The Claimants' notification was addressed to the Republic of Moldova, and the answers were written by the Department of Privatization, without any objections to the identity of the addressee.

2.3 Jurisdiction ratione temporis

According to Article 13 of the BIT, treaty protection is enjoyed by investments that took place after 1 January 1992. The Privatization Contract was entered into in 1999, and is therefore covered by the BIT.

3. Basis for the award

3.1 The pleadings made by the Claimant

The facts, evidence and legal arguments upon which the Arbitral Tribunal is requested to render the award were presented by the Claimant in the Request of Arbitration, the Statement of Claim and the Additional Written Statement, in accordance with the Arbitration Rules of the Arbitration Institute of the Stockholm Chamber of Commerce and the time schedules proposed by the Arbitral Tribunal, agreed upon by the Claimant and not objected to by the Respondent. Since the Respondent was in default, and since all evidence was produced by the Claimant in writing, the Arbitral Tribunal decided (and the parties did not object thereto) not to hold an oral hearing. The Arbitral Tribunal, however, did not consider the legal arguments presented to it sufficient to make a decision on the merits of the dispute, and requested the parties to clarify their respective legal arguments in respect of the violation (if any) of the BIT by the Respondent and in respect of the regime of reimbursement of damages under Moldovan law.
The written statement submitted by the Claimant in response to the Arbitral Tribunal's request for clarifications constitutes also basis of this award, to the extent that it addresses the matters on which the Arbitral Tribunal had requested clarifications. The new legal arguments and new elements of evidence introduced in this statement by the Claimant beyond the clarifications requested by the Arbitral Tribunal were not admissible at such a late stage of the proceeding, and are not taken into consideration.

3.2 The applicable law

To evaluate the pleadings presented by the Claimant, the Arbitral Tribunal applies the BIT and the law of the Republic of Moldova. The law of the Republic of Moldova is applicable on the basis of the BIT, is pleaded by the Claimant and is considered applicable by the Arbitral Tribunal on the basis of the choice of law rule contained in article 24 of the Arbitration Rules of the Arbitration Institute of the Stockholm Chamber of Commerce (it being the law of the host country of the investment and mandatorily applicable to questions regarding the privatization of state assets).

3.3 Independent analysis by the Arbitral Tribunal

The circumstance that the Respondent did not present its case does not, as already mentioned in section 1.4 above, prevent the continuation of the arbitral proceeding. However, this does not mean that the Arbitral Tribunal is obliged to accept the pleadings of the Claimant as well-founded without any independent evaluation.

Therefore, the Arbitral Tribunal evaluated the facts and the legal arguments presented by the Claimant in light of the applicable sources of law, as presented by the parties.

The Arbitral Tribunal did not engage in fact finding or legal investigations on behalf of the Respondent to compensate the latter's lack of assistance: it simply evaluated the facts and legal arguments as presented by the Claimant in order to satisfy itself of their soundness.

4. The Findings of the Arbitral Tribunal

On the basis of the foregoing, the Arbitral Tribunal finds as follows:

4.1 The principle of non-retroactivity

The Claimant argues that a real compensation for the Transferred Assets cannot be obtained because of the Department of Privatization's application of its Order of 17 December 2001, limiting the range of Compensation Shares by applying a cap of 30% state ownership for the companies whose shares may be included in the List of Eligible Compensation Shares. The cap was later, on 4 February 2003, further reduced to 25% state ownership, and codified into an amendment to the Governmental Regulation No 482 of 1998. Application of the Order and of the amendment to the Regulation violate, according to the Claimant, the principle of non-retroactivity of legislation, contained in Moldovan law and, in particular, in article 43 of the Foreign Investment Act.

The Arbitral Tribunal observes initially that is seems beyond any doubt that the Foreign Investor (as well as the Local Investment Company) fall within the scope of application of the Foreign Investment Act, according to the definition contained in Article 2 of the Act.

In evaluating whether application of the mentioned criterion restricting the List of Eligible Compensation Shares is unlawful, the Arbitral Tribunal observes first that the Privatization Contract does not contain guidelines on how the Compensation Shares shall be chosen; it is therefore necessary to look at Governmental Regulation No 482 of 1998, which was in force when the Privatization Contract was entered into, and to which therefore the Privatization Contract is subject. In article 10 c), the Regulation No 482 of 1998 states that the identity of the Compensation Shares shall be agreed upon between the Ministry of Finance, the Department of Privatization and the creditor. No further guidelines are contained in the Regulation.

This means, on the one hand, that the restriction to shares in companies in which the State owns less than 30% is not contained in the Regulation; on the other hand, however, it means that the Regulation does not provide for an obligation by the competent authorities to accept any request of Compensation Shares made by the creditor, nor does it contain restrictions regarding the criteria that the competent authorities may apply to agree on the eligibility of the state-owned shares as

Compensation Shares. By making reference to an agreement to be reached between the parties, the Regulation contains an element of discretion for both parties, permitting them to evaluate whether to agree or not. The Order issued by the Department of Privatization may be deemed to be a concretization of the discretionary power that the competent authorities enjoy on the basis of article 10 c) of the Regulation No 482 of 1998 and does not seem, therefore, to introduce a restriction to the eligibility of shares that could not have been applied under the original version of Regulation No 482 of 1998.

Even if the Order in itself were not considered applicable because it was issued after the obligation to compensate arose, the criterion of the cap of state ownership contained therein might still be applied as part of the Department's discretion based on article 10 c) of the Regulation No 482 of 1998. Application of this criterion lies within the frame of the Regulation No 482 of 1998 as it was in force at the time of the Privatization Contract, which the Claimants must be deemed to have accepted by signing the Privatization Contract without specifying in its article 5.5 any criteria to limit the competent authorities' discretion in reaching an agreement on the Compensation Shares.

On the basis of the above, the Arbitral Tribunal finds that the Respondent's decision to determine the compensation of the Transferred Assets by exchanging shares contained in the List of Eligible Compensation Shares may not be deemed a violation of the principle of non-retroactivity of legislation contained in Moldavian law and, in particular, in article 43 of the Foreign Investment Act.

4.2 Other legal grounds under the BIT

4.2.1 Compensation mechanism without substance

The Claimant argues that the criterion upon which the List of Eligible Compensation Shares is based deprives the compensation of its substance, because the shares contained in the list have a market value that is substantially lower than their face value.

The List of Eligible Compensation Shares is, as set forth in section 4.1 above, a concretization of the wide discretion that the competent authorities enjoyed under the Regulation No 482 of 1998 and the Privatization Contract. By entering into the Privatization Contract without specifying the criteria for the eligibility of the Compensation Shares, the Claimant accepted the risk of not being able to reach a completely satisfactory agreement on the identity of the Compensation Shares. A specification of the competent authorities' discretion, even if it may reduce the effective value of the compensation, lies within the borders of a conduct that is permissible under the Privatization Contract and Regulation No 482 of 1998. The right acquired by the Claimant with the Privatization Contract was, in other words, so vague, that a concretization thereof was necessary and does not appear to be arbitrary to the Arbitral Tribunal.

The questions that remain are whether using the criterion of the cap of state ownership to concretize the discretion regarding the eligible Compensation Shares in fact

deprives the compensation mechanism of its substance, as alleged by the Claimant, and whether this circumstance has legal consequences that the Arbitral Tribunal has to act upon.

The List of Eligible Compensation Shares refers to nearly 150 companies; the concretization of the criterion for the eligibility of the Compensation Shares does not seem, therefore, to have unreasonably limited the number of eligible shares. The Claimant produced evidence that some of the shares of companies included in the List of Eligible Compensation Shares have a market value that is substantially lower than their nominal value, and seeks, by so doing, to establish that all shares contained in the List of Eligible Compensation Shares have a much lower market value than their nominal value. The Arbitral Tribunal regrets that the Respondent failed to participate in the proceeding and therefore failed to assist the Arbitral Tribunal in the evaluation of the allegations presented by the Claimant. The Arbitral Tribunal underlines that under Swedish arbitration law, which is applicable to this proceeding, a certain evidential significance may be attached to a party's passivity (HEUMAN, L., "Arbitration Law of Sweden: Practice and Procedure", *cit.*, pp.404f.). Failure by the Respondent to comment on the Claimant's allegation gives the Arbitral Tribunal reason to conclude that the Respondent cannot produce evidence that the threshold of state ownership has no effect on the value of the shares.

Therefore, having regard to the lack of evidence or arguments presented by the Respondent to rebut the Claimant's allegations, the Arbitral Tribunal accepts the evidence produced by the Claimant as sufficient to prove the point made by the Claimant, i.e. that the List of Eligible Compensation Shares consists of shares with a market value that is materially lower than their nominal value.

4.2.2 Relevance under the BIT

The Arbitral Tribunal observes that it has jurisdiction to interpret and to apply Moldovan law, but not to evaluate whether the contents of the internal legislation or normative acts of the Republic of Moldova are satisfactory. The Arbitral Tribunal, however, has the authority to evaluate whether the Respondent's conduct violates obligations contained in the BIT.

The Claimant did not invoke other legal grounds apart from the violation of the non-retroactivity principle. The Claimant did not argue that the Respondent's conduct violates the BIT; however, the BIT is put forward by the Claimant as one of the legal sources to be applied in the proceeding. As already explained under section 2.2.1 above, the Arbitral Tribunal is not limited to the legal arguments made by the parties. As long as the Arbitral Tribunal limits its evaluation to the facts as presented by the parties, it remains free, within the borders of the applicable law (particularly, as long as it remains within the frame of the legal sources mentioned in the proceeding), to give the legal qualifications and determine the legal consequences that it deems appropriate, even if they were not pleaded by the parties. Swedish arbitral practice recommends that the parties are invited to comment on new legal sources introduced by the arbitrators. The Arbitral Tribunal observes that this recommendation has the aim of preventing that the parties are taken by surprise by the consideration of legal issues that were not taken into consideration in the proceedings (HEUMAN, L.,

91

"Arbitration Law of Sweden: Practice and Procedure", *cit.*, pp.324ff.). In the present proceeding, even though the Claimant did not invoke any specific article of the BIT, the BIT constitutes the legal basis of the arbitral proceeding, as the Claimant has initiated the present proceeding under the BIT, and has listed the BIT as one of the legal sources to be applied in the decision. Therefore, consideration of the BIT may not be deemed as a surprise to any of the parties. However, considering the importance of the interpretation and application of a Bilateral Investment Treaty, the Arbitral Tribunal deemed it advisable to request both parties to expressly comment on the violation (if any) of the BIT by the Respondent, so as to ensure, *ex abundante cautela*, that both parties were given the possibility to present their arguments in respect of the applicability of the BIT's rules to the dispute.

In its answer to the Arbitral Tribunal's invitation to comment on the violation of the BIT, the Claimant made reference to Article 6 (discussed below, in section 4.2.5). The Respondent did not respond.

The Arbitral Tribunal finds that the conduct documented by the Claimant is to be evaluated in the light of the principles of full protection contained in article 2 of the BIT, fair and equitable treatment contained in article 3 of the BIT, and indirect expropriation contained in article 6 of the BIT

4.2.3 Full protection

Article 2(2) of the BIT contains the obligation of the host country to guarantee, in accordance with its own legislation, full and unconditional legal protection of the investments made by investors of the other contracting state.

The question is whether the full protection standard is violated by the introduction of the cap of share ownership. The wording of article 2(2) of the BIT makes clear that the full protection principle is not to be considered as a corrective of the host country's legislation, but has to be applied in accordance with the host country's law. As long as the restrictions regarding the choice of Compensation Shares are in accordance with Moldovan law, therefore, the full protection standard of the BIT may not be deemed violated.

As explained in section 4.1 above, the Arbitral Tribunal finds that the conduct of the Respondent does not violate Moldovan law; therefore, the Respondent's conduct is not in violation of the full protection standard contained in article 2 of the BIT.

4.2.4 Fair and equitable treatment

Article 3 of the BIT contains the obligation of the host country to grant to the foreign investor a fair and equitable treatment, excluding discriminatory measures that could prevent the management or availability of the investment. The second paragraph of article 3 specifies the fair and equitable treatment by reference to the standards of national treatment and most favoured nation treatment.

The question is whether the fair and equitable treatment standard is violated by the application of the cap on share ownership. A restrictive interpretation of Article 3 of the BIT might indicate that the fair and equitable treatment standard is equivalent to the absence of discriminatory measures, including national treatment and most favoured nation treatment.

From the pleadings made by the Claimant it does not appear that the Claimant was affected by discriminatory measures, or that the Respondent's conduct towards the Claimant differed from that towards Moldovan nationals or nationals of other countries. On the contrary, the Order and the amendment that the Claimant contests have a general scope and are applicable to all entities that participated in privatization.

The fair and equitable treatment standard, however, must be interpreted in accordance with the ordinary meaning of the terms, as well as the object and purpose of the BIT (see the Vienna Convention on the Law of Treaties, Article 31). The purpose of the BIT, in accordance with its preamble, is to promote and protect investments by creating investment-friendly conditions. Therefore, the fair and equitable treatment granted in Article 3 must be interpreted to cover also any conduct that, even if it is in compliance with the national law of the host country and it is not discriminatory, has unjust or unreasonable results (SCHREUER, C., "Fair and Equitable Treatment in Arbitral Practice", in *Journal of World Investment and Trade*, 2005, 357ff., p. 367). Even if the evaluation of what is fair and equitable is necessarily based on the specific circumstances of the case, various criteria have been developed in international law to define the fair and equitable standard. Among the parameters that are recurrently applied to verify the compliance with this standard, are the principles of transparency and the protection of the investor's legitimate expectations (SCHREUER, C., "Fair and Equitable Treatment", *cit.*, pp. 374ff.), as well as the principle of good faith (Ivi., pp. 383ff.).

As explained in section 4.1 above, the Arbitral Tribunal considers that the Respondent is entitled, under the Privatization Contract and under the Regulation No 482 of 1998, to restrict the choice of eligible Compensation Shares according to its reasonable discretion. As explained in section 4.2.1 above, the Arbitral Tribunal considers that the Claimant, also due to the Respondent's passivity, successfully proved that the criterion upon which the List of Eligible Compensation Shares is made deprives the compensation mechanism of substance, and that the Respondent failed to prove that the List of Eligible Compensation Shares is based on reasonable criteria.

The question that remains is whether the criterion applied by the Respondent in compiling the List of Eligible Compensation Shares is abusive and arbitrary, because it deprives the compensation mechanism of substance without any reasonable foundation, and whether this circumstance represents a violation of the fair and equitable treatment standard.

The Arbitral Tribunal observes that the Claimant agreed in the Privatization Contract to a mechanism of compensation on the basis of the face value of shares owned by the state. The Privatization Contract failed to specify the criteria according to which such shares should be chosen. It is in the normal course of events that the market value differs from the face value of shares. By entering into the Privatization Contract on such vague terms, the Claimant must have been aware of the risk that the

compensation in Compensation Shares at their face value might not be fully satisfactory.

The Arbitral Tribunal finds that, even if the Respondent is entitled to restrict the choice of eligible Compensation Shares according to its reasonable discretion, and the Claimant must be deemed to have accepted the risk connected therewith, the Respondent was not entitled to choose the Compensation Shares in such a way that the compensation was deprived of its value. By taking this measure, the Respondent has in practice avoided to pay compensation for the Transferred Assets, thus negatively affecting the Claimant's legitimate expectations of obtaining compensation (even if not necessarily a fully satisfactory compensation).

The Arbitral Tribunal, therefore, finds that the Respondent, by establishing a system for compensation of the Transferred Assets that permitted an abusive application and by its subsequent application, is in violation of the fair and equitable treatment standard contained in article 3 of the BIT.

4.2.5 Indirect expropriation

Article 6 of the BIT contains the obligation of the host country to proceed to direct or indirect expropriation only for a purpose in the public interest, in a non discriminatory way, in accordance with the due process of law, and accompanied by the payment of prompt, adequate and effective compensation. If one of these criteria is not met, article 6 of the BIT is deemed violated.

A transfer of assets without compensation might, therefore, under certain circumstances amount to an indirect expropriation and a violation of article 6 of the BIT. Even if the restriction contained in the List of Eligible Compensation Shares was deemed to prevent an adequate compensation for the Transferred Assets, however, the Arbitral Tribunal does not find Article 6 of the BIT applicable, because the concept of indirect expropriation applies only to measures having the effect of expropriation that affect the totality or a substantial part of the investment (SCHREUER, C., "The Concept of Expropriation under the ETC and other Investment Protection Treaties", in *Transnational Dispute Management* Volume 2 - Issue #03 June 2005, pp.5ff.). In the instant case, the value of the Transferred Assets, upon which the parties agree, corresponds to less than 7% of the nominal value of the Privatized Company at the moment of the Privatization Contract, and circa 3% of the total investment carried out by the Local Investment Company. This is not sufficient to turn the lack of compensation for the Transferred Assets into a measure affecting the totality or a substantial part of the investment.

In conclusion, the Arbitral Tribunal does not deem that the Respondent's conduct is in violation of the prohibition of indirect expropriation without adequate compensation contained in article 6 of the BIT.

4.3 Other legal sources

The Claimant lists also the Minsk Convention as a source applicable to the present proceeding; however, the Arbitral Tribunal does not consider this instrument as applicable, because its Article 15 excludes disputes regarding privatization from arbitration. Moreover, no articles in the Minsk Convention seem to be violated in the instant case. In the Statement of Claim and the Additional Written Statement, the two documents where the parties were supposed to present their legal arguments, the Claimant failed to explain what specific rules of the Minsk Convention are allegedly violated by the Respondent's conduct, and in what way they should be applicable.

5. Assessment of damages

5.1 The quantification of the loss

The Arbitral Tribunal considers the following circumstances sufficiently proven by the documentation produced by the Claimant, and observes that the documentation originating from the Respondent, that was produced by the Claimant, directly confirms the correctness of the first three circumstances mentioned below:

(i) The Local Investment Company transferred the Transferred Assets to the Respondent, or an agency thereof, in accordance with the Privatization Contract entered into between the Local Investment Company and the Respondent;

(ii) The Privatization Contract provides for compensation of the Transferred Assets by assigning Compensation Shares to the statutory fund of the Privatized Company for a value equal to the nominal value of the Transferred Assets, amounting to 621021 lei;

(iii) Compensation has not taken place;

(iv) The Respondent is entitled to offer Compensation Shares according to its discretion, but the criterion applied by the Respondent to compile the List of Eligible Compensation Shares deprives the compensation of any substance;

(v) The Respondent's conduct caused a loss to the Local Investment Company, because the assets and the statutory fund of the Privatized Company (wholly owned by the Local Investment Company) were decreased by the value of the Transferred Assets and were not increased by a corresponding value of Compensation Shares;

(vi) According to Regulation No 482 of 1998, the loss of the Local Investment Company amounts to the nominal value of the Transferred Assets.

In the practice of investment arbitration it is generally accepted that the shareholders may be awarded indirect damages (SCHREUER, C., "Shareholder Protection in International Investment Law", *cit.*, pp. 18f.). The remedy that may be claimed by the Foreign Investor, therefore, is not limited to the damage directly affecting his rights as shareholder in the Local Investment Company, but extends to any losses affecting the assets of the Local Investment Company, including also any reduction in value of the assets due to any alleged breach of contract by the Respondent. The indirect damage

suffered by the Foreign Investor, therefore, corresponds to the loss of the Local Investment Company, assessed as in item (vi) above.

5.2 Respondent's liability for reimbursement of damages

The Arbitral Tribunal does not find that the Respondent is liable for payment of damages corresponding to the entire loss, and that the Local Investment Company must be deemed partially responsible for the loss because it did not ensure that the Privatization Contract contained an appropriately precise regulation of the compensation.
Article 6 of the Moldovan Civil Code authorizes the Arbitral Tribunal to estimate the damages that the Respondent is liable to pay.

Under the Arbitral Tribunal's estimate the part of loss which the Respondent has to reimburse amounts to 310000 lei.

The Claimant requested also reimbursement of moral damages. The Arbitral Tribunal observes that the Claimant failed to produce any factual evidence for moral damages. Therefore, the Arbitral Tribunal rejects the request of reimbursement of moral damages.

5.3 Interest

The Arbitral Tribunal considers interest payable in the amount documented by the Claimant, up to the date of the Claimant's Additional Written Statement (as requested by the Claimant), as follows: interests calculated at the rate of 30.98% from 19 June 2001 (on 190000 lei) and from 16 August 2001 (on 120000 lei) to 31 December 2001, at the rate of 24.18% from 1 January 2002 to 31 December 2002, at the rate of 21.05% from 1 January 2003 to 31 December 2003, at the rate of 23% from 1 January 2004 to 31 December 2004, and at the rate of 23% from 1 January 2005 to 31 March 2005.

The Arbitral Tribunal does not consider it appropriate to increase the amount of damages by the inflation rate, in addition to computing the average bank interest rate, as the interest rate already includes a compensation for the inflation.

5.3 Currency

The Arbitral Tribunal observes that the Claimant requests payment of the equivalent in Euro of the amounts calculated in lei. The Arbitral Tribunal does not deem it appropriate to award payment of damages in Euro, since the credit of the Local Investment Company, which represents the indirect damage to the Claimant to be reimbursed by the Respondent, is expressed in lei. The Claimant failed to present any legal foundation for converting the payment into Euro.

6. Allocation of costs

According to article 40(2) of the Arbitration Rules of the Arbitration Institute of the Stockholm Chamber of Commerce, the Arbitral Tribunal decides on the allocation of the arbitration costs between the parties taking into account the outcome of the case and other circumstances.

In view of the inconvenience caused by the Respondent's uncooperative attitude, and even though the requests presented by the Claimant were only partially accepted, the Arbitral Tribunal decides that all the costs of the arbitration shall be borne by the Respondent, but that each party shall bear its own costs incurred in connection with the proceeding.

7. Award

For the reasons stated above, the Arbitral Tribunal renders the following

Arbitral Award

1. The Respondent, Republic of Moldova, is ordered to pay to the Claimant, Iurii Bogdanov, damages in the sum of 694896 lei (corresponding to a principal of 310000 lei, plus interest calculated at the rate of 30.98% from 19 June 2001 (on 190000 lei) and from 16 August 2001 (on 120000 lei) to 31 December 2001, at the rate of 24.18% from 1 January 2002 to 31 December 2002, at the rate of 21.05% from 1 January 2003 to 31 December 2003, at the rate of 23% from 1 January 2004 to 31 December 2004, and at the rate of 23% from 1 January 2005 to 31 March 2005);

2. In accordance with the decision of the Arbitration Institute of the Stockholm Chamber of Commerce, the sole arbitrator and the Arbitration Institute shall be entitled to fees and compensation for expenses in the following amounts:

   a. Giuditta Cordero Moss, sole arbitrator

Fees	EUR 17250
Costs	EUR 2207

   b. The Arbitration Institute

Administrative Fee	EUR 6000
Sum Total	EUR 25457

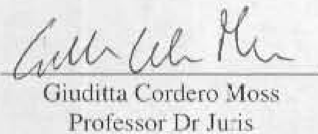
   The parties are jointly and severally liable to pay the costs of the arbitration with EUR 25457 as specified above. The costs shall be drawn from the advanced costs deposited by the Claimants with the Arbitration Institute of the Stockholm Chamber of Commerce;

3. As between the parties, the Respondent shall be responsible for 100% of the above mentioned costs of the arbitration. The totality of the advanced costs having been paid by the Claimants, the Respondent is ordered to pay to the Claimant, Iurii Bogdanov, the arbitration costs, amounting to EUR 25457;

4. Each party is to bear its own costs and expenses connected with the arbitral proceedings, including also counsel fees;

5. Payments to be made by the Respondent to the Claimant shall occur within 30 days from the date hereof. In case payment is not made or only partially made by that date the Respondent shall pay default interests at the rate of 23% for payments in lei and of 2.5% for payments in Euro, compounded quarterly.

Stockholm, 22 September 2005



Giuditta Cordero Moss
Professor Dr Juris

CLA-000069

International Centre for Settlement of Investment Disputes

IOAN MICULA,
VIOREL MICULA,
S.C. EUROPEAN FOOD S.A.,
S.C. STARMILL S.R.L.
AND
S.C. MULTIPACK S.R.L.

CLAIMANTS

v.

ROMANIA

RESPONDENT

ICSID Case No. ARB/05/20

AWARD

Rendered by an Arbitral Tribunal composed of:

Dr. Laurent Lévy, President
Dr. Stanimir A. Alexandrov, Arbitrator
Prof. Georges Abi-Saab, Arbitrator

Secretary of the Tribunal
Ms. Martina Polasek

Assistant to the Tribunal
Ms. Sabina Sacco

Date of Dispatch to the Parties: 11 December 2013

TABLE OF CONTENTS

I. INTRODUCTION 9

A. Overview of the Dispute 9

B. The Parties 9

1. *The Claimants* 9
2. *The Respondent* 10

II. PROCEDURAL HISTORY 11

A. Initial Phase 11

B. The Jurisdictional Phase 12

C. The Merits Phase 12

1. *Initial procedural steps* 12
2. *The written phase on the merits* 13
3. *Procedural steps predating the hearing on the merits* 24
4. *The hearing on the merits and quantum* 25
5. *Procedural matters following the hearing* 28

a. The Claimants' Applications for Provisional Measures and the Respondent's Application for Revocation of Provisional Measures 28

b. The Claimants' Renewed Application for a Site Visit 35

c. The Claimants' Revised Request for Relief 36

d. Post-hearing briefs and oral closing arguments 36

e. Closure of the Proceeding and Submissions on Costs 38

III. FACTUAL BACKGROUND 40

A. Overview 40

B. Legal Framework for the Disfavored Regions 41

1. *Romania's efforts to attract investment in the early 1990s* 41
2. *EGO 24/1998* 42
3. *Government Decision 194/1999 and the 1999 Methodological Norms* 45

C. The Claimants' Investments 47

1. *The Claimants' initial investments in reliance on previous incentive regimes* 47
2. *The Claimants' investments in reliance on the EGO 24 incentives* 49
3. *Permanent Investor Certificates* 51

D. Romania's Accession Process 52

1. *Early steps: the Europe Agreement and Romania's application for EU membership* 52
2. *Romania's initial efforts to align its state aid laws* 57
3. *Romania and the EU begin formal accession negotiations* 62
4. *The Decision of the Romanian Competition Council and amendments to the EGO 24 regime* 62
5. *Romania's progress towards accession in the period 2000-2001* 64
6. *Further amendments to the EGO 24 Regime (2000-2001)* 69
7. *Parallel developments in the EU and EGO 24 fronts (2002)* 70
8. *Events leading up to the revocation of EGO 24* 72
9. *Subsequent events* 76

IV. SUMMARY OF THE PARTIES' POSITIONS 77

A. THE CLAIMANTS' POSITION 77
B. THE RESPONDENT'S POSITION 82

V. PRELIMINARY MATTERS 86

A. THE TRIBUNAL'S JURISDICTION 86
B. APPLICABLE LAW 87
1. The Claimants' position 88
a. There is no conflict of treaties, and even if there were, the BIT should prevail 88
b. Romania's interpretation of the provisions of the BIT is flawed 89
c. EU law requirements would not justify or excuse breaches of the BIT or international law 89
2. The Respondent's position 91
a. The BIT must be interpreted consistently with EU law 91
b. In any event, the Contracting Parties to the BIT intended European law to prevail 92
c. EU law is relevant to the determination of wrongfulness 93
3. The Commission's position 93
4. The Tribunal's analysis 93
C. THE ENFORCEMENT OF THE ARBITRAL AWARD AND EU LAW 95
1. The Respondent's position 96
2. The European Commission's position 96
3. The Claimants' position 97
4. The Tribunal's analysis 97

VI. ANALYSIS OF THE CLAIMANTS' TREATY CLAIMS 99

A. UMBRELLA CLAUSE 99
1. The Claimants' position 99
a. Nature and scope of the BIT's umbrella clause 99
b. The EGO 24 regime gave rise to a specific obligation vis-à-vis the Claimants 102
c. Romania breached the BIT's umbrella clause 107
2. The Respondent's position 107
a. Nature and scope of the BIT's umbrella clause 107
b. Romania did not enter into a specific obligation with the Claimants 109
c. Even if the umbrella clause were applicable, Romania did not breach it 112
3. The Tribunal's analysis 113
a. Interpretation of the BIT's umbrella clause 113
b. Did Romania enter into a specific obligation with the Claimants? 116
i. Content of the Claimants' entitlement 116
ii. Does Romania's undertaking qualify as an "obligation" under Romanian law? If yes, did Romania breach it? 123
B. FAIR AND EQUITABLE TREATMENT 128
1. Summary of the Parties' positions 128
a. The Claimants' position 128
b. The Respondent's position 133
2. Nature, interpretation and content of the fair and equitable treatment standard 138
a. Interpretation and general contours of the standard 138
b. Conduct that is substantively improper 143
c. Regulatory stability and legitimate expectations 145
d. Transparency / Consistency 146

3. *Did Romania fail to provide a predictable and stable legal framework for the Claimants' investments? In particular, did it violate the Claimants' legitimate expectations of regulatory stability?* *147*
a. The Claimants' position 147
i. The standard for determining whether there has been a breach of legitimate expectations 148
ii. Romania made a promise or assurance to the Claimants that gave rise to a legitimate expectation 149
iii. The Claimants relied upon that promise or assurance 150
iv. The Claimants' reliance was reasonable 153
(a) The purpose and content of EGO 24 and its enacting legislation 153
(b) The issuance and content of the PICs 154
(c) Romania's intimate involvement in the granting of the EGO 24 incentives 155
(d) Romania's promotion and support of the EGO 24 regime and previous incentive regimes 156
(e) Romania's interaction with the Competition Council 157
(f) The Claimants' expectations were reasonable in light of Romania's impending accession to the EU 159
v. Romania violated this legitimate expectation 164
b. The Respondent's position 165
i. The standard for determining if a measure has undermined legitimate expectations 166
ii. Romania did not make a promise or assurance that could have created a subjective expectation 168
iii. Any expectation of regulatory stability would have been unreasonable 174
iv. The Claimants have not proven that they relied on a subjective expectation that the facilities would not change for 10 years 178
c. The Tribunal's analysis 181
i. The standard to determine whether a legitimate expectation has been breached 181
ii. Did Romania make a promise or assurance that gave rise to a legitimate expectation? 183
iii. Was this expectation reasonable? 187
(a) Reasonableness in the context of Romania's Accession to the EU 188
(b) Reasonableness under Romanian law 192
iv. Did the Claimants in fact rely on that expectation? 194
4. *Did Romania act unreasonably?* *196*
a. The Claimants' position 196
b. The Respondent's position 197
i. The Respondent's motivation in amending EGO 24 was to comply with EU accession 198
ii. Romania reasonably balanced conflicting policies 200
iii. None of the Claimants' contentions about what Romania could or should have done differently prove that Romania acted unreasonably 201
c. The Tribunal's analysis 202
i. Did Romania act in pursuit of a rational policy? 202
ii. The Claimants' specific allegations of unreasonable conduct 214
(a) The Claimants' allegation that Romania actively promoted and extended the EGO 24 regime, while at the same time negotiating for the scheme's early termination 214
(b) The Claimants' allegation that Romania revoked the incentives regime prematurely, without being required to do so by any competent legal authority and without attempting to mitigate damages 215
(c) The Claimants' allegation that Romania revoked the benefits of the incentives regime for investors, while maintaining the investors' obligations under that regime 217

iii. Conclusion 220

5. Did Romania act in bad faith? 221

a. The Parties' positions 221

b. The Tribunal's analysis 221

6. Did Romania fail to act transparently or consistently? 223

a. The Claimants' position 223

b. The Respondent's position 224

i. Romania's balancing of confidentiality and openness was reasonable 225

ii. Romania complied with any standard of consistency or transparency that could reasonably be imposed in the context of complex or politically sensitive legislation and negotiation 226

iii. It was common knowledge that the facilities were vulnerable 229

c. The Tribunal's analysis 230

C. THE CLAIMANTS' REMAINING CLAIMS 233

VII. DAMAGES 234

A. OVERVIEW 234

1. Overview of the Claimants' damages case 234

a. The Claimants' original damages case 234

b. The Claimants' damages case in their Reply 235

c. The Claimants' revised request for relief 237

2. Overview of the Respondent's position 240

B. PRELIMINARY MATTERS 243

1. Legal Standards 243

2. Does the Tribunal have jurisdiction over claims for damages relating to the non-claimant companies of the EFDG? 247

C. ANALYSIS OF THE CLAIMANTS' DAMAGES CLAIMS 252

1. General comments 252

2. Increased cost of raw materials 254

a. Increased cost of sugar 254

b. Increased cost of PET 256

c. Increased cost of other raw materials 258

d. Lost opportunity to stockpile sugar 259

3. The Claimants' claims for lost profits 262

a. Standard for an award of lost profits 263

i. The Respondent's position 263

ii. The Claimants' position 265

iii. The Tribunal's analysis 267

b. Lost profits on sales of finished goods 268

c. Lost profits on sales of sugar containing products (SCPs) 277

i. The Claimants never sold SCPs to industrial third parties 279

ii. The Claimants have not proven that they would have in fact engaged in the business of selling SCPs to industrial third parties 281

d. Lost profits incurred as a result of the Claimants' inability to complete the Incremental Investments 286

i. Overview of the Parties' positions 286

ii. The Tribunal's analysis 288

(a) The Claimants' integrated business model – Advance planning for the Incremental Investments 288

(b) The malt manufacturing plant 291
(c) The can manufacturing plant 295
(d) The co-generation plant 298
(e) Conclusions 304
4. Financial penalties for failure to pay taxes 306
a. Overview 306
b. The Tribunal's analysis 311
D. THE RESPONDENT'S DEFENSE THAT ACCESSION TO THE EU BENEFITED THE CLAIMANTS 317
E. THE CLAIMANTS' REQUEST THAT DAMAGES BE AWARDED NET OF TAXES 322
F. TO WHOM SHOULD THE AWARD BE MADE? 324
1. The Claimants' request for a different allocation of damages 324
2. The Parties' positions 326
a. The Individual Claimants' right to claim damages in their capacity as shareholders 326
b. Is it possible for the Individual Claimants to be designated as the sole or principal claimants at this stage of the proceedings? 333
c. The impact of the Claimants' requested allocation on the factual or legal bases for the claimed damages or their quantification 336
3. The Tribunal's analysis with respect to the requested allocation of damages 341
a. The Claimants' request that all damages be awarded to the Individual Claimants 341
b. Allocation of damages to all five Claimants 342

VIII. INTEREST 346

A. INTRODUCTION 346
B. THE CLAIMANTS' POSITION 347
C. THE RESPONDENT'S POSITION 349
D. THE TRIBUNAL'S ANALYSIS 351
1. Simple versus compound interest 351
2. Rate 351
3. Date of calculation 352

IX. THE PARTIES' OTHER REQUESTS FOR RELIEF 355

A. THE PARTIES' REQUESTS CONCERNING SET-OFF OF THE AMOUNTS AWARDED AGAINST THE EFDG'S TAX DEBTS 355
1. The Respondent's position 355
2. The Claimants' position 355
3. The Tribunal's analysis 357
B. THE CLAIMANTS' REQUEST FOR POST-AWARD INJUNCTIVE RELIEF 359
1. The Claimants' position 359
2. The Respondent's position 360
3. The Tribunal's analysis 361

X. COSTS 366

XI. DECISION 367

ABBREVIATIONS

Arbitration Rules	ICSID Rules of Procedure for Arbitration Proceedings effective 1 January 2003
BIT	Agreement between the Government of the Kingdom of Sweden and the Government of Romania on the Promotion and Reciprocal Protection of Investments dated April 1, 2003
Claimant 1	Mr. Ioan Micula
Claimant 2	Mr. Viorel Micula
Claimant 3	European Food S.A
Claimant 4	Starmill S.R.L.
Claimant 5	Multipack S.R.L.
Commission	European Commission
C-PHB	Claimants' Post-Hearing Submission dated May 13, 2011
C-Reply	Claimants' Reply dated December 22, 2009
C-SoC	Claimants' Statement of Claim dated March 9, 2007
EC	European Community
EC Treaty	Treaty Establishing the European Community
ECHR	European Court of Human Rights
ECJ	European Court of Justice
Commission's Written Submission	European Commission's Written Submission dated July 20, 2009
EFDG or EFDC	European Food and Drinks Group (or European Food and Drinks Companies)
EGO	Emergency Government Ordinance
ER	Expert Report
Exh. C	Claimants' Exhibits
Exh. EC	European Commission's Exhibits
Exh. HEC	Exhibits referred to at the Hearing on the merits and quantum
Exh. R	Respondent's Exhibits
Exh. RB	Exhibits filed with the Legal Opinion of F. Baias dated June 11, 2010
Exh. RJ	Exhibits filed with Expert Opinion of F. Jacobs dated June 11, 2010
EU	European Union
GD	Government Decision
GO	Government Ordinance
ICSID Convention	Convention on the Settlement of Investment Disputes Between States and Nationals of Other States dated March 18, 1965
ICSID or the Centre	International Centre for the Settlement of Investment Disputes
ILC Articles	The ILC Articles on State Responsibility
PIC	Permanent Investor Certificate
R-CM	Respondent's Counter-Memorial dated April 6, 2009
RFA	Request for Arbitration dated July 28, 2005
RL or RLA	Respondent's Legal Authorities
R-PHB	Respondent's Post-Hearing Submission dated May 13, 2011

R-SPHB	Respondent's Supplementary Post-Hearing Submission dated May 27, 2011
R-Rejoinder	Respondent's Rejoinder dated June 11, 2010
TIC	Temporary investment certificate
TGIE	Transilvania General Import Export S.R.L.
Tr.	Transcripts of the Hearing on the merits and quantum
Tr. Jur.	Transcripts of the Hearing on jurisdiction
VCLT	Vienna Convention on the Law of Treaties of 1969

I. INTRODUCTION

A. OVERVIEW OF THE DISPUTE

1. The present dispute arises from Romania's introduction and subsequent revocation of certain economic incentives, contained in Emergency Government Ordinance 24/1998 ("EGO 24"), for the development of certain disfavored regions of Romania. The Claimants claim that, in reliance on those incentives, and in reliance on the expectation that these incentives would be maintained during a 10-year period, they made substantial investments in the Ştei-Nucet-Drăgăneşti disfavored region located in Bihor County in northwestern Romania. The Claimants further claim that Romania's premature revocation of these incentives was in breach of its obligations under the Agreement Between the Government of the Kingdom of Sweden and the Government of Romania on the Promotion and Reciprocal Protection of Investments (the "BIT" or the "Treaty"), which entered into force on 1 April 2003 (Exh. C-1), and caused damages to the Claimants, as described further below.

B. THE PARTIES

1. The Claimants

2. There are five claimants in this case: two individual persons (the "Individual Claimants" or "Messrs. Micula") and three companies (the "Corporate Claimants") owned directly or indirectly by the Individual Claimants.

3. The Individual Claimants are:

   a. **Mr. Ioan Micula**, who is domiciled at Teatrului Street no. 1-2, Oradea, Bihor County, Romania (hereinafter referred to as "Claimant 1"). Mr. Ioan Micula was born in Romania on 8 April 1957. He moved to Sweden in 1987 where he obtained Swedish nationality in 1992 after having renounced his Romanian nationality.

   b. **Mr. Viorel Micula**, who is domiciled at Colinelor Street no. 48, Oradea, Bihor County, Romania (hereinafter referred to as "Claimant 2"). Mr. Viorel Micula is Ioan Micula's twin brother. He left Romania for Sweden in 1989. He obtained Swedish nationality in 1995 after having renounced his Romanian nationality.

4. The Corporate Claimants are:

   a. **European Food S.A.**, with its registered office at 13 Septembrie Street, Ştei, Bihor County, Romania, registered with the trade register under no. J5/892/1999, registration number 12457015 (hereinafter referred to as "Claimant 3" or "European Food"). Claimant 3 specializes in industrial manufacturing of food products.

b. **Starmill S.R.L.**, with its registered office at 41 Drăgăneşti, Pantasesti Village, Bihor County, Romania, registered with the trade register under no. J5/177/2002, registration number 14467201 (hereinafter referred to as "Claimant 4" or "Starmill"). Claimant 4 specializes in the manufacturing of milling products.

c. **Multipack S.R.L.**, with its registered office at 41, Drăgăneşti, Pantasesti Village, Bihor County, Romania, registered with the trade register under no. J5/178/2002, registration number 14467210 (hereinafter referred to as "Claimant 5" or "Multipack"). Claimant 5 specializes in the manufacturing of plastic packaging.

5. In its Decision on Jurisdiction and Admissibility of 24 September 2008 (the "Decision on Jurisdiction and Admissibility"), the Tribunal found that the Individual Claimants and the Corporate Claimants (collectively, the "Claimants") are Swedish nationals for the purposes of this arbitration.

6. Mr. Ioan Micula and the Corporate Claimants are represented in this arbitration by Messrs. Kenneth R. Fleuriet, Reginald R. Smith and Craig S. Miles and Ms. Amy Roebuck Frey of the law firm of King & Spalding, London, Houston and Paris. They were previously represented by Mr. Eric A. Schwartz of the law firm of King & Spalding, as well as by Mr. Gerold Zeiler of the law firm of Schönherr Rechtsanwälte OEG, Vienna, in cooperation with Prof. Christoph Schreuer as Of Counsel, of the University of Vienna.

7. Mr. Viorel Micula is represented in this arbitration by Prof. Emmanuel Gaillard, Dr. Yas Banifatemi and Ms. Veronika Korom of the law firm of Shearman & Sterling LLP, Paris. He was previously represented by Messrs. David Reed and Alex Bevan of Shearman & Sterling LLP, London, Messrs. Eric A. Schwartz and Alain Farhad of the law firm of Dewey & LeBoeuf, Paris, and Messrs. Gheorghe Muşat and Gelu Titus Maravela and Mrs. Luminita Popa of the law firm Muşat & Asociaţii, Bucharest.

2. The Respondent

8. The Respondent is Romania (the "Respondent" or "Romania").

9. The Respondent is represented in this arbitration by H.E. Daniel Chitoiu, Minister of Public Finances and Messrs. Cipriam Badea and Mr. Bogdan Mirghiş, Legal Department of the Ministry of Public Finances; Messrs. D. Brian King, Georgios Petrochilos and Boris Kasolowsky of the law firm of Freshfields Bruckhaus Deringer, New York, Paris and Frankfurt, and Mmes. Adriana I. Gaspar, Ana Diculescu-Sova and Manuela M. Nestor of the law firm of Nestor Nestor Diculescu Kingston Petersen in Bucharest.

II. PROCEDURAL HISTORY

A. INITIAL PHASE

10. On 2 August 2005, the Claimants filed a Request for Arbitration dated 28 July 2005 (the "Request" or "RFA") with the International Centre for Settlement of Investment Disputes ("ICSID" or the "Centre"), accompanied by 14 exhibits (Exh. C-1 to C-14).

11. On 3 August 2005, the Centre, in accordance with Rule 5 of the ICSID Rules of Procedure for the Institution of Conciliation and Arbitration Proceedings (the "Institution Rules"), acknowledged receipt and transmitted a copy of the Request to Romania.

12. On 21 September 2005, the Request was supplemented by a statement concerning the entry into force of the BIT with accompanying exhibits C-15 to C-19.

13. On 13 October 2005, the Acting Secretary-General of the Centre registered the Request as supplemented, pursuant to Article 36(3) of the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (the "ICSID Convention"). On the same date, in accordance with Institution Rule 7, the Acting Secretary-General notified the Parties of the registration of the Request as supplemented and invited them to proceed, as soon as possible, to constitute an Arbitral Tribunal.

14. On 10 January 2006, in the absence of an agreement between the Parties, the Claimants elected to submit the arbitration to a Tribunal constituted of three arbitrators, as provided in Article 37(2)(b) of the ICSID Convention. On the same day they appointed Prof. Dr. Stanimir A. Alexandrov, a national of Bulgaria. On 7 February 2006, Romania appointed Dr. Claus-Dieter Ehlermann, a national of Germany. The Parties agreed to appoint Dr. Laurent Lévy, a national of Switzerland and Brazil, as the President of the Tribunal.

15. On 12 September 2006, the Acting Secretary-General of ICSID, in accordance with Rule 6(1) of the ICSID Rules of Procedure for Arbitration Proceedings (the "Arbitration Rules"), notified the Parties that all three arbitrators had accepted their appointments and that the Tribunal was therefore deemed to be constituted and the proceedings to have begun on that date. The Parties were also informed that Mrs. Martina Polasek, ICSID Counsel, would serve as Secretary to the Tribunal.

16. On 10 November 2006, the Tribunal held the first session of the Tribunal in Paris, France. At the outset of the session, the Parties expressed agreement that the Tribunal had been duly constituted (Arbitration Rule 6) and stated that they had no objections in this respect. It was agreed that the applicable ICSID Arbitration Rules were the ones that entered into force on 1 January 2003. The remainder of the procedural issues set forth in the agenda of the session were discussed and agreed upon. In particular, the Tribunal and the Parties agreed upon a timetable for the submissions on the merits and reserved provisional hearing dates. It was agreed that

if Respondent decided to raise any objections to jurisdiction or admissibility before the filing of its Counter-Memorial, the schedule would be revisited. It was also decided that the language of the proceedings would be English, and that the place of arbitration would be Paris, France. The audio recording of the session was later distributed to the Parties. Minutes of the first session were drafted and signed by the President and the Secretary of the Tribunal, and sent to the Parties on 20 December 2006.

B. THE JURISDICTIONAL PHASE

17. The proceedings in respect of the jurisdictional phase are described in detail in the Decision on Jurisdiction and Admissibility, which was notified to the Parties on 25 September 2008 and makes integral part of this Award.

18. The Tribunal dismissed the Respondent's objections on jurisdiction and admissibility and concluded that it had jurisdiction over the claims asserted by the Claimants for breaches of the BIT. Specifically, the dispositive part of the Decision on Jurisdiction and Admissibility stated:

> For the reasons set forth above,
>
> - The objections of Respondent are dismissed.
> - The Tribunal has jurisdiction over the dispute submitted to it in this arbitration and rejects any objections as to the admissibility of the claims.
> - The decision on costs is deferred to the second phase of the arbitration on the merits.
>
> (Decision on Jurisdiction and Admissibility, ¶ 170).

C. THE MERITS PHASE

1. Initial procedural steps

19. By letter of 26 September 2008, the Tribunal invited the Parties to confer and revert to the Tribunal within six weeks from the date of notification of the Decision on Jurisdiction and Admissibility with joint or separate proposals concerning the timetable and other motions and suggestions for the proceedings on the merits.

20. On 29 September 2008, Messrs. Zeiler and Schreuer resigned as counsel for Mr. Ioan Micula and the Corporate Claimants effective 26 September 2008. On 30 September 2008, the Tribunal was advised that Mr. Ioan Micula and the Corporate Claimants would be henceforth represented by Messrs. Kenneth R. Fleuriet, Reginald R. Smith and Craig S. Miles of the law firm of King & Spalding, London and Houston.

21. By letters of 7 November 2008 (Claimants) and 13 November 2008 (Respondent), the Parties presented their proposals for the timetable on the merits. On the basis of the Parties' agreements and after considering their positions on the points in dispute, on

18 November 2008 the Tribunal fixed the procedural schedule for the merits phase. After further correspondence from the Parties, by letter of 2 December 2008 the Secretary confirmed the procedural schedule for the merits phase.

22. By letter of 25 March 2009, the Respondent advised the Tribunal that the Parties had agreed on certain time extensions to the time limits set in the Secretary's letter of 2 December 2008. By letter of the Secretary of 27 March 2009, the Tribunal confirmed the time extensions agreed by the Parties and set out the amended procedural schedule as follows:

Respondent's Counter-Memorial	6 April 2009
Claimants' Reply (including full case on quantum and any accompanying expert reports)	20 August 2009
Respondent's Rejoinder (including any expert reports)	27 November 2009
Pre-hearing Conference	4 January 2010;
Claimants' Rebuttal Expert Reports on Quantum	26 January 2010;
Respondent's Rebuttal Expert Reports on Quantum	5 March 2010;
Hearing	3-7 May 2010;
Hearing reserve days	10-11 May 2010.

23. On 2 April 2009, the European Community ("EC") requested that it be allowed to file a written submission as a non-disputing party in this arbitration. On 7 April 2009, the Tribunal invited the Parties to file their observations on the EC's request by 7 May 2009.

2. The written phase on the merits

24. In accordance with the procedural schedule agreed by the Parties and confirmed in the Secretary's letter of 27 March 2009, the Respondent filed its Counter-Memorial on the merits ("R-CM") on 6 April 2009. The Counter-Memorial was accompanied by:

a. Expert Report of Professor Rudolf Streinz ("First ER of R. Streinz")

b. Exhibits R-59 through R-132

c. Legal authorities RL-177 through RL-273.

25. On 7 May 2009, the Parties submitted their observations on the EC's request to file a written submission as a non-disputing party. The Claimants opposed that request. The Respondent submitted that the EC's request was one that could not be reasonably opposed, but in the event that the Claimants opposed that request, it requested the opportunity to provide a fuller response.

26. Also on 7 May 2009, Mr. Viorel Micula advised that the law firm of Dewey & LeBoeuf would no longer be representing him, although the firm of Muşat & Asociaţii remained as his counsel.

27. By letter of the Secretary of 15 May 2009, having considered the Parties' positions and the applicable procedural rules, the Tribunal decided that it would allow the participation of the EC as a non-disputing party in the present case. The Tribunal noted that:

> In doing so, the Tribunal is particularly sensitive to the fact that the European Community may bring a factual or legal perspective that could assist the Tribunal in the adjudication of the Parties' rights. In granting leave to the European Community to participate as a non-disputing party, the Arbitral Tribunal is mindful of the need to preserve due process and the good order of the proceeding. In particular, the European Community shall act as *amicus curiae* and not as *amicus actoris vel rei*. In other words, the non-disputing party shall remain a friend of the court and not a friend of either Party.

28. In light of this, the Tribunal invited the Parties to confer and agree on a procedure for the participation of the EC as a non-disputing party on or before 22 May 2009, and provided certain guidelines for that procedure. It also requested the Parties' comments on a draft letter to the EC by the same date.

29. On 18 May 2009, Mr. Ioan Micula and the Corporate Claimants submitted a request for a site visit pursuant to Article 43(b) of the ICSID Convention and Rule 37 of the 2003 ICSID Arbitration Rules.

30. On 22 May 2009, all Parties submitted their observations on the Tribunal's draft letter to the EC concerning its *amicus* participation and the proposed procedure for such participation. Mr. Ioan Micula and the Corporate Claimants also expressed a concern at certain communications that had taken place between the Respondent and the EC, and requested an instruction from the Tribunal that Romania, its counsel and its expert refrain from any further communications with the EC about this case until after the hearing and the closure of the proceedings.

31. On 25 May 2009, the Respondent opposed Mr. Ioan Micula's and the Corporate Claimants' request for a site visit. It also argued that this request was being used to present an entirely new case on damages, which was impermissible at that stage of the proceedings.

32. Also on 25 May 2009, Dr. Claus-Dieter Ehlermann submitted his resignation as an arbitrator to the other members of the Tribunal and to the Acting Secretary-General of ICSID and indicated his grounds of personal nature for such resignation. On 26 May 2009, pursuant to Arbitration Rule 8(2), the Tribunal consented to Dr. Ehlermann's resignation and on that day notified the Acting Secretary-General of its decision. On that same day, pursuant to Arbitration Rule 10(1) and (2) and on behalf of the Acting Secretary-General, the Secretary notified the Parties of Dr. Ehlermann's resignation and the Tribunal's consent thereto, and of the resulting vacancy on the Tribunal. In accordance with Arbitration Rule 11(1), the Respondent was invited to promptly

appoint an arbitrator to fill that vacancy. Pursuant to Arbitration Rule 10(2), the arbitration proceedings were suspended until the vacancy created by Dr. Ehlermann's resignation had been filled. The Parties were also invited to inform the Tribunal, as soon as the vacancy had been filled, whether they would agree to maintain the existing procedural timetable.

33. On 4 June 2009, the Respondent advised the Tribunal that it was in the process of identifying a new arbitrator and that it was committed to attempting to preserve the current procedural schedule. Given that the question of the modalities of the EC's participation as an *amicus curiae* was still pending before the Tribunal and would likely impact the procedural schedule, the Respondent invited the Claimants to agree, and the Tribunal to approve, that

> (a) the stay on the proceedings be lifted insofar as the Tribunal's decision on the modalities of the European Community's participation as *amicus curiae* is concerned;
>
> (b) the Tribunal render that decision in its present, provisionally truncated formation, by consent of the parties.

34. At the invitation of the Tribunal, on 16 June 2009 Mr. Ioan Micula and the Corporate Claimants agreed with the Respondent's proposal that the Tribunal should proceed to rule on the modality of the EC's participation as an *amicus curiae*, notwithstanding the stay of the proceedings. The Claimants noted that they were not in a position to communicate their views as to the impact of the stay on the procedural timetable, but would do so once the Tribunal's vacancy was filled.

35. On 19 June 2009, Mr. Viorel Micula advised that he had retained as new counsel Messrs. David Reed, Alex Bevan and Emmanuel Gaillard of the law firm of Shearman & Sterling LLP, London and Paris, and accepted the Respondent's request for a partial lift of the stay of the proceedings.

36. By letter of the Secretary of 25 June 2009, the Tribunal approved the Parties' agreement to partially lift the stay of the proceedings concerning the modalities of the EC's *amicus curiae* participation and issued its decision on those modalities, as set forth below. On that same day, the Tribunal informed the EC that it would be allowed to participate as a non-disputing party in this arbitration, specifying that the purpose of such participation would be to assist the Tribunal in its adjudicatory work. The Tribunal set forth the following procedure for the EC's participation:

> 1. The European Community shall file a written submission on or before July 20, 2009. It shall send an electronic copy of the submission by e-mail to the Secretary of the Tribunal at mpolasek@worldbank.org and 15 (fifteen) hard copies of the submission by courier to the Secretary at ICSID, for transmission to the Tribunal and the Parties.
>
> 2. The European Community's written submission shall not respond or comment upon the Parties' prayers for relief, but shall be focused on assisting the Tribunal in the determination of factual or legal issues at stake in the present dispute. It is expected that the scope of the Community's input will be limited to facts within its own knowledge and to European law rather than to any other facts or legal matters at

issue in this arbitration. The Community may within this scope decide which facts and laws are relevant to the dispute.

3. The European Community's written submission shall be limited in length (40 pages) and written in English.

4. The European Community may file any relevant exhibits with its written submission within the scope described under paragraph 2 above. Any exhibit for which the original language is not English shall be submitted in the original language accompanied by a translation into English. If the document is lengthy and relevant only in part, it is sufficient if only the relevant parts, which must be precisely specified, are translated.

5. The Tribunal may request the European Community to produce any document or evidentiary material that the Tribunal deems useful for the resolution of this dispute, or which has been requested by either Party.

6. The European Community shall have access to the Parties' pleadings in their entirety as existing at this juncture, except for materials that have been designated as commercially confidential or legally privileged. Should a disagreement arise as to whether such materials have been so designated, the Tribunal will resolve such disagreement. The Secretary of the Tribunal will transmit electronic copies of the materials to the European Community at the latest by July 6, 2009.

7. Any person who has participated in the elaboration of the European Community's written submission may be called to provide clarifications on that submission at the hearing, as may be required by the Tribunal of its own initiative or at the request of the Parties. Such clarifications will be given in the form directed by the Tribunal and under its control.

8. The European Community will bear its own costs incurred in connection with its participation in the proceeding, including any costs relating to any appearance by the Community's representative(s) for examination at the hearing.

9. The European Community shall indicate whether it had any direct contact with either Party to this arbitration concerning the subject matter of this arbitration and should as far as possible avoid any future contact in this respect.

37. In its letter to the Parties of 25 June 2009, the Tribunal also invited the Parties to comment on the Commission's Written Submission within two months from the date of receipt of that submission.

38. On 7 July 2009, the Secretary sent the EC two CD-ROMs containing the Parties' pleadings on the merits, including supporting documents, filed as of that date.

39. On 16 July 2009, in accordance with Articles 56(1) and 37(2)(b) of the ICSID Convention and Arbitration Rule 11(1) and (3), the Respondent appointed as its arbitrator Professor Georges Abi-Saab, a national of the Arab Republic of Egypt. The Respondent also agreed to maintain the current procedural timetable.

40. On 20 July 2009, the EC submitted its written submission as a non-disputing party, including 10 exhibits.

41. On 22 July 2009, the Secretary informed the Parties that the Tribunal had been reconstituted and the proceedings resumed. On 24 July 2009, the Tribunal proposed to the Parties that, subject to their reasoned objection by 7 August 2009, the acts accomplished by the Tribunal regarding the modalities of the EC's participation as a non-disputing party while the suspension of the proceeding was partially lifted were validated. In that same letter, the Tribunal also invited the Parties to state their views on the procedural timetable in consideration of the suspension of the proceedings.

42. By letters of 30 and 31 July 2009, all Claimants agreed to the validation of the acts taken by the Tribunal during the suspension of the proceedings with respect to the EC's *amicus curiae* submission and submitted their views on the procedural timetable. Specifically, the Claimants stated that they would require an extension of the time limits set out in the procedural timetable as a result of the suspension of the proceedings. On 7 August 2009, the Respondent submitted its comments on the new procedural timetable suggested by the Claimants.

43. On 7 September 2009 the Respondent informed the Tribunal that the Parties had reached an agreement on the procedural timetable. By letter of 14 September 2009, the Tribunal confirmed the procedural timetable agreed by the Parties, as follows:

Parties' responses to EC amicus brief	16 November 2009
Claimants' Reply	14 December 2009
Respondent's Rejoinder	12 April 2010
Claimants' Rebuttal Expert Reports on Quantum	10 June 2010
Respondent's Rebuttal Expert Reports on Quantum	19 July 2010

44. After consultation between the Parties and the Tribunal, on 19 October 2009 the Tribunal confirmed that the hearing on the merits would take place between 8 and 19 November 2010, excluding the weekend.

45. On 16 November 2009, the Parties submitted their comments to the EC's *amicus curiae* submission. In addition, the Claimants expressed their concern that there may have been improper contact between the EC and the Respondent or its counsel, in violation of the Tribunal's instructions of 25 June 2009, and requested the Tribunal to order the Respondent to produce copies of all records of communications between the Respondent or any of the Respondent's legal counsel and the EC since 1 January 2009 related to the subject matter of this arbitration.

46. On 23 November 2009, the Tribunal invited the Respondent to provide its comments to the Claimants' request for production of documents by 11 December 2009. This deadline was subsequently extended by agreement of the Parties to 16 December 2009.

47. On 4 December 2009, counsel for Mr. Ioan Micula and the Corporate Claimants informed the Tribunal that all Parties had agreed to extend the deadlines for their upcoming briefs. On 14 December 2009, the Secretary confirmed the amended procedural timetable as follows:

Respondent's Reply to the Claimants' request for production of documents	16 December 2009
Claimants' Reply	22 December 2009
Respondent's Rejoinder	28 April 2010
Claimants' Rebuttal Expert Reports on Quantum	25 June 2010
Respondent's Rebuttal Expert Reports on Quantum	4 August 2010
Hearing on the Merits	8-19 November 2010

48. On 16 December 2009, the Respondent submitted its objections to the Claimants' request for the production of communications between the EC and the Respondent or its counsel.

49. On 22 December 2009, the Claimants submitted their Reply on the Merits ("C-Reply"), which was accompanied by the following evidence:

a. Third Witness Statement of Mr. Ioan Micula ("Third WS of I. Micula")

b. Third Witness Statement of Mr. Viorel Micula ("Third WS of V. Micula)

c. Witness Statement of Mr. Sorin Baciu ("First WS of S. Baciu")

d. Witness Statement of Mr. Moisa Ban ("First WS of M. Ban")

e. Witness Statement of Mr. Mircea Halbac ("First WS of M. Halbac")

f. Witness Statement of Mr. Christian Balog ("First WS of C. Balog")

g. Witness Statement of Mr. Neculai-Liviu Marcu ("WS of N. Marcu)

h. Witness Statement of Mr. Nicolae Staiculescu ("WS of N. Staiculescu")

i. Expert Report of Professor Donald L. Lessard ("First ER of D. Lessard")

j. Expert Report of Professor Alan Dashwood ("First ER of A. Dashwood")

k. Expert Report of Professor David Caron ("ER of D. Caron")

l. Expert Report of Professor Lucian Mihai ("ER of L. Mihai")

m. Expert Report of Professor Jan-Benedict Steenkamp ("First ER of J. Steenkamp")

n. Expert Report of Mr. Chris Osborne (FTI) ("First ER of C. Osborne")

o. Expert Report of Dr. James Fry (LMC) ("First ER of J. Fry")

p. Boston Consulting Group Report, originally filed as Exh. C-655 ("First ER of BCG")

q. Claimants' Exhibits and Legal Authorities 271 to 675

50. By means of Procedural Order dated 8 January 2010, the Tribunal rejected the Claimants' request for the production of correspondence between the EC and the Respondent or its counsel. Specifically, the Tribunal found:

> 6. That after deliberating on the arguments advanced by the Parties, the Tribunal is not persuaded that the documents requested by the Claimants are necessary or useful for the determination of the outcome of the dispute in this arbitration;
>
> 7. That even if, for the sake of argument, the Tribunal were to accept the Claimants' allegations and find that the European Community cooperated with the Respondent in preparing its Submission, which the Respondent denies, such finding would not affect the Tribunal's conclusion that the requested documents lack relevance;
>
> 8. That to the extent that the requested documents might be relevant for the purposes of establishing the objectivity of the arguments advanced by the non-disputing party in its Submission and the weight to be given to them by the Tribunal, this matter has already been adequately addressed in the Tribunal's letter of 25 June 2009, which, if necessary, provides the Claimants with the opportunity to examine at the hearing any person who has participated in the preparation of the Submission.

51. On 14 January 2010, the Claimants advised that they had found inadvertent errors and omissions in their Reply submission, and submitted corrected versions of their Reply Memorial, three witness statements and 29 exhibits, together with an errata sheet.

52. By letter of 5 February 2010, the Respondent notified the Tribunal that, in accordance with its obligations under the Treaty of Lisbon, it proposed to make available to the EC the Claimants' Reply and its annexes. The Respondent alleged that the Claimants' Reply represented a fundamentally new case, and that, as an EU Member State, it is obliged under the Treaty of Lisbon to notify the EU of any pending international litigation threatening to jeopardize a state's EU law obligations. By letters of 9 February 2010, the Claimants objected to the proposed disclosure, alleging, *inter alia*, that the *amicus curiae* phase of the arbitration had been concluded, that the Reply did not present a fundamentally new case, that such disclosure would violate the Tribunal's order of 25 June 2009, and that the Reply contained material that was commercially confidential to the Claimants.

53. Considering that the Respondent's proposed disclosure could raise issues of confidentiality and privilege, on 10 February 2011 the Tribunal invited the Parties to

make brief submissions addressing (i) the content and scope of Respondent's legal obligation under the Treaty of Lisbon to notify the EU of any pending international litigation threatening to jeopardize a state's EU law obligations; (ii) whether the disclosure would possibly aggravate the dispute and/or adversely affect the conduct of the proceedings, and (iii) whether the disclosure would violate the Claimants' rights to confidentiality and/or privilege. The Parties filed their submissions on 19 February 2010. An additional submission was made by Mr. Viorel Micula on 22 February 2010.

54. By means of a Procedural Order issued on 3 March 2010 and pursuant to Article 47 of the ICSID Convention and Arbitration Rule 39, the Tribunal recommended that the Respondent refrain from providing the EC with the full text of the Claimants' Reply and its exhibits, inviting it instead to provide the EC with the text of the Claimants' amended request for relief, as set forth in the Reply. In making its decision, the Tribunal took into consideration the role of the EC as an *amicus curiae*, the fact that the Claimants had withdrawn a claim and amended their prayers for relief, and issues of confidentiality, privilege, and possible aggravation of the dispute.

55. On 8 April 2010, following the Tribunal's recommendation, the Respondent notified the EC that the Claimants had withdrawn their request for restitution of the legal framework in force at the time of approval of EGO 24/1998.

56. On 19 March 2010, the Respondent requested an extension of its time limit to file its Rejoinder on the merits, alleging, inter alia, that the Claimants' Reply was incomplete. On 25 March 2010, the Claimants objected to that request. After further correspondence among the Parties and a proposal from the Tribunal, the Parties and the Tribunal finally agreed on the following procedural calendar, as confirmed by the Secretary's letter of 12 April 2010:

Respondent's Rejoinder	11 June 2010
Claimants' Rebuttal Expert Reports on Quantum	30 July 2010
Respondent's Rebuttal Expert Reports on Quantum	10 September 2010
Hearing on the Merits and Quantum	8-19 November 2010

57. On 9 April 2010, the Respondent made an application for production of documents. The Claimants objected to that request by letters of 19 and 26 April 2010. After further comments from the Parties (Respondent's letter of 27 April 2010 and Claimants' submissions of 29 April and 10 May 2010), on 27 May 2010 the Tribunal issued a Procedural Order ruling on the Respondent's request. The Parties further agreed on the timing for the Parties' comments on the documents produced (Respondent's letter of 3 June 2010). The Tribunal approved the Parties' agreement by letter of 7 June 2010 and invited the Parties to report on the production progress (which they did through the Claimants' letter of 10 June 2010).

58. On 13 April 2010, Ioan Micula and the Corporate Claimants renewed their request for a site visit. The Respondent objected to that request on 22 April 2010, and the Claimants submitted further comments on 26 and 28 April 2010. On 5 May 2010,

having considered the Parties' submissions, the Tribunal concluded that a site visit would not enlighten the Tribunal at that stage in the proceedings, as any information gleaned from such visit would be either irrelevant for the resolution of the dispute or unnecessary given that the record supplied sufficient evidence, at least at that juncture. However, the Tribunal invited the Parties to renew the application for a site visit after the hearing on the merits if they continued to wish for one.

59. On 28 May 2010, Mr. Viorel Micula advised that Muşat & Asociaţii no longer represented him as counsel.

60. On 11 June 2010, the Respondent submitted its Rejoinder ("R-Rejoinder"), which was accompanied by the following evidence:

a. Expert Report of Professor Flavius Baias ("ER of F. Baias")

b. Expert Report of Sir Francis Jacobs ("ER of F. Jacobs")

c. Expert Report of Mr. Asger Petersen ("ER of A. Petersen")

d. Rebuttal Expert Report of Professor Dr. Rudolf Streinz ("Second ER of R. Streinz")

e. Expert Report of Agra CEAS Consulting, Mr. Conrad Caspari, in conjunction with F.O. Licht ("ER of C. Caspari")

f. Expert Report of KPMG, Mr. John Ellison ("First ER of J. Ellison")[1]

g. Expert Report of Dr. Bill Robinson ("First ER of B. Robinson")

h. Witness Statements of Mr. Leonard Orban ("WS of L. Orban")

i. Witness Statement of Professor Mihai Berinde ("WS of M. Berinde")

j. Documentary evidence (Exhibits R-134 through R-203)

k. Legal authorities (Exhibits RL-284 through RL-336).

61. On 22 July 2010, the Respondent submitted its comments on the documents produced by the Claimants in response to the Procedural Order of 27 May 2010. The Claimants submitted their comments on 3 September 2010. In the interim, the Parties further corresponded on the production of specific documents.

62. On 21 July 2011, Ioan Micula and the Corporate Claimants requested permission to submit four additional witness statements that would be relied upon by the Claimants' damages experts in their rebuttal expert reports due on 30 July 2010. On 22 July 2010, the Respondent objected to that request. The Parties submitted further comments (Claimants' letters of 23 and 26 July 2010 and Respondent's letter of 26

[1] Mr. Ellison also submitted an expert report during the jurisdictional phase that is not referred to in this Award.

July 2010). After considering the Parties' submissions and in the exercise of the discretion granted to it under paragraphs 14(II)(c) and (e) of the Minutes of the First Session, by letter of 28 July 2010 the Tribunal granted the Claimants permission to submit, by 30 July 2010, new witness statements from the following persons: Messrs. Juan Gamecho, Mircea Halbac, Sorin Baciu and Cristian Balog. The Tribunal specified that these witness statements should be strictly limited to factual allegations that will be relied upon by the Claimants' damages experts in their rebuttal expert reports, and that the Claimants should make these witnesses available for cross-examination at the hearing.

63. On 30 July 2010 (by separate letters sent by counsel to Mr. Ioan Micula and the Corporate Claimants, on one hand, and counsel to Mr. Viorel Micula, on the other), the Claimants submitted the following rebuttal expert reports on quantum and additional witness statements:

    a. Expert Reply Report of Professor Donald R. Lessard ("Second ER of D. Lessard")

    b. Expert Reply Report of Professor Jean-Benedict Steenkamp ("Second ER of J. Steenkamp")

    c. Expert Opinion of Professor Georghe Piperea ("ER of G. Piperea")

    d. Rebuttal Expert Report of Dr. James Fry of LMC International ("Second ER of J. Fry")

    e. Expert Report of Mr. Richard Boulton of LECG ("ER of R. Boulton")

    f. Rebuttal Expert Report of BCG ("Second ER of BCG")

    g. Witness Statement of Mr. Juan Gamecho ("WS of J. Gamecho")

    h. Second Witness Statement of Mr. Mircea Halbac ("Second WS of M. Halbac")

    i. Second Witness Statement of Mr. Sorin Baciu ("Second WS of S. Baciu")

    j. Second Witness Statement of Mr. Christian Balog ("Second WS of C. Balog")

    k. Exhibits and Legal Authorities C-680 to C-1034

64. On 2 August 2010, the Claimants submitted the rebuttal expert report of Mr. Chris Osborne of FTI Consulting.

65. In their letter of 30 July 2010, Mr. Ioan Micula and the Corporate Claimants also noted that the Claimants continued to suffer from acts of the Romanian state, including the initiation of forced execution proceedings against companies of the EFDG, that directly threatened their ability to continue their business activities and reserved their right to request interim relief from the Tribunal. The Claimants also objected to Section VI.G of the Respondent's Rejoinder, entitled "Any Compensation Must Be

Reduced by the Value of Benefits Received as a Result of Romania's EU Accession." The Claimants argued that this defense constituted a new legal theory that had been raised in the Respondent's Counter-Memorial and was thus untimely. In the event that the Tribunal was minded to accept it, the Claimants alleged that it should be rejected on the substantive grounds described in their letter.

66. By letter of 10 August 2010, the Respondent requested the Tribunal to (i) strike certain new evidence (specifically, certain expert reports or relevant parts of them, and new factual exhibits) filed by the Claimants with their rebuttal expert reports submitted on 30 July 2010 and 2 August 2010, as well as certain new legal submissions and allegations made by the Claimants in their letters accompanying such reports; (ii) grant it a four week extension to submit its rebuttal expert reports on quantum; and (iii) grant it the opportunity to comment on the Claimants' new evidence and allegations, to the extent that they are not stricken and, if necessary, to adduce responsive evidence. At the Tribunal's invitation, all Claimants commented on these requests by letters of 19 August 2010. The Respondent submitted further comments on 24 August 2010.

67. By means of a Procedural Order issued on 24 August 2010 and in accordance with ICSID Arbitration Rule 34, the Tribunal declined to strike any evidence filed by the Parties at this stage of the proceeding, stating that it would decide in due time what weight to give to any such evidence. The Tribunal also granted the Respondent a two-week extension (until 24 September 2010) to submit rebuttal expert reports on quantum, and invited the Respondent to produce in advance of the new time limit whatever written evidence they were able to produce without disruption of their work. The Tribunal also ruled that, if the Respondent wished to present new witness statements, it should file a formal application pursuant to Paragraph 14(II)(c) and (e) of the Minutes of the First Session. The scope of any such witness statements would in any event be strictly limited to the factual allegations relied upon by the Respondent's damages experts in their rebuttal expert reports. Finally, the Tribunal ruled that the Respondent should respond to the new documents submitted by the Claimants together with its rebuttal expert reports on damages.

68. By letter of 14 September 2010, the Tribunal asked the Parties if they would be agreeable to the appointment of Ms. Sabina Sacco of the law firm of Lévy Kaufmann-Kohler as Assistant to the Tribunal, which the Parties accepted.

69. On 24 September 2010, the Respondent submitted its Observations on Claimants' Additional Evidence, together with the following evidence and rebuttal expert reports:

    a. Factual Exhibits R-210 through R-229

    b. Legal Authorities RLA-337 through 346

    c. Reply Expert Report of Mr. Conrad Caspari ("Second ER of C. Caspari")

    d. Reply Expert Report of Mr. John Ellison ("Second ER of J. Ellison")

e. Reply Expert Report of Dr. Bill Robinson ("Second ER of B. Robinson")

3. Procedural steps predating the hearing on the merits

70. On 30 September 2010, the President of the Tribunal and the Parties held a pre-hearing telephone conference to discuss all outstanding matters with respect to the organization of the hearing on the merits and quantum. During that telephone conference, the Parties reached an agreement with respect to certain issues, but maintained disagreement on others (in particular the sequestration of the Messrs. Micula and the modality for the examination of certain witnesses and experts). In addition, the Respondent requested clarification from the Claimants with respect to their quantum case.

71. On 8 October 2011, all Parties identified the witnesses and experts they would call for cross-examination at the hearing and provided further comments on outstanding issues with respect to the hearing. After further correspondence from the Parties, the Tribunal ruled on these issues by means of a Procedural Order of 13 October 2010.

72. By letters of 15 October 2010, the Parties submitted proposed hearing schedules and discussed the need for oral closing submissions. The Claimants also requested that the Tribunal, of its own initiative, call Professor David Caron, Claimants' international law expert, to appear at the hearing for examination despite the fact that the Respondent did not call him for cross-examination. The Respondent provided further comments on 20 October 2010. The Tribunal ruled on these issues by letter of 22 October 2010. By letter of 28 October 2010, the Respondent expressed concerns with respect to the time allocation during the hearing and reserved its rights. On 1 November 2010, the Tribunal clarified that the ruling of 22 October 2010 contained a clerical error, and issued a corrected time allocation.

73. On 5 October 2010, the Secretary invited the representatives of the EC who had drafted the EC's *amicus* brief to provide clarifications on that submission at the hearing. On 13 October 2010, the relevant EC representatives confirmed they would attend the hearing. On 15 October 2010, the Tribunal informed the Parties of the EC representatives' attendance and invited the Parties to confer in view of reaching an agreement with respect to the timing, scope and form of the EC's testimony. The Parties provided their comments on 22 and 25 October 2010. On 27 October 2010 the Tribunal issued directions with respect to the EC's participation at the hearing, which were communicated to the EC on 28 October 2010. On 3 November 2010, the Claimants [Viorel Micula] advised the Tribunal that due process required that the EC be treated as a hostile witness vis-à-vis the Claimants, and required more time for their cross-examination. After hearing the Respondent's position, the Tribunal ruled on this matter during the hearing.

74. By letter of 1 November 2010, the Claimants alleged that Romanian tax enforcement officials had seized significant assets of the EFDG necessary for the continuation of the Claimants' business (in particular, production equipment and machinery) and were threatening to commence the forced sale of these assets as early as 8

November 2010. The Claimants advised that they would shortly file an application for provisional measures and for a temporary "standstill" order, and requested that their applications be heard during the first day of the hearing. After an invitation from the Tribunal, on 3 November 2010 the Respondent submitted preliminary comments on the Claimants' letter, to which the Claimants responded on the same date.

75. On 3 November 2010, the Claimants submitted an Application for Provisional Measures ("Claimants' Application for Provisional Measures") pursuant to Article 47 of the ICSID Convention and Arbitration Rule 39, together with a request for an emergency temporary order.

76. On 5 November 2010, at the invitation of the Tribunal, the Respondent submitted its comments on the Claimants' request for an emergency temporary order, requesting that it should be dismissed for the reasons stated in that submission. In that same letter, the Respondent proposed that the Claimants' Application for Provisional Measures be addressed following, rather than during, the evidentiary hearing, preferably in December 2010, noting that there was no need to disrupt the hearing due to the Claimants' Application for Provisional Measures.

77. On 5 November 2010, the Tribunal issued a Procedural Order in which it (i) denied the Claimants' request for an emergency temporary order, without prejudice to the Tribunal's authority to issue a different determination at a later stage in the proceedings if the circumstances should change; (ii) determined that it would address the Claimants' Application for Provisional Measures after the hearing on the merits; and (iii) gave instructions with respect to briefing by the Parties.

4. The hearing on the merits and quantum

78. From 8 to 19 November 2010, the Tribunal and the Parties held a hearing on the merits and quantum in Paris, France. During the course of the hearing, the Parties made oral arguments regarding their merits and quantum cases, had the opportunity to examine the witnesses and experts that had been called to testify, and addressed several evidentiary and procedural issues. The EC representatives invited by the Tribunal provided clarifications to their written submission and answered the Parties' questions. The Tribunal was addressed by Messrs. Eric A. Schwartz, Reginald R. Smith and Kenneth R. Fleuriet and Ms. Amy R. Frey on behalf of Mr. Ioan Micula and the Corporate Claimants; by Messrs. Emmanuel Galliard and David Reed on behalf of Mr. Viorel Micula, and by Messrs. D. Brian King, Georgios Petrochilos, Noah Rubins, Boris Kasalowsky and Ben Juratowitch on behalf of the Respondent.

79. The following persons participated in the hearing:

On behalf of Mr. Ioan Micula and the Corporate Claimants:

Mr. Ioan Micula
Mr. Eric Schwartz, King & Spalding
Mr. Reggie Smith, King & Spalding
Mr. Ken Fleuriet, King & Spalding

Mr. Ric Toher, King & Spalding
Mrs. Amy R. Frey, King & Spalding
Ms. Jamie Miller, King & Spalding
Ms. Catalina Constantina, King & Spalding
Mrs. Eva Micula
Ms. Natalie Micula
Ms. Olivia Micula
Mrs. Oana Popa
Mrs. Diana Radu
Mr. Vasile Popa-Bota
Mr. Traian Bulzan

On behalf of Mr. Viorel Micula:

Mr. Viorel Micula
Mr. Emmanuel Gaillard, Shearman & Sterling
Mr. David Reed, Shearman & Sterling
Mr. Robert Williams, Shearman & Sterling
Ms. Veronika Korum, Shearman & Sterling
Mr. Henry Ovens, Shearman & Sterling
Ms. Valerie Ollivier, Shearman & Sterling
Ms. Ioana Aron Blahuta
Ms. Medora Purle
Mr. Cristian Flora
Mr. Calin Vidican
Ms. Eva Fogarassy
Mr. Adrian Rotar
Ms. Alexandra Gheorghe-Duca
Mr. Mihai Clepce

On behalf of the Respondent:

HE Minister Gheorghe Ialomiţianu, Ministry of Public Finance
Ms. Manuela Nestor, Nestor Nestor Diculescu Kingston Petersen
Ms. Georgeta Harapcea, Nestor Nestor Diculescu Kingston Petersen
Mr. D. Brian King, Freshfields Bruckhaus Deringer LLP
Mr. Georgios Petrochilos, Freshfields Bruckhaus Deringer LLP
Mr. Noah Rubins, Freshfields Bruckhaus Deringer LLP
Mr. Boris Kasolowsky, Freshfields Bruckhaus Deringer LLP
Mr. Jonathan J Gass, Freshfields Bruckhaus Deringer LLP
Mr. Ben Juratowitch, Freshfields Bruckhaus Deringer LLP
Mr. Sami Tannous, Freshfields Bruckhaus Deringer LLP
Ms. Evgeniya Rubinina, Freshfields Bruckhaus Deringer LLP
Mr. Moritz Keller, Freshfields Bruckhaus Deringer LLP
Mr. Marcus Benzing, Freshfields Bruckhaus Deringer LLP
Mr. Ignacio Stratta, Freshfields Bruckhaus Deringer LLP

Ms. Victoria Bokelmann, Freshfields Bruckhaus Deringer LLP
Ms. Rebecca Smith, Freshfields Bruckhaus Deringer LLP
Ms. Lauren Henschke, Freshfields Bruckhaus Deringer LLP
Ms. Smaranda Miron, Freshfields Bruckhaus Deringer LLP
Ms. Eleonore Gleitz, Freshfields Bruckhaus Deringer LLP

80. The Tribunal heard oral testimony from the following persons:

Claimants' witnesses and experts

Mr. Ioan Micula	Claimant
Mr. Viorel Micula	Claimant
Professor Lucian Mihai	Expert Witness, University of Bucharest
Professor Alan Dashwood QC	Expert Witness, Henderson Chambers
Professor David Caron	Expert Witness, University of California at Berkeley
Mr. Liviu Marcu	Witness
Mr. Nicolae Staiculescu	Witness
Mr. Mircea Halbac	Witness
Mr. Moisa Ban	Witness
Mr. Sorin Baciu	Witness
Mr. Jaun Gamecho	Witness
Professor Don Lessard	Expert Witness, MIT, The Brattle Group
Mr. Alexis Maniatis	Expert Witness, The Brattle Group
Ms. Natasha Dupont	Expert Witness, The Brattle Group
Mr. Chris Osborne	Expert Witness, FTI Consulting
Mr. Richard Edwards	Expert Witness, FTI Consulting
Mr. Richard Boulton	Expert Witness, LECG
Mr. Ian Clemmence	Expert Witness, LECG
Dr. James Fry	Expert Witness, LMC
Mr. Laszlo Juhasz	Expert Witness, BCG

Respondent's witnesses

Mr. Leonard Orban	Fact Witness, Office of the President of Romania
Professor Mihai Berinde	Witness
Sir Francis Jacobs QC	Expert Witness, Fountain Court Chambers
Mr. Alexander Milner	Expert Witness, Fountain Court Chambers
Professor Flavius Baias	Expert Witness, Bucharest Public University
Professor Dr. Rudolf Streinz	Expert Witness, University of Munich
Professor Dr. Christoph Herrmann	Expert Witness, University of Passau
Mr. John Ellison	Expert Witness, KPMG
Dr. Bill Robinson	Expert Witness, KPMG
Mr. Nishad Morjaria	Expert Witness, KPMG
Mr. Dan Aylward	Expert Witness, KPMG
Mr. Conrad Caspari	Expert Witness, Agra CEAS

Mr. Asger Petersen	Expert Witness, Cleary Gottlieb Steen & Hamilton

Non-disputing Parties (EC)

Mr. Bernd Martenczuk, Legal Representative, European Commission
Mr. Frank Hoffmeister, Legal Representative, European Commission
Mr. Ion Rogalski, Legal Representative, European Commission

81. A transcript of the hearing was distributed among the Parties. An audio recording was made in English and Romanian and also distributed among the Parties.

5. Procedural matters following the hearing

82. By the end of the hearing, the following evidentiary and procedural issues remained outstanding: (i) the Claimants requested that Mr. Mihai Berinde, who had to leave the hearing early, be made available for cross-examination at a later date, whether in person or via videoconference; (ii) the Claimants confirmed that their (or rather Mr. Ioan Micula's) application for a site visit was still in place; (iii) the form and time of the Parties' closing arguments remained outstanding, and (iv) the Respondent requested that the Claimants reformulate their request for relief in such a way that it identified each breach alleged and the specific relief requested on the basis of such breaches.

83. On 25 November 2010, the Tribunal issued a Procedural Order ruling on the evidentiary and procedural matters that remained outstanding. Specifically, the Tribunal (i) decided that Mr. Berinde would not be called for oral examination, but specified that this would not prevent the Parties or the Tribunal from relying on Mr. Berinde's written testimony (and that the same would apply to the other called witnesses/experts that the Parties did not cross-examine at the hearing); (ii) gave instructions on further briefing with respect to the Claimants' application for a site visit; (iii) determined that the Parties should present oral closing arguments and gave instructions for a future hearing in that respect, but also invited the Parties to submit voluntary post-hearing briefs; and (iv) gave directions to the Claimants with respect to the submission of their amended request for relief. The Tribunal also gave further instructions to the Parties with respect to the review of the hearing transcript and audio tapes, and with respect to the Parties' briefs on provisional measures.

84. The Tribunal will address the more relevant procedural matters separately below.

a. The Claimants' Applications for Provisional Measures and the Respondent's Application for Revocation of Provisional Measures

85. As noted in para. 75 above, on 3 November 2010 the Claimants submitted an Application for Provisional Measures, as well as a request for an emergency temporary order. Specifically, the Claimants requested (Claimants' Application for Provisional Measures, ¶ 43):

a. "an Order preserving the *status quo ante* by instructing Respondent to withdraw or otherwise cease and desist from enforcing the above-described seizure orders, or from implementing any new such orders against any of the EFDG companies, prior to the Tribunal's issuance of its final award (and that the award itself deal with the matter as appropriate at that time, such as by maintaining the Order in place until Romania has satisfied the terms of the award in full); and

b. an Order that Respondent refrain from taking any other measure against any of the EFDG companies that would aggravate or extend the existing dispute prior to the Tribunal's issuance of its final award."

86. By Procedural Orders of 5 and 25 November 2010, the Tribunal gave instructions with respect to briefing by the Parties. In accordance with these instructions, on 30 November 2010, the Respondent submitted its observations on the Claimants' Application for Provisional Measures. After further correspondence from the Parties and leave from the Tribunal, on 20 December 2010 the Claimants submitted a reply in support of their Application for Provisional Measures, and the Respondent submitted a rejoinder on 17 January 2011. At the invitation of the Tribunal, the Parties submitted further comments on 9 February 2011.

87. On 2 March 2011, the Tribunal issued a Decision on the Claimants' Application for Provisional Measures (the "Decision on Provisional Measures"). In that Decision, the Tribunal recommended that the Respondent "inform the Claimants, with a copy to the Tribunal, if it intends to proceed with the seal or forced sale of the seized assets or take any other tax collection measure that could have a similar effect, two months prior to the date in which it intends to implement such seal, sale or other measure, until this arbitration is completed or until reconsideration of this Decision." The Tribunal denied at that stage the remaining requests for provisional measures brought by the Claimants, and invited either Party to apply to the Tribunal for a reconsideration of the Decision if it should consider that the circumstances under which the Decision was made had changed (Decision on Provisional Measures, ¶ 98).

88. On 4 March 2011, the Claimants informed the Tribunal that the Romanian government had garnished Starmill's bank accounts to satisfy the payment of overdue taxes and associated penalties, in violation of "the spirit, if not the letter, of the Tribunal's Decision [on Provisional Measures]" (Claimants' letter of 4 March 2011, p. 1, or "Claimants' Second Application for Provisional Measures"). The Claimants requested the Tribunal to order the Respondent to (i) lift the current garnishment of Starmill's accounts; (ii) replenish those accounts with any funds that have been transferred to the Government's accounts; (iii) refrain from garnishing the bank accounts of any of Claimants' companies in relation to the taxes and penalties covered by the Decision on Provisional Measures unless it provides the two months' advance notice required by the Decision, and (iv) clarify its position on the impending sale of Starmill's (and the other companies') seized physical assets (Second Application, pp. 3-4). By letter of 7 March 2011, the Tribunal stated that it understood

this letter to be a new request for provisional measures, and invited the Respondent to comment.

89. By letter of 11 March 2011, the Respondent submitted its comments to the Claimants' letter of 4 March 2011, noting that it also considered the letter to be a new application for provisional measures and requesting that Claimants' request be denied with a full award of costs. The Claimants replied by letter of 17 March 2011, reiterating their first three requests for relief but denying that the 4 March letter constituted a new request for provisional measures. The Parties exchanged further correspondence setting out their positions (Respondent's letters of 23 and 31 March 2011, and Claimants' letters of 28 March and 13 and 22 April 2011).

90. On 27 May 2011, the Tribunal issued a Supplemental Decision on Provisional Measures (the "Supplemental Decision on Provisional Measures") in which it confirmed its Decision on Provisional Measures, with certain amendments. Specifically, the Tribunal recommended that the Respondent inform the Claimants, with a copy to the Tribunal, if it intended to proceed with the seal or forced sale of the seized assets or take any other tax collection measure (including garnishments of bank accounts) that could have a similar effect, two months prior to the date in which it intends to implement such seal, sale or other measure, until this arbitration is completed or until reconsideration of the Supplemental Decision. The Tribunal also recommended that the Parties seek to reach an agreement on a mutually acceptable security or assurance to be provided by the Claimants and that, conditioned upon that agreement, the Respondent should lift the current garnishments over Starmill's accounts. The Tribunal denied the Claimants' request that the garnished accounts be replenished. Once again, the Tribunal invited either Party to apply to the Tribunal for a reconsideration of this Decision if it should consider that the circumstances under which this Decision was made changed (Supplemental Decision on Provisional Measures, ¶ 80).

91. On 5 July 2011, the Claimants informed the Tribunal of further enforcement actions taken by the Respondent with respect to the Claimants' assets, and requested the Tribunal to confirm that the Supplemental Decision on Provisional Measures covered all assets of the EFDG companies seized by the Respondent at any time until the completion of the arbitration. In a letter of 12 July 2011, the Respondent agreed with the Claimants' interpretation. By letter of 22 July 2011, the Tribunal confirmed that the parties' interpretation concerning the scope of the Supplemental Decision was correct.

92. On 13 September 2011, the Respondent notified the Tribunal and the Claimants that it intended to take enforcement measures with respect to three EFDG companies: European Food, European Drinks S.A. ("European Drinks") and Transilvania General Import Export SRL ("TGIE"). The enforcement measures consisted of the seizure of further movable and immovable property of the three companies and the garnishment of their bank accounts for approximately EUR 55 million. The Respondent advised that the seized property would remain in the companies' control, to be used in their

business. The Respondent attached the notices in respect of the enforcement measures to each of the three EFDG companies ("Garnishment Notices").

93. On 12 October 2011, the Respondent notified the Tribunal and the Claimants that, pursuant to Romanian tax law, two EFDG companies had been denied renewal of certain authorisations which enabled the companies to postpone the payment of customs and excise duties for goods imported into or manufactured in the EU if the goods were stored in "fiscal warehouses". The Respondent did not consider that the decisions to repeal and deny renewal of the authorisations were within the scope of the provisional measures recommended by the Tribunal, but advised that it would voluntarily refrain from giving effect to the decisions until two months from the date of their communication.

94. On 14 October 2011, the Claimants submitted an Emergency Supplement to their Application for Provisional Measures ("Claimants' Third Application"), seeking the following emergency interim relief:

   a. "preventing the Respondent from proceeding with the garnishments of the bank accounts of European Food, European Drinks and TGIE as set out in the [Garnishment] Notices;

   b. ordering the Respondent to refrain from garnishing the accounts of any other EFDC company until the Tribunal issues its Final Award (collectively, the 'Garnishment Application'); and

   c. ordering the Respondent to refrain from repealing the fiscal warehouse authorizations of European Food and Scandic Distilleries until the Parties have fully briefed that issue and the Tribunal issues a decision with respect to it ('Fiscal Warehouse Application').

   d. Insofar as any further briefing may be required on any of these issues or the Tribunal is not able to take up this application immediately, the Claimants further request that the Tribunal issue a temporary emergency order instructing the Respondent to refrain from the acts cited in the preceding paragraph until such time as the Tribunal is able rule upon this application."

95. The Claimants clarified that they "do not in this application request an order preventing the seizure orders as announced in the [Garnishment] Notices over additional assets up to an aggregate value of €55 million, provided that Romania continues to abide by the existing orders of the Tribunal regarding the seal and forced sale of those assets" (Claimants' Third Application, ¶ 25). The Claimants' Third Application was divided into two applications with separate briefing schedules: the Garnishment Application and the Fiscal Warehouse Application.

96. On 1 November 2011, the Claimants supplemented their Fiscal Warehouse Application, requesting the Tribunal to order the Respondent to refrain from repealing the fiscal warehouse authorizations until the final award.

97. The Parties and the Tribunal exchanged correspondence with respect to the briefing schedule and the timing of the enforcement measures. At the invitation of the Tribunal, the Respondent represented that the garnishments would not take effect before 25 November 2011, and that the decision regarding fiscal warehouse authorizations would not take effect before 12 December 2011 (Respondent's letter of 20 October 2011).

98. On 11 November 2011, in accordance with the agreed briefing schedule, the Respondent submitted its observations on the Claimants' Garnishment Application. On 16 November 2011, the Claimants wrote to rebut certain allegations made by the Respondent with respect to the Garnishment Application, and offered to produce the documentation supporting these allegations at the Tribunal's request. On 18 November 2011, the Tribunal requested the Claimants to produce such supporting documentation and also invited the Respondent to submit any documentation it deemed relevant. The Claimants produced the requested documentation to the Tribunal on 21 November 2011.

99. On 22 November 2011, the Respondent submitted its comments on the Claimants' letter of 16 November 2011, requesting the Tribunal to dismiss the Claimants' Garnishment Application.

100. On 23 November 2011, the Tribunal issued the following temporary order concerning the Claimants' Garnishment Application (the "Temporary Order on Garnishment"):

> 5.1. The Claimants' request for a temporary emergency order is granted, until the Tribunal is able to issue its final recommendation with respect to the Claimants' Third Application in its entirety. Specifically, until the Tribunal is able to hand down its final recommendation,
>
> (i) the Respondent shall refrain from proceeding with the garnishments of the bank accounts of European Food, European Drinks and TGIE;
>
> (ii) the Respondent shall refrain from garnishing the accounts of any other EFDC company.

101. Following a further exchange of correspondence (Respondent's letters of 29 and 30 November and 8 December 2011, and Claimants' letter of 5 December 2011) on the Garnishment and Fiscal Warehouse Applications, on 16 December 2011 the Tribunal issued a Third Decision on Provisional Measures ("Third Decision"). The Tribunal made the following recommendations (Third Decision, ¶ 109):

a. "The Respondent shall refrain from proceeding with the garnishments of the bank accounts of European Food, European Drinks and TGIE as set out in the [Garnishment] Notices.

b. The Respondent shall refrain from repealing the fiscal warehouse authorizations of European Food and Scandic Distilleries until the Tribunal issues its Final Award.

c. The Tribunal otherwise confirms its (First) Decision on Provisional Measures of 2 March 2011. Accordingly, the Respondent shall inform the Claimants, with a copy to the Tribunal, if it intends to proceed with the seal or forced sale of the seized assets or take any other tax collection measure (including garnishments of bank accounts) that could have a similar effect, two months prior to the date in which it intends to implement such seal, sale or other measure, until this arbitration is completed or this Decision is reconsidered.

d. The Parties shall continue to seek to reach an agreement on a mutually acceptable security or assurance to be provided by the Claimants.

e. If either Party considers that the circumstances under which this Decision is made have changed, either Party may apply to the Tribunal for reconsideration of this Decision.

f. The other prayers are dismissed.

g. Costs are reserved for a later decision or award."

102. The Tribunal noted in its Third Decision that no additional security had been provided by the Claimants in respect of the lifting of the garnishment on Starmill's accounts, a condition that was imposed by the Tribunal in its Supplemental Decision. It did, however, note that the Micula brothers made a good faith offer of certain properties to satisfy their debts, and requested that the Claimants submit a formal valuation of these properties as soon as it was finalized. Although the Tribunal granted the Claimants' Garnishment Application, it repeated that it expected the Claimants to supply some form of security and recommended that the Parties continue to seek to reach an agreement on a mutually acceptable security or assurance.

103. On 14 March 2012, the Respondent asked the Claimants to produce the valuation report pursuant to the Tribunal's instructions in the Third Decision. On 30 March 2012, the Respondent repeated its request. Following further exchanges of correspondence (Claimants' letters of 17 April, 7 June and 11 July 2012 and Respondent's letters of 18 May, 21 June, 19 and 20 July 2012), the parties failed to reach a mutual agreement on security to be provided by the Claimants.

104. On 1 August 2012, the Respondent filed an Application to Revoke Provisional Measures ("Respondent's Revocation Application") seeking the revocation of the provisional measures recommended by the Tribunal, or, in the alternative, the suspension of the provisional measures until the Claimants had posted security adequate to protect the Respondent's right to collect taxes owed by the eleven EFDG companies. The Respondent also requested that the Tribunal's Award provide that any amount awarded to any of the Claimants (whether as damages or costs) be subject to set-off against the EFDG companies' tax debts, including lawful interest and penalties. At the Tribunal's invitation, the Parties consulted and agreed on a briefing schedule to submit their comments on the Respondent's Revocation Application. The Parties informed the Tribunal of this briefing schedule on 17 August 2012.

105. On 28 September 2012, the Claimants submitted their observations on Respondent's Revocation Application. The Claimants opposed the Respondent's Application in its entirety and requested that the provisional measures remain in force until the date of the Award. In addition, the Claimants made three requests of their own: (i) that the Award provide that the Respondent be enjoined from any further tax collection measures until full payment of any damages awarded to the Claimants by the Tribunal, (ii) that the Tribunal declare that the Respondent cannot set-off tax debts as requested, and (iii) that the Respondent is ordered to pay all the Claimants' costs in relation to Respondent's Application.

106. On 8 October 2012, the Respondent submitted a request for production of the valuation reports in regard to the properties which the Claimants had offered to the Respondent as payment in kind to extinguish their existing tax debts. On 18 October 2012, the Claimants opposed production of the valuation reports, stating that the arbitral proceedings were not the appropriate forum to negotiate the details of a proposed payment in kind and that they were prepared to make the reports available to the Romanian authorities in direct meetings.

107. On 30 October 2012, the Tribunal issued a Procedural Order in which it ordered the production of the valuation reports, if the Claimants confirmed that the relevant properties were offered as security for their tax debts owed to the Respondent, rather than as payment in kind. The Tribunal found that the reports were relevant and material to its assessment of the Claimants' good faith efforts to provide additional security to meet the requirement of proportionality, so that they were thus necessary for the determination of the Respondent's Revocation Application. On 9 November 2012, the Claimants confirmed that the properties were offered as payment in kind and not as security, but produced the valuation reports nonetheless. They also mentioned additional assets as potential security. Valuation reports concerning these additional assets were submitted on 23 November 2012.

108. On 21 December 2012, the Respondent filed its reply concerning its Revocation Application and, on 15 February 2013, the Claimants filed their rejoinder.

109. On 5 March 2013, the Claimants submitted their Fourth Application for Provisional Measures ("Claimants' Fourth Application"). The Claimants informed the Tribunal that, on 5 March 2013, Romania had seized brewery-related assets belonging to European Food and requested that the Tribunal order provisional relief to stop the seizure and forced execution of assets. The Claimants argued that the seizure violated the existing provisional measures because Romania had given no notice of the measures and planned a forced sale if the Claimants' tax debt was not paid within 15 days.

110. At the invitation of the Tribunal, the Respondent submitted its response to the Claimants' Fourth Application on 8 March 2013. It argued that the seizure of assets belonging to European Food did not constitute a violation of the provisional measures in place because no notice requirement applied to the seizure of assets and Romania did not intend to proceed with a forced sale of the assets. The Respondent

contended that the seizure was justified because of time limitations on debt collection efforts under Romanian law. The Parties filed further comments by letters of 14 March 2013 (Claimants) and 21 March 2013 (Respondent).

111. On 27 March 2013, the Tribunal issued its Fourth Decision on Provisional Measures ("Fourth Decision") concerning the Respondent's Revocation Application. The Tribunal concluded that the Claimants had made good faith attempts to reach an agreement with the Respondent regarding a mutually acceptable security and that the provisional measures preventing garnishment of the bank accounts of European Food, European Drinks and TGIE remained proportional. It further considered that the circumstances surrounding the fiscal warehouse authorizations had not changed to such an extent as to warrant the revocation, suspension or modification of the provisional measures in question. The Tribunal thus confirmed the existing provisional measures and dismissed Romania's request for revocation or suspension of those measures (Fourth Decision, ¶ 119). It further ruled that the Claimants' request for post-award injunctive relief concerning Romania's tax debt collection measures, as well as the Parties' requests with respect to the set-off of tax debts against a pecuniary award in favor of the Claimants, would be deferred for determination in the Award.[2]

112. On 5 April 2013, the Tribunal issued its Fifth Decision on Provisional Measures ("Fifth Decision") concerning Claimants' Fourth Application. The Tribunal found that the mere seizure of assets without providing any notice that did not prevent the Claimants from continuing to use those assets did not, in and of itself, violate the provisional measures recommended by the Tribunal. The Tribunal thus dismissed Claimants' Fourth Application and all other prayers for relief (Fifth Decision, ¶ 39). The Tribunal also urged the parties to continue seeking a mutually acceptable agreement on security, as previously recommended (Fifth Decision, ¶ 38).

b. The Claimants' Renewed Application for a Site Visit

113. On 9 December 2010, the Claimants submitted a renewed application for a site visit, specifying which allegations a site visit would help prove or disprove and commenting on the Tribunal's authority to order it. On 17 December 2010, the Respondent objected to Claimants' application, stating that a site visit was unnecessary and would be procedurally unfair.

114. After careful consideration of each Party's position and a review of the evidence in the record, the Tribunal concluded that a site visit was neither necessary nor useful for the resolution of the dispute. Accordingly, by Procedural Order of 20 January 2011 the Tribunal denied the Claimants' application for a site visit. In that same Procedural Order, the Tribunal gave further directions to the Parties with respect to oral closing arguments.

---

[2] These matters are addressed in Section IX below.

c. The Claimants' Revised Request for Relief

115. On 20 December 2010, the Claimants submitted a revised request for relief (the "Revised Request for Relief").[3] On 10 January 2011, the Respondent objected to the procedural propriety and content of the Revised Request for Relief and requested that the Tribunal reject specific evidence. The Parties exchanged further submissions on this matter (Claimants' letters of 31 January 2011 and 9 February 2011, and the Respondent's letter of 2 February 2011).

116. The Tribunal ruled on this matter by means of a Procedural Order issued on 6 April 2011. With respect to the procedural propriety of the Revised Request for Relief, the Tribunal declined to reject any evidence submitted by the Claimants, but found that the Claimants' reliance on certain quantum experts was new, and thus invited the Respondent to rebut these testimonies in writing or by further examination of those experts.

117. The Tribunal also found that there had been no prejudice to the Respondent as a result of the reformulation of the Claimants' expropriation case or of their claim for interest. However, it found that the Claimants' request that any damages be awarded to the Individual Claimants on a 50/50 basis, and in the alternative that any damages be awarded to all five Claimants, was a reformulation of the Claimants' case that raised several issues of procedure and merits. The Tribunal also requested the Parties to address the merits of the Claimants' damages case in their post-hearing briefs and gave further directions with respect to briefing. The Tribunal also noted that the Claimants' reformulation of their damages case could affect the procedural schedule for closing arguments. It thus invited the Claimants to confirm if they wished to maintain their request for an award of damages to be distributed to the Individual Claimants on a 50/50 basis. The Claimants provided this confirmation on 15 April 2011.

d. Post-hearing briefs and oral closing arguments

118. The Tribunal's Procedural Order of 25 November 2010 provided that the Parties would present oral closing arguments, setting as a tentative date 1-2 March 2011. It also provided that the Parties could submit voluntary post-hearing briefs.

119. On 25 January 2011, the Respondent informed the Tribunal that its Romanian counsel would not be available for a hearing on 1-2 March 2011. After consulting with the Parties, on 3 February 2011 the Tribunal determined that the hearing for the Parties' closing arguments would take place on 6 and 7 June 2011.

120. As mentioned in paragraph 116 above, on 6 April 2011 the Tribunal issued a Procedural Order that ruled on the Claimants' Revised Request for Relief and gave directions to the Parties with respect to further briefing. Following the Claimants' confirmation that they wished to maintain their reformulated damages case, at the

[3] The Claimants' Revised Request for Relief is addressed in more detail in Sections IV.A and VII.A.1 below.

Tribunal's invitation the Parties consulted on the next procedural steps. On 4 May 2011 they informed the Tribunal that they had reached an agreement with respect to post-hearing briefs, additional submissions on damages, the hearing schedule and cross-examination of experts.

121. On 12 April 2011, the Respondent requested leave to submit three new fact exhibits. After hearing both Parties' positions, on 29 April 2011 the Tribunal determined that the record was sufficiently complete on the subject matters of those documents insofar as such matters were relevant to the outcome of the dispute, and denied the Respondent's request.

122. On 6 May 2011, in accordance with its Procedural Order of 25 November 2010, the Tribunal submitted to the Parties a list of questions to be addressed in their closing arguments.

123. On 13 May 2011, the Parties submitted their written post-hearing briefs. On 27 May 2011, the Respondent submitted an additional submission with respect to the Claimants' Revised Request for Relief in accordance with the Tribunal's Procedural Order of 6 April 2011.

124. On 6 and 7 June 2011, the Parties and the Tribunal held a hearing in Paris. During the course of the hearing, the Parties presented their oral closing arguments and responded to questions from the Tribunal. The Tribunal was addressed by Messrs. Fleuriet, Gaillard, Reed and Schwartz, on behalf of the Claimants, and by Messrs. King, Petrochilos and Rubins, on behalf of the Respondent.

125. The following persons participated in the hearing:

<u>On behalf of Mr. Ioan Micula and the Corporate Claimants</u>:

Mr. Eric Schwartz	King & Spalding
Mr. Ken Fleuriet	King & Spalding
Mr. Ric Toher	King & Spalding
Ms. Amy R. Frey	King & Spalding
Mr. Ioan Micula	Claimant
Ms. Nathalie Micula	Representative for Ioan Micula, European Food, Starmill, and Multipack
Ms. Olivia Micula	Representative for Ioan Micula, European Food, Starmill, and Multipack
Ms. Dorin Floruta	Representative for Ioan Micula, European Food, Starmill, and Multipack
Mr. Vasile Popa-Bota	Representative for Ioan Micula, European Food, Starmill, and Multipack
Mr. Mircea Halbac	Representative for Ioan Micula, European Food, Starmill, and Multipack
Mrs. Oana Popa	Representative for Ioan Micula, European Food, Starmill, and Multipack

Mr. Ciprian Popa	Representative for Ioan Micula, European Food, Starmill, and Multipack

On behalf of Mr. Viorel Micula:

Prof. Emmanuel Gaillard	Shearman & Sterling
Mr. David Reed	Shearman & Sterling
Mr. Robert Williams	Shearman & Sterling
Ms. Veronika Korom	Shearman & Sterling
Mr. Richard Kiveal	Shearman & Sterling
Ms. Gresa Matoshi	Shearman & Sterling
Mr. Viorel Micula	Claimant
Ms. Doina Micula	Representing Mr Viorel Micula
Mr. Victor Micula	Representing Mr Viorel Micula
Ms. Ioana Aron Blahuta	Representing Mr Viorel Micula
Ms. Medora Purle	Representing Mr Viorel Micula
Mr. Calin Vidican	Representing Mr Viorel Micula
Mr. Cristian Flora	Representing Mr Viorel Micula
Ms. Eva Fogarassy	Representing Mr Viorel Micula

On behalf of the Respondent:

Ms. Georgeta Harapcea	Nestor Nestor Diculescu Kingston Petersen
Mr. D. Brian King	Freshfields Bruckhaus Deringer LLP
Mr. Georgios Petrochilos	Freshfields Bruckhaus Deringer LLP
Mr. Boris Kasolowsky	Freshfields Bruckhaus Deringer LLP
Mr. Noah Rubins	Freshfields Bruckhaus Deringer LLP
Mr. Jonathan J. Gass	Freshfields Bruckhaus Deringer LLP
Mr. Ben Juratowitch	Freshfields Bruckhaus Deringer LLP
Mr. Sami Tannous	Freshfields Bruckhaus Deringer LLP
Ms. Evgeniya Rubinina	Freshfields Bruckhaus Deringer LLP
Mr. Moritz Keller	Freshfields Bruckhaus Deringer LLP
Ms. Smaranda Miron	Freshfields Bruckhaus Deringer LLP
Mr. Tunde Oyewole	Freshfields Bruckhaus Deringer LLP
Mr. Ignacio Stratta	Freshfields Bruckhaus Deringer LLP
Ms. Kate Bousfield	Freshfields Bruckhaus Deringer LLP
Mr. Nishad Morjaria	KPMG

126. A transcript of the hearing was distributed among the Parties.

e. Closure of the Proceeding and Submissions on Costs

127. On 14 June 2013, in accordance with ICSID Arbitration Rule 28(2), the Tribunal invited the Parties to file statements of costs by 12 July 2013, and their comments on the other Parties' statements of costs by 2 August 2013. The Parties were given the opportunity to inform the Tribunal if they saw a need for submissions on costs, rather than statements. By the same letter, the Tribunal declared the proceeding closed

pursuant to Rule 38(1) of the ICSID Arbitration Rules. The Parties subsequently agreed that they would file submissions on costs, but that they would not file any reply submissions.

128. On 19 July 2013, the Parties submitted their respective submission of costs, each requesting an award requiring the other party to bear the entirety of the expenses incurred by the parties, the fees and expenses of the members of the Tribunal, and the charges for the use of ICSID's facilities. The Claimants also requested compound interest on a costs award. The Claimants' submission was accompanied by an Annex and Exhibits C-1035 to C-1044. The Respondent's submission was accompanied by two declarations of co-counsel Nestor Nestor Diculescu Kingston Petersen and Freshfields Bruckhaus Deringer LLP, Exhibits R-245 to R-268 and Legal Authorities RL-375 and RL-376.

129. On 7 October 2013, the period of 120 days for the rendering of the award was extended pursuant to Rule 46 of the Arbitration Rules.

III. FACTUAL BACKGROUND

A. OVERVIEW

130. The present dispute arises from Romania's introduction of certain economic incentives for the development of disfavored regions of Romania, and their subsequent revocation in the context of Romania's accession to the European Union ("EU").

131. Specifically, in 1998, Romania enacted Emergency Government Ordinance 24/1998 ("EGO 24/1998" or "EGO 24"), which made available certain tax incentives, including customs duties exemptions (called alternatively by the Parties the "Incentives" or the "Facilities"), to investors in certain disfavored regions who met the requirements set out in EGO 24/1998 and its implementing legislation. The Claimants claim that, in reliance on those incentives, and in reliance on the expectation that they would be maintained for a 10-year period, they made substantial investments in the Ştei-Nucet-Drăgăneşti disfavored region located in Bihor County, northwestern Romania. The Claimants further claim that Romania's revocation of these incentives (effective 22 February 2005) was in breach of its obligations under the BIT and caused damages to the Claimants, as described further below.

132. Romania does not dispute that in 1998 it passed EGO 24, which offered tax incentives to investors investing in disfavored regions, nor does it dispute that, effective 22 February 2005, it repealed most of the tax incentives offered under EGO 24, with the exception of a profit tax incentive. However, it denies that this revocation breached any of its obligations under the BIT. In addition, it argues that this revocation was necessary to comply with EU state aid obligations, which in turn was necessary for Romania to complete its accession to the EU.

133. The Claimants began to invest in Romania in 1991, and continued investing throughout the next two decades. During this time, Romania was undergoing its economic transition from communism to a market economy. As stated by the Respondent, during this time "the factual record [...] portrays a government trying to pursue two policies that came into increasing conflict" (R-Rejoinder, ¶ 103): one directed to the development of its disfavored regions, and another directed to obtaining accession to the EU.

134. There are, therefore, three main areas of factual inquiry for the Tribunal: the evolution of Romania's policy for the development of disfavored areas, the history of the Claimants' investments, and Romania's EU accession process.

135. The Tribunal will first describe the evolution of Romania's policy for the development of disfavored areas, in particular the EGO 24 framework, up to the point at which the Claimants allege that they began investing in reliance on it (Section B). The Tribunal will then describe the Claimants' investments (Section C). It will then describe the main facts surrounding Romania's accession process, together with related events affecting the EGO 24 framework as that process developed (Section D).

136. Sections B, C and D are meant to give a general overview of the facts of the present dispute. They do not include all factual aspects which may be of relevance, particularly as they emerged from the extensive testimony of witnesses and experts at the hearing. The latter, as far as is relevant, will be discussed in the context of the Tribunal's analysis of the disputed issues.

B. LEGAL FRAMEWORK FOR THE DISFAVORED REGIONS

1. Romania's efforts to attract investment in the early 1990s

137. As noted by the European Commission in a 1997 report, "[a]fter the overthrow of the Ceausescu regime in December 1989, Romania found itself in a deep economic and social crisis" (Exh. C-317). This was followed by several years of reforms directed at transforming Romania into a market economy with the ultimate objective of obtaining EU accession.

138. In this context, Romania undertook serious efforts to attract investment, both foreign and domestic. On 14 March 1990, Romania issued Decree Law 96/1990, entitled "on certain measures for the attraction of foreign capital investment in Romania" (Exh. R-134), which contained provisions regulating foreign investment in Romania and granted foreign investors certain tax benefits.

139. This Decree Law was replaced a year later by Law 35/1991 on foreign investment ("Law 35", enacted on 3 April 1991 and effective 10 April 1991, Exh. C-275). To "induce foreign investment in Romania", this law offered the following incentives for new investments made by foreign investors [later amended to include domestic investors] (Arts. 12-15):

a. An exemption from customs duties related to certain types of imported machinery, equipment and means of transportation;

b. A two-year exemption from customs duties on imported raw materials;

c. A profit-tax exemption ranging from 2 to 5 years, depending on the type of investment; and

d. A profit-tax reduction for certain investments following the expiration of the profit-tax exemption.

140. On 5 August 1996, Romania passed Government Ordinance No. 27/1996 ("GO 27/1996", Exh. C-276), which offered certain benefits to individuals domiciled or working in some localities from the Apuseni Mountains and the Biosphere Reserve (also known as "the Danube Delta"). These benefits included a corporate profit tax incentive for investors ranging from 5 to 10 years, depending on the location of the investment.

141. In the following years, Romania began serious efforts to promote regional development, which was identified as "one of the essential elements of the general

strategy reform of Romania" in Romania's Government Program for 1998-2000. One of the objectives of this regional development was "[s]trengthening the ability of Romania to undertake responsibilities as a future member of the European Union." The program also stated that the Government defined a minimum set of priorities, "achievement of which is in full compliance with the criteria and objectives of the National Program on the Accession of Romania to the European Union." (Annex 2 to Government Decision 6 issued 15 April 1998, Exh. C-567).

142. In this context, on 16 July 1998, Romania passed Law 151/1998 on Regional Development (the "Regional Development Law", Exh. C-392). Among its objectives was the "diminution of existing regional imbalances by stimulation of a balanced development, by accelerated recovery of delays in the development of deprived zones as a result of some historical, geographic, economic, social, and political conditions, and prevention of the production of new imbalances." (Art. 1(a)). The methodological norms issued for Law 151 (Exh. C-392) stated that the objective of regional development was the improvement of the economic performance of certain development regions, and that such objective had the support of the Government and the EU (Art. 1).

143. The Regional Development Law divided the country into 8 development regions. The area in which the Claimants invested (the Ştei-Nucet-Drăgăneşti region in Bihor County) is located in the North West Regional Development Area, and was managed by the NW-Regional Development Agency (NW-RDA). A key objective of the NW-RDA was to "increase[e] the living standard and long-lasting social-economic development of the region within a European context", by *inter alia* increasing the attractiveness of the region, establishing a business environment and promoting long-lasting development (Exh. C-393, Section III.2).

144. At the time of these reforms, unemployment levels in Bihor County were high. In its effort to restructure the mining industry, between 1997 and 2005 the Romanian government closed down over 500 uneconomic mines. By the end of 1998, approximately 100,000 miners were out of work. Unemployment was felt strongly in Bihor County, which had been dependent on mining for many years (Exh. C-319, C-320, C-321, C-325, C-566).

2. EGO 24/1998

145. It was in this context that on 30 September 1998 (effective 2 October 1998), Romania adopted Emergency Government Ordinance No. 24/1998 ("EGO 24/1998" or "EGO 24", Exh. R-5 or C-38). EGO 24/1998 established the legislative framework for the granting of certain incentives to investors investing in certain "disfavored" regions.

146. EGO 24/1998 was subsequently approved and amended by Law No. 20/1999 of 15 January 1999 (effective 19 January 1999) (Exh. C-39), and a renumbered version containing the amendments made by Law 20 was republished on 8 November 1999 (Exh. R-68). It is on this republished version that the Claimants claim they relied. As

a result, for the sake of simplicity, henceforth all references to EGO 24/1998 will refer to its reformulated version republished on 8 November 1999 (Exh. R-68).

147. EGO 24/1998 provided that the Government could declare the creation of certain "disadvantaged areas", in response to proposals of the National Council for Regional Development (Art. 3). This declaration would be done by means of a "government decision", which would also approve (a) the period for which a geographical area would be declared a disadvantaged region, (b) the fields of interest for investments, and (c) "the required financing and advantages provided by law, and granted to the investors" (Art. 4). Article 5 provided that "[a] geographical area may be declared a disadvantaged area for a period of at least 3 years, but for not more than 10 years, with possibility for extension, under the conditions of this Emergency Ordinance."

148. Article 6(1) went on to say that investors meeting certain requirements "will be granted the following advantages for their new investments in these regions", and proceeded to list the incentives:

> Art. 6. - (1) Privately held companies, Romanian legal entities, as well as small or family businesses, authorized pursuant to the Decree-Law no. 54/1990 concerning the organization and operation of free initiative-based economic activities that are headquartered and conduct business within the disadvantaged region, will be granted the following advantages for their new investments in these regions:
>
> (a) exemptions from payment of:
>
> - customs duties and value added tax on machinery, tools, installations, equipment, means of transportation, other goods subject to depreciation which are imported for the purpose of making investments in that region;
>
> - value added tax on machinery, tools, installations, equipment, means of transportation, other goods subject to depreciation manufactured domestically with the purpose of making investments in that region;
>
> [the "***Machinery Incentive***" or "***Machinery Facility***"]
>
> (b) refunds of customs duties on raw materials, spare parts and/or components necessary for achieving the investor's own production in that region. The refunds will be made based on the approval by the regional development agencies of the companies' production sales documents. The funds necessary for the refund of the customs duties will be provided to the Agency for Regional Development from the Regional Development Fund. In case [of] unprivileged regions belonging to two or more administrative-territorial units, the funds necessary for the refund of the customs duties will be provided by the National Agency for Regional Development from the National Development Fund [the "***Raw Materials Incentive***" or "***Raw Materials Facility***"];
>
> (c) exemptions from payment of the profit tax during the existence of the disadvantaged region [the "***Profit Tax Incentive***" or "***Profit Tax Facility***"];

(d) exemptions from payment of the taxes collected for the changes of the destination of the land or for the removal from the agricultural use of some plots of land that had been earmarked for the fulfillment of the investment [the "***Agricultural Land Incentive***" or "***Agricultural Land Facility***"][;]

(e) preferred payments from the Special Development Fund of the Romanian Government, which was established pursuant to the Emergency Government Ordinance no. 59/1997 concerning the purpose of the funds collected by the State Property Fund during the privatization process of the companies where the State is a shareholder, with the purpose of:

- encouraging the exports of the final products and/or for the industrial services, as the case may be;

- guaranteeing external credits, within the annual limit set by the Ministry of Finance;

- financing special programs, approved by Government Decision;

- financing investment projects for companies through the state's participation in the share capital.

[the "***Subsidies***"]

2) The advantages and the financing stipulated in paragraph (1) letter e) is established through a Government Decision.

149. Article 8 provided the requirements for investors to qualify for the incentives: "[t]he advantages stipulated in the present Emergency Ordinance are granted to businesses, privately held Romanian legal entities, as well as to small and family businesses, authorized according to Decree-Law No. 54/1990, who have their headquarters and conduct business in this area, if the investment made yields new jobs for the unemployed or for their family members who live in the disadvantaged area."

150. Articles 7 and 9 set out investors' obligation to stay in the disadvantaged area for twice the period they received the incentives, as follows:

> Art. 7. - If an investment which is benefiting from the provisions of the present Emergency Ordinance is ***voluntarily liquidated in a period of time shorter than twice the period of time in which they enjoyed the advantages*** granted through the Government Decision to create the underprivileged area, ***the liquidator(s) is/are obligated first to pay the funds related to the advantages*** granted in accordance with the provisions of the present Emergency Ordinance, to the State Budget, the State Social Insurance Budget and the Special Funds Budgets from the funds resulting from the liquidation procedure.
>
> […]
>
> Art. 9. - Businesses established in a disadvantaged area ***may voluntarily cease to operate in the respective area***, and those opening subsidiaries as legal entities in such an area may ***close them or move the location of their headquarters out of the disadvantaged area in a period shorter than the one provided in Art. 7 only if they pay the funds they owe*** to

the State Budget, the State Social Insurance Budget and the Special Funds Budgets ***related to the advantages granted*** in accordance with the provisions of the present Emergency Ordinance.

151. Finally, Article 15 provided that "the Government will approve, through a decision, the methodological standards to be used for the implementation of this Emergency Ordinance."

3. Government Decision 194/1999 and the 1999 Methodological Norms

152. By means of Government Decision 194/1999, dated 25 March 1999 (Exh. C-31, also C-280), Romania designated the Ştei-Nucet region as a disfavored region for a period of ten years, starting on 1 April 1999. The Ştei-Nucet region is located in Bihor County in the northwestern part of Romania, and its primary industry at the time was the mining and oil industry. GD 194/1999 also stipulated that all six incentives offered under EGO 24/1998 would be available to investors in the Ştei-Nucet region while that region was designated disfavored, and set out the types of investments that could benefit from the incentives. Specifically, GD 194/1999 provided:

> Art. 1. - The mining area of Ştei-Nucet, Bihor county, is established as a disfavoured region.
>
> Art. 2. - The geographical boundaries of the mining area of Ştei-Nucet, Bihor county are represented by Ştei and Nucet, as administrative-territorial units having a surface of 4,678 ha, according to annex no. 1.
>
> Art. 3. - The mining area referred to in art. 1 will be established as a disfavoured region for a period of 10 years.
>
> Art. 4. - During the existence of the disfavoured region, established according to this decision, the facilities under annex no. 2*) ***will be granted***. ["se acordă" in the Romanian original]

153. In turn, Annex 2 of GD 194/1999 listed all of the incentives provided under Article 6(1) of EGO 24, with slightly amended language. Specifically, it stated:

> Companies the majority of the share capital of which is privately owned, Romanian legal entities, as well as the private investors or family associations authorized pursuant to the "Decree-Law no. 54/1990 on the organization and operation of economic activities based on free initiative" that were set up after the date of establishment of the disfavoured region and have their registered seat and operate in the disfavoured region, will be granted the following facilities for new investments in these regions:
>
> (a) an exemption from payment of:
>
> - custom duties and value added tax on machinery, tools, installations, equipment, means of transportation, other goods subject to depreciation which are imported with a view to performing and conducting investments in that region;
>
> - value added tax on machinery, tools, installations, equipment, means of transportation, other goods subject to depreciation manufactured in the country with a view to performing and conducting investments in that region;

(b) refund of custom duties on raw materials, spare parts and/or components necessary for achieving the investor's own production in that region;

(c) an exemption from payment of profit tax during the existence of the disfavoured region;

(d) an exemption from payment of taxes collected for changes in the nature of land or for conversion of agricultural plots of land into industrial land for the implementation of the investment;

(e) preferred payment of amounts available from the Special Development Fund at the disposal of the Romanian Government that was established pursuant to the "Emergency Government Ordinance no. 59/1997 on the amounts collected by the State Property Fund during the privatization process of the companies in which the State is shareholder" to - encourage the export activities for the final products and/or for the industrial services, as the case may be;

- guarantee the external credits within the annual limit set by the Ministry of Finance;

- finance special programs approved by Government Decision;

- finance investment projects for companies through the state's participation in the share capital.

154. On 29 June 1999, Romania issued Government Decision No. 525/1999, which set out the methodological norms for the application of EGO 24/1998 (the "1999 Methodological Norms", Exh. R-6). (The 1999 Methodological Norms repealed a previous version issued in December 1998 which has not been relied upon in this arbitration).

155. With respect to the requirements for granting the incentives, Article 5 of the 1999 Methodological Norms provided:

(1) The incentives provided by the law ***shall be granted*** [in Romanian, "se acorda"] pursuant to the certificate of investor in a disfavored area, which is issued, upon the business entity's request, by the Regional Development Agency under the jurisdiction of which the head office of such business entity is located.

[…]

(3) Business entities requesting the issuance of the certificate of investor in a disfavored area shall prove they meet the requirements set forth by the [EGO].

(4) Emerging business entities, unable to produce evidence regarding the investment, the commissioning of the operations and the creation of new jobs, may request the issuance of a temporary certificate of investor in a disfavored area, for a maximum of 3 months. In case they do not bring, during this period, evidence of having met the requirements set forth by the [EGO], they shall be compelled to pay and return, respectively the equivalent value of all the incentives they have benefited of.

(5) The temporary certificate shall be issued pursuant to the business entity's commitment regarding the investment and the creation of new jobs.

[…]

C. THE CLAIMANTS' INVESTMENTS

156. The Individual Claimants claim to be the majority shareholders of a group of companies (the European Food and Drinks Group or "EFDG") engaged in food and beverage production in the disfavored region of Ştei-Nucet-Drăgăneşti, Bihor County. The Corporate Claimants (European Food, Starmill and Multipack) are part of the EFDG, and are thus owned directly or indirectly by the Individual Claimants.

157. The evolution of the Claimants' investments can be separated in two phases: their initial investments (principally in the beverage production business), allegedly made in reliance on the incentive programs that predated EGO 24, and their investments (in the food and beverage production business), allegedly made in reliance on the EGO 24 incentives.

1. The Claimants' initial investments in reliance on previous incentive regimes

158. The Individual Claimants allege that their beverage business was initially developed in reliance on the incentive programs established by Law 35 and GO 27, predecessors to EGO 24. (C-Reply, ¶¶ 62-124; Third WS of I. Micula ¶¶ 10-27). Law 35 (C-275) was enacted in 1991 to attract foreign investors to Romania by offering the incentives for new investments, including customs duties and profit tax exemptions (see ¶ 139 above). GO 27/1996 (Exh. C-276) was enacted in 1996 to attract investments in Bihor County and other disadvantaged regions, and provided a corporate profit tax incentive ranging from 5 to 10 years, depending on the location of the investment (see ¶ 140 above).

159. The Claimants claim that these incentives allowed them to produce a wide variety of beverages at a low cost. Law 35's encouragement of additional production activities and the Claimants' knowledge of advanced technologies enabled them to sell their beverages in a variety of different packages, including TetraPak and PET packaging. Capitalizing on this expertise, they began to produce intermediate products related to packaging (C-Reply, ¶¶ 81-96, Third WS of I. Micula, ¶¶ 10-24).

160. After the success of their initial investments, Messrs. Micula expanded their beverage production business, building what would become an integrated system of production companies. All of the core companies, with the exception of the Corporate Claimants and Scandic Distilleries, were established under Law 35 (C-Reply, ¶¶ 77, 81-96; Third WS of I. Micula, ¶ 29).[4]

[4] The record shows the following with respect to the Claimants' incorporation or participation in companies during this period (1991-1997):

161. The Claimants claim that their business model was premised on the existence and specific form of the incentives. Because an investor could benefit from Law 35 incentives each time he created a new company, the Law 35 incentives encouraged the establishment of an expanding group of companies. New companies, and thus the expansion of Claimants' production business, were planned and created to coincide with the expiration of the incentives for older companies. The new companies and investments were integrated into the existing companies and investments, so that all companies functioned cooperatively to create, manufacture, package, and distribute products efficiently (C-Reply, ¶¶ 77-80; Third WS of I. Micula, ¶¶ 26-27; WS of M. Ban, ¶ 27).

162. The Claimants allege that this integration allowed them to realize an increased level of profit. They also state that profits were consistently re-invested to support the expansion of the business and to take advantage of the tax profit exemption under Law 35. Moreover, the raw materials customs duty exemption in Law 35 encouraged production activities, because it only applied to raw materials used to produce new end-products. It thus encouraged a proliferation of businesses that worked together to produce a variety of products, and provided a competitive advantage because the incentives allowed the companies to keep product prices low (C-Reply, ¶¶ 80-81, Third WS of I. Micula, ¶ 25).

163. The Claimants claim that they were able to successfully expand their production activities by using savings from the incentives programs and their profits, which they consistently reinvested in the business. The Claimants claim that they followed this approach throughout the years: using the realized savings during the time in which the incentives were offered to reinvest and build facilities that were functional and profit-producing by the time the incentives expired. (C-Reply, ¶ 96).

---

a. On 19 October 1990, Messrs. Micula allegedly incorporated the Romanian company Transilvania General Import Export S.R.L ("TGIE") (Claimants' "Correct Timeline of Messrs. Micula's Investments", C-Reply at page 25). The Claimants allege that this company was set up to benefit from Law 35/1991, as it was originally set up for the five years for which Law 35 granted corporate profit tax exemptions (C-Reply, Note 102). The Tribunal notes however that Law 35 was enacted after TGIE's stated date of incorporation, so it understands the Claimants to be saying that TGIE was established to benefit from the earlier Decree Law 96/1990, which was later replaced by Law 35. That being said, the Tribunal also notes that, according to the information provided by the Bihor Trade Register Office (Exh. R-60) and TGIE's 1993 Fiscal Report (Exh. C-356), TGIE was assigned its trade register reference number in May 1991. TGIE's date of incorporation is therefore not established with certainty.

b. From June 1993 to April 1995, Messrs. Micula incorporated or acquired an interest in ten Romanian companies, including European Drinks S.A. and Rieni Drinks S.A. (Claimants' "Correct Timeline of Messrs. Micula's Investments", C-Reply at page 25; R-CM, Figure 1, p. 7; Exh. R-60 and R-61).

c. From November 1996 to July 1998, the Claimants incorporated or acquired an interest in three additional Romanian companies (Claimants' "Correct Timeline of Messrs. Micula's Investments", C-Reply at page 25; R-CM, Figure 1, p. 7; Exh. R-60 and R-61.)

d. On 8 July 1997, the Claimants, through their company Edri Trading SRL purchased shares in SC Ipic Bucaresti S.A., a previously state-owned company which owned 88,000 square meters of land in Bucharest (Third WS of I. Micula, ¶¶ 31-36; Tr., Day 2, 211, Day 3, 133,141,145-150 (I.Micula); Exh. C-346; C-439).

164. In turn, the GO 27 incentives motivated the Claimants to relocate certain projects to Drăgăneşti (in the Apuseni region of Bihor County, which was expressly covered by GO 27). In particular, the Miculas relocated the distillery for what would eventually become Scandic Distilleries from the Madaras region to Drăgăneşti (C-Reply, ¶¶ 105-110). Other companies developed new projects in Bihor County to realize GO 27 benefits (C-Reply, ¶¶ 111-118).

165. The Claimants claim that their beverage business was very successful. By 2001, they state that European Drinks held an estimated 55% of the total carbonated drink market in Romania and a 51% share of the bottled mineral water market (C-Reply, ¶ 87).

2. The Claimants' investments in reliance on the EGO 24 incentives

166. After Romania's introduction of the EGO 24 incentives, the Claimants allege that they built a large, highly integrated food production platform in reliance on these incentives, in particular the Raw Materials Incentive. The Respondent disputes this reliance, the Claimants' description of their business plan and the Claimants' intention to build certain parts of the platform.

167. Specifically, the Claimants allege that, starting in 1998, they expanded their business under a ten-year plan to capitalize on the EGO 24 incentives with the objective of building an integrated food platform, incorporating several companies in the process.[5] In 1999 they incorporated European Food (Claimant 3), which as explained below was the first Corporate Claimant to benefit from the EGO 24 program (see paragraph 174 below). The Claimants state that they imported the majority of their raw material products through European Food, which brought them customs duties savings and allowed them to pursue a two-phase expansion plan (C-Reply, ¶¶ 161-170).

168. The <u>first phase</u> consisted in production of fast-moving consumer products new to the Romanian market, which had significant market potential and would generate quick

---

[5] The record shows the following with respect to the Claimants' incorporation or participation in companies during this period (1998-2007):

a. From June 1998 to December 1999, Messrs. Micula incorporated or acquired an interest in 23 Romanian companies, including S.C. European Food S.A., which was established as a Romanian joint stock company in Ştei, Bihor county on 30 November 1999 (Exh. HEC-1).

b. During 2000, Messrs. Micula incorporated or acquired an interest in five other Romanian companies ("Correct Timeline of Messrs. Micula's Investments", C-Reply at page 25), including Scandic Distilleries S.A., which was incorporated on 20 January 2000 (Exh. R-60).

c. During 2001, Messrs. Micula incorporated or acquired an interest in 3 Romanian companies ("Correct Timeline of Messrs. Micula's Investments", C-Reply at page 25; Exh. R-60).

d. During 2002, Messrs. Micula incorporated or acquired an interest in five Romanian companies, including S.C. Multipack S.R.L. and S.C. Starmill S.R.L., which were incorporated on 21 February 2002 ("Correct Timeline of Messrs. Micula's Investments", C-Reply at page 25; Exh. R-60).

e. During 2003 and 2004, Messrs. Micula incorporated or acquired an interest in four Romanian companies ("Correct Timeline of Messrs. Micula's Investments", C-Reply at page 25; Exh. R-60).

f. Between July 2005 and January 2007, Messrs. Micula incorporated or acquired an interest in three Romanian companies ("Correct Timeline of Messrs. Micula's Investments", C-Reply at page 25; Exh. R-60).

cash flow. Together with the incentive savings, this approach would allow the companies to integrate vertically and achieve economies of scale. The companies could thereby save on operational costs and minimize waste and energy consumption.

169. In this context, in February 2002 the Claimants incorporated Starmill and Multipack (Claimants 4 and 5):[6]

 a. Starmill was incorporated to establish integrated in-house grain milling facilities. It was designed to provide the milling capacity necessary for the planned brewery, but started as a corn mill which provided raw materials for the distillery. It was also responsible for the production of flour for several food products. According to the Claimants, through the use of the Raw Materials Incentive, Starmill would create cost efficiencies to help carry the businesses forward after the incentives expired. The Claimants claim that they made substantial investments for Starmill, including the purchase of land and construction (C-Reply, ¶¶ 197-200).

 b. Multipack was incorporated to carry out the packaging and labeling for nearly all of the companies' products. The Claimants also allege that it relied heavily on the Raw Materials Incentive, and required substantial investments and created over 200 new jobs (C-Reply, ¶¶ 201-204).

170. The <u>second phase</u> of the Claimants' alleged expansion plan was to build a brewery, the core capital expenditure for which would be funded by the profits from the other investments. According to the Claimants, the construction and integration of the brewery consisted of 4 components:

 a. A state-of-the-art brewery with an initial capacity for 2M hectoliters/year, expandable to 6M.

 b. A malt plant, which would reduce the cost of malt by in-house manufacture;

 c. A canning plant, which would reduce packaging costs;

 d. A co-generation plant, which would use the biomass by-products of the brewery and other food and beverage production, and would save costs and produce revenue through sales back to the state of excess electricity.

171. The Claimants allege that in 2001 they started construction of the brewery (component (a) of paragraph 170 above), which was integrated into the other facilities of the companies. The first phase of construction was completed in 2003 and the second in 2006. (C-Reply, ¶¶ 205-207).

172. The Claimants claim that they had plans to build the components identified in letters (b) through (d) of paragraph 170 above, but their completion was thwarted by cash-

[6] Starmill and Multipack were incorporated on 21 February 2002 ("Correct Timeline of Messrs. Micula's Investments", C-Reply at page 25; Exh. R-60).

constraints caused by the revocation of the incentives. The Claimants further claim that the construction of these components began prior to the revocation of the incentives, but that none of these components was ever completed. The Respondent disputes all of these assertions (*See* Section VII below on Damages).

3. Permanent Investor Certificates

173. In order to benefit from EGO 24, the Claimants allege that the three Corporate Claimants were required to obtain Permanent Investor Certificates ("PICs"), all of which were issued by the North-West Regional Development Agency. Prior to their issuance, the Claimants state that the Corporate Claimants could operate on the basis of a Temporary Investor Certificate ("TIC") for a period of 3 months (C-Reply, ¶¶ 156-160; WS of M. Ban, ¶¶ 41-46).

174. European Food (Claimant 3) obtained its Temporary Investor Certificate on 9 December 1999 (Exh. C-442). It was then issued PIC No. 524 on 1 June 2000 (Exh. C-42, Exh. C-638), which stated that European Food

> is the beneficiary of the facilities under Government Decision no. 194/1999, in accordance with the provisions of Emergency Government Ordinance no. 24/1998, republished and subsequently amended, and in accordance with the provisions of Government Decision no. 728/2001 on the approval of the methodological norms for the application of Emergency Government Ordinance no. 24/1998 on the disfavoured regions regime.
>
> The present certificate is valid until 01.04.2009.[7]

175. Starmill (Claimant 4) was issued PIC No. 1664 on 17 May 2002 (Exh. C-43), which stated that Starmill

> is the beneficiary of the facilities under Government Decision no. 194/1999, in accordance with the provisions of Emergency Government Ordinance no. 24/1998, approved and amended by Law no. 20/1999 and in accordance with the provisions of Government Decision no. 525/1999 on the approval of the methodological norms for application of Emergency Government Ordinance no. 24/1998 on the disfavoured regions regime.
>
> The present certificate is valid until 4/1/09

176. Multipack (Claimant 5) holds PIC No. 1663 issued on 17 May 2002 (Exh. C-44), which stated that Multipack

> is the beneficiary of the facilities under Government Decision no. 194/1999, in accordance with the provisions of Emergency Government Ordinance no. 24/1998, republished and subsequently amended, and in accordance with the provisions of Government Decision no. 728/2001 on the approval

[7] The Tribunal observes that this cannot have been the original PIC, because it includes a reference to the 2001 Methodological Norms, which had not been issued at the time. The original PIC appears to be at page 1 of Exh. C-638, which has not been translated. This version also appears to state that European Food is the beneficiary of the facilities under GD 194/1999, in accordance with the provisions of EGO 24. However, it does not say "republished and subsequently amended", but rather appears to say "approved and amended by Law 20/1999", and adds a reference to the 1999 Methodological Norms (GD 525/1999).

> of the methodological norms for application of Emergency Government Ordinance no. 24/1998 on the disfavoured regions regime.
>
> The present certificate is valid until 01.04.2009.

177. The legal nature and relevance of the PICs are disputed by the Parties.

D. ROMANIA'S ACCESSION PROCESS

178. In this section, the Tribunal will set out the chronology of events leading up to Romania's accession to the EU. One of the key areas of tension between Romania and the EU during this process was the alignment of Romania's competition policy and state aid laws with the *acquis communautaire* (hereinafter the "*acquis*"), namely the European body of law as it existed at a given time and resulting from, without limitation, legal acts, court decisions or Commission's ordinances. In this process, the incentives granted under the EGO 24 framework became increasingly relevant, and were finally repealed. As a result, the Tribunal will include in this chronology the developments relating to this framework.

1. Early steps: the Europe Agreement and Romania's application for EU membership

179. On 1 February 1993, Romania signed the Europe Agreement with the predecessor of the EU (the "European Community"[8]) and its Member States (Exh. R-10, C-565). The Europe Agreement, which was to enter into force on 1 February 1995, established an association between the European Community, its existing Member States and Romania and provided the legal framework for the accession process. Among its objectives was the promotion of Romania's economic development and its gradual integration into the European Community, in exchange for which Romania would have to work towards fulfilling certain conditions (Europe Agreement, Article 1).

180. The Europe Agreement covered many different areas of governance, including competition. With respect to state aid, Article 64 of the Europe Agreement provided:

> Article 64
>
> 1. The following are incompatible with the proper functioning of this Agreement, in so far as they may affect trade between the Community and Romania: [...] (iii) any public aid which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods.
>
> 2. Any practices contrary to this Article shall be assessed on the basis of criteria arising from the application of the rules of Articles 85, 86, and 92[9] of the Treaty establishing the European Economic Community.

---

[8] The Tribunal will use the term "European Community" to refer to the predecessor of the EU that signed the Europe Agreement, formed by the European Economic Community, the European Atomic Energy Community and the European Coal and Steel Community.

[9] Article 92 of the Treaty establishing the European Economic Community became Article 87 of the EC Treaty (Exh. RS-9; C-583), which provided:

3. The Association Council shall, within three years of the entry into force of the Agreement, adopt the necessary rules for the implementation of paragraphs 1 and 2.

4. (a) For the purposes of applying the provisions of paragraph 1, point (iii), the Parties recognize that during the first five years after the entry into force of the Agreement, any public aid granted by Romania shall be assessed taking into account the fact that Romania shall be regarded as an area identical to those areas of the Community described in Article 92(3)(a) of the Treaty establishing the European Economic Community. The Association Council shall, taking into account the economic situation of Romania, decide whether that period should be extended by further periods of five years. [...]

181. In turn, Article 87(3)(a) of the EC Treaty (which replaced Article 92(3)(a) of the Treaty establishing the European Economic Community) (Exh. RL-177; C-583) provided:

> The following may be considered to be compatible with the common market: (a) aid to promote the economic development of areas where the standard of living is abnormally low or where there is serious underemployment; […]

182. Another of the aims of the Europe Agreement was to promote economic cooperation between Romania and the EC Member States. In this context, Article 74 of the Europe Agreement on investment promotion and protection provided:

> Article 74 - Investment promotion and protection
>
> 1. Cooperation shall aim to establish a favourable climate for private investment, both domestic and foreign, which is essential to the economic and industrial reconstruction of Romania.
>
> 2. The particular aims of the cooperation shall be:
>
>   - for Romania to establish and improve a legal framework which favours and protects investment;
>
>   - the conclusion by the Member States and Romania of Agreements for the promotion and protection of investment [...]

183. In addition to establishing principles and rules of governance, the Europe Agreement provided that Romania would have to harmonize its existing and future legislation with that of the Community:

> Article 69 - The Parties recognize that an important condition for Romania's economic integration into the Community is the approximation of

---

1. Save as otherwise provided in this Treaty, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the common market.
2. The following shall be compatible with the common market:

[…]

3. The following may be considered to be compatible with the common market:

(a) aid to promote the economic development of areas where the standard of living is abnormally low or where there is serious underemployment; […]

> Romania's existing and future legislation to that of the Community. Romania shall endeavour to ensure that its legislation will be gradually made compatible with that of the Community.
>
> Article 70 - The approximation of laws shall extend to the following areas in particular: [...] rules on competition [...].

184. On 21-22 June 1993, the European Council concluded at its meeting in Copenhagen that countries from Central and Eastern Europe which wished to become members of the European Union would have to satisfy the economic and political conditions required for membership (known as the "Copenhagen criteria"), including "the existence of a functioning market economy as well as the capacity to cope with competitive pressure and market forces within the Union." The European Council also "underlined the importance of approximation of laws in the associated countries to those applicable in the Community, in the first instance with regard to distortion of competition [...]" (Exh. R-62).

185. On 1 February 1995, the Europe Agreement entered into force.

186. On 22 June 1995, Romania presented its application for EU membership. On 17 July 1995, Romania's application was submitted to the Commission, which pursuant to [the EC Treaty] was required to give a favorable opinion for accession negotiations to begin (Exh. C-317).

187. In its December 1995 meeting in Madrid, the European Council referred to the need, in the context of the pre-accession strategy, "to create the conditions for the gradual, harmonious integration of the applicant countries, particularly through: the development of the market economy, the adjustment of their administrative structure, [and] the creation of a stable economic and monetary environment" (Exh. C-317).

188. The European Commission, in an opinion dated 15 July 1997 (Exh. C-317), summarized the state of Romania's economy in 1995 as follows:

> Romania, with a population of 22.6 million, had in 1995 a gross domestic product (GDP) of ECU 93 billion (expressed in purchasing power parity); its population was about 6.5% of the Union's, while its economy was only about 1.5%. Per capita GDP is about 24% of the Union average.

189. On 10 April 1996 (effective 30 April 1996), Romania passed Law No. 21/1996 on competition (Exh. R-73). The purpose of this law was to "protect, sustain and stimulate competition and a normal competitive environment in order to promote the interests of consumers." This law created the Competition Office and the Competition Council, which were tasked with overseeing the implementation of the law.

190. On 15 July 1997, the European Commission issued its Opinion on Romania's Application for Membership of the European Union (Exh. C-317). That Opinion concluded that, despite its post-communist reforms, Romania did not meet the Copenhagen criteria and thus was not yet ready to initiate accession talks. Specifically, the European Commission concluded that:

> - Romania has made considerable progress in the creation of a market economy, but it would still face serious difficulties to cope with competitive pressure and market forces within the Union in the medium term;
>
> - despite the progress that has been made, Romania has neither transposed nor taken on the essential elements of the acquis, particularly as regards the internal market. It is therefore uncertain whether Romania will be in a position to assume the obligations of membership in the medium term. […]

191. The European Commission described Romania's economic situation in the pre-accession context as follows (Section 2.2):

> Romania has made enormous progress since the beginning of the transition, although it cannot be considered, as yet, to be a functioning market economy. […]
>
> Policy-making on economic issues has not always been coherent. As a result, progress towards macroeconomic stability has not been steady: recent years have been characterised by widely fluctuating performances in term of growth, inflation and unemployment. Economic agents do not necessarily perceive the macroeconomic environment to be stable enough to promote the necessary level of savings and investment (both domestic and foreign).
>
> If fully implemented, the comprehensive programme of macroeconomic stabilisation and structural reforms announced by the authorities in early 1997 should radically transform Romania's economy and lay the foundations for healthy growth in the years ahead. But the implementation of the basic features of the programme, especially with regard to restructuring, will take many years. It is yet too early to assess whether the programme will be implemented fully and successfully. […]
>
> In order to complete its transformation process successfully and prepare for EU membership, the country still needs to implement many, detailed and complex measures. […]
>
> In the past, foreign investors have singled out the unpredictable evolution of the legal system and the different interpretation of double taxation treaties as obstacles to doing business in Romania. […]
>
> [T]he ability to withstand competitive pressure depends not only on the current structure of the economy, but also on the way in which it will develop in the near to medium-term future. In this respect, Romania offers a contrasted situation: the existing economic structure points to very important structural weaknesses, while the reforms that have been announced at the beginning of 1997 could have a very positive impact in a relatively short period of time, especially if rapid privatisation is achieved and foreign direct investment is forthcoming. However, in order to withstand competition within the Union both the industrial and agricultural sectors would need to undergo major structural transformation.
>
> […]
>
> The current production base in industry relies to a large extent, although not exclusively, on sectors with very high energy intensity, or which are strongly dependent on imported raw materials, or have been the object of exercises of capacity reduction within the Union. […] The current structural reforms should aim at the restructuring of the very large state-owned

combinats, which, in their present condition, would face strong competitive pressures from their western competitors.

A diversification of the industrial base towards lighter industries, entailing the creation of a large number of new, small and medium-sized enterprises, and increased participation of foreign capital and know-how, will help Romania adjust to the restructuring of the large enterprises. Light industry is already well-developed in some sectors (wood products, leather, textiles) and has achieved good performances on exports markets.

Although agriculture has been neglected in the last decades, it represents a potentially important source of comparative advantage for Romania […]. But the process of modernisation of the agricultural sector has just begun and will require a policy aiming at stimulating investments both in the farming sector and in the food industry.

Foreign direct investment has been low for a country the size of Romania: at the end of 1996 cumulative FDI per capita stood at ECU 50. With a few notable exceptions, FDI has not made a significant contribution to the modernisation of either industry or agriculture. This means that production in many sectors still relies on old and obsolete technologies. Increasing the chances that Romanian producers will be able to withstand competition of high-quality, high-standards EU goods, and improving the level of skills in the economy calls for much bigger inflows of FDI.

[…]

Romania possesses a number of key advantages: its geographical location at the cross-roads of many trade routes and in particular as the sea-gate for accessing central European markets; the size of its population which will attract industries with economies of scale; the relatively young population which points to vast needs for durable goods; and its low level of labour costs. All these factors could make Romania a strong export base for accessing markets of smaller neighbours, especially for consumer goods.

[…]

The relative success which Romania achieved in macroeconomic stabilisation during 1995 and 1996 rested on very fragile foundations. In fact, given the very slow progress in structural reforms, the high growth rates of this period were not sustainable, and not compatible with the aim of integrating Romania in the European and world economy. This diagnosis was at the heart of the economic and social programme of the new government elected in November 1996.

The programme of macroeconomic stabilisation and structural reforms announced in February 1997 represents a very ambitious attempt to radically transform, in a relatively short period of time, the old economic structures and lay the foundations for a fully-functioning market economy. However, this is only a first step in the right direction and much remains to be done.

A stable and predictable macroeconomic framework is the first key condition for laying the foundations of sustainable growth and modernisation of the microeconomic side of the economy. […]

The new Romanian authorities have already recognised the crucial role that foreign investors and international financial institutions will play in the success of their reform efforts. Restoring confidence among international

investors and lenders and securing their medium-term investment in Romania calls for a stable macroeconomic framework, a sustained and credible commitment to structural reforms, a clear and broad political consensus over a medium-term strategy and the continuing legitimacy of reforms among the population. These conditions are indispensable to reduce political and economic uncertainty and so lay the foundations for successful investment planning.

192. The Commission concluded with respect to the economic conditions for accession (Section 2.3):

> Romania has made considerable progress in the creation of a market economy. The reorientation of economic policy since the recent change of government marks a change for the better, but much still needs to be done. While prices have been almost fully liberalised, property rights are not yet fully assured for land, the legal system is still fragile and policy-making on economic issues has not always been coherent. Further efforts to consolidate the legal and administrative framework, and to address persistent macroeconomic imbalances, are required to ensure a stable environment.
>
> Romania would face serious difficulties coping with competitive pressure and market forces within the Union in the medium term. It has recently made progress towards improving the competitive capacity of its economy, notably by addressing major distortions such as low energy prices, accelerating privatisation and beginning to wind up large loss-making state-owned firms. However, much of Romania's industry is obsolete, and agriculture needs to be modernised. The low levels of research and development, and of skills among the workforce also suggest that the economy needs a number of years of sustained structural reform.

2. Romania's initial efforts to align its state aid laws

193. On 10 March 1998, the European Commission issued its Guidelines on Regional Aid, a set of criteria for assessing whether to allow regional aid under Article 87(3) of the EC Treaty (previously Article 92(3) of the Treaty establishing the ECC) (Exh. RJ-9). These Guidelines stated:

> 1. Introduction
>
> […]
>
> Regional aid is designed to develop the less-favoured regions by supporting investment and job creation in a sustainable context. It promotes the expansion, modernisation and diversification of the activities of establishments located in those regions and encourages new firms to settle there. In order to foster this development and reduce the potential negative effects of any relocation, it is necessary to make the granting of such aid conditional on the maintenance of the investment and the jobs created during a minimum period in the less favoured region.
>
> In exceptional cases, such aid may not be enough to trigger a process of regional development, if the structural handicaps of the region concerned are too great. ***Only in such cases may regional aid be supplemented by operating aid.***
>
> […]

2. Scope

A derogation from the incompatibility principle established by Article 92(1) of the Treaty may be granted in respect of regional aid only if the equilibrium between the resulting distortions of competition and the advantages of the aid in terms of the development of a less-favoured region (6) can be guaranteed. The weight given to the advantages of the aid is likely to vary according to the derogation applied, having a more adverse effect on competition in the situations described in Article 92(3)(a) than in those described in Article 92(3)(c) (7).

3. Demarcation of regions

[…]

The derogation in Article 92(3)(a)

3.5. Article 92(3)(a) provides that aid to promote the economic development of areas where the standard of living is abnormally low or where there is serious underemployment may be considered compatible with the common market. As the Court of Justice of the European Communities has held, 'the use of the words "abnormally" and "serious" in the exemption contained in Article 92(3)(a) shows that it concerns only areas where the economic situation is extremely unfavourable in relation to the Community as a whole` (12).

The Commission accordingly considers, following a tried and tested approach, that the conditions laid down are fulfilled if the region, being a NUTS (13) level II geographical unit, has a per capita gross domestic product (GDP), measured in purchasing power standards (PPS), of less than 75,0 % of the Community average (14). The GDP/PPS of each region and the Community average to be used in the analysis must relate to the average of the last three years for which statistics are available. These amounts are calculated on the basis of data furnished by the Statistical Office for the European Communities.

[…]

4. Object, form and level of aid

4.1. The object of regional aid is to secure either productive investment (initial investment) or job creation which is linked to investment. Thus this method favours neither the capital factor nor the labour factor.

4.2. To ensure that the productive investment aided is viable and sound, the recipient's contribution (20) to its financing must be at least 25 %.

The form of the aid is variable: grant, low-interest loan or interest rebate, government guarantee or purchase of a State shareholding on favourable terms, ***tax exemption***, reduction in social security contributions, supply of goods and services at a concessionary price, etc.

In addition, aid schemes must lay down that an application for aid must be submitted before work is started on the projects.

[…]

Operating aid

> 4.15. Regional aid aimed at reducing a firm's current expenses (operating aid) is normally prohibited. Exceptionally, however, such aid may be granted in regions eligible under the derogation in Article 92(3)(a) provided that (i) it is justified in terms of its contribution to regional development and its nature and (ii) its level is proportional to the handicaps it seeks to alleviate (36). It is for the Member State to demonstrate the existence of any handicaps and gauge their importance.
>
> 4.16. In the outermost regions qualifying for exemption under Article 92(3)(a) and (c), and in the regions of low population density qualifying either for exemption under Article 92(3)(a) or under 92(3)(c) on the basis of the population density test referred to at point 3.10.4, aid intended partly to offset additional transport costs (37) may be authorised under special conditions (38). It is up to the Member State to prove that such additional costs exist and to determine their amount.
>
> 4.17. With the exception of the cases mentioned in point 4.16, operating aid must be both limited in time and progressively reduced. In addition, operating aid intended to promote exports (39) between Member States is ruled out.
>
> (Emphasis added).

194. In its Annual Report of 1998 regarding PHARE Program[10] (Exh. C-391), the European Commission concluded:

> Romania meets the Copenhagen political criteria. Much remains to be done in rooting out corruption, improving the working of the courts and protecting individual liberties and the rights of the Roma. Priority should also be given to reform of the public administration.
>
> Romania has made very little progress in the creation of a market economy and its capacity to cope with competitive pressure and market forces has worsened.
>
> Despite progress made in transposition of key parts of the acquis, Romania has a long way to go in terms of additional legislative transposition, implementation and enforcement before the country will be able to assume the obligations of membership. (p. 61).

195. The EC's 1998 Annual Report also highlighted the importance of regional development in Romania (p. 63):

> Case study: regional development in Romania
>
> Through a series of projects beginning in 1994, Phare is contributing to the creation of the institutional and legal framework for the development of

[10] The Programme of Community aid to the countries of Central and Eastern Europe (Phare) is the main financial instrument of the pre-accession strategy for the Central and Eastern European countries (CEECs) which have applied for membership of the European Union. Since 1994, Phare's tasks have been adapted to the priorities and needs of each CEEC. The revamped Phare programme, with a budget of over EUR 10 billion for the period 2000-2006 (about 1.5 billion per year), has two main priorities, namely institutional and capacity-building and investment financing. Although the Phare programme was originally reserved for the countries of Central and Eastern Europe, it is set to be extended to the applicant countries of the western Balkans (See http://europa.eu/ legislation_summaries/enlargement/ 2004_and_2007_enlargement/e50004_en.htm).

> regional policy in Romania, and to preparations for programmes to be implemented along the lines of the EU structural funds.
>
> Under a 1994 Phare budget, EU and Romanian experts prepared an analysis of regional disparities in Romania, and drew up proposals for a legal and institutional framework for the development of regional policy.
>
> In 1997, the conclusions of a Phare-financed study were published as a Green Paper on Regional Development, which proposed the establishment of a number of macro regions as planning units, based on associations of elected county councils. The Green Paper also defined a national framework for the development of regional policy and the financing of programmes.
>
> The government adopted the main points of the Green Paper as its policy on regional development; consequently, a 1997 Phare budget was approved, providing support for institution building at national and regional level.
>
> In 1998 a Law on Regional Development was passed, creating an appropriate institutional framework and establishing a National Agency for Regional Development and a National Fund for Regional Development.
>
> A 1998 Phare budget was approved, providing preliminary financial support for projects which would be proposed by the regions and financed out of the National Fund for Regional Development. Linked to this is technical assistance under the Special Preparatory Programme for Structural Funds, which provides further support and training to relevant institutions at regional and national level.

196. It is in this context that Romania adopted EGO 24/1998, which established the legislative framework for the incentives at issue in this arbitration. As noted in paragraph 145 above, the original version of EGO 24/1998 was passed on 30 September 1998 and entered into force on 2 October 1998.

197. On 22 March 1999, the Council of the EU issued Council Regulation (EC) No. 659/1999, which set out detailed rules for the application of Article 93 of the EC Treaty with respect to the implementation of state aid measures and recovery of unlawful and incompatible state aid (Exh. R-128).[11] Article 1 of this Regulation provided the following definitions:

---

[11] Articles 88 and 89 of the EC Treaty (previously Articles 93 and 94 of the Treaty establishing the EEC) provided:

> *Article 88 [previously Article 93]*
>
> 1. The Commission shall, in cooperation with Member States, keep under constant review all systems of aid existing in those States. It shall propose to the latter any appropriate measures required by the progressive development or by the functioning of the common market.
>
> 2. If, after giving notice to the parties concerned to submit their comments, the Commission finds that aid granted by a State or through State resources is not compatible with the common market having regard to Article 87, or that such aid is being misused, it shall decide that the State concerned shall abolish or alter such aid within a period of time to be determined by the Commission.
>
> If the State concerned does not comply with this decision within the prescribed time, the Commission or any other interested State may, in derogation from the provisions of Articles 226 and 227, refer the matter to the Court of Justice direct.

> (b) “existing aid” shall mean: (i) all aid which existed prior to the entry into force of the Treaty in the respective Member States, that is to say, aid schemes and individual aid which were put into effect before, and are still applicable after, the entry into force of the Treaty; […]
>
> (c) 'new aid' shall mean all aid, that is to say, aid schemes and individual aid, which is not existing aid, including alterations to existing aid; […]
>
> (f) 'unlawful aid' shall mean new aid put into effect in contravention of Article 93(3) of the Treaty;

198. Under the Regulation, if the Commission considered that an existing aid scheme was not, or was no longer, compatible with the common market, it would consult with the Member State and issue a recommendation, which could consist in a substantive amendment of the aid scheme, the introduction of procedural requirements, or the abolition of the aid scheme. If the Member State did not accept the proposed measures, the Commission could initiate a formal investigation procedure (Articles 17-19, 4(4), 6-9 of the Regulation).

199. On 27 July 1999, Romania passed Law No. 142/1999 on state aid (the “State Aid Law”, Exh. R-75), which granted the Competition Council a wide range of powers to regulate state aid in Romania, including the power to authorize or forbid the granting of state aid.

200. In its composite paper “Reports on Progress towards Accession by each of the Candidate Countries” dated 13 October 1999 (Exh. R-76), the EC noted that Romania had made “some progress” in aligning state aid laws.

201. For context, the Tribunal recalls that, during 1999, the following events relating to the EGO 24 framework and the Claimants’ investments took place:

On application by a Member State, the Council may, acting unanimously, decide that aid which that State is granting or intends to grant shall be considered to be compatible with the common market, in derogation from the provisions of Article 87 or from the regulations provided for in Article 89, if such a decision is justified by exceptional circumstances. If, as regards the aid in question, the Commission has already initiated the procedure provided for in the first subparagraph of this paragraph, the fact that the State concerned has made its application to the Council shall have the effect of suspending that procedure until the Council has made its attitude known.

If, however, the Council has not made its attitude known within three months of the said application being made, the Commission shall give its decision on the case.

3. The Commission shall be informed, in sufficient time to enable it to submit its comments, of any plans to grant or alter aid. If it considers that any such plan is not compatible with the common market having regard to Article 87, it shall without delay initiate the procedure provided for in paragraph 2.

The Member State concerned shall not put its proposed measures into effect until this procedure has resulted in a final decision.

Article 89 [previously Article 94]

The Council, acting by a qualified majority on a proposal from the Commission and after consulting the European Parliament, may make any appropriate regulations for the application of Articles 87 and 88 and may in particular determine the conditions in which Article 88(3) shall apply and the categories of aid exempted from this procedure.

a. On 25 March 1999, by means of Government Decision No. 194/1999 ("GD 194/1999", Exh. C-31), Romania designated the Ştei-Nucet region as a disfavored region for a period of ten years, starting on 1 April 1999, and stipulated that all six incentives offered under EGO 24/1998 would be available to investors in the Ştei-Nucet region while that region was designated disfavored.

b. As noted in paragraph 146 above, on 8 November 1999, Romania republished a renumbered version of EGO 24/1998 (Exh. R-68).

c. On 9 December 1999, European Food obtained its Temporary Investor Certificate (Exh. C-442).

3. Romania and the EU begin formal accession negotiations

202. On 10 and 11 December 1999, the European Council met in Helsinki to take a series of decisions related to the EU's enlargement process. As reflected in the Presidency's Conclusions (Exh. R-11, C-318), the European Council decided to convene bilateral intergovernmental conferences in February 2000 to begin accession negotiations with Romania and other countries.

203. In February 2000, Romania began its formal accession negotiations with the EU. Chapter 6 was dedicated to competition policy.

204. The Respondent's expert Prof. Streinz notes that in July 2000, "[i]n accordance with its mandate under Article 106 of the Europe Agreement, the Association Council determined [...] to extend retroactively the application of Art. 87(3)(a) of the EC Treaty to Romania for an additional period of five years." (First ER of R. Streinz, p. 7, note 22). According to Prof. Dashwood, this was done in Decision 4/2000 published in April 2001 (Exh. R-65; C-579).

4. The Decision of the Romanian Competition Council and amendments to the EGO 24 regime

205. On 15 May 2000, the Romanian Competition Council, in the context of reviewing proposed amendments to EGO 24/1998, issued Decision No. 244/2000 (Exh. R-78), in which it determined, *inter alia*, that certain facilities provided under EGO 24/1998 distorted competition (specifically, the Raw Materials Incentive and the Components Incentive) and had to be eliminated. It stated:

> Whereas:
>
> 3. Exemption from customs duties· on raw materials are deemed State aid for operating purposes and goes beyond the purpose of Emergency Government Ordinance No 24/1998 on Less-Favoured Areas, leading to distortion of competition. The granting of such facilities, subject to the conditions set forth in the Ordinance, solely to economic operators who make and register new investments puts the economic operators already in the market at a disadvantage, as was alleged before the Competition Council by both the Milling and Baking Industry Employers' Association and the Romanian Meat Association. Exemption from paying customs duties effectively stimulates imports to the detriment of domestic

producers. Largescale importing of live pigs from Hungary and the mere slaughtering of these animals in Less Favoured Areas have occurred, with the meat being sold in the form of carcases and no significant degree of processing occurring. The cost of these products, which were subsidised in their country of origin and also benefited from the facilities provided by Emergency Government Ordinance No 24/1998, is lower and they are penetrating neighbouring markets, with the result that they are in competition with products produced outside Less Favoured Areas.

The Competition Council takes the view that the granting of these facilities is distorting competition within the market, and has also expressed this opinion in other similar cases.

[…]

On the basis of Article 12(2) [unclear letter - possibly "c" or "e"], the Competition Council hereby takes the following·

DECISION

Article 1. The aid scheme set forth in Article 6 of Emergency Government Ordinance No 24/1998 is authorised subject to the following conditions:

a) the provisions of Article 6(1)(b) of Emergency Government Ordinance No 24/1998 republished, concerning the reimbursement of customs duties on imported raw materials, spare parts and/or components necessary for own production purposes within an area, and consequently, the proposed amendment concerning exemption from customs duties on raw materials shall be deleted;

[…]

d) the methodological standards for the application of Emergency Government Ordinance No 24/1998 on Less Favoured Areas are to be submitted to the Competition Council for approval, in accordance with the provisions of Article 27(j) of Law No 21/1996.

Article 2. Pursuant to Article 13(2) of Law No 143/1999, the Competition Council may decide to suspend the State aid scheme if the aid provider fails to take the steps referred to in Article 1 of this Decision.

[…]

206. It was in this context that, on 1 June 2000, European Food was issued its PIC (see paragraph 174 above).

207. On 16 June 2000 (effective 1 July 2000), Romania passed Emergency Government Ordinance No. 75/2000 (“EGO 75/2000”, Exh. C-45, R-81), which amended EGO 24/1998 in the following ways: (a) it provided for an exemption (rather than the refund originally contemplated) on customs duties on imported raw materials; (b) it excluded spare parts and components from the customs duty exemption, and (c) it amended the provisions regarding the award of funds under the Special Development Fund. It did not eliminate the Raw Materials Incentive and the Components Incentive, as recommended by the Competition Council.

5. Romania's progress towards accession in the period 2000-2001

208. On 1 August 2000, the Romanian government presented a Position Paper on Chapter 6 (Competition Policy) (Exh. EC-1), in which Romania "accepts the entire *acquis communautaire* in force on 31 December 1999, does not request transition periods or derogations and declares that it will be able to entirely implement it upon accession." However, Romania added that:

> Regarding the state aid rules and agreeing to the principles provided for in Art. 87 and 88 of the Treaty establishing the European Community, it is necessary to grant state aids to the sensitive sectors of economy and the deprived areas due to the difficulties confronting the Romanian economy during the transition to a market economy.
>
> It is also obvious that, after accession, Romania's development level will not exceed the EU average, and, consequently, the whole territory of Romania will comply with the conditions laid down in Art. 87(3) of the Treaty establishing the European Community.

209. In this Position Paper, Romania gave a detailed description of EGO 24/1998, as amended by EGO 75/2000:

> Regional development. Deprived areas
>
> Based on the Romanian legislation, namely the Law on Regional Development no. 151/1998, eight development regions were established. Those regions correspond to the NUTS II level of the European classification. At that level, the programs and projects of regional development are funded through the National Fund for Regional Development that was established according to the Law no. 151/1998. The funds for these programmes are yearly allocated through the state budget as distinct item [sic] for the policy on regional development and also from other domestic and foreign resources. The National Agency for Regional Development administers, as provided for in the law, the National Fund for Regional Development by annual allocations of funds to the eight Funds for Regional Developments that were established in accordance to same law and are managed by eight Agencies for Regional Development. The funds allocated in this manner are granted to the recipients on competitive basis, such as tendering for regional development projects.
>
> The Government Emergency Ordinance no. 24/1998 on the deprived areas (D areas) ensures a framework for granting state aid for the NUTS IV (villages) to NUTS III (counties) areas. Since July 1999 the majority of facilities granted to the investors within those areas became applicable after the Methodological Rules which were authorised by Government Decision no. 525/1999, came into effect.
>
> On 16 June 2000, the Government Emergency Ordinance no. 75 amending the Government Emergency Ordinance no. 24/1998 was adopted, the main facilities granted to the investors acting within the D areas being the following:
>
> - customs duty and VAT exemptions for machinery, equipment, motor-vehicles, other capital assets which are imported for making investments within the area;

- VAT exemption for the domestic machinery, equipment, motor-vehicles, other capital assets which are used for making investments within the area;

- customs duty exemption for the raw materials imported for producing within the area; profit tax exemption during the existence of the 0 area;

- fee exemption for the alteration of destination or driving out from agricultural use of lands necessary for the investment.

In accordance to the legislation in force, the terms under which the investors are deemed to benefit of the mentioned facilities are the following:

- the facilities are granted only to the companies where the majority is owned by private shareholders, Romanian legal persons; to private undertakings or family associations which are licensed in accordance to the Law no. 54/1990;

- the companies must have their headquarters and act within the D area;

- the new investment to be made and registered within the financial records of the undertaking, after the qualification of [sic] as a D area;

- the investment to be made within the interest fields which are covered by the Government Decision qualifying the area as D area;

- through investment new jobs must be created for the unemployed people which live within the D area;

- the goods for which facilities, such as fee exemption, must be used for investments/production within the D area;

- the investment within the D area must be in function for a period twice as long as the period when the facilities were granted, otherwise, the investor is held to reimburse the amounts granted as facilities.

210. On 31 October 2000, at an Accession Conference with Romania, fifteen EU Member States and Romania adopted the first European Union Common Position on Competition Policy ("EU Common Position 2000", Exh. EC-2). In this Common Position, the EU stated:

> The EU underlines the particular importance of the "acquis" under chapter 6 for the proper functioning of the internal market, including the creation of a level playing field for investment. The significance of the "acquis" is such that Romania has undertaken, under the Europe Agreement, to comply with the Community rules on competition. Thus, while welcoming Romania's statement that it accepts the "acquis" and will apply it as from the accession, the EU underlines that the "acquis" under chapter 6, in accordance with the Europe Agreement, has to be applied by Romania already now. In this context, the EU also underlines the importance of reinforcing the administrative capacity for effective implementation and enforcement of the "acquis". Therefore, the EU will conduct a general assessment of whether Romania has set up effective structures to enforce and apply the relevant substantive rules of the "acquis". Moreover, the full and immediate application of the "acquis" is also necessary in order to adapt companies well before the date of accession to be able to withstand

> the competitive pressures of the internal market resulting from the full and direct application of the competition "acquis" upon accession. It is inconceivable that the Romanian economy would be able to support the switching from one day to the next to the full and correct application of the "acquis".

211. With respect to the timely implementation of the Europe Agreement and the fulfillment of accession criteria in the state aid field, the EU invited Romania, *inter alia*, to

> - provide details regarding existing aid measures (i.e. those programs on the basis of which aid continues to be granted and which existed already before the entry into force of the present state aid law). In particular, Romania should explain which measures are envisaged for bringing such aid into line with the EU "acquis";
>
> - provide a more detailed analysis of the aid facilities in the so-called D areas of the country. In particular, Romania should explain what action, in light of the Community Guidelines on Regional Aid, the Competition Council has taken with regard to the Government Ordinances providing for these aid facilities.

212. In its Regular Report on Romania's progress towards accession dated 8 November 2000, the EC noted that:

> Romania has made further progress in the transposition in the *acquis* in this chapter.
>
> Further alignment with the EC competition legislation and the improvement of the administrative capacity in this field is a short-term priority in the Accession Partnership.
>
> Romania's anti-trust legislation is largely in line with the *acquis*. During the period under consideration the legislative framework for anti-trust has been developed further by the adoption of secondary legislation. The anti-trust enforcement authorities have dealt with an increasing number of cases. The main challenge is now to ensure that the application and enforcement of the anti-trust rules is effective and that priority is given to such cases that concern the most serious distortions of competition. In order to achieve this, the administrative capacity of the Romanian Competition Council and Competition Office will need to be reinforced.
>
> As concerns state aid the entry into force of the new state aid law on 1 January 2000 and the subsequent adoption of secondary legislation is an important step forward. However, the major challenge is to ensure that the legislation will be properly implemented and enforced. The recent adoption of the law on 'industrial parks' is a major concern.
>
> State aid reports have still to be submitted for the years 1998 and 1999. The latest report broadly follows the methodology and the presentation of the Community's Survey on State Aid. Additional work is needed in order to finalise a comprehensive state aid inventory covering all aid measures in operation in Romania.
>
> In order to ensure a differentiation of maximum aid intensities in assisted areas, Romania still has to prepare a regional aid map in consultation with the Commission.

213. On 28 February 2001, Romania issued its Complementary Position Paper on Chapter 6 (Competition Policy) (Exh. EC-3). In this Complementary Position Paper, Romania explained the EGO 24/1998 incentive regime as follows:

> Through the Emergency Ordinance no. 75/2000 modifying the Emergency Ordinance no. 24/1998 on the deprived areas, the following facilities may be granted to the investors within D areas:
>
> - customs duty and VAT exemptions for machinery, equipment, installations, motor-vehicles, other capital assets which are imported for making investments within the area;
> - VAT exemption for the domestic machinery, equipment, installations, motor vehicles, other capital assets, which are used for making investments within the area;
> - customs duty exemption for the raw materials imported for the own production within the area;
> - profit tax exemption during the existence of D area;
> - fee exemption for the alteration of destination or driving out from agricultural use of lands necessary for the investment.
>
> Facilities provided for by Government Emergency Ordinance (GEO) no. 24/1998, amended by GEO no. 75/2000, are granted to undertakings operating within deprived areas, mention being made that in the deprived area co financing is approved only for projects selected by the National Agency for Regional Development (NARD) through public tender, nationwide, and within "Special Programs", as approved by decision of the Government, programs which have been notified to the Competition Council.
>
> [The] Competition Council analyzed the existing state aid scheme provided in GEO no. 24/1998; it found out that it seriously distorts competition, and thus issued Decision no. 244/15.05.2000 whereby it authorized with conditions the state aid scheme as contained in art. 6 of the GEO no. 24/1998. Providing for the elimination of art. 6 (I)(b) referring to refunding of customs duties for imported raw materials, spare parts and/or components dedicated to the own production in the deprived area, and for modification of art. .6 (I)(c), mainly, the exemption from profit tax payment during the existence of the deprived area shall be done only for plowed-back profit. The modification of the existing state aid scheme contained in 311.6 of the GED no. 24/1998, referring to exemption from customs duty payment for imported raw materials, notified by NARD, has not been authorized by the Competition Council.
>
> GEO no. 75/2000 amending GED no. 24/1998 overlooked the conditions set by the Competition Council through Decision no. 244/15.05.2000, and maintained the facilities in art. 6 (I)(b) and (c) of GEO no. 24/1998. Although the Competition Council did not authorize the modification of the state aid scheme, GEO no. 75/2000 provides for exemption from payment of custom duties for imported raw materials for the own production in the deprived area.
>
> In December 2000, the Competition Council has brought action at the Court of Appeals alleging failure to comply with Competition Council's Decision no. 244/15.05.2000 by the Government, which authorized, with

> conditions, the modification of the state aid scheme within GEO no. 24/1998, modification made through GEO 00.75/2000.
>
> The request was made in front of the Court of Appeals to cancel GED no. 75/2000 and to recover the state aid.
>
> The Government will made [sic] a study in order to assess the effects of enforcing this Ordinance, and further takes necessary measures.

214. On 10 April 2001, the EU-Romania Association Council adopted Decision 4/2000 (the "Implementing Rules", Exh. R-65), which prescribed the manner in which Article 64 of the Europe Agreement would be implemented by Romania.

215. In its Regular Report on Romania's progress towards accession dated 13 November 2001 (Exh. R-141), the EC provided the following assessment of Romania's competition policy:

> Romania has made considerable progress in creating a legal framework in this area that is broadly aligned with the Community *acquis*. However, additional efforts are necessary to complete the legal framework and ensure its adequate enforcement.
>
> As regards anti-trust, Romania's legislation is largely in line with, and covers most of, the *acquis* provisions. However, further secondary legislation still needs to be adopted, to take account of the Commission's new vertical restraints policy and its policy on horizontal cooperation agreements. The Competition Council has broad powers to enforce competition rules but will need further reinforcements- especially in the form of training and IT equipment, in order to fulfil the tasks assigned to it. It is essential that the Competition Council could focus its resources more effectively on cases with most serious distortions to competition. A more deterrent sanctioning policy will also be required. Finally, general transparency, including an improved access of the public to relevant documents should be increased.
>
> As regards state aids, the existing legislation covers the basic principles of state aid control. However, the field of application of this law is not comprehensive and numerous state aid measures are not notified to the competition authorities. Romania should rapidly adopt the required secondary legislation on state aids, which is currently being prepared. This is a precondition to any effective enforcement activities. A significant number of unaligned aid schemes remains such as the profit tax rate 5% on export earnings and the law on direct investment promotion. Moreover, implementation of state aid policy in sensitive sectors is still at an early stage. There are continuous problems with the monitoring of frequent waivers by public bodies of the accumulated debt.
>
> Romania has now formally adopted state aid reports for the period 1996 – 1999 but has yet to finalise the state aid inventory. In addition, Romania's recent proposal for the regional aid map would allow aid intensities for regional investment aid of up to 50% net grant equivalent. In the area of state aids, both the Competition Office and the Competition Council require further strengthening in terms of human resources and training.
>
> In addition to strengthening administrative capacity within the competition authorities, particular attention should also be given to intensifying the training of the judiciary in the specific fields of anti-trust and state aid. There is also a need to raise awareness amongst all market participants,

> and especially amongst administrations granting state aids, of the policy and legislative provisions in this area.

216. The EU Common Position issued on 21 November 2001 (the "2001 EU Common Position", Exh. EC-5) once again stressed "the particular importance of the *acquis* under chapter 6 for the proper functioning of the internal market, including the creation of a level playing field for investment", and reminded Romania that "the *acquis* under chapter 6, in accordance with the Europe Agreement, has to be applied by Romania already now." The EU Common Position also stated:

> The EU further notes that there are a number of existing as well as new incompatible aid schemes which have not been brought into line with the *acquis*. The EU notes that such schemes include in particular the new draft law on industrial parks, the fiscal facilities offered in the free areas which are set up under Law No. 84/1992, the reduced rate of corporate income tax of 5% for income from exports, and facilities provided under Emergency Ordinances no. 24/1998 and 75/2000 in the so-called "D-areas". The EU urges Romania to align the existing incompatible aid schemes without delay. (2001 EU Common Position, p. 4)

217. However, the 2001 EU Common Position also stated:

> With regard to aid which Romania wishes to operate beyond the date of accession, the EU invites Romania to draw up a list of those existing aid measures which the Competition Council considers as compatible with the *acquis*. The EU invites Romania to transmit this list to the Commission; Romania may continue to operate any aid which is included in the list and against which the Commission has not objected for the period for which the aid was approved by the Competition Council. A reference to the existing aid list and to the procedure for its establishment will be included in the Accession Treaty. (2001 EU Common Position, p. 4)

6. Further amendments to the EGO 24 Regime (2000-2001)

218. On 29 November 2000, by means of Government Decision No. 1199/2000 (Exh. C-32) Romania extended the boundaries of the Ştei-Nucet disfavored region to include Drăgăneşti, and specified that the entire region would remain disfavored until 31 March 2009.

219. On 26 January 2001, by means of Civil Decision No. 26 (Exh. C-582, R-140), the Bucharest Court of Appeals dismissed the Competition Council's application for the partial annulment of EGO 75/2000.

220. On 26 April 2001, Government Decision No. 728/2001 repealed the earlier methodological norms [for the implementation of] EGO 24/1998 and provided new methodological norms (the "2001 Methodological Norms", Exh. R-69, R-35).

221. In August 2001, Prime Minister Nastase announced a new policy in relation to the establishment of new disfavored regions and the time periods for which the zones would be declared disfavored. As reported by the press, he stated that "for the existing zones, the current law shall be maintained", although "the economic and social status of the area shall be considered when allotting budgetary funds, with a view to balance facilities through the level of budgetary allotments" (Exh. C-630).

222. On 7 November 2001, Romania passed Law No. 621/2001 (Exh. R-33, R-129), which amended EGO 75/2000 by, among others, reinstating the customs duties exemption on imported components.

7. Parallel developments in the EU and EGO 24 fronts (2002)

223. In its Regular Report on Romania's progress towards accession dated 9 October 2002, the EC noted that "there are still a large number of incompatible fiscal aid schemes which need to be aligned" (Exh. R-109).

224. On 19 February 2002, the High Court of Cassation of Justice of Romania rejected, on admissibility grounds, the lawsuit brought by the Competition Council for the partial annulment of EGO 75/2000 (Exh. C-643).

225. On 17 May 2002, Multipack and Starmill were issued their PICs (see paragraphs 175-176 above). Both PICs stated that they would be valid until 1 April 2009.

226. On 29 May 2002, Romania and Sweden signed the Bilateral Investment Treaty under which this arbitration is brought (Exh. C-1). Romania ratified the BIT through Law No. 651/2002 (Exh. C-15) enacted on 7 December 2002. The BIT entered into force on 1 April 2003.

227. On 1 June 2002, Romania passed Law No. 345/2002 (Exh. R-90), which abolished two of the incentives contemplated under EGO 24/1998, the Machinery Incentive and the VAT Incentive.

228. In June 2002, the Romanian Government issued a "Report on the progress in preparing for the accession to the European Union September 2001-May 2002", dated June 2002 (Exh. HEC-6), which stated that:

> All existing State aid measures will be assessed, establishing their compatibility with the acquis in order to suggest measures eliminating or transforming the incompatible ones in compatibles [sic] aids, taking into account the legal and economic implication of the modification of any incompatible schemes on the already granted specific allocations.
>
> This approach will be made according to the European Commission recommendation and will take into consideration [sic] following three steps: (i) closing the incompatibles [sic] schemes in order to stop potential future allocations; (ii) the modification of these scheme to reach the compatibility with the acquis; (iii) the identification of the solutions for the economic agents that received the State aid under the present schemes (e.g. Free areas, deprived areas etc). […] (p. 132)

229. More specifically with respect to EGO 24, it stated that:

> Regarding the "D areas", the State aid granted in the present ***must*** **[]** ***be converted into a compatible State aid.*** The Ministry of Development and Prognosis started the technical debates with the beneficiary associations in order to identify solutions and to make, in 2 months, proposals for alteration of the present system of facilities. (p. 133)

230. At the same time, Romania's "National Programme for Accession of Romania to the European Union" dated June 2002 (Exh. HEC-7) stated that "[t]he provisions of the normative acts on facilities granted for 'D areas' will be maintained till the moment of Romania's accession to the European Union" (p. 148).

231. On 1 July 2002, Romania passed Law No. 414/2002 (Exh. C-48), which repealed the Profit Tax Incentive but grandfathered it for investors who held a PIC prior to the date in which this law entered into force. The Profit Tax Incentive was later reintroduced on 1 January 2004 by Law No. 507/2004 (Exh. C-52).

232. On 7 November 2002, Romania provided the EC with Additional Information on Chapter 6 – Competition Policy (Exh. EC-6). With respect to EGO 24, Romania merely informed the Commission that state aid for the D-areas was regulated by Law 621/2001, which approved EGO 75/2000, and informed the Commission of the amendment to the VAT and the repeal of the profit tax incentive (noting that it had been grandfathered for PIC holders).

> "D area" granted facilities
>
> Presently in Romania D areas are regulated by Law no. 621/2001 on the approval of Government Emergency Ordinance (GEO) no. 75/2000 for the alteration of Government Emergency Ordinance no. 24/1998, republished, on deprived area (OG no. 737 of 19th November 2001), GEO no. 75/2000 for the alteration of GEO no. 24/1998, republished and GEO no. 24/1998 on deprived areas, approved and modified by Law no. 20/1999.
>
> The regime of the facilities granted in '"D" areas was changed by the recent entering into force of the law on VAT and of the law on profit tax.
>
> The Law 345/2002 on VAT entered into force on 01.06.2002 and abrogated the facility of exempting from VAT payment granted for machines, outfits, installations, equipments, means of transport, other depreciable goods imported or produced in the country that were necessary for the investments in a D area. This facility was stipulated in Art. 6(1) of the GEO no. 24/1998 regarding the regime of the deprived areas.
>
> The Law no. 414/2002 (OG no. 456/27.06.2002) on profit tax abrogated the facility of exempting undertakings acting in "D" areas from the payment of the profit tax. This facility was stipulated in Art. 6(1), let. c) of the GEO no. 24/1998 regarding the regime of the deprived areas.
>
> For ensuring the legislative continuity, the legal persons that had obtained the permanent certificate of investor in "D" area before the Law no. 414/2002 entered into force, will further benefit from the profit tax exemption on the whole duration of existence of the deprived area, according to Art. 35, par. 3.

233. On 19 November 2002, Romania passed Law No. 678/2002 (Exh. C-49) which amended the Raw Materials Incentive by excluding from the customs duties exemption raw materials for the production, processing and preservation of meat.

8. Events leading up to the revocation of EGO 24

234. On 7 April 2003, the Mission of Romania to the EU sent a communication to the Romanian Minister for European Integration and other state officials, including Mr. Orban and Mr. Berinde (Communication No. 1480, Exh. R-93). It stated:

> Community officials stated clearly that the ***negotiations on this chapter may be closed if, and only if, the following conditions*** (relating primarily to State aid, which was found to have the highest potential to distort the Internal Market) ***are met:*** new aid must comply strictly with the acquis, ***existing aid must be aligned or in the process of being aligned*** (including in terms of duration; the granting of transition periods may be considered depending on the outcomes of discussions between the competent institutions in Romania and the relevant operators), and ALL cases of non-notified State aid must be analysed and resolved.
>
> […]
>
> The Commission stated that it had asked all of the candidate countries to bring their tax breaks into line with the acquis communautaire, including those granted in Free Zones or ***Less Favoured Areas***, which entails either their withdrawal or their conversion into compatible aid. In the latter case, ***negotiations with a view to converting them into compatible schemes must be pursued directly by the Competition Council with the economic operators concerned.*** Only once this has occurred can the companies for which transition periods may be negotiated with the EU be identified.
>
> (Emphasis added)

235. In its Common Position dated 28 May 2003 (Exh. EC-8), the EU invited Romania to provide information on benefits granted in disfavored regions and urged Romania to close "incompatible aid schemes for new entrants with immediate effect." More specifically:

> The EU recalls that all fiscal aid provisions, (for example those included in the VAT Law; the ***Law on customs duties exemptions*** - including benefits for transactions undertaken by firms located in industrial parks, free zones and ***disadvantaged areas*** […]) ***should be subject to the approval by the Competition Council. In cases where the Competition Council assesses the respective measures to be incompatible with the State aid rules, the EU invites Romania to either end the measures or to align them with the acquis.***
>
> The EU invites Romania to bring all incompatible aid measures in line with the acquis without delay and to continue to provide information on the progress made towards this goal. […]
>
> The EU moreover invites Romania to provide information on individual benefits granted in the free zones and the disadvantaged areas and on any other individual tax benefits that have already been granted and which provide for tax benefits beyond Romania's target date for accession. ***The EU urges Romania to close incompatible aid schemes for new entrants with immediate effect.***
>
> In this context Romania is further invited to present a ***plan outlining how it intends to convert the benefits that are incompatible with the acquis***

> and to hold further technical consultations with the Commission to explore the possibilities for this conversion.
>
> […]
>
> With regard to aid which Romania wishes to operate beyond the date of accession, the EU recalls it's invitation to Romania to draw up a list of those existing aid measures which the Competition Council considers as compatible with the acquis and to transmit this list to the Commission. The EU recalls that Romania may continue to operate any aid which is included in the list and against which the Commission has not objected for the period for which the aid was approved by the Competition Council. A reference to the existing aid list and to the procedure for its establishment will be included in the Accession Treaty.
>
> The EU recalls that the ***existing aid measures*** are subject in accordance with Article 88(1) of the EC Treaty to the ***appropriate measures procedure***, under which the Commission can, in cooperation with the (future) Member State, propose changes to an aid measure for the future. To the extent that Romania wishes to benefit from this mechanism, the EU invites Romania to present the following to the Commission, every six months as from 1 January 2002, and up until the date of accession:
>
> (a) a list of all existing aid measures (both schemes and ad hoc aid) (i) which have been assessed by the Competition Council and (ii) which it found to be compatible with the *acquis*; (b) any other information which is essential for the assessment of the compatibility of the aid measures referred to under (a).
>
> Details on the precise format for this reporting have been provided by the Commission.
>
> The EU underlines that all aid measures in Romania which are considered State aid according to the acquis and which are not included in this list shall be considered as new aid upon Romania's accession. After that date, application of such an aid measure will be conditional upon Romania's notification of it pursuant to Article 88 of the EC Treaty, and a decision of the Commission that the aid measure in question is compatible with the Common Market. As regards individual aid, no measures which continue to have effects after accession and which are incompatible will be acceptable.
>
> (Emphasis added)

236. On 23 December 2003, Law No. 571/2003 on the Fiscal Code (Exh. R-37) revoked Law 345/2002, thus reinstating the Machinery Incentive and the VAT Incentive.

237. In an interview on national TV conducted on 12 January 2004, Prime Minister Nastase indicated that the incentives regime provided by EGO 24/1998 could be terminated due to EU requirements. However, he also stated that the Government was examining whether some of the incentives would remain in place until 2007, noting that the Government had negotiated some transition periods with the EU and that they were trying to find “elegant solutions” (Exh. C-651). When asked to confirm if certain investors could benefit from the program until 2007, Minister Nastase stated that they would try to negotiate an extension that would allow the incentives to remain in place until that time. When asked what would happen to investors who had

invested large amounts of money, the Minister stated that the Government was negotiating with each investor.

238. On 24 March 2004, Romania issued its Complementary Position Paper III on Chapter 6 – Competition Policy (Exh. EC-9). With respect to EGO 24/1998, Romania noted:

> The Ministry of Administration and Interior elaborated a draft law for completing the Government Emergency Ordinance no. 24/1998 on the regime of deprived areas. The draft provides that the facilities the undertakings that have an investor certificate and operate in deprived areas benefit from, will be granted below the maximum admitted intensity foreseen in the Regulation on regional aid. At present, the draft normative act is under inter-ministerial endorsement procedure.
>
> By entering into force of the Fiscal Code, the fiscal facilities have been significantly diminished. In fact, ***the undertakings with investor certificate in the deprived areas will benefit from*** the exemption from the payment of the taxes perceived for changing the destination or removing from the agrarian circuit of certain fields designated to achieving the investment as well as ***the exemption from the custom duties payment for raw materials and imported components, excepting the import of the raw material for meat production, processing and preserving***. Also the undertakings that obtained before 1 July 2003 the permanent certificate of investor in the deprived area, will benefit from exemption from the profit tax payment related to the new investment, during the whole existing duration of the deprived area.
>
> (Emphasis added).

239. In May 2004, in an interview in Oradea, Bihor County (Exh. C-652), Prime Minister Nastase indicated that "[s]ubsequent to 2007, when we want to be accepted in the European Union, these disfavored areas will no longer exist in Romania." When asked about compensation to investors in those areas, the Prime Minister answered that Romania would discuss these matters during its negotiations with the European Union and they would see if Romania was "able to obtain some transition periods for them." The Prime Minister specified that "there will be no fiscal incentives, there will be some compensation packages, established during direct negotiations." The Prime Minister also stated that the government would talk to the investors, and "based on the conclusions of the negotiations of the Competition Chapter, we will negotiate with those who initially obtained these fiscal incentives" (Exh. C-652, pp. 7-9 of translation).

240. On 7 June 2004, Romania passed Law No. 239/2004 to supplement EGO 24/1998 (Exh. R-147). This law subjected all state aid to a maximum intensity requirement.[12] In other words, it provided that the EGO 24/1998 facilities could not exceed the thresholds of permissible state aid approved by the Competition Council. If investors exceeded the maximum permitted intensity, the facilities would cease to be granted.

[12] In June 2004, Romania passed Law 239/2004, which made all State aid subject to a maximum-intensity requirement. According to a definition provided by the Respondent, "[v]alid intensity is measured as the amount of aid in relation to the costs of production or the costs of investment of the company or project that receives the aid." P. Nicolaides, M. Kekelekis, P. Buyskes, State Aid Policy in the European Community (2nd edn 2005) (Exh. RL-179), p. 38.

241. On 31 August 2004, by means of Government Ordinance No. 94/2004 ("GO 94/2004", Exh. R-94), Romania repealed Article 6(1)b)d) and e) of EGO 24/1998, thus repealing/revoking the incentives provided under EGO 24/1998, including the Raw Materials Incentive, with the exception of the Tax Profit Incentive. The repeal was originally to become effective 90 days from the date of entry into force of GO 94/2004 (that is, on 3 December 2004). However, the date of repeal was subsequently extended to 22 February 2005 by means of Law No. 507/2004 of 22 November 2004 (Exh. C-52), which approved and amended GO 94/2004 to that effect. The substantiation report accompanying GO 94/2004 stated:

> In order to meet the criteria in the Community rules on state aid, and also to complete the negotiations under Chapter No. 6 – Policy it is necessary to eliminate all forms of State aid in national legislation incompatible with the *acquis communautaire* in this area and, in this respect, it is proposed to repeal […] the provisions of Article 6 paragraph (1), letter (b), letter (d) and letter (e) of the Emergency Government Ordinance no. 24/1998 on the disadvantaged areas […]
>
> (Substantiation Report accompanying EGO 94/2004, 26 August 2004, Exh. R-95, pp. 12-13).

242. On 13 September 2004, the Claimants requested Romania to restore the tax incentive regime (Exh. C-8, ER of G. Piperea, ¶ 5.3).

243. On 8 December 2004, the EU issued a Common Position ("2004 EU Common Position", Exh. EC-10), in which it welcomed the amendments to the regimes related to Free Trade Areas and Deprived Areas. In this context, the EU noted that Romania had requested two transitional periods, one with respect to the Profit Tax Incentive under EGO 24/1998 and another with respect to a royalty exemption under Law No. 84/1992. The EU accepted both transitional arrangements proposed by Romania. With respect to the Deprived Areas, this meant that investors holding a PIC granted prior to 1 July 2003 could continue to benefit from the Profit Tax Incentive for as long as the Deprived Areas continued to exist, under certain conditions (limited to 2008, 2009 or 2010, depending on the deprived area; net intensity of aid granted must remain below certain specified aid ceilings and the eligible costs must be defined in accordance with the Regional Aid Guidelines).

244. On 22 February 2005, the revocation of the EGO 24/1998 incentives (with the exception of the Profit Tax Incentive) became effective.

245. Also on 22 February 2005, the EC issued its Opinion on Romania's EU application (Exh. R-50) where it stated:

> (7) In joining the European Union, the Republic of Bulgaria and Romania accept, without reserve, the Treaty establishing a Constitution for Europe, and until its entry into force, the Treaty on European Union and the Treaties establishing the European Communities including all their objectives and all decisions taken since their entry into force, and the options taken in respect of the development and strengthening of those Communities and of the Union.

> (8) It is an essential feature of the legal order introduced by the Treaties establishing the European Communities and, at its entry into force, the Treaty establishing a Constitution for Europe that certain of their provisions and certain acts adopted by the institutions are directly applicable, that the law of the Union takes precedence over any national provisions which might conflict with it, and that procedures exist for ensuring the uniform interpretation of the law of the Union; accession to the European Union implies recognition of the binding nature of these rules, observance of which is indispensable to guarantee the effectiveness and unity of the law of the Union.

9. Subsequent events

246. On 25 April 2005, the Member States of the EU signed the Accession Treaty with Romania and Bulgaria (the "Accession Treaty", Exh. R-27). The Treaty was to enter into force on 1 January 2007 [i.e., this would be the date of accession]. However, pursuant to Article 4(3), the institutions of the EU could adopt before accession certain measures specified in the Protocol annexed to the Accession Treaty, which set out the conditions and arrangements for admission. Annex VII to the Accession Protocol (Exh. R-52, R-98), Section 4 on Competition Policy, subsection A on Fiscal Aid, set out the transitional period with respect to the Profit Tax Incentive referred to in the 2004 EU Common Position. With respect to the Ştei-Nucet disfavored regions, it stated that Romania could continue granting the Profit Tax Exemption until 31 December 2009, subject to certain state aid intensity requirements and other conditions.

247. On 28 July 2005, the Claimants filed their Request for Arbitration.

248. On 4 March 2006, the EC issued the Guidelines on National Regional Aid for 2007-2013 (Exh. C-298), which set out the principles according to which EU Member States could grant regional aid to disadvantaged areas. With respect to operating aid, the Guidelines provided:

> Regional aid aimed at reducing a firm's current expenses (operating aid) is normally prohibited. Exceptionally, however, such aid may be granted in regions eligible under the derogation in Article 87(3)(a) provided that (i) it is justified in terms of its contribution to regional development and its nature and (ii) its level is proportional to the handicaps it seeks to alleviate (69). It is for the Member State to demonstrate the existence and importance of any handicaps (70). In addition, certain specific forms of operating aid can be accepted in the low population density regions and the least populated areas.

249. On 1 January 2007, the Accession Treaty entered into force and Romania became a Member State of the EU.

IV. SUMMARY OF THE PARTIES' POSITIONS

250. The purpose of this section is to provide an overview of the Parties' positions. The Parties' detailed positions with respect to each claim are described in Section VI below (Analysis of the Claimants' Treaty Claims).

A. THE CLAIMANTS' POSITION

251. The Claimants' case has evolved over time. Although its core elements remain unchanged, the focus of the Claimants' arguments has shifted, as has the structure of these arguments.

252. The Claimants contend that "[i]n the course of enacting, promoting and implementing the EGO 24 regime, the Respondent made unambiguous and binding commitments to foreign investors, the Micula brothers, that they would be granted a number of incentives for a 10 year period in return for making certain large investments in one of the poorest and least developed regions of Romania" (C-PHB, ¶ 1). The Claimants claim that, in specific reliance on these commitments, and in particular in reliance on the expectation that the incentives would last through the entire 10 year period, the Claimants invested massively in the Ştei-Nucet-Drăgăneşti area, one of Romania's most remote and disfavored regions.

253. In the latest formulation of their case, the Claimants argue that Romania entered into these binding commitments through EGO 24; its implementing legislation, in particular GD 194/1999; and the issuance of Permanent Investor Certificates (PICs) to the three Corporate Claimants. The Claimants submit that these PICs certified that the Claimants had the right to receive the incentives until 1 April 2009, which was also the date in which Ştei-Nucet-Drăgăneşti would cease to be considered a disfavored region.

254. The Claimants argue that Romania's binding commitment to provide the incentives to the Claimants until 1 April 2009 gave rise to a right to receive those incentives until that date, or at least generated a legitimate expectation that they would benefit from those incentives until that date. The Claimants contend that Romania's revocation of these incentives effective 22 February 2005 (approximately 4 years before they were set to expire) breached that commitment or undermined that legitimate expectation.

255. The Claimants contend that Romania's premature revocation of the incentives was unfair and unlawful. While Romania argues that it was forced to revoke the incentives to comply with EU requirements, the Claimants assert that the incentives were in fact compatible with EU law, and no competent authority had issued a decision requiring Romania to terminate the incentives. The Claimants also complain that Romania did not attempt to negotiate with either the EU or the Claimants to find a solution that would mitigate the adverse effects on their business of the premature revocation of the incentives. The Claimants argue that, most egregiously, Romania revoked only the provisions of EGO 24 that established the incentives, while retaining those that

set out the Claimants' obligations to remain invested in the Ştei-Nucet-Drăgăneşti region for twice the time they received the incentives.

256. In view of the above, the Claimants argue that Romania has breached the Claimants' rights under the Sweden-Romania BIT and under international law. Specifically, they contend that the premature revocation of the EGO 24 incentives:

a. Breached a clear commitment undertaken by Romania vis-à-vis the Claimants, and therefore breached the BIT's umbrella clause contained in Article 2(4) of the BIT;

b. Undermined the Claimants' legitimate expectations, upset the stability of the regulatory regime, lacked transparency and consistency, and was taken in bad faith, and therefore breached Romania's obligation under Article 2(3) of the BIT to afford the Claimants fair and equitable treatment;

c. Impaired by unreasonable measures the management, maintenance, use, enjoyment and disposal of the Claimants' investments, and therefore breached Article 2(3) of the BIT; and

d. Expropriated without compensation the Claimants' right to receive the incentives and substantially deprived their entire investment of value, and therefore breached Article 4(1) of the BIT.

257. The Claimants claim that, because the early revocation of these incentives violated an obligation entered into by Romania vis-à-vis the investors (and thus breached the BIT's umbrella clause), the revocation also undermined the Claimants' legitimate expectations (and consequently breached the BIT's fair and equitable treatment standard). However, in the Claimants' view, even if the premature revocation of the incentives does not breach the umbrella clause (e.g., because the promise allegedly made by the Respondent does not rise to the level of an obligation protected by the umbrella clause), the Tribunal could still find a violation of the fair and equitable treatment standard because the revocation upset the Claimants' legitimate expectations (Tr., Day 12, 126:22-128:6 (Reed)).

258. The Claimants deny that the termination of the incentives was required under EU law. The Claimants allege that, to the contrary, the incentives were one of the factors that allowed Romania to accede to the EU in the first place. Indeed, the Claimants argue that Romania desperately needed economic development, particularly in certain distressed regions, to be able to join the EU. In their view, incentive programs such as EGO 24 greatly contributed to this development.

259. The Claimants argue that Romania has failed to show how the EGO 24 incentives conflicted with EU law and that Romania has not provided evidence that the EU required the termination of the incentives in order to obtain accession.

260. The Claimants specific arguments with respect to the alleged treaty breaches are discussed in Section VI below (Analysis of the Claimants' Treaty Claims).

261. The Claimants argue that these breaches caused substantial damage to the Claimants, as set out in Section VII below (Damages).

262. On the basis of the foregoing, the Claimants request the following relief:

> The Claimants request an award be made granting the relief set out in paragraphs 1 to 6 below.
>
> Any damages payable, including interest and costs, should be awarded to the individual Claimants, Ioan Micula and Viorel Micula, to be divided between them on a 50:50 basis.
>
> In the alternative, any damages payable, including interest and costs, should be awarded to all five Claimants.
>
> 1. A declaration that Romania has violated the Sweden-Romania Bilateral Investment Treaty ("Treaty") and customary international law by:
>
>   1.1 failing to ensure fair and equitable treatment of the Claimants' investments (Article 2(3) of the Treaty) by treating the Claimants' investments in a manner that was inconsistent, ambiguous, and not transparent;
>
>   1.2 failing to ensure fair and equitable treatment of the Claimants' investments (Article 2(3) of the Treaty) by violating the Claimants' legitimate expectations regarding their investments;
>
>   1.3 impairing the Claimants' investments through unreasonable and discriminatory measures (Article 2(3) of the Treaty);
>
>   1.4 failing to observe obligations entered into with the Claimants with regard to their investments (Article 2(4) of the Treaty); and
>
>   1.5 expropriating the Claimants' investments without the payment of prompt, adequate, and effective compensation (Article 4(1) of the Treaty).
>
> 2. Damages for the following losses suffered by the Claimants:
>
> **A. Expectation losses**
>
>   2.1 Losses suffered as a result of the increased cost of raw materials following revocation of the incentives provided by Emergency Government Ordinance 24/1998 ("Incentives") and the lost opportunity to build a sugar stockpile in 2009, comprising:
>
>   (a) increased costs of sugar in the amount of RON 85.1 million;
>
>   (b) increased costs of PET in the amount of RON 6.3 million;
>
>   (c) increased costs of raw materials other than sugar and PET in the amount of RON 17.5 million; and
>
>   (d) lost opportunity to stockpile sugar in 2009 in the amount of RON 62.5 million.

2.2 Financial penalties incurred but not yet paid as a result of the Claimants being financially constrained due to the losses incurred as a result of the revocation of the Incentives in the amount of RON 63.65 million as 30 September 2010 unless these financial penalties are waived by the Respondent and a declaration that the Respondent shall waive or reimburse all additional financial penalties imposed or assessed until the date of Romania's full and final satisfaction of the award.

2.2A Financial penalties paid by the Micula brothers' companies in the period 1 April 2005 to 30 September 2010 in the amount of RON 40 million.

2.3 Lost profits on sales of finished goods following revocation of the Incentives of no less than RON 427 million.

2.4 Lost profits on sales of Sugar Containing Products ("SCPs") following revocation of the Incentives in the amount of RON 492.3 million.

2.5 Lost profits incurred as a result of the Claimants' inability to complete their incremental investments following revocation of the Incentives comprising:

(a) a malt plant in the amount of RON 28 million;

(b) a cogeneration [p]lant in the amount of RON 712.6 million; and

(c) a canning [p]lant and subsequent sales of private label beer in the amount of RON 720.4 million.

2.6 In the alternative to paragraphs 2.3, 2.4 and 2.5 above, lost profits on sales of finished goods following revocation of the Incentives in the amount of RON 2423.2 million.

B. Reliance losses

2.7 In the alternative to the losses described in paragraphs 2.1, 2.2A, and 2.3 to 2.6 above, but not 2.2, the amounts lost by the Claimants as a result of investing in reliance on the Incentives in the amount of RON 811 million.

3. An award of interest on the damages payable pursuant to paragraph 2 above calculated in the following manner:

3.1 For losses as described in paragraphs 2.1(a) to (c) above, interest compounded on a quarterly basis at a rate of 3 month ROBOR (Romanian Interbank Offer Rate) plus 5% from 1 March 2007 until the date of Romania's full and final satisfaction of the award.

3.2 For losses as described in paragraph 2.1(d) above, interest compounded on a quarterly basis at a rate of 3 month ROBOR plus 5% from 1 July 2010 until the date of Romania's full and final satisfaction of the award.

3.3 For penalties as described in paragraph 2.2A above, interest compounded on a quarterly basis at a rate of 3 month ROBOR

plus 5% from 1 July 2007 until the date of Romania's full and final satisfaction of the award.

3.4 For losses as described in paragraph 2.3 above, interest compounded on a quarterly basis at a rate of 3 month ROBOR plus 5% from 1 May 2008 until the date of Romania's full and final satisfaction of the award.

3.5 For losses as described in paragraph 2.4 above, interest compounded on a quarterly basis at a rate of 3 month ROBOR plus 5% from 1 March 2007 until the date of Romania's full and final satisfaction of the award.

3.6 For losses as described in paragraph 2.5 above, interest compounded on a quarterly basis at a rate of 3 month ROBOR plus 5% from 30 September 2009 until the date of Romania's full and final satisfaction of the award.

3.7 For losses as described in paragraph 2.6 above, interest compounded on a quarterly basis at a rate of 3 month ROBOR plus 5% from 15 August 2007 until the date of Romania's full and final satisfaction of the award.

3.8 For the amounts lost by the Claimants as a result of investing in reliance on the Incentives as described in paragraph 2.7 above, interest to be applied compounded on a quarterly basis at a rate of 3 month ROBOR plus 5% from 1 January 2002 until the date of Romania's full and final satisfaction of the award.

3.9 The ROBOR rate to be applied in relation to paragraphs 3.1 to 3.8 above is to be the average annual rate for each year or part thereof.

4. The total amount of damages payable by the Respondent comprising the amounts set out in paragraphs 2, 3 and 5 to be received net of any tax obligations imposed by Romania on the proceeds.

5. All costs incurred by the Claimants in relation to these proceedings, including but not limited to the Claimants' lawyers' fees and expenses, experts' fees and expenses, and all costs of ICSID and the Tribunal.

6. Any further relief that the Tribunal may deem fit and proper.

(Claimants' Revised Request for Relief, footnotes omitted)

263. In addition, the Claimants request that the Tribunal:[13]

[…]

b. provide in the Award that Romania is enjoined from any further tax collection measures of any kind in respect of the Claimants and the EFDC until such a time as the damages awarded by the Tribunal have been paid in full, and include a pecuniary alternative in case of non-performance;

---

[13] These additional requests were made in the context of the Respondent's application to revoke the provisional measures recommended by the Tribunal. As noted in paragraph 111 above, the determination of these matters was deferred to the final Award.

c. issue a declaration that Romania is not entitled to set-off tax debts of the EFDC against an Award in favor of Claimants;

d. order Romania to pay all of Claimants' costs in responding to this Application, including reasonable lawyers' fees and other costs; and

e. grant any other relief that the Tribunal may deem fit and proper in these proceedings.

(Claimants' Rejoinder on the Respondent's Revocation Application, ¶ 75).

B. THE RESPONDENT'S POSITION

264. The Respondent rejects each of the Claimants' claims under the BIT.

265. The Respondent argues that the key question in this case is "who bore the risk of regulatory change: the state or the investors who benefitted from the existing regulatory regime" (R-Rejoinder, ¶ 9).

266. The Respondent contends that the BIT does not require the Contracting States to tailor their laws and regulations to the preference of foreign investors, nor does it establish liability for every regulatory change that has a negative impact on the foreign investors' businesses. To the contrary, investment protection treaties accord host states considerable deference in relation to regulatory policy. As a result, the Respondent argues that where a state has exercised its sovereign powers to regulate in a general, non-discriminatory way to advance public welfare (including by legislative changes), such conduct is not an "expropriation", "unfair and inequitable treatment", or otherwise in breach of the provisions of an investment protection treaty. Absent a clear commitment from the state to stabilize a regulatory framework, states are usually free to change their laws.

267. Indeed, the Respondent argues that businessmen know this, and factor regulatory risk into their business plans. According to the Respondent, the Claimants did not do so because they thought they had a special status that protected them from any regulatory changes.

268. In the present case, the Respondent notes that it is undisputed that the modification of the facilities that had been granted pursuant to EGO 24/1998 was a generally applicable act. The Respondent also argues that it was compelled to curtail the facilities as an essential precondition to accession to the EU. Accordingly, the Tribunal should give deference to Romania's action when applying the substantive provisions of the BIT (R-CM, ¶ 92).

269. Building on this fundamental premise, the Respondent makes four main arguments.

270. The Respondent's <u>first</u> line of argument is that three (and possibly four) of the Claimants' claims fail because the Claimants have not proven that Romania made a binding promise to the Claimants that the facilities under EGO 24, either in their totality or the Raw Materials Facility individually, would remain unchanged until 2009. The Respondent argues that the Claimants' ability to establish the existence, terms

and duration of this promise is an essential condition for the following three claims (although it is not a sufficient condition for the success of any of them) (Tr., Day 13, 60:2-65-7; 73:3-83-25 (Petrochilos)):

a. First, the existence of such a promise is the basis for the Claimants' assertions regarding their legitimate expectations, including their expectation of legal stability, and is therefore necessary for proving this aspect of the Claimants' fair and equitable treatment claim.

b. Second, the existence of such a promise is necessary to establish the existence and scope of an obligation under Romanian law, the breach of which could result in the breach of the umbrella clause.

c. Third, the existence of such a promise is allegedly what gave rise to the Claimants' right to the facilities, which Claimants assert has been expropriated.

271. In addition, the Respondent contends that the Claimants' claims relating to an asserted lack of transparency and consistency in the regulatory regime are based on the notion that the Claimants were entitled to receive some kind of an advance notice or warning from Romania that the Raw Materials Incentive would change, because Romania had allegedly promised that the incentive would remain in place until 2009.

272. The Respondent argues that the Claimants must prove two distinct components of this promise: (i) that the EGO 24 facilities would remain unchanged until 2009, and (ii) that the promise was contained in an instrument which either conferred individual rights on them, or was otherwise one on which they could legitimately rely as securing some form of entitlement that was specific to them and that would remain in place even in the case of a general legislative or regulatory change.

273. The Respondent further contends that, to establish any of these claims, the Claimants must prove that Romania's promise was binding under Romanian law:

a. With respect to the fair and equitable treatment claim, the Respondent argues that the Claimants must show that, after exercising due diligence, they legitimately and reasonably relied on an instrument which a reasonable investor, properly advised by Romanian lawyers, would have understood as an assurance of the immutability of the EGO 24 facilities.

b. With respect to the umbrella clause and expropriation claims, the Respondent argues that the Claimants must show that they had an actionable vested right existing under Romanian law which was breached or expropriated.

274. According to the Respondent, the Claimants' claims fail because they have failed to establish the existence of a binding promise under Romanian law.

275. The Respondent's <u>second</u> line of argument is that, regardless of the existence of a promise, either the Claimants did not rely on the existence of that promise to make their investments, or any such reliance was unreasonable. The Respondent argues

that, given the lack of reliance, the Claimants' fair and equitable treatment claim fails, even if a promise existed. In this respect (and as noted below), the Respondent argues that the Claimants' case hinges on the credibility of their witnesses, and their testimony is neither credible nor reliable (Tr., Day 13:19-43 (King)).

276. The Respondent's third line of argument is that the remaining claims (namely, the Claimants' other fair and equitable treatment claims and their claims that Romania impaired the Claimants' investments through unreasonable measures) fail because Romania's actions were reasonably related to a rational policy, which was EU accession. The Respondent also argues that the actions giving rise to the Claimants' assertions of lack of transparency and inconsistency in the regulatory regime were, in fact, reasonable and consistent with the BIT.

277. The Respondent advances further arguments with respect to each of the Claimants' claims, which will be addressed in the specific analysis of each of the Claimants' claims in Chapter VI.

278. Finally, as discussed in Section VII below, the Respondent challenges the Claimants' case on quantum.

279. In addition to these four main arguments, the Respondent challenges the credibility and reliability of the Claimants' witnesses. The Respondent argues that this lack of credibility and reliability was exposed during the November 2010 hearing on the merits, and that this is the reason why the Claimants shifted the focus of their case. Specifically, the Respondent argues that while the Claimants originally focused on their legitimate expectations claim (which requires proof of the Claimants' subjective reliance on their alleged expectations and of the reasonableness of that reliance), after the hearing on the merits the Claimants shifted their focus to their claims related to the umbrella clause, expropriation and transparency. According to the Respondent, these are "claims that have nothing to do with the Claimants in particular", and the Claimants shifted their focus to them because they believe that "these are claims that might survive without the need to rely on the doubtful words of the Miculas and their employee witnesses" (Tr., Day 13, 30:21-31:2 (King)).

280. The Respondent has stated that its challenge to the credibility and reliability of the Claimants' witnesses extends to "all aspects that the Claimants have asserted" (Tr., Day 13, 62:6-8). However, given that the Respondent acknowledges that the umbrella clause, expropriation and transparency claims are premised on objective rather than subjective factors, it seems that the Respondent's challenge to the credibility and reliability of the Claimants' witnesses is directed principally to the Claimants' legitimate expectations claim and their damages case.

281. The Respondent also argues that, despite the Claimants' shift in focus, this is not and has never been a case about transparency; it has only become so because the hearing undermined the Claimants' previous case theory (Tr., Day 13, 19-43 (King)).

282. For the foregoing reasons, the Respondent requests the Tribunal to:

"(a) DISMISS the Claimants' claims in their entirety; and

(b) ORDER the Claimants to pay in their entirety the costs of this arbitration, including the fees and expenses of the Tribunal and the Centre and the reasonable fees and expenses incurred by Romania in defending against the Claimants' claims."

(Respondent's Post-Hearing Brief, ¶ 354).

283. In addition, the Respondent requests the Tribunal to:[14]

"[…]

c. if any amount is awarded to any of the Claimants, whether as damages, arbitration costs, or otherwise, explicitly provide in the award that the amount awarded is subject to set-off against the tax debts of all eleven EFDG companies, including lawful interest and penalties;

d. grant any other relief the Tribunal considers just and proper."

(Respondent's Reply regarding its Revocation Application, ¶ 41)

[14] These additional requests were made in the context of the Respondent's application to revoke the provisional measures recommended by the Tribunal. As noted in paragraph 111 above, the determination of these matters was deferred to the final Award.

V. PRELIMINARY MATTERS

A. THE TRIBUNAL'S JURISDICTION

284. The Tribunal's jurisdiction over this dispute was addressed in the Decision on Jurisdiction and Admissibility, which makes integral part of this Award. In that Decision, the Tribunal found that it had jurisdiction over the dispute submitted to it in this arbitration and rejected any objections as to the admissibility of the claims (Decision on Jurisdiction and Admissibility, ¶ 170).

285. Specifically, in the Decision on Jurisdiction and Admissibility the Tribunal found that:

a. The Tribunal's jurisdiction is determined by Article 25 of the ICSID Convention and Article 7 of the BIT.

b. Regarding jurisdiction *ratione personae*, the Tribunal rejected Romania's argument that the Individual Claimants' Swedish nationality could not be opposed to Romania because of purported tenuous links with Sweden. Accordingly, the Tribunal concluded that Messrs. Micula are and have been Swedish nationals at all times relevant to the Tribunal's jurisdiction. As for the three Corporate Claimants, the Tribunal resolved that they were held by nationals of another Contracting State at the time of consent to arbitration, in accordance with the requirements of Article 25(2)(b) of the ICSID Convention and Article 7(3) of the BIT.

c. Regarding jurisdiction *ratione materiae*, the Tribunal found that the investments made by the Corporate Claimants qualified as such for the purposes of the ICSID Convention. In the same vein, the Tribunal was satisfied that the shareholding of Messrs. Micula qualified as an investment under the ICSID Convention. The Tribunal also held that there was an investment for the purposes of the BIT. Further, the Tribunal expressed no doubt that the dispute was of a legal nature, arising directly out of an investment, for the purposes of Article 25 of the ICSID Convention. Moreover, the Tribunal understood that the dispute was not merely hypothetical and that the Claimants had made a *prima facie* case of entitlement.

d. Regarding jurisdiction *ratione temporis*, the Tribunal found that the dispute arose after the entry into force of the BIT and therefore fell within the scope of application of the BIT *ratione temporis*.

e. The Tribunal also rejected the Respondent's objection related to the remedy of restitution sought by the Claimants, ruling that the Tribunal had powers to order restitution both under the ICSID Convention and the BIT.

B. APPLICABLE LAW

286. Article 42(1) of the ICSID Convention provides that:

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

287. The Parties note that the BIT does not contain a choice of law clause (C-SoC, ¶ 170; R-CM, ¶ 72; R-Rejoinder, ¶ 230). Accordingly, Article 42(1) of the ICSID Convention directs the Tribunal to apply the host state's law (here, Romanian law) and "such rules of international law as may be applicable." The Parties agree that, in the case of conflict between Romanian law and international law, international law should take precedence (C-SoC, ¶¶ 172; R-CM, ¶ 72).[15]

288. The Claimants submit that "where the basis of jurisdiction is a BIT and the claims put forward are based on the BIT, it is established practice to accept the BIT's substantive rules as the applicable law" (C-SoC, ¶ 170). The Respondent appears to agree, noting that "the interpretation of the BIT must be guided by relevant principles of international law", and adding that "[i]ts actual text is of course the starting point" (R-CM, ¶ 73;). Indeed, the Respondent contends that the rule of international law of primary significance to the Claimants' case is Article 2(3) of the BIT (R-Rejoinder, ¶ 230).

289. The Parties disagree however on the role of other rules of international law in this dispute. The Claimants contend that no international law principle displaces the terms of the BIT or otherwise excuses Romania's treaty breaches. In turn, the Respondent argues that the BIT must be interpreted in light of the context in which it was concluded, and should be consistent with Romania's and Sweden's other relevant international law obligations, including in particular Romania's obligations under the Europe Agreement and the EC Treaty. Romania argues that, in any event, the Parties intended EU law to prevail.

290. The Tribunal addresses the Parties' positions below, as well as comments made by the European Commission in its capacity as *amicus curiae*.

[15] See, e.g., *Compañía de Desarrollo de Santa Elena SA v Republic of Costa Rica* (ICSID Case No ARB/96/1), Award, 17 February 2000 (hereinafter *"Santa Elena v. Costa Rica"*), ¶¶ 64-65; *LG&E Energy Corp, LG&E Corp, LG&E International Inc. v Argentine Republic* (ICSID Case No ARB/02/1), Decision on Liability, 3 October 2006 (hereinafter *"LG&E v. Argentina" or "LG&E"*), ¶ 94; *Amco Asia Corporation and others v. Republic of Indonesia* (ICSID Case No. ARB/81/1), Resubmission Proceeding, Award, 5 June 1990, ¶ 40.

1. The Claimants' position

291. The Claimants contend that EU law does not displace the terms of the BIT (C-Reply, ¶¶ 515-555; ER of D. Caron; C-PHB, ¶¶ 86-95). The Claimants argue that there is no conflict of treaties that could make EU law prevail over the BIT, but even if there were, the BIT should prevail (Section (a) below). The Claimants further contend that the Respondent's attempts to interpret the BIT in accordance with EU law should be rejected (Section (b) below). In any event, the Claimants contend that EU law requirements would not justify or excuse breaches of the BIT (Section (c) below).

a. There is no conflict of treaties, and even if there were, the BIT should prevail

292. The Claimants submit that there is no conflict of treaties in this case because the Accession Treaty and the EC Treaty were not in force vis-à-vis Romania at the time it entered into the BIT, or at the time when the breaches of the BIT occurred. Thus, the Claimants assert that:

> Everything here in this case is crystallised prior to the accession of Romania to the EU. The BIT was entered in force before, the breach predates the accession and hence the right to be compensated predates accession. [...] [T]he only element which postdates accession is the payment: the payment of a sum of money which represents the consequences of the breach which predates accession (Tr., Day 12, 141 (Gaillard)).

293. The Claimants also note that the Commission expressly concludes that the BIT has been neither superseded nor terminated by Romania's accession to the EU pursuant to Article 59 of the Vienna Convention.

294. In the Claimants' view, the only treaty with which the BIT could be deemed to be in conflict is the Europe Agreement. The Claimants deny that such a conflict exists, but if such a conflict were deemed to exist, they submit that the BIT should prevail:

a. First, under the preservation of rights provision in Article 9(2) of the BIT, the BIT prevails over external provisions, except to the extent that the latter would be more favorable to the investor than the provisions of the BIT.

b. Second, the BIT prevails as *lex posterior* pursuant to Article 30(3) of the Vienna Convention on the Law of Treaties of 1969 (the "VCLT")[16] because none of the requirements for Article 30(3) to apply is met (in particular, the Europe Agreement and the BIT were not entered into between the same parties, nor do they have the same subject matter).

c. Third, the BIT prevails as *lex specialis*, because it is the treaty with a more precisely delimited scope of application. In addition, the Claimants argue that

[16] Article 30(3) of the VCLT provides: "When all the parties to the earlier treaty are parties also to the later treaty but the earlier treaty is not terminated or suspended in operation under article 59, the earlier treaty applies only to the extent that its provisions are compatible with those of the later treaty."

there is no evidence of Romania's and Sweden's common intention to give precedence to EU law and subordinate the BIT to it. Indeed, the Claimants note that, in the few instances where Romania has intended to give precedence over a BIT to a particular source of law, it has done so expressly.

b. Romania's interpretation of the provisions of the BIT is flawed

295. The Claimants further argue that Romania misapplies Article 31(3)(c) of the VCLT in an attempt to supplant the BIT with EU law. Article 31(3)(c) of the VCLT provides: "There shall be taken into account, together with the context: […] (c) any relevant rules of international law applicable in the relations between the parties." According to the Claimants, Romania's attempt to "interpret" the BIT by taking into account EU law as part of the "relevant rules of international law applicable in the relations between the parties" is an improper attempt to displace the BIT and apply EU law instead. Relying on Prof. Caron's expert opinion, the Claimants argue that:

a. An "interpretation" cannot be construed to abrogate express language in the BIT;

b. The meaning of the terms "shall be taken into account" should be understood to mean that an interpreter of the treaty has the discretion to consider relevant rules of international law, not that such rules must be incorporated into the treaty, and

c. The "relevant rules of international law" are only those that are in place at the time of the violation.

296. As a result, the Claimants argue that, for purposes of Article 31(3)(c) of the VCLT, the Tribunal could "take into account" the Europe Agreement, which existed at the time the BIT entered into force and at the time Romania breached the BIT's provisions (subject to the additional requirement of the Europe Agreement being "between the parties", which the Claimants deny). However, the Tribunal cannot take into account the Accession Agreement or the EC Treaty, as Romania had not entered into either at the time it concluded the BIT. Therefore, in the view of the Claimants, if the Tribunal seeks to determine the relevant state aid requirements that applied to Romania, the Tribunal should refer to the regime existing under the Europe Agreement, rather than the post-accession regime.

c. EU law requirements would not justify or excuse breaches of the BIT or international law

297. The Claimants submit that even if Romania was required by EU law to repeal the EGO 24 incentives prior to their planned expiration in 2009, this would not justify or excuse breaches of the BIT and international law.

298. The Claimants note that, according to Art. 12 of the ILC Articles on State Responsibility (the "ILC Articles"),[17] "[t]here is a breach of an international obligation

[17] Articles on Responsibility of States for Internationally Wrongful Acts adopted by the International Law Commission (ILC) in 2001. The Tribunal notes that the Claimants have included a complete version of the ILC Articles, with commentaries, at Exh. C-592 (ILC Articles on State Responsibility,

by a State when an act of that State is not in conformity with what is required of it by that obligation, regardless of its origin or character." In the Claimants' submission, the relevant international obligations here are those contained in the BIT. Romania would breach those obligations even if its actions were required by EU law. Pursuant to Article 31(1) of the ILC Articles, "[t]he responsible State is under an obligation to make full reparation for the injury caused by the internationally wrongful act."

299. The Claimants submit that, for all of their claims except their fair and equitable treatment claim, the obligation to compensate arises irrespective of the rationale for the adoption of the internationally wrongful act. In their view, Romania's reasons for adopting the measure could only be relevant if Romania were trying to avail itself of one of the circumstances precluding wrongfulness described in Chapter V of the ILC Articles, i.e., force majeure (Article 23), duress (Article 24), or necessity (Article 25). Thus, for their expropriation and umbrella clause claims, the Claimants argue that Romania's "EU law defense" should be assessed after the Tribunal has decided whether there is liability under the BIT, to determine if the reasons for Romania's actions qualify as a circumstance precluding wrongfulness.

300. The Claimants note that Romania has not expressly invoked Articles 23-25 of the ILC Articles, but in any event the Claimants submit that none of them applies. In particular, Romania has not proven the "necessity" of its alleged compliance with its EU law obligations in the terms of Article 25.

301. Even if the doctrine of "necessity" applied, the Claimants contend that Romania would still be required to compensate them. Article 25 only provides an excuse for an act by a state; it does not affect a state's obligation to pay compensation for damages caused by that act (even if excused). Indeed, according to the Claimants ILC Article 27(b) leaves open whether a state relying on a circumstance precluding wrongfulness should nonetheless be expected to make good any material loss suffered.

302. In contrast, the Claimants submit that Romania's EU law defense is relevant to the determination of whether Romania has breached the fair and equitable treatment standard. As explained in further detail below, the Claimants argue that EU law is part of the factual matrix against which the Tribunal must determine whether the Claimants' expectations were legitimate and, specifically, whether they were reasonable (Tr., Day 1, 159-164, 170-177 (Gaillard)). Thus, the Tribunal must assess Romania's EU law defense during the Tribunal's analysis of whether Romania has breached the fair and equitable treatment standard.

Report of the International Law Commission on the Work of Its Fifty-third Session, UN GAOR, 56th Sess., Supp. No. 10, at 43, UN Doc. A/56/10 (2001), and that the Respondent has done the same at Exh. RL-8 (International Law Commission, "Draft Articles on Responsibility of States for Internationally Wrongful Acts with commentaries", [2001-II(2)] Yearbook of the International Law Commission 59). The Tribunal understands that all of these versions are identical and will use them indistinctly. The Tribunal further notes that, by Resolution 53/83 of 12 December 2001, the UN General Assembly took note of the ILC Articles and "commend[ed] them to the attention of Governments without prejudice to the question of their future adoption or other appropriate action." All references to the ILC Articles themselves in this Award are to the version to which the UN General Assembly referred in Resolution 53/83. All references to the commentary to the Articles are to the version adopted by the ILC.

2. The Respondent's position

303. The Respondent argues that the BIT must be interpreted in light of the context in which it was concluded, and should be consistent with Romania's and Sweden's other relevant international law obligations, including in particular Romania's obligations under the Europe Agreement and the EC Treaty. Romania argues that, in any event, the Parties intended EU law to prevail (R-CM, ¶¶ 72-84; R-Rejoinder, ¶¶ 226-258; Tr. Day 13, 50:18-51:24 (King)).

a. The BIT must be interpreted consistently with EU law

304. As noted above, the Respondent does not dispute that the substantive rules of international law applicable to this dispute are those contained in the BIT. However, it argues that the BIT cannot be interpreted in a vacuum. Citing *AAPL v. Sri Lanka*, the Respondent argues that an investment protection treaty "is not a self-contained closed legal system limited to provide for substantive material rules of direct applicability, but it has to be envisaged within a wider juridical context [...]."[18] In this respect, the Respondent argues that the BIT must be interpreted in light of the context in which it was negotiated and concluded between Romania and Sweden. In Romania's submission, this context should take into account the purpose for which it was concluded (Article 31(1) of the VLCT), as well as the circumstances of its conclusion (Article 32 of the VCLT). Romania argues that the conclusion of the BIT was a direct consequence of the Europe Agreement, in the context of Romania's accession to the EU and adoption of the *acquis.*

305. The Respondent also argues that, pursuant to Article 31(3)(c) of the VCLT, when interpreting a treaty, the "relevant rules of international law applicable in the relations between the parties" must also be taken into account. According to Romania, this includes the rules of international law existing at the time the BIT is being interpreted (that is, today). Thus, in Romania's submission, the Europe Agreement and the EC Treaty fall under the category of relevant rules of international law that should be considered when construing the BIT. In this respect, Romania notes that the ILC has stated that "[i]t is a generally accepted principle that when several norms bear on a single issue they should, to the extent possible, be interpreted so as to give rise to a single set of compatible obligations."[19]

306. Specifically, Romania claims that "the BIT should be interpreted as part of a harmonious set of treaty obligations that Romania and Sweden have entered into, starting with the 1993 Europe Agreement and continuing, all pursuant to that same initial instrument with the BIT and the accession treaty [...] [T]he Europe Agreement indeed called on Romania to negotiate BITs with EU countries" (Tr., Day 13, 51 (King)). The Respondent submits that, if the BIT is construed in that light, no conflict between the various instruments arises.

---

[18] *Asian Agricultural Products Limited v. Republic of Sri Lanka* (ICSID Case No. ARB/87/3), Award, 27 June 1990 (hereinafter *"AAPL v. Sri Lanka"*), ¶ 21.

[19] International Law Commission, "Report of the International Law Commission on the Work of its 58th Session", UN Doc A/61/10 (2006), Exh. RL-187, p 408.

307. Romania contends that, in the present case, such a "systemic" interpretation of the BIT is of special importance. It submits that the treatment of foreign investors that Sweden and Romania intended to mandate through the BIT cannot be divorced from Romania's obligations under the Europe Agreement and the EC Treaty. The Respondent argues that Sweden, together with the other EU Member States, expected Romania to take all reasonable measures to comply with the EU treaties, and in particular expected Romania to abolish EGO 24.

308. In view of the above, the Respondent contends that all substantive obligations contained in the BIT must be interpreted in a manner consistent with EU law. This includes in particular Article 64 of the Europe Agreement and Article 87 of the EC Treaty.

b. In any event, the Contracting Parties to the BIT intended European law to prevail

309. The Respondent further submits that, in the unlikely event that the Tribunal should find Romania's obligations under EU law and the BIT impossible to reconcile, any conflict ought to be resolved in favor of EU law.

310. In this respect, the Respondent argues that where conflicts arise between competing rules of international law which cannot be resolved by systemic interpretation, the intention of the relevant States determines which of the competing rules takes precedence. According to the Respondent, in the present case the common intention of Romania and Sweden is clear: they intended the BIT to be subordinated to EU law. As EU law contains more specific rules on state aid, EU law should prevail by application of the principle *lex specialis derogat generali*.

311. In addition, the Respondent argues that it concluded the BIT with Sweden precisely in furtherance of its obligations to the EU and the EU Member States. It would thus be irrational to suppose that Sweden and Romania intended the BIT to circumvent or otherwise weaken EU law. Indeed, for Sweden this would mean breaching the EC Treaty.

312. Finally, the Respondent notes that the European Court of Justice ("ECJ") has ruled that EU law takes precedence over all pre-accession bilateral treaties concluded between Member States (Exh. RL-197 to RL-200).

c. EU law is relevant to the determination of wrongfulness

313. The Respondent asserts that, contrary to the Claimants' contentions, EU law is relevant to the determination of whether it breached the BIT.

314. Specifically, Romania argues that the rights and obligations of Romania and Sweden under the Europe Agreement and, eventually, the Accession Treaty, are not only rules of international law that the Tribunal should take into account when interpreting the BIT, but are relevant in at least three ways: (i) as the factual motivation for the change in Romanian law that is the basis of the Claimants' allegations; (ii) as binding rules of Romanian law, having been incorporated into Romanian law, and (iii) as factual circumstances to take into account as part of the consideration of what would have constituted fair and equitable treatment (R-Rejoinder, ¶ 227).

315. The Respondent further submits that it was indeed "necessary" for Romania to repeal EGO 98 in order to either comply with EU law or accede to the EU. However, the Respondent submits that "necessity" is not the test; the question is whether Romania's course of action was reasonable (R-Rejoinder, ¶ 99). The Tribunal understands Romania's position to be that the requirements of EU law play a role in determining whether Romania breached the standards of the BIT that require the state to act reasonably, in particular, the fair and equitable treatment obligation and the obligation not to impair the Claimants' investments by unreasonable or discriminatory measures. The Tribunal also understands that Romania is not invoking Articles 23, 24 or 25 of the ILC Articles to plead that there are circumstances precluding wrongfulness that would excuse any liability under the BIT.

3. The Commission's position

316. In its capacity as *amicus curiae*, the European Commission submitted comments on the law applicable to this dispute.

317. The Commission's position in this respect is similar to that of the Respondent. The Commission submits that the interpretation of the BIT should take into account the BIT's European context and origin. It notes that the ECJ has recommended interpreting intra-EU BITs in the light of EU law (ECJ Case 26/62, *Van Gend en Loos* [1963], ECR 3). The Commission also submits that the parties to the Europe Agreement intended that any future BIT should subscribe to the same logic regarding state aid law. Therefore, the Tribunal should take into account the EU's state aid rules when interpreting specific BIT provisions. The Commission further contends that Article 30(3) of the VCLT directs the Tribunal to apply the EU's state aid law rather than provisions of the BIT that would prove incompatible with the EC Treaty.

4. The Tribunal's analysis

318. There is no dispute among the Parties that the primary source of law for this Tribunal is the BIT itself. The disagreements lie in the role of other rules of international law, in particular rules arising from treaties established under EU law to which Romania and Sweden are parties.

319. As a first step, the Tribunal notes that there is no real conflict of treaties. In the time period relevant to this dispute, the relevant rules of international law applicable to Romania and Sweden were the Europe Agreement (which entered into force on 1 February 1995) and the BIT (which entered into force on 1 April 2003). The Accession Treaty was not signed until 25 April 2005, and entered into force on 1 January 2007 (date on which the EC Treaty also entered into force with respect to Romania) (ER of F. Jacobs, ¶ 12). Thus, from 1 February 1995 to 1 January 2007, Romania was in a negotiating phase during which it declared that it accepted the *acquis* but it was not properly subject to EU law, with the exception of its international obligations under the Europe Agreement itself. As a result, EU law was not directly applicable to Romania.

320. The relevant question then becomes whether EU law plays a role in the interpretation of the BIT. To answer that question, the Tribunal needs to address three points.

321. First, the Tribunal notes that the BIT does not contain any reference to EU accession or to the EU. Further, the Accession Treaty did not contain any references to the BIT, let alone seek to modify any of the BIT's provisions. To recall, the Europe Agreement entered into force on 1 February 1995, the BIT entered into force on 1 April 2003, and the Accession Treaty was signed on 25 April 2005, and entered into force on 1 January 2007 (on which date the EC Treaty also entered into force with respect to Romania). The Tribunal cannot therefore assume that by virtue of entering into the Accession Treaty or by virtue of Romania's accession to the EU, either Romania, or Sweden, or the EU sought to amend, modify or otherwise detract from the application of the BIT.

322. Second, Article 31(1) of the VCLT provides that "[a] treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose." Article 31(2) expressly notes that such context comprises, *inter alia*, the text of the treaty, including its preamble and annexes. The Preamble of the BIT states that the Contracting Parties have agreed on the terms of the BIT:

> *desiring* to intensify economic cooperation to the mutual benefit of both States and to maintain fair and equitable conditions for investments by investors of one Contracting Party in the territory of the other Contracting Party,
>
> *recognizing* that the promotion and protection of such investments favour the expansion of the economic relations between the two Contracting Parties and stimulate investment initiatives […]

323. The Tribunal must interpret the BIT in light of these overarching goals, which the Parties do not dispute.

324. Likewise, it is undisputed that one of the goals of the Europe Agreement, which predated the BIT, was to promote economic cooperation between Romania and the EC Member States. In this context, Article 74 of the Europe Agreement on investment promotion and protection provided:

Article 74 - Investment promotion and protection

1. Cooperation shall aim to establish a favourable climate for private investment, both domestic and foreign, which is essential to the economic and industrial reconstruction of Romania.

2. The particular aims of the cooperation shall be:

   - for Romania to establish and improve a legal framework which favours and protects investment;

   - the conclusion by the Member States and Romania of Agreements for the promotion and protection of investment [...]

325. This suggests that the BIT was part of Romania's strategy to develop economically in order to obtain accession.

326. That being said (and this is the third point), the Tribunal will interpret each of the various applicable treaties having due regard to the other applicable treaties, assuming that the parties entered into each of those treaties in full awareness of their legal obligations under all of them. In other words, there is no reason to assume that Sweden and Romania had any intent to defeat their obligations under any of the applicable treaties when they entered into each of them and the Tribunal must interpret each treaty – in particular, the BIT – according to that intent of the parties.

327. The Tribunal finds that, factually, the general context of EU accession must be taken into account when interpreting the BIT. In particular, the overall circumstances of EU accession may play a role in determining whether the Respondent has breached some of its obligations under the BIT.

328. The Tribunal notes in this regard that the Parties appear to agree that EU law forms part of the "factual matrix" of the case. In particular, the Parties agree that the question of EU law may be relevant to determining whether Romania acted fairly and equitably with respect to the Claimants' investments in accordance with Article 2(3) of the BIT. The Tribunal concurs. The overall context of EU accession in general and the pertinent provisions of EU law in particular may be relevant to the determination of whether, *inter alia*, Romania's actions were reasonable in light of all the circumstances, or whether Claimants' expectations were legitimate.

329. The Tribunal also sees merit in the Claimants' suggestion that, in theory, EU law could also possibly come into play as a circumstance precluding wrongfulness under ILC Articles 23, 24 or 25. However, as noted above, the Respondent has not put forth a case of force majeure, duress or necessity. Accordingly, the Tribunal does not address the relevance of EU law in this context.

C. THE ENFORCEMENT OF THE ARBITRAL AWARD AND EU LAW

330. The Respondent and the Commission contend that any payment of compensation arising out of this Award would constitute illegal state aid under EU law and render the Award unenforceable within the EU. Prior to determining whether it is useful for

the Tribunal to decide this question (Section 4 below), the Tribunal will set out the Parties' positions. As this point was first raised by the Respondent and second by the Commission, the Tribunal will address the Respondent's position first (Section 1 below), then the Commission's position (Section 2 below), and finally the Claimants' position (Section 3 below).

1. The Respondent's position

331. The Respondent contends that an award of damages in the present case would constitute impermissible state aid (R-CM, ¶ 78 (note 142); First ER of R. Streinz, ¶¶ 29-34; Second ER of R. Streinz, ¶¶ 21-24; ER of F. Jacobs, ¶¶ 45-49; 50(4) and (5); Respondent's observations on Commission's Submission, ¶ 3).

332. Relying on Professor Streinz's expert opinion, the Respondent argues that an award of damages for the abolition of the EGO 24 regime would amount to the granting of new state aid by Romania to the Claimants. For such new state aid to be granted, Romania must first seek and obtain prior approval from the Commission, which in the opinion of the expert would most likely be denied.

333. Professor Jacobs, another of the Respondent's experts, confirms that the payment of compensation in lieu of aid must be regarded as equivalent to a payment of the relevant aid itself. Such a payment in this case would amount to a payment of new state aid and could not be made without the European Commission being informed pursuant to Article 88(3) of the EC Treaty. Prof. Jacobs also states that, as a matter of EU law, an award of compensation in lieu of aid in respect of the period 2007-2009, and possibly in respect of earlier years as well, may be denied enforcement in the EU on grounds of public policy.

2. The European Commission's position

334. The Commission submits that "[i]f the Tribunal rendered an award that is contrary to obligations binding on Romania as an EU Member State, such award could not be implemented in Romania by virtue of the supremacy of EC law, and in particular State aid rules" (Commission's Written Submission, ¶ 125(4)).

335. In particular, the Commission submits that "any award requiring Romania to reestablish investment schemes which have been found incompatible with the internal market during accession negotiations, is subject to EU State aid rules", and "[t]he execution of such award can thus not take place if it would contradict the rules of EU State aid policy." The Commission notes that in the *Eco Swiss* case,[20] the ECJ held that the competition rules of the EC Treaty are part of the public order which national courts must take into account when they review the legality of arbitral awards under the public policy exception recognized by the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards (Commission's Written Submission, ¶ 121).

[20] ECJ, Case C-126/97 *Eco Swiss v. Benetton* ECR [1999] 1-3055, ¶¶ 35-41.

336. The Commission acknowledges that Article 54(1) of the ICSID Convention provides that each Contracting State shall automatically recognize and enforce an ICSID award within its territory as if it were a final judgment of a court in that State. However, it contends that if a national court in the EU were asked to enforce an ICSID award that is contrary to EU law and EU state aid policy rules, the proceedings would have to be stayed under the conditions of Article 234 of the EC Treaty so that the ECJ may decide on the applicability of Article 54 of the ICSID Convention, as transposed into the national law of the referring judge. The Commission notes that "the ICSID Convention is not binding on the EC under Article 300(7) EC, as the terms of the Convention do not allow the EC to become a Contracting Party to it" and concludes that, "[a]ccordingly, the ICSID Convention does not form part of the EC legal order." However, the Commission adds that it "sincerely believes that such a conflict between the BIT, the ICSID Convention, and EC law can be avoided through a contextual interpretation of the BIT or the application of Article 30(3) of the Vienna Convention, as the case may be" (Commission's Written Submission, ¶¶ 122-124).

3. The Claimants' position

337. The Claimants argue that issues regarding enforcement of an award are irrelevant to the Tribunal's decision on the substance of the Claimants' claims. In particular, the Claimants deny that considerations relating to the enforcement of the Award should affect the interpretation of the BIT or the Tribunal's decision as to whether Romania has breached certain provisions of the BIT (Claimants' comments on the Commission's submission, ¶¶ 167-170; C-PHB, ¶¶ 270-278; ER of A. Dashwood, ¶¶ 92-100).

338. In any event, the Claimants submit that, contrary to the Respondent's and the Commission's contention, an award of damages in the present arbitration could not be characterized as a grant of state aid, since the payment of damages would result from the Tribunal's determination that Romania breached the BIT. The Claimants rely on the opinion of Prof. Dashwood, who asserts that an award of damages cannot be equated with the granting of state aid and consequently would not involve any conflict between Romania's obligations under the BIT and its present obligations as a Member State of the EU.

339. The Claimants further contend that Romania was not bound by EU state aid laws when it breached the BIT. The purpose of any award of damages would be to compensate the Claimants for the harm resulting from the Respondent's unlawful conduct, which occurred before Romania joined the EU and became bound by EU law. According to the Claimants, a payment for a breach that predates Romania's EU accession cannot violate EU law.

4. The Tribunal's analysis

340. The Tribunal finds that it is not desirable to embark on predictions as to the possible conduct of various persons and authorities after the Award has been rendered, especially but not exclusively when it comes to enforcement matters. It is thus

inappropriate for the Tribunal to base its decisions in this case on matters of EU law that may come to apply after the Award has been rendered. It will thus not address the Parties' and the Commission's arguments on enforceability of the Award.

341. That being said, the Tribunal notes that Articles 53 and 54 of the ICSID Convention, which are reproduced below, apply in any event to the Award:

> Article 53
>
> (1) The award shall be binding on the parties and shall not be subject to any appeal or to any other remedy except those provided for in this Convention. Each party shall abide by and comply with the terms of the award except to the extent that enforcement shall have been stayed pursuant to the relevant provisions of this Convention.
>
> (2) For the purposes of this Section, "award" shall include any decision interpreting, revising or annulling such award pursuant to Articles 50, 51 or 52.
>
> Article 54
>
> (1) Each Contracting State shall recognize an award rendered pursuant to this Convention as binding and enforce the pecuniary obligations imposed by that award within its territories as if it were a final judgment of a court in that State. A Contracting State with a federal constitution may enforce such an award in or through its federal courts and may provide that such courts shall treat the award as if it were a final judgment of the courts of a constituent state.
>
> (2) A party seeking recognition or enforcement in the territories of a Contracting State shall furnish to a competent court or other authority which such State shall have designated for this purpose a copy of the award certified by the Secretary-General. Each Contracting State shall notify the Secretary-General of the designation of the competent court or other authority for this purpose and of any subsequent change in such designation.
>
> (3) Execution of the award shall be governed by the laws concerning the execution of judgments in force in the State in whose territories such execution is sought.

VI. ANALYSIS OF THE CLAIMANTS' TREATY CLAIMS

342. In the latest presentation of their argument, the Claimants contend in the first place that, by revoking the EGO 24 incentives before they were due to expire, Romania violated an obligation entered into by Romania vis-à-vis the Claimants and thus breached the BIT's umbrella clause. However, even if the premature revocation of the incentives does not breach the umbrella clause (e.g., because the promise allegedly made by the Respondent does not rise to the level of an obligation protected by the umbrella clause), the Claimants argue that the Tribunal could still find a violation of the fair and equitable treatment standard because the revocation undermined the Claimants' legitimate expectations (Tr., Day 12, 126:22-128:6 (Reed)). In view of this alternative argument, the Tribunal will first address the Claimants' umbrella clause claim. If necessary, it will then move on to the Claimants' remaining claims.

A. UMBRELLA CLAUSE

343. Article 2(4) of the BIT provides in relevant part:

> Each Contracting Party shall observe any obligation it has entered into with an investor of the other Contracting Party with regard to his or her investment.

1. The Claimants' position

344. The Claimants contend that through the EGO 24 framework and the related PICs, Romania entered into an obligation with the Claimants with regard to their investment. As a result, they argue that, by revoking the Raw Materials Incentive before it was due to expire, the Respondent breached the BIT's umbrella clause, contained in Article 2(4) of the BIT.

345. Section (a) below addresses the Claimants' position with respect to the nature and scope of the BIT's umbrella clause. Section (b) sets out the Claimants' position with respect to the existence of a specific obligation vis-à-vis the Claimants. Section (c) sets out the Claimants' arguments with respect to the Respondent's alleged breach of that umbrella clause.

a. Nature and scope of the BIT's umbrella clause

346. The Claimants submit that the purpose of umbrella clauses (such as Article 2(4) of the BIT, also called "undertakings clauses") is to put the host state's compliance with commitments assumed vis-à-vis investors under the protective "umbrella" of the relevant treaty. This protection is extended to the state's commitments vis-à-vis the investor independently of whether a violation of the other provisions of the treaty has occurred, with the result that any violation of an assurance given by the host state becomes a violation of the treaty. As a result, claims raised under an umbrella clause are additional to and independent of claims based on unfair and inequitable

treatment, unreasonable or discriminatory measures, treatment less favorable than required by international law and expropriation (C-SoC, ¶ 286).

347. The Claimants submit that, unless a treaty expressly provides otherwise, an umbrella clause is not limited to contractual obligations or undertakings, but may cover unilateral undertakings by the host state, including obligations arising from legislation and regulations (C-SoC, ¶¶ 289-299; C-Reply, ¶¶ 461-468; C-PHB, ¶¶ 6-14).

348. In support of this contention, the Claimants argue that there is no justification to interpret Art. 2(4) of the BIT narrowly. First, pursuant to Article 31(1) of the VCLT, treaty provisions are to be interpreted in accordance to their ordinary meaning. Relying on *SGS v. Philippines*[21], *Eureko v. Poland*[22], *CMS v. Argentina*[23], *LG&E v. Argentina* and *Enron v. Argentina*[24], the Claimants contend that the ordinary meaning of the relevant terms supports the binding nature of the clause, as well as its comprehensive scope. The Claimants rely in particular on *Eureko v. Poland*, where the language of the umbrella clause at issue was very similar to the umbrella clause in the Sweden-Romania BIT ("Each Contracting Party shall observe any obligation it may have entered into with regard to investments of investors of the other Contracting Party"). In that case, the tribunal held that:

> The plain meaning—the "ordinary meaning"—of a provision prescribing that a State "shall observe any obligations it may have entered into" with regard to certain foreign investments is not obscure. The phrase "shall observe" is imperative and categorical. "Any" obligations is capacious; it means not only obligations of a certain type, but "any"—that is to say, all—obligations entered into with regard to investments of investors of the other Contracting Party.[25]

349. In addition, the Claimants note that the tribunal in *Enron v. Argentina* held that "[u]nder its ordinary meaning the phrase 'any obligation' refers to obligations regardless of their nature", noting that "[t]ribunals interpreting this expression have found it to cover both contractual obligations such as payment as well as obligations assumed through law or regulation."[26]

350. The Claimants argue that this is all the more so when the legislation or regulations are specifically designed to induce investors to invest in reliance on those assurances. The Claimants point out that the tribunal in *LG&E v. Argentina* found

---

[21] *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, 29 January 2004 (hereinafter *"SGS v. Philippines"*).

[22] *Eureko B.V. v. Republic of Poland*, Partial Award, 19 August 2005 (hereinafter "*Eureko v. Poland*").

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

[24] *Enron Creditors Recovery Corporation (formerly Enron Corporation) and Ponderosa Assets, L.P*, (ICSID Case No. ARB/01/3), Award, 22 May 2007 (hereinafter *"Enron v. Argentina")*.

[25] *Eureko v. Poland*, ¶ 246.

[26] *Enron v. Argentina*, ¶ 274, (citing *Fedax N.V. v. Republic of Venezuela* (ICSID Case No. ARB/96/3), Award, 9 March 1998, ¶ 29; *SGS v. Philippines*, ¶¶ 127-128; *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, 6 August 2003, ¶ 166; *LG&E v. Argentina*, ¶ 175).

that laws and regulations that targeted foreign investors and applied specifically to their investments gave rise to "obligations" under the meaning of the relevant treaty's umbrella clause.[27]

351. In addition, the Claimants contend that the Contracting States could have chosen to draft the BIT's umbrella clause more restrictively (for example, limiting it to contractual obligations), and chose not to do so.

352. The Claimants deny that the wording of Article 2(4) makes it a particularly narrow umbrella clause, to the extent that it requires that an obligation be "entered into with an investor of the other Contracting Party". In the Claimants' view, this language does not set it apart from other umbrella clauses, as all umbrella clauses require that there be a party to whom the obligation is owed (i.e., the investor). Similarly, the Claimants argue that there is no real distinction between the term "obligations" and "undertakings" for these purposes: when someone undertakes to do something, he or she becomes obliged to do that thing.

353. Second, the Claimants argue that the umbrella clause must be interpreted in a manner that gives it substantive meaning. Relying on *Eureko v. Poland*, they contend that

> It is a cardinal rule of the interpretation of treaties that each and every operative clause of a treaty is to be interpreted as meaningful rather than meaningless. It is equally well established in the jurisprudence of international law, particularly that of the Permanent Court of International Justice and the International Court of Justice, that treaties, and hence their clauses, are to be interpreted so as to render them effective rather than ineffective.
>
> It follows that the effect of Article 3.5 [the umbrella clause] in this proceeding cannot be overlooked, or equated with the Treaty's provisions for fair and equitable treatment, national treatment, most-favored-nation treatment, deprivation of investments, and full protection and security. On the contrary, Article 3.5 must be interpreted to mean something in itself. [28]

354. Third, the Claimants also argue that the binding force of obligations unilaterally assumed by the host State is supported by the binding nature of the consent to international arbitration granted by host states through their national legislation, and is in accordance with the treatment of unilateral undertakings in customary international law (citing the *Nuclear Tests Cases*[29]).

355. Finally, the Claimants argue that there is no way in which EU law can limit the breadth of this umbrella clause. EU law is only part of the factual matrix of the case, and thus the only role it could play in relation to an umbrella clause claim is when any factors precluding wrongfulness come to be examined.

---

[27] *LG&E v. Argentina*, ¶ 175.

[28] *Eureko v. Poland*, ¶¶ 248-249.

[29] *Nuclear Tests Cases (Australia/New Zealand v. France)*, Judgment, 20 December 1974, ICJ Reports 1974 (hereinafter "*The Nuclear Tests Cases*").

356. In response to the Respondent's arguments, the Claimants acknowledge that there is no dispute that umbrella clauses only protect specific obligations. However, as explained below, the Claimants submit that Romania entered into a specific obligation with the Claimants.

b. The EGO 24 regime gave rise to a specific obligation vis-à-vis the Claimants

357. The Claimants contend that, through the EGO 24 regime, Romania entered into a specific obligation vis-à-vis the Claimants, which consisted of Romania's undertaking with respect to the Claimants to maintain the incentives in the Ştei-Nucet disfavored region for the full 10-year period provided by GD 194/1999, which the Claimants argue was stabilized for 10 years (C-SoC, ¶ 300; C-Reply, ¶¶ 467-468; C-PHB, ¶¶ 6-24; Tr., Day 12, 70-91 (Reed), 163-164 (Gaillard)).

358. Although the Claimants acknowledge that, taken on its own, EGO 24 is a general and non-specific piece of legislation, they argue that "the regime as a whole and its specific application to the Claimants gives rise to a specific obligation" (C-PHB, ¶ 15).[30]

359. In the Claimants' view, this specific obligation arises primarily from the content of EGO 24 and its implementing legislation. The Claimants claim that, properly construed, EGO 24, read in conjunction with the implementing measures (in particular, GD 194/1999, the Methodological Norms and the PICs), contained a clear and unequivocal undertaking to provide PIC holders such as the Corporate Claimants with the Raw Materials Incentive until 1 April 2009. According to the Claimants, this undertaking arises from the following features of the EGO 24 regime:

   a. EGO 24 was specifically targeted to persons who invested and conducted business within specific disfavored regions. To benefit from the incentives offered by EGO 24, investors had to be headquartered and conduct business in the disfavored area and had to create new jobs there for the unemployed (EGO 24, Articles 6 and 8).

   b. These disfavored regions were created by government decisions (such as GD 194/1999 and GD 1199/2000), which set out a specific geographic scope and a specific period for which that region would be considered disfavored, as well as the incentives that would be made available in that area and the types of investments that could benefit from them (EGO 24, Articles 3 and 4).

[30] The Claimants had initially argued that Romania had entered into obligations towards foreign investors, including the Claimants, when it granted the incentives on the basis of EGO 24, GD 194 and GD 1199, and that these were the obligations protected under the umbrella clause (C-SoC, ¶ 300). The Claimants have since clarified that the obligations allegedly breached by the Respondent do not arise solely from provisions of a general legislative framework; they arise also from specific commitments and obligations undertaken by Romania in the form of the PICs granted to each of the Corporate Claimants (C-Reply, ¶ 466).

c. To take advantage of the incentives, investors were required to make a specific application for an investor certificate (either temporary or permanent), which required them to submit a detailed investment plan. If they wished to undertake new investments or activities, they needed to submit a new investment plan.

d. Investors were awarded a PIC that set out the period for which it was valid and the fields of activity for which it was valid. PICs were required for investors to obtain the incentives, and had to be presented to the Romanian authorities every single time that investors wished to take advantage of the incentives.

e. Investors assumed obligations in exchange for the incentives. In particular, they were required to employ persons living in the disfavored area (EGO 24, Article 8); they were required to undertake investments prior to obtaining the PIC and, after receiving the PIC, they had to maintain their investments in the disfavored region for twice the period of time they enjoyed the incentives (EGO 24, Articles 7 and 9).

360. In addition, the Claimants argue that the existence of Romania's specific obligation was evidenced by Romania's conduct, in particular its promotion of the EGO 24 regime and the extensive monitoring that PIC holders were subjected to throughout the period during which they received the incentives.

361. In view of the above, the Claimants contend that "the entire EGO 24 regime was far more than a general legislative scheme. Instead it was a specific scheme targeted to specific investors in specific regions for specific periods of time. Further the rights granted were given in exchange for investors undertaking specific obligations, carrying out investments specified in investment plans and receiving specific PICs by which the investors' rights were granted (and conversely from which the Respondent's obligations arose)" (C-PHB, ¶ 16). Relying on the testimony of Mr. Neculai Liviu Marcu, the Claimants add that "[t]he specific purpose of that regime was to entice investors to invest in the least developed areas of Romania; areas in which they would not otherwise invest" (*Id. See* also WS of N. Marcu, ¶¶ 31-32; Tr., Day 7, 51-53).

362. The Claimants argue that the fact that Romania's undertaking is not contained in one particular document is irrelevant. It is plain from EGO 24 itself that it did not stand alone; it required and expressly provided for implementing measures to be taken by the Romanian Government. Articles 3 and 4 of EGO 24 required government decisions to declare and delineate disfavored areas, determine the period of time for which each disfavored zone is to be declared, and determine the eligible investments and the incentives which would be granted to investors. In addition, Article 15 required methodological norms to be established by government decision.

363. Nonetheless, the Claimants contend that the basic scheme of the incentives program was set out in EGO 24 (Exh. R-68). Disfavored areas had to satisfy the conditions set out in Article 1. They could be declared for a period of between 3 and 10 years at the discretion of the government authorities. The incentives that could be granted

were set out in Article 6, but it was the government decision for each disfavored area that would determine which incentives were available in that area. In turn, Article 8 provided that, to benefit from the incentives, companies had to be headquartered and conduct business in the disfavored area and had to create new jobs there for the unemployed. Articles 7 and 9 provided that investors would have to refund the incentives if the investments were not maintained in the disfavored area for twice the period during which they had been eligible to receive the incentives.

364. Although the Claimants concede that EGO 24 did not spell out that the incentives available within the disfavored area would be maintained for the entire period for which the disfavored area had been declared disfavored, this is, in the Claimants' submission, the only sensible interpretation of EGO 24. Indeed, they argue that it is also the way it was interpreted by the Romanian Government, as evidenced by the government decisions that implemented EGO 24.

365. The Claimants rely in particular on GD 194/1999 (Exh. C-280, also C-31), which is the government decision that declared Ştei-Nucet a deprived zone (Article 1). Article 3 provides that the period for which Ştei-Nucet shall be declared a deprived zone is 10 years. Article 4 then states that "[d]uring the period of existence of the deprived zone [...] there shall be granted the facilities provided in Annex No. 2." In turn, Annex No. 2, which forms part of GD 194/1999, sets out that investors shall benefit from all of the facilities provided for in Article 6 of EGO 24. As a result, the Claimants argue that Article 4 of GD 194/1999 explicitly ties the period during which the incentives are granted to the period of existence of the deprived zone.

366. The Claimants find additional support in the fact that the language of Article 4 in 37 of the 38 government decisions which declared disfavored areas between 1998 and 2003 is either identical or virtually the same as the language of Article 4 of GD 194/1999 (Table contained at Tab 5 of Vol. 1 of the Claimants' documents for the closing hearing (Shearman & Sterling)). They note that 20 of these 37 government decisions, including GD 194/1999, were signed by Mr. Nicolae Staiculescu, who testified that the incentives were to be offered for the entire period during which the area was a disfavored region (WS of N. Staiculescu, ¶¶ 21-22).

367. The Claimants also note that Mr. Marcu, who was the president of the National Agency for Regional Development, submitted similar testimony:

> We interpreted Article 4 as a firm pledge, commitment on behalf of the government to maintain the zone for a ten-year period in order to persuade investors that we were meaning what we were saying and to give them incentives to invest bigger sums of money in those areas to fulfil the needs of those regions, for example. This created employment, provided social protection through income and also social protection for the families of the miners. (Tr., Day 7, 15:2-9 (Marcu))

368. The Claimants argue that neither Mr. Staiculescu nor Mr. Marcu's testimony was challenged at the hearing on that point.

369. The Claimants find further support in the Methodological Norms issued through GD 728/2001 (Exh. R-35, R-69), which define the period in which companies are deemed to have benefitted from the incentives for purposes of the obligation to repay the incentives if they are voluntarily liquidated or cease operations under Articles 7 and 9 of EGO 24, as "the period between the moment when the certificate of investor in the disfavored area was obtained and the moment when the disfavored area ceases to exist" (Article 1(f) of GD 728/2001, as translated in Exh. R-69). In the case of temporary investor certificates, "followed by the procurement of the certificate of investor in disfavored area, the period is calculated from the moment the provisional certificate of investor is obtained until the disfavored area ceases to exist" (*Id.*). Further, Article 5 of GD 728/2001 (as translated in Exh. R-35) confirms this when it states that "[t]he business entities which obtained the certificate of investor in the disfavored area and which perform activities from fields of interest other than those provided under annex no. 1 shall continue to benefit from facilities under the law, until the expiry of the period for which the disfavored area was declared."

370. According to the Claimants, it is thus clear from EGO 24, read in conjunction with the methodological norms, that the incentives were to be granted for the entire period between the date of the granting of the investment certificate (temporary or permanent), and the expiry of the disfavored area, which in the case of Ştei-Nucet was 1 April 2009. This was further evidenced by the PICs issued to the Corporate Claimants, which expressly stated that the certificate holder benefitted from the incentives under GD 194/1999 and that the certificate was valid until 1 April 2009.

371. The Claimants also submit that this interpretation is the only one that makes sense from a teleological standpoint. According to the Claimants, if the incentives could have been revoked at any time, they would have been ineffective in incentivizing investment, because investors would have lacked the certainty that they would have needed to commit funds.

372. Contrary to the Respondent's contentions, the Claimants submit that the implementing measures (such as GD 194/1999 and the PICs) did not go beyond what was authorized in the primary legislation (EGO 24). They argue that the only sensible interpretation of EGO 24 is that it authorized the grant by government decision of a predetermined list of incentives for a period between 3 and 10 years. The Claimants contend that this was confirmed by Prof. Baias, the Respondent's expert on Romanian law, who testified that when GD 194/1999 was adopted, it was not in conflict with EGO 24. Rather, his position was that it became in conflict with the modified version of EGO 24 when the incentives were revoked, because GD 194/1999 was not modified accordingly (Tr., Day 5, 264:5-266-2 (Reed/Baias)).

373. According to the Claimants, Prof. Baias's testimony confirms that, at the time when GD 194/1999 was enacted, it provided that the incentives set out in Annex 2 were being granted for the full period until 1 April 2009, and that it neither contradicted nor added to EGO 24. This proves that, at the time that the investments were made, the Claimants had a clear and unambiguous commitment from the Romanian State that the incentives would be granted for 10 years. There was nothing unlawful or

improper in that commitment, and any contradiction only arose when the incentives were repealed prematurely.

374. The Claimants also deny that the various amendments made to the EGO 24 regime demonstrate the absence of such a commitment by the Romanian State. Even if significant amendments were made to the EGO 24 regime to the investors' detriment, they were done in a way to protect existing investors' rights, or in order to address specific problems in relation to specific industries or in relation to Romania's tax regime.

375. The Claimants also argue that the absence of a stabilization clause did not mean that Romania could renege on its commitment. Contrary to the Respondent's contention, the *Parkerings v. Lithuania*[31] case does not require a stabilization clause to prevent a state from amending its legislation. In the Claimants' view, the *Parkerings* tribunal cites a stabilization clause as one (but not the only) type of measure pursuant to which a state can promise to freeze or stabilize an existing regulatory framework. The Claimants submit that an express promise enshrined in the legislation to keep a particular regulatory framework in place for a defined period of time also constitutes such an undertaking. In other words, the Claimants submit that, in agreeing to provide certain incentives for ten years, the state in effect agrees not to change the law before then. According to the Claimants, an additional promise that the state will not renege on its earlier promise would be superfluous.

376. Finally, the Claimants contend that the Respondent's reliance on Decision 130/2003 of the Constitutional Court of Romania (Exh. RL-214) is misplaced, because it deals with incentives granted under Law 35 and not the incentives granted under EGO 24. It is thus a matter of pure speculation what the Constitutional Court would have found if it had been dealing with EGO 24.

377. In particular, the Claimants reject Prof. Baias' opinion that it is possible to extrapolate from Decision 130/2003 what the Constitutional Court would have decided in a case dealing with EGO 24. The Claimants argue that Prof. Baias based his opinion on the premise that Law 35 and EGO 24 were "more or less identical" (Tr., Day 6, 27:9-10), when in fact there are key differences between Law 35 and EGO 24 which according to the Claimants go to the root of the Constitutional Court's reasoning in Decision 130/2003. The Claimants contend that Law 35 provided positive discrimination in the form of incentives for foreign investors investing anywhere in Romania, without requiring the investor to fulfill any requirements. Unlike EGO 24, Law 35 did not require the investor to invest in a disfavored area, nor did it require it to create any particular number of new jobs or employ the unemployed. It was not even necessary to obtain an investor certificate; all that was required was proof that the investor was foreign. The Claimants argue that the Constitutional Court decided that the repeal of Law 35 incentives did not breach the rule of law because it merely did away with

[31] *Parkerings-Compagniet AS v. Republic of Lithuania* (ICSID Case No. ARB/05/8), Award, 11 September 2007 (hereinafter *"Parkerings v. Lithuania"* or *"Parkerings"*),

positive discrimination and put foreign investors on a level playing field with domestic competition.

378. To the contrary, the Claimants argue that, to qualify for the incentives under EGO 24, the investor was required to show that it had met its side of the bargain. This included fulfilling all the obligations mentioned above, in addition to submitting an investment plan, undergoing an on-site inspection and various monitoring procedures during the lifetime of the investments. Thus, in the Claimants' submission, Decision 130/2000 is of no assistance and of no relevance to an analysis of EGO 24.

c. Romania breached the BIT's umbrella clause

379. In view of the above, the Claimants contend that, by revoking the Raw Materials Incentive effective 22 February 2005, Romania breached a specific obligation it had entered into with respect to the Claimants' investments, and as such violated the BIT's umbrella clause.

2. The Respondent's position

380. The Respondent denies that it has breached the BIT's umbrella clause. It contends that the Claimants' umbrella clause claim does not comport with the plain text of Article 2(4) of the BIT, and is inconsistent with established jurisprudence on the application of umbrella clauses. In particular, the Respondent argues that the regulatory acts upon which the Claimants rely created no "obligation" enforceable through Article 2(4). Thus, the necessary predicate of Article 2(4) – an enforceable obligation under Romanian law – is absent. The Respondent argues that Romania never "entered into" any obligation specifically with the Claimants, and nothing in the relevant Romanian legal texts suggests that Romania undertook to freeze its regulatory regime for ten years (R-CM, ¶¶ 175-188; R-Rejoinder, ¶¶ 37-38, R-PHB, ¶¶ 104-120, 203-206; Tr., Day 13, 75-134 (Petrochilos)).

381. Section (a) below addresses the Respondent's comments with respect to the nature and scope of the BIT's umbrella clause. Section (b) sets out its comments on the existence of an obligation covered by the umbrella clause. Section (c) addresses its arguments on the absence of a breach of the umbrella clause.

a. Nature and scope of the BIT's umbrella clause

382. The Respondent contends that the umbrella clause contained in Article 2(4) of the BIT is one of the narrowest used in investment treaties. According to the Respondent, its formulation limits the scope of the provision in the following ways:

a. It is limited to "obligations", and does not cover "undertakings".

b. The obligations must have been "entered into with an investor". It is not open to obligations or undertakings "related to an investment", as do the majority of umbrella clauses.

c. The obligations must be specific (i.e., entered into with a specific investor), and thus it does not cover general obligations.

383. The Respondent notes that there is debate on whether umbrella clauses elevate municipal law rights to the international law realm, or simply provide an international remedy to enforce rights that remain in their essence and scope creations of national law. However, it argues that the Claimants' case fails under either proposition. This is because, according to the Respondent, generally-applicable regulatory and legislative acts, standing alone, do not give rise to the kind of obligations covered by umbrella clauses (even under those more broadly formulated). In the Respondent's view, umbrella clauses only protect contractual or quasi-contractual obligations.

384. The Respondent relies on the writings of Dr. F.A. Mann, Dr. Shihata, Prof. Dolzer and Ms. Stevens, Prof. Gaillard and Prof. Schreuer, noting that in their view umbrella clauses mainly or exclusively protect contractual commitments. The Respondent also relies on *Continental Casualty v. Argentina*, where the tribunal, faced with an umbrella clause broader than the present one (applying to obligations "with regard to investments"), found that

> It should be clear that this umbrella clause does not come into play when the breach complained of concerns general obligations arising from the law of the host State. … Therefore, the provisions of the [disputed legislation] cannot be a source of obligations that Argentina has assumed specifically with regard to the Claimant's investment company and which are protected under the BIT's umbrella clause.[32]

385. To the contrary, the Respondent contends that there is no authority for the Claimants' position that legislative or regulatory acts, standing alone, can constitute "obligations" enforceable through an umbrella clause. They note that most decisions applying umbrella clauses have involved contractual obligations entered into by the state, and in the few cases where tribunals have found a breach of provisions due to a legislative change (such as *LG&E v. Argentina*), the state had provided separate and specific commitments to investors in which it guaranteed that a particular legislative regime would not change. Specifically, it argues that, in *LG&E v. Argentina,* the tribunal's determination that the dismantling of the regulatory regime in the gas-transmission sector resulted in the breach of the (broadly-worded) umbrella clause turned upon specific assurances that Argentina had given investors that the regulatory environment would remain stable.

386. The Respondent further contends that the Claimants' reliance on *CMS v. Argentina* is misplaced, noting that the part of that award dealing with umbrella clauses was subsequently annulled by an ICSID *ad hoc* committee. The Respondent argues that the *CMS v. Argentina* annulment committee reversed the tribunal's findings with respect to whether umbrella clauses can, as a matter of principle, extend to general legislative acts, in the following terms:

---

[32] *Continental Casualty Company v Argentine Republic* (ICSID Case No ARB/03/9), Award, 5 September 2008 (hereinafter *"Continental Casualty v. Argentina"*), ¶¶ 300 and 302.

> [I]t seems clear that Article II(2)(c) is concerned with consensual obligations arising independently of the BIT itself (i.e. under the law of the host State or possibly under international law). Further they must be specific obligations concerning investment. They do not cover general requirements imposed by the law of the host State.[33]

387. According to the Respondent, the drafting of the umbrella clause applicable in this case reinforces the inadmissibility of a claim based upon regulatory acts. It argues that, by limiting the scope of the provision to obligations "entered into with" qualifying investors, the drafters of the BIT intended it to apply exclusively to contractual or quasi-contractual obligations (e.g., those arising from an individual license granted by the state), which are created and enforceable under domestic law. Unilateral instruments such as laws and regulations, which are per se liable to change, cannot be understood to have been "entered into" with anyone.

b. Romania did not enter into a specific obligation with the Claimants

388. Further, the Respondent argues that, whatever the scope of the BIT's umbrella clause, the claim fails because there is no "obligation" that may trigger the application of the clause. The Respondent contends that, in order to be elevated to the protection of the umbrella clause, this obligation must have given the Claimants an actionable vested right under Romanian law.

389. Relying on *SGS v. Philippines* and *Eureko v. Poland,* the Respondent submits that the obligation that is protected under the umbrella clause has a proper law (usually domestic law), and its nature does not change by being enforced under the treaty. Therefore, to be actionable under the treaty, the obligation must have been actionable under domestic law. For this, the alleged obligation must have constituted a vested right under domestic law, which the Respondent argues was the case in *Enron v. Argentina* and *LG&E v. Argentina*. However, it argues that it is not the case here.

390. Contrary to the Claimants' contentions, the Respondent argues that under Romanian law the Romanian State was under no obligation to make all of the facilities available to the Claimants for 10 years. The Claimants have identified no contractual or quasi-contractual obligations of any kind that might have been entered into and owed to them in relation to the facilities, nor have the Claimants alleged any assurances or other unilateral undertakings by Romania directed to them specifically. As a result, the Claimants had no vested right to the facilities.

391. The Respondent argues that the Claimants' case as to the source of that alleged obligation (and corresponding right) has changed over time, but all of those theories fail. The Respondent also contends that if Romania had decided to bind itself to regulatory stasis for ten years, it would have done so in one clear instrument, through an appropriate organ, and that instrument would contain clear terms with respect to the promise of stability and its duration. This obligation cannot be implied from a patchwork of documents and a selection of surrounding circumstances.

[33] *CMS v. Argentina,* Decision on Annulment, 25 September 2007, ¶ 95a.

392. More specifically, the Respondent contends that none of the regulatory acts invoked by the Claimants (EGO 24/1998, GD 194/1999 and GD 1199/2000), whether alone or in conjunction with the PICs, created obligations "entered into" with the Claimants.

393. First, the source of the obligation could not have been EGO 24. The Respondent concedes that "there is no doubt that EGO 24 set forth a generalized entitlement that could be claimed by qualifying investors" (Tr., Day 13, 85:7-10 (Petrochilos)). Article 4(c) of EGO 24 stated that a government decision would determine the facilities "provided by law" that would be granted to investors (which confirms that the source of the entitlement is EGO 24). But it contained no promise as to the length of time the facilities would remain available, nor any stabilization language (unlike its predecessor, Law 35, which did contain express stabilization language). The Respondent further argues that, under Romanian law, general laws such as EGO 24 do not confer individual vested rights (as was confirmed by the Romanian Constitutional Court in Decision 130/2003).

394. Second, the Respondent notes that the Claimants' latest theory seems to be that GD 194/1999, read together with the PICs, creates an obligation for the State. However, according to the Respondent this is impossible as a matter of Romanian law. Relying on the expert opinion of Prof. Baias, it argues that these were subsidiary normative or administrative instruments issued to implement and administer EGO 24 and Law 20/1999, which could not modify or contradict the authority of a government ordinance or a law, and as such could not have granted an entitlement beyond what EGO 24 authorized. In particular, they could not have imposed significant, long-term obligations on the State that the authorizing statute did not impose. As a result of the hierarchy of Romanian laws, the Government, implementing the law through the government decision, could not have bound the legislature not to change the law. And once EGO 24 was modified, GD 194/1999 could not have had a broader field of application than the modified EGO 24. Thus, no prudent investor in Romania could have understood Annex 2 of GD 194/1999 as freezing the facilities there listed. For the same reason, because EGO 24 created no vested right but only a general entitlement, neither could GD 194/1999 or the PICs create such a vested right.

395. In any event, the Respondent argues that the Claimants' theory has no support from their Romanian law expert, Prof. Mihai. Considering that the nature of GD 194/1999 and the PICs has become the cornerstone of their expropriation, umbrella clause and fair and equitable treatment cases, the Respondent considers it notable that Prof. Mihai made no mention of either instrument in his expert report.

396. The Respondent also denies that the PICs could have been the source of an investor's right to the EGO 24 incentives. For the Respondent, the correct interpretation is that the PICs were merely administrative tools that certified the holders' eligibility to obtain the facilities; the source of the right was EGO 24. Specifically, the Respondent argues that Article 5 of the GD 525/1999 published on 8 July 1999 (Exh. R-6),[34] which approved the 1999 Methodological Norms for the

[34] The Respondent notes that GD 525/1999 replaced an earlier version of the methodological norms, contained in GD 907 of 1998, published on 22 December 1998.

application of EGO 24, stated that the "incentives provided by the law shall be granted pursuant to the certificate of the investor in a disadvantaged region". Such a certificate was to be issued by the relevant Regional Development Agency, upon an investor's request. According to the Respondent, the language of Article 5 makes it explicit that the PICs merely certified eligibility to "incentives provided by the law". That law was EGO 24, as approved by Law 20, neither of which contained any provision concerning their duration nor any restriction on the government's ability to amend or repeal them.

397. According to the Respondent, this conclusion was reaffirmed by a subsequent version of the Methodological Norms, adopted by GD 728/2001 (Exh. R-35). Article 4(1) of these Methodological Norms stated: "The *facilities provided by the law* are granted based on the certificate of the investor in the disfavored area" (emphasis added by the Respondent). According to the Respondent, this demonstrates that the content of the facilities was established by law (i.e., EGO 24) and that PICs were an administrative tool attesting to eligibility to access facilities available under EGO 24.

398. The Respondent contends that the language of the PICs themselves does not change this conclusion. All the PICs stated was that the titleholder was the beneficiary of the facilities granted under GD 194/1999, in accordance with the provisions of EGO 24 approved and amended by Law 20, and in accordance with the government decision approving the methodological norms. Accordingly, all the PICs did was certify that the titleholder was the beneficiary of the facilities granted by the law, whatever the law determined that those facilities were at any point in time.

399. The Respondent further argues that the PICs did not list any individual facilities, let alone purport to stabilize them for any particular period. The PICs only stated that they were valid until a given date. That only meant that they certified eligibility to whatever facilities were available under the law until that date.

400. The Respondent rejects the Claimants' argument that the PICs were the source of the right to the facilities because they had to present them every time that they wanted to benefit from them. The PICs were needed so that administrators did not have to evaluate eligibility on each occasion that a business applied for an exemption. This conclusion is also supported by the fact that it was not necessary to obtain a new PIC each time EGO 24 was amended; the PIC continued to certify eligibility to the remaining facilities in EGO 24, as amended. This was confirmed by the Claimants' expert, Prof. Mihai (Tr., Day 5, 215).

401. The Respondent also denies that the administrative process to qualify for a PIC was equivalent to a contractual negotiation, or that the PICs were tantamount to contracts. In the legal order in which that process occurred, the issuance of a PIC did not create a contract. Nor did the obligation to submit an investment plan amount to a bilateral deal; the investment plan was merely a requirement for the government to establish that investors met the qualifying criteria.

402. Similarly, the requirements to employ a certain number of unemployed persons and to have made certain investments were part of the criteria for eligibility; they did not establish the existence of a promise that the facilities would be available for a certain duration. The Respondent adds that it is misleading to suggest that these requirements show that EGO 24 was intended to foster capital intensive industries, because there was no threshold of magnitude for a qualifying investment, the employment requirement was met by employing ten persons, five of which had to be unemployed, and the eligible sectors covered a wide range of activities.

403. The Respondent also denies that EGO 24 created an obligation for investors to maintain their investments for twice as long as the investor is a recipient of the incentives. The Respondent alleges that it "has repeatedly stated that the obligation does not exist and that (therefore) it has no intention of enforcing it" (R-Rejoinder, ¶ 118). In any event, it argues that the alleged obligation is of only theoretical interest, because the Claimants have no desire to move the operations from Bihor county, and thus the state has never had the occasion to enforce the alleged obligation. However, it notes that Prof. Mihai did not address this matter in his expert opinion, and the Claimants have not cited any instances in which any investor has been subjected to the supposed obligation, or any Romanian court or agency has interpreted it in that fashion.

404. The Respondent further contends that neither the monitoring process to which the Claimants were submitted, nor the alleged promotion of the EGO 24 regime by government officials, could have given rise to a promise that the facilities would remain unchanged for any period of time.

405. Finally, the Respondent contends that the Romanian Constitutional Court disagrees with the Claimants' theory: when the profit tax exemption available under Law 35 of 1991 was repealed, the Constitutional Court found that the repeal of that exemption could not be construed as the termination of a contract, nor as an infringement of the right to property or of the investor's right to recover debt (Decision 130/2003). The Respondent notes that Prof. Mihai called this decision *ultra vires* at the hearing but did not discuss it in his expert report, while Prof. Baias confirmed the decision's relevance for this case. Thus, Romania submits that the Tribunal should afford this decision great weight and conclude that GD 194/1999, alone or together with the PICs, did not constitute a contractual or other obligation under Romanian law.

c. Even if the umbrella clause were applicable, Romania did not breach it

406. Even assuming that the regulatory acts relied upon by the Claimants could have created "obligations entered into" with the Claimants, the Respondent argues that it could not have failed to observe such obligations simply by modifying the facilities. If the underlying obligation (properly construed under its governing law) has not been breached, then there cannot be a breach of the umbrella clause.

407. Specifically, the Respondent argues that nothing in EGO 24 could be construed as a guarantee to preserve EGO 24 unchanged for ten years. The only reference to

duration is found in Article 5, which provides that "[a] geographical area can be declared a disfavoured zone at least for three years but not for more than ten". Romania did not breach or amend this provision: both Ştei-Nucet and Drăgăneşti retained their status of "disfavoured regions" until April 2009, as provided in GD 94/1999[35] and GD 1199/2000.

408. As to the availability of the facilities, the Respondent argues that there was nothing in EGO 24 that prevented the Respondent from eliminating some of them (the Respondent notes that the Profit Tax Incentive was maintained). Relying on *Parkerings v. Lithuania*,[36] the Respondent contends that the mere existence of a law or regulation in no way implies that the government will not amend its terms. EGO 24/1998 contained no "stabilization" element that could ensure that the facilities listed therein would remain unchanged for ten years. Thus, Romania could not have assumed any obligation to freeze the content of the facilities regime simply by promulgating EGO 24/1998. To the contrary, the Respondent argues that by the time the facilities were first extended under EGO 24/1998, Romanian law on state aid (Exh. R-75) specifically provided that such measures were subject to possible repeal at any time. In particular, Article 13 of the State Aid Law provided:

> (1) The Competition Council and the Competition Office will supervise on a permanent basis all the existent aids. If it is determined that an existent aid distorts relevantly the normal competitive environment and affects the proper enforcement of the international agreements in which Romania is a party, the Competition Council will request the aid provider to adopt proper measures in order to remove its incompatibility with this law. Such measures may include a recommendation for cancellation or amendment of the existent aid. Such recommendations will be submitted also to the Competition Office achievement monitoring of the imposed measures.
>
> (2) If the measures are not adopted by the aid provider, within the time frame indicated in the request, the Competition Council may decide to stop the granting of the existent aid or may impose conditions and obligations which may insure the compatibility of the aid with this law's dispositions. The decision will not have a retroactive effect and must allow the aid provider a reasonable time period in order to comply with such decision.

409. Accordingly, the Respondent argues that as Romania was under no obligation to make all of the facilities available to the Claimants for 10 years, failure to do so cannot constitute a breach of the umbrella clause.

3. The Tribunal's analysis

a. Interpretation of the BIT's umbrella clause

410. Article 2(4) of the BIT provides that "[e]ach Contracting Party shall observe any obligation it has entered into with an investor of the other Contracting Party with regard to his or her investment."

[35] The Tribunal understands that the Respondent refers to GD 194/1999.

[36] *Parkerings v. Lithuania*, ¶ 332.

411. The Parties agree that, for the umbrella clause to apply, Romania must have entered into an obligation with the Claimants with regard to their investment. The Parties further agree that this obligation must be specific. The Parties dispute whether the EGO 24 framework and the PICs did in fact give rise to such an obligation. The Parties also dispute whether the repeal of the Raw Materials Facility constituted a breach of any such obligation, to the extent it arose.

412. The first step in the Tribunal's analysis is thus to determine whether the EGO 24 framework gave rise to an "obligation" in the meaning of Article 2(4) of the BIT. Pursuant to Article 31(1) of the VCLT, "[a] treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose." The Tribunal sees no reason to deviate from this rule.[37] Accordingly, the Tribunal must first turn to the ordinary meaning of the term "obligation".

413. Relying on *Enron v. Argentina*, the Claimants argue that "[u]nder its ordinary meaning the phrase 'any obligation' refers to obligations regardless of their nature", noting that "[t]ribunals interpreting this expression have found it to cover both contractual obligations such as payment as well as obligations assumed through law or regulation."[38]

414. The Respondent denies this. It argues that generally-applicable regulatory and legislative acts, standing alone, do not give rise to the kind of obligations covered by umbrella clauses (even under those more broadly formulated). In the Respondent's view, umbrella clauses only protect contractual or quasi-contractual obligations.

415. The Tribunal agrees with the tribunal in *Eureko v. Poland* that the term "'[a]ny' obligations is capacious; it means not only obligations of a certain type, but 'any' – that is to say, all – obligations entered into with regard to investments of investors of the other Contracting Party."[39] In addition, the BIT specifies that these obligations must also be "entered into with an investor [...] with regard to his or her investment". This language suggests that the state must have committed with respect to a particular investor with regard to his or her investments.[40] Indeed, both sides agree

[37] In doing so, the Tribunal adopts the line followed by the tribunals in *SGS v. Philippines*, ¶¶ 114- 128 (although it partially based its decision on considerations extrinsic from the text); *Eureko v. Poland*, ¶¶ 244-260; *Enron v. Argentina,* ¶¶ 273-277; *SGS Société Générale de Surveillance S.A. v. Republic of Paraguay* (ICSID Case No. ARB/07/29), Decision on Jurisdiction, 12 February 2010, ¶¶ 167-168; *Burlington Resources, Inc. v. Republic of Ecuador* (ICSID Case No. ARB/08/5), Decision on Liability, 14 December 2012 (hereinafter *"Burlington v. Ecuador"*), ¶ 212.

[38] *Enron v. Argentina*, ¶ 274.

[39] *Eureko v. Poland*, ¶ 246.

[40] *See, e.g.,* F.A. Mann, "British Treaties for the Promotion and Protection of Investments," 52 British Yearbook of International Law (1981), Exhibit RL-257, p 246 (explaining that an umbrella clause "only covers an obligation arising from a particular commitment either of the Contracting Parties may have entered into. […] What is assumed is that the State has entered into a particular commitment which imposes obligations. Such obligations may arise from contract with the State or from the terms of the licence granted by it. It may be express or implied, it may be in writing or oral. But it must be clearly ascertainable as an obligation of the State itself arising from its own commitments. No difficulty occurs where the contract is made with the State itself – and the term may fairly be said to comprise its instrumentalities, even if they are separate legal entities, as well as companies of which it is the sole

that the obligation must be specific. Thus, the umbrella clause in this BIT covers obligations of any nature, regardless of their source, provided that they are indeed "obligations" entered into with a particular investor with regard to his or her investment.

416. Having said this, for the umbrella clause to be triggered, there must be an obligation in the first place. The BIT does not define "obligation", nor have the Parties attempted to do so. The Claimants simply state that the term obligation is equivalent to an "undertaking", because when someone undertakes to do something, they become obliged to do that thing. The Respondent, however, submits (and the Claimants do not seem to dispute) that the determination of whether an obligation exists must be done in accordance to domestic law. Specifically, the Respondent has argued that in order to be elevated to the protection of the umbrella clause, the obligation must have given the Claimants an actionable vested right under Romanian law.

417. In the Tribunal's view, establishing whether an obligation exists is a question that cannot be answered by turning solely to the interpretation of the meaning of this term as stated in the BIT. The purpose of the umbrella clause is to cover or "elevate" to the protection of the BIT an obligation of the state that is separate from, and additional to, the treaty obligations that it has assumed under the BIT. As noted by the *Burlington v. Ecuador* tribunal, this separate and additional obligation does not exist in a vacuum; it is subject to its own proper law.[41] In the words of the tribunal in *SGS v. Philippines*, an umbrella clause

> … does not convert non-binding domestic blandishments into binding international obligations. It does not convert questions of contract law into questions of treaty law. In particular it does not change the proper law of the [relevant agreement] from the law of the Philippines to international law.[42]

418. This Tribunal concurs with this view. Thus, whether an obligation has arisen depends on the law governing that obligation, and so the interpretation of the term "obligation" for purposes of the umbrella clause would rely primarily on that law rather than on international law. In other words, to be afforded the protection of the BIT, the obligation must qualify as such under its governing law. In this case, the governing law cannot be other than Romanian law and the Parties did not point to any other possibly applicable law. The obligation to which the Claimants wish to extend the protection of the BIT purportedly arose under EGO 24, its implementing legislation and/or the granting of the PICs. Thus, the existence and content of that purported obligation depends on Romanian law.

---

shareholder. But where the contract is made with a private person, then the provision only applies if and in so far as an obligation of the State arising from its own particular commitment (as opposed to existing general legislation) may be discerned. Thus if the law of the land provides that the State is liable for the torts of its servants this is not an 'obligation arising from a particular commitment' the State may have entered into and may be changed, though in certain circumstances this may become subject to the provisions about expropriation.").

[41] *Burlington v. Ecuador*, ¶ 214.

[42] *SGS v. Philippines*, ¶ 126.

419. Accordingly, whether Romania was bound by an "obligation" to provide the incentives to the Claimants until 31 March 2009 is a question to be determined by Romanian law. The Tribunal will now address whether such an obligation arose.

b. Did Romania enter into a specific obligation with the Claimants?

420. The Claimants argue that, through the EGO 24 framework, Romania entered into a specific obligation with the Claimants with regard to their investment, which consisted of Romania's undertaking with respect to the Claimants to maintain the EGO 24 incentives in the Ştei-Nucet disfavored region for the full 10-year period provided by GD 194/1999. The Respondent concedes that EGO 24 created a generalized entitlement that could be claimed by qualifying investors, but denies that it promised that the incentives would remain in place or unchanged for any specific period. It also denies that this entitlement gives rise to an obligation on the part of Romania under Romanian law.

421. The Tribunal will first address the content of the entitlement created by EGO 24 (Section (i)). It will then address whether it gives rise to a specific obligation for Romania under Romanian law that may trigger the application of the umbrella clause (Section (ii)).

i. Content of the Claimants' entitlement

422. Having reviewed the evidence before it, the Tribunal's conclusion is that EGO 24 created a general scheme of incentives available to investors who fulfilled certain requirements, which were later "granted" to qualifying investors through a specific administrative act (the PIC). In other words, the legislation created a generalized entitlement that could be claimed by qualifying investors, but this general entitlement later crystallized with respect to qualifying investors through the granting of the PICs, becoming from that moment on a specific entitlement with respect to specific investors. Therefore, the Tribunal does not need to decide whether a general entitlement, in a law or regulation, could give rise to an obligation subject to the umbrella clause; here the general obligation was converted into a specific commitment.

423. In particular, EGO 24, as republished on 8 November 1999 (Exh. R-68) provided that the Government could declare the creation of certain "disadvantaged areas", at the proposal of the National Council for Regional Development (Article 3). This declaration would be made by means of a "government decision", which would also approve (a) the period for which a geographical area was declared a disadvantaged region, (b) the fields of investments, and (c) "the required financing and advantages provided by law, and granted to the investors" (Article 4). Article 5 provided that "[a] geographical area may be declared a disadvantaged area for a period of at least 3 years, but for not more than 10 years, with possibility for extension, under the conditions of this Emergency Ordinance." Article 6(1) went on to say that investors meeting certain requirements "will be granted the following advantages for their new

investments in these regions", and then listed those advantages (that is, the incentives or facilities) (*see* paragraph 148 above).

424. It is thus clear that EGO 24 did not stand alone: by its own terms it required an important part of its implementation to be carried out by way of a government decision (including the determination of the disfavored area and of the incentives or facilities that would be available for investors in that area). For the case of Ştei-Nucet, this government decision was GD 194/1999 (Exh. C-31, C-280), later extended to Drăgăneşti by GD 1190/2000. The boundaries of the disfavored region were extended to include Drăgăneşti by means of GD 1190/2000 on 29 November 2000 (Exh. C-32).

425. The Respondent argues that, even if EGO 24 delegated certain aspects to a government decision, because of the hierarchy of norms under Romanian law it was legally impossible for GD 194/1999 or GD 1190/2000 to grant anything that EGO 24 did not authorize. This may be so, but based on the relevant laws and regulations and the testimony of the Respondent's expert, Prof. Baias, the Tribunal concludes that GD 194/1999 and GD 1190/2000 did exactly what was authorized by EGO 24:

a. GD 194/1999 determined that Ştei-Nucet would be a disfavored region (Articles 1 and 2), established the time period for that (i.e., 10 years, Article 3), and provided that, "during the existence of the disfavored region, established according to this decision, the facilities under annex no. 2*) will be granted" (Article 4 of GD 194/1999). In turn, Annex 2 of GD 194/1999 listed all of the incentives provided under Article 6(1) of EGO 24 (*see* paragraph 153 above). Article 5 of GD 194/1999 also provided that "[t]he domains of interest for the achievement of investments in the zone shall be those provided for in Annex No. 3." In turn, Annex 3 provided that these domains of interest were agriculture and "zootechny", production (except the manufacture of distilled alcoholic drinks and manufacture of ethyl alcohol by fermentation), services (except public alimentation not included in an investment in tourism), trade (except marketing of products not made in activities performed in the zone) and environmental protection and rehabilitation of natural sites. Article 6 of GD 194/1999 provided that Annexes 1-3 would "be an integral part of the present decision."

b. Similarly, GD 1190/2000 extended the boundaries of the disfavored region to include Drăgăneşti (Article I), confirmed that "the period for which the Ştei-Nucet region is established as a disfavored region shall end on 31 March 2009", and added that "[f]or the commune of Drăgăneşti, the facilities related to the disfavored region shall be granted commencing with the date this decision is published in the Official Gazette of Romania, Part I." (Article II)

426. Prof. Baias confirmed that GD 194/1999 was *intra vires* at the time it was issued and until the time when EGO 24 was amended in 2004 by GO 94/2004 to revoke the facilities, because, in Prof. Baias's view, the subsidiary norm is automatically restricted to the scope of the amended primary norm.[43] However, at the time of its

[43] Specifically, Prof. Baias testified:

issuance in 1999 and up until the facilities were revoked in November 2004 (or February 2005, if we take the effective date), GD 194/1999 validly provided that qualifying investors investing in the Ştei-Nucet area (later expanded to include Drăgăneşti) would be granted the incentives listed in Annex 2 until the date in which the region ceased to be disfavored (i.e., 1 April 2009). The same conclusion should apply to GD 1190/2000.

427. Thus, EGO 24, GD 194/1999 and GD 1190/2000 by themselves do nothing more than establish a general entitlement to qualifying investors in the Ştei-Nucet disfavored region. Standing alone, they do not give rise to a specific entitlement to a specific investor. The rules for the actual granting of the incentives to investors were established by the Methodological Norms (GD 525/1999, the "1999 Methodological Norms", and later by GD 728/2001, the "2001 Methodological Norms"). Pursuant to these Methodological Norms, qualifying investors (only) became entitled to the incentives once they received their PIC (or TIC, on a temporary basis).

428. Specifically, Article 5 of the 1999 Methodological Norms provided:

> "(1) The incentives provided by the law ***shall be granted*** [in Romanian, "*se acorda*"] pursuant to the certificate of investor in a disfavored area, which is issued, upon the business entity's request, by the Regional Development Agency under the jurisdiction of which the head office of such business entity is located.
>
> […]
>
> (3) Business entities requesting the issuance of the certificate of investor in a disfavored area shall prove they meet the requirements set forth by the [EGO].
>
> (4) Emerging business entities, unable to produce evidence regarding the investment, the commissioning of the operations and the creation of new jobs, may request the issuance of a temporary certificate of investor in a disfavored area, for a maximum of 3 months. In case they do not bring, during this period, evidence of having met the requirements set forth by the [EGO], they shall be compelled to pay and return, respectively the equivalent value of all the incentives they have benefited of.

Q. So are we agreed, then, that when the government decision was issued, the way in which it should be interpreted is that in Ştei-Nucet, the incentives granted, or indicated in Annex 2, would be granted for the full duration of the time when Ştei-Nucet was declared a disfavoured zone; that was the position at that time?

A. At the very moment of the adoption of this government decision, I agree.

Q. That was in conformity with EGO 24 at that time?

A. At that moment.

Q. So your position is that because EGO 24 was subsequently changed, this government decision became in contradiction with -- not EGO 24 as it was, but the subsequent legislative position?

A. Yes. With the subsequent form of the EGO 24 as it was modified.

(Tr., Day 5, 265:11-266-2 (Reed/Baias)).

(5) The temporary certificate shall be issued pursuant to the business entity's commitment regarding the investment and the creation of new jobs.

[…]"

(Emphasis added).

429. The substance of these requirements was repeated in Articles 4 and 5 of the 2001 version, which added two specifications:

a. Investors applying for a certificate of investor had to prove that they had "at least 10 employees with individual employment contracts for an indefinite term out of which at least 5 should be employed from the unoccupied work" (Article 4(4)).

b. "The business entities which obtained the certificate of investor in the disfavoured area and which perform activities from fields of interest other than those provided under annex no. 1 shall continue to benefit from facilities under the law, until the expiry of the period for which the disfavoured area was declared" (Article 5(3)).

430. Prof. Mihai testified in cross-examination that the correct translation of Article 5(1) of GD 525/1999 should be "[t]he facilities provided by the law shall be granted on the basis of the certificate of investor" (Tr., Day 5, 214:14-215:1). Although the Respondent argues that the key words here are "provided by the law", in the Tribunal's view the key words are rather that such facilities "shall be granted." The applicable regulation (EGO 24) "provided" or created certain incentives or facilities; GD 194/1999 and GD 1190/2000 (by express delegation of the law) determined which of these incentives would be available to investors in a particular disfavored area and for what time period, and the Methodological Norms established the rules under which these incentives would be granted to specific investors. But the actual "granting", "awarding" or "vesting" of the entitlement to the incentives occurred at the moment of the issuance of the PICs. It is in this moment when the general entitlement becomes a specific entitlement with respect to a particular investor.

431. In other words, the specific entitlement of a particular investor to the incentives provided under the EGO 24 framework arises from an administrative act of specific scope (i.e., directed to specific investors with respect to specific investments). This administrative act is evidenced by the issuance of the PICs. In the Tribunal's view, it is irrelevant for purposes of determining the existence of a specific entitlement whether the PIC merely certified eligibility to the incentives under generally applicable legislation. The fact is that, without having been granted a PIC, an investor could not benefit from the incentives offered by EGO 24, GD 194/1999 and GD 1190/2000. In other words, the granting of the PIC was the moment in which a particular relationship between the Government and the investor was "perfected": an investor could benefit from the privileges offered by the legislative framework only after having applied for a PIC, proved it fulfilled the requirements and received a favorable decision from the government in the form of a PIC. Only thereafter did the investor have the actual entitlement to the incentives, and only after that moment did it have the obligations established under EGO 24.

432. The question that follows is: did the regulatory framework provide that this specific entitlement would last until 1 April 2009? The Tribunal finds that it did.

433. EGO 24 itself did not say anything with respect to the timing of the entitlement, but by its own terms it delegated this determination to a government decision. For Ştei-Nucet, this government decision was GD 194/1999. Article 4 of GD 194/1999 provided that the facilities listed in Annex 2 "shall be granted" ("*se acorda*" in Romanian) during the existence of the disfavored region. In turn, Article 3 provides that Ştei-Nucet is designated a disfavored region for a period of 10 years, starting on 1 April 1999. This was confirmed by GD 1199/2000 when the boundaries of the region were extended to include Drăgăneşti, which stated that the designation of the region as disfavored would end on 31 March 2009.

434. This was further confirmed by Article 5(3) of the 2001 version of the Methodological Norms (GD 728/2001, Exh. R-35), which provided that:

> The business entities which obtained the certificate of investor in the disfavoured area and which perform activities from fields of interest other than those provided under annex no. 1 ***shall continue to benefit from facilities under the law, until the expiry of the period for which the disfavoured area was declared***. (Emphasis added)

435. In addition, Article 1(f) of the 2001 Methodological Norms defined the period during which it would be understood that an investor had benefitted from the incentives for purposes of Article 7 and 9 of EGO 24 as the period "comprised between obtaining the certificate of investor in [the] disfavored area and disappearance of the disfavored area; in case of a temporary investor certificate, followed by obtaining an investor certificate in the disfavored area, the period shall be calculated as of obtaining a temporary investor certificate until the disfavored area ceases to exist."

436. It is true that these provisions were added in the 2001 Methodological Norms, and not in the 1999 version. However, they confirm an interpretation that was already reasonable in light of the interplay of the legal provisions.

437. In addition, all three of the Corporate Claimants' PICs provided that the certificate (which certified that they were the beneficiaries of the facilities granted under EGO 24 and GD 194/1999) would be valid until 1 April 2009. Indeed, Romania concedes that the PICs certified eligibility to the incentives until 1 April 2009, arguing however that the PICs only entitled the Claimants to whatever incentives were available under the general scheme from time to time.

438. Thus, the Tribunal concludes that the PICs, in the context of the EGO 24 regulatory framework, provided (or, to use Respondent's words, entitled) that PIC holders would be entitled to the incentives offered under EGO 24 until 1 April 2009.

439. The third question that arises is: did the legislative framework provide that the Claimants would be entitled to the same incentives, or at least substantially the same incentives, that were originally provided under GD 194/1999? The PICs merely state that the investor is the "beneficiary" of the facilities provided under the general

scheme, as republished and amended. This seemingly supports Romania's contention that they merely certified eligibility to whatever incentives were available under the general scheme from time to time.

440. However, Article 4 of GD 194/1999 provides that the facilities listed in Annex 2 "shall be granted" during the existence of the disfavored region, and that annex was attached to GD 194/1999 and was deemed to form an "integral part" of that decision (*see* paragraph 425.a). It could thus be argued that the facilities listed in that annex are incorporated into the Government Decision and thus "stabilized" in some form by the reference to a specific time period. It would be a difficult question to determine whether the Government would thus unduly exceed its authority under Romanian law and what the legal consequences would be under such law, but it is unnecessary to make that determination.

441. In fact, the incentives underwent several amendments during the life of EGO 24, which included the revocation of some of the facilities. Specifically:

a. On 16 June 2000 (effective 1 July 2000), Romania passed Emergency Government Ordinance No. 75/2000 ("EGO 75/2000", Exh. C-45, R-81). Although the Competition Council had issued Decision 244/2000 a month before, EGO 75/2000 ignored the Competition Council's recommendation to eliminate the Raw Materials Incentive. Instead, it amended EGO 24 in the following ways:

   i. It amended the Raw Materials Incentive by providing for an exemption (rather than the refund) on customs duties, and excluded spare parts and components from the customs duty exemption. Article 6(1)(b) of EGO 24 was replaced with the following text:

   > b) the exemption from the payment of customs duties for imported raw material necessary for the own production in the area.

   ii. It amended the provisions regarding the award of funds under the Special Development Fund.

b. On 7 November 2001, Romania passed Law No. 621/2001 (Exh. R-33, R-129), which amended EGO 75/2000 by, among others, reinstating the customs duties exemption on imported components. Article 6(1)(b) of EGO 24 was replaced with the following text:

   > b) the exemption of customs duties for imported raw materials and components required to perform the area's own production.

c. On 1 June 2002, Romania passed Law No. 345/2002 (Exh. R-90), which abolished the Machinery Incentive provided under Article 6(1)(a) of EGO 24 (both with respect to customs duties and VAT).

d. On 1 July 2002, Romania passed Law No. 414/2002 (Exh. C-48, R-34), which repealed the Profit Tax Incentive but grandfathered it for investors who held a PIC prior to the date on which this law entered into force (Articles 36(1)(d), 35(3)).

e. On 19 November 2002, Romania passed Law No. 678/2002 (Exh. C-49) which amended the Raw Materials Incentive by excluding from the customs duties exemption raw materials for the production, processing and preservation of meat.

f. In June 2004, Law 239/2004 (Exh. C-50) subjected the remaining facilities to a requirement that they not exceed a threshold of maximum intensity of state aid.

g. On 31 August 2004, Romania passed EGO 94/2004 (Exh. R-94), which abolished all the remaining incentives with the exception of the grandfathered Profit Tax Incentive. EGO 94/2004 also provided that "[i]n calculating the intensity of state aid, eligible costs related to investments made before 15 September 2004 shall be taken into account."

442. Thus, from its enactment in 1998 and until its final revocation in 2004, EGO 24 was amended several times, either to the benefit or to the detriment of PIC holders. The Machinery Incentive was eliminated completely in 2002. The Profit Tax Incentive was repealed in 2002, but grandfathered for PIC holders. The Raw Materials Incentive survived, in some ways enhanced (it was transformed into an exemption instead of a refund in 2000), but its scope of application was modified (it was eliminated for components in 2000 and then reinstated in 2001, and later eliminated for meat products in 2002). Only the Profit Tax Incentive was grandfathered for PIC holders.

443. This seems to confirm the Respondent's argument that the legislative framework only provided that PIC holders would be entitled to whatever incentives were available under the regime from time to time. However, the Claimants argue that these amendments (at least until 2002) did not indicate in any way that the entire regime would be brought to a premature conclusion. They argue that EGO 75/2000 strengthened the regime, even against the Competition Council's recommendation, noting that the Raw Materials Incentive was made into an exemption rather than a refund, and that the components part of it was reinstated the following year. They also argue that the amendments to the Machinery Incentive and the Profit Tax Incentive were made in the context of other reforms (VAT laws, profit tax laws) and did not target EGO 24 in the context of state aid. Finally, they argue that the elimination of the Raw Materials Incentive with respect to raw materials for the production, processing and preservation of meat was made to address problems specific to the Romanian meat industry.

444. In the Tribunal's view, Romania's conduct cannot change the content of the entitlement. That Romania did as a matter of fact amend or eliminate certain incentives without grandfathering them does not mean that it was entitled to do so, at least not if that amendment or elimination, in itself or in conjunction with other amendments or eliminations, would amount to a repeal of the entitlement altogether, more precisely of the entitlement based on PICs (or TICs). This does not contradict

the principle *lex posterior derogat legi priori:* it is undisputed that Romania may validly amend its laws, and presumably GD 194/1999 could be validly amended by subsequent legislation, but this is not the question.

445. The question is whether such an amendment could affect rights or entitlement created by previous laws with respect to private parties. In this case, the question is whether PIC holders continued to have the entitlement to the same incentives specified in Annex 2 of GD 194/1999 despite the later amendments to the EGO 24 regime. This question is addressed in the following section.

ii. Does Romania's undertaking qualify as an "obligation" under Romanian law? If yes, did Romania breach it?

446. The Tribunal has found that the EGO 24 framework, once specified with respect to the Claimants through the granting of the PICs, created for the Claimants a specific entitlement to the EGO 24 incentives until 1 April 2009. Thus, under the EGO 24 framework Romania committed to provide the EGO 24 incentives until 1 April 2009.

447. However, for purposes of the umbrella clause, the Tribunal will determine whether this commitment (or undertaking) amounts to an "obligation" under Romanian law. In addition, the Tribunal must answer the question raised in the preceding section: whether that undertaking, commitment or obligation consisted of providing the Claimants the *same* incentives that were listed in Annex 2 of GD 194/1999 until 1 April 2009. Both questions are relevant. If there is no obligation under Romanian law, the umbrella clause is not triggered. If an obligation under Romanian law exists but its scope is limited to providing the Claimants with whatever incentives are available under the regime from time to time, Romania discharges that obligation by providing whatever incentives were in force in a particular time. If, on the other hand, there is an obligation under Romanian law to maintain the same incentives through 1 April 2009 with respect to the Claimants, then Romania would be in violation of the BIT's umbrella clause.

448. The Tribunal considers two alternative approaches potentially relevant to that analysis. Under the first approach, the answer to the questions above depends on whether the EGO 24 framework provided the Claimants with a vested right to the incentives listed in Annex 2 of GD 194/1999 until 1 April 2009. In other words, under that approach, the Tribunal would need to decide whether the Claimants' entitlement qualifies as a "vested right" under Romanian law, and whether Romania's corresponding undertaking qualifies as an "obligation" under Romanian law. In many legal systems, the existence of a debtor's obligation is inseparable from the existence of the creditor's vested right to performance of the obligation and is a mirror view of that right from the debtor's perspective. Thus, presumably, under this approach, in order for Romania to be legally obligated to provide the Claimants with the incentives listed in Annex 2 of GD 194/1999 until 1 April 2009 (or legally obligated to compensate the Claimants if those incentives were eliminated or amended), the EGO 24 framework would have had to provide the Claimants with a vested right to receive those very same incentives.

449. These are matters of Romanian law that the Tribunal cannot answer in the abstract or with reference to comparative law. It is the Claimants' burden to prove that Romania's undertaking amounts to an obligation under Romanian law, and that the content of that obligation is such that Romania's actions have breached it. The Claimants have not addressed these issues convincingly. The Claimants' legal expert on Romanian law, Prof. Mihai, did not address whether the regulatory framework created an obligation under Romanian law. In particular, he did not address the nature of GD 194/1999 or of the PICs in his expert report, and only briefly in his oral examination. Nor was this matter addressed by Romania's expert, Prof. Baias. His report only referred to whether EGO 24, GD 194/1999 or the PICs created contractual relations between the Claimants and the state (his answer was no) (ER of F. Baias, ¶¶ 5.1-5.2).

450. Similarly, the Claimants have not addressed to the Tribunal's satisfaction whether their alleged right to the incentives might be lawfully withdrawn without compensation under Romanian law. The Tribunal has paid particular attention to Decision 130/2003 of the Constitutional Court. The Respondent argues that this decision (which applied to the incentives provided by Law 35 on Foreign Investment) proves that the EGO 24 framework did not give PIC holders a vested right to the incentives, and their withdrawal did not give PIC holders a right to compensation. Decision 130/2003 specifically stated:

> The Court finds that no contract was concluded between the Romanian State and the potential investors by the adoption of this law, as the entity raising the objection of unconstitutionality groundlessly claims, and no ownership right or right to recover debt was created in their favor, but a legal framework was created that could offer to the foreign investors an attractive business climate, taking into account the requirements of the transition from a State centralized economy to the market economy. Therefore, the fact that the contested provisions provide for the cessation of the applicability of such facilitations may not be construed as the termination of a contract and the least as infringement of the ownership right or of the investors; rights to recover debt, but the amendment of the legal framework in connection with the business background. The measure is not meant to harm foreign investors, as they must still carry out their activity under the usual conditions of a market economy, without the facilities that represented positive discriminations by comparison to the other participants to the business circuit. (Exh. RL-214, p.4).

451. The Claimants contend that the findings of this decision cannot be extrapolated to EGO 24 because the regimes created by Law 35 and EGO 24 were significantly different (in particular, because Law 35 provided all foreign investors in Romania with benefits, while EGO 24 only benefited investors who met certain specific criteria who invested in disfavored regions and fulfilled other obligations), adding that the testimony of the Respondent's expert, Prof. Baias, was based on the mistaken premise that both regimes were substantially similar. During cross-examination it became evident that Prof. Baias did not know the details of either incentive regime (Tr., Day 6, 26-31), while the Claimants' expert, Prof. Mihai, testified that there were important differences between EGO 24 and Law 35 (Tr., Day 5, 252 (Mihai)). Prof. Mihai (a former president of the Constitutional Court) also characterized Decision 130/2003 as "extremely infelicitous" and "ultra vires", stating that the reasoning of the

Constitutional Court was “inappropriate” and “not in line with the reality“ because “by the repeal of [EGO] 24, damages were brought to the foreign investors, because that repeal created […] a worse legal and economic situation than before the repeal.” (Tr., Day 5, 231, 252 (Mihai)). In the circumstances, the Tribunal is far from certain that it should revisit as such the validity of the Constitutional Court's decision, as opposed to the extent of its possible application by way of extrapolation to EGO 24, but finds that Decision 130/2003 is in any circumstance not decisive when interpreting the nature of the EGO 24 incentives.

452. However, the fact that Decision 130/2003 may not be applicable to the EGO 24 incentives does not prove that the EGO 24 incentives gave rise to vested rights or a right to compensation if they were withdrawn, and Prof. Mihai’s testimony was insufficient to establish this. Prof. Mihai testified that the constitutional principle of the rule of law set out in Article 1(3) of the Romanian Constitution[44] “required the Romanian state to maintain unchanged all facilities granted under prior regulations in favour of holders of investment certificates, issued before [GO 94/2004] was enforced”, or required GO 94/2004 to contain grandfathering provisions (ER of L. Mihai, ¶¶ 12.6-12.7). He also stated that, by failing to do so, GO 94/2004 was issued in breach of the ECHR’s jurisprudence on legitimate expectations and legal foreseeability, as well as the Romanian principles of vested/acquired rights (ER of L. Mihai, ¶¶ 13.1-13.3) and non-retroactivity (Tr., Day 5, 207-208, 247 (Mihai)). But Prof. Mihai refrained from going as far as stating that the EGO 24 framework gave rise to vested rights. He did say, with respect to the Machinery Facility repealed in 2000, that “those who had already acquired this right on the basis of some laws which were in effect at the moment when these rights had been acquired […] could continue to claim these tax exemptions” (Tr., Day 5, 210 (Mihai)). However, he accepted that most of the changes made to EGO 24 during its life did not contain grandfathering provisions (e.g., the revocation of the meat facility and the machinery facility), although he did characterize these regulations as unconstitutional (Tr., Day 5, 212, 234-238 (Mihai)). In the Tribunal’s view, this is not sufficient to establish the existence of a vested right to the incentives for the Claimants (and a corresponding obligation for Romania), or a right to compensation if the incentives were withdrawn.

453. The Tribunal concurs with the Claimants in that the entitlement created by the EGO 24 framework and the PICs creates an appearance, perhaps even a distinct appearance, of a vested right giving rise to the corresponding obligation. In particular, as discussed in paragraph 457 below, the relationship between the Claimants and the Romanian State included a certain *quid pro quo*. However, the Claimants have not proved that Romanian law would characterize such an appearance, even in the presence of such *quid pro quo*, as a vested right or obligation, or afford it the same protection.

[44] Article 1 paragraph (3) of the Romanian Constitution provides: "Romania is a democratic and social state governed by the rule of law, in which human dignity, the citizens' rights and freedoms, the free development of human personality, justice and political pluralism represent supreme values, in the spirit of the Romanian people's democratic traditions and the ideals embodied by the December 1989 Revolution, and shall be guaranteed."

454. Under this approach, therefore, the Tribunal lacks sufficient evidence on the content of Romanian law to be able to ascertain whether the EGO 24 framework, including after "crystallizing" through the issuance of a PIC, gave the Claimants a vested right under Romanian law to the incentives listed in Annex 2 of GD 194/1999 until 1 April 2009. For the same reason, it cannot ascertain that the EGO 24 framework created the corresponding obligation for Romania to provide those very incentives during that period.[45]

455. Under the second approach, it is not necessary that the obligation be "vested" or "actionable" in order to be considered an obligation covered by the umbrella clause. Although the Respondent has argued that granting a "vested" or "actionable" right is a prerequisite for an obligation to arise and to have binding legal effect under Romanian law, its experts have not established that this is the case. Thus, to find an obligation it would be sufficient to find that (i) Romania undertook a firm commitment vis-à-vis the Claimants, and (ii) that the scope of that commitment was to provide substantially the same incentives during a specific period of time.

456. The first question is whether Romania undertook a firm commitment vis-à-vis the Claimants under Romanian law. Through its regulatory framework, which was intended to promote investments and job creation in certain disadvantaged regions, Romania made an offer to investors who would consider establishing their business in those regions. The offer included granting the incentives and maintaining them through 1 April 2009. The offer was however, conditional. Investors who accepted the offer would only qualify if they met certain requirements and remained in compliance with those requirements for a period twice as long as the period of the incentives. Therefore, Romania's offer and the Claimants' acceptance of that offer established a relationship of mutual rights and duties: Romania accepted to grant the incentives and maintain them through 1 April 2009 and the Claimants committed to comply with the requirements of the offer for the requisite period. To state it differently, Romania had the right to insist that the Claimants carry out their business activities in compliance with the requirements while the Claimants had the right to receive the incentives. The investors were taking a firm commitment and the regulatory framework required a firm commitment on the side of Romania. This relationship was certified by the PICs, the wording of which confirms that analysis of the regulatory framework. The offer and the acceptance thus included a *quid pro quo* and, therefore, can be considered a relationship of mutual rights and obligations. If such is the nature of the relationship, Romania must have undertaken an obligation to maintain the incentives through 1 April 2009 and the Claimants must have the corresponding right to the incentives during that period. Romania's obligation, and the Claimants' corresponding rights, are by definition obligations and rights under Romanian law because they were established through the regulatory framework that created the incentives.

457. The second inquiry relates to the scope of Romania's undertaking. Romania has argued that, even if an obligation existed (which it denies), the scope of the obligation

[45] Arbitrators Lévy and Abi-Saab favor this approach.

was only to grant whatever incentives might be available under the EGO 24 framework from time to time. The question is thus whether Romania's commitment to provide the incentives contained an element of stabilization in the event of an amendment of the laws governing the EGO 24 framework. The commitment to maintain the incentives for a certain specific time period induced investors to take advantage of the offer. Therefore, Romania cannot in good faith ignore the fact that such a commitment would necessarily be understood as including a promise of stabilization; that is, that the incentives would be maintained for the specified period. Stated differently, because Romania promised certified investors that it would maintain the incentives through a certain date, that promise could not be understood otherwise than as including the undertaking that the incentives would not be withdrawn earlier. Thus, while Romania did not make a commitment not to amend its laws as a general matter, certified investors understood that they would benefit from the incentives through 1 April 2009. For example, if Romania promised to waive customs duties on the imports of certain raw materials for a certain period of time with respect to a certified investor, that promise would be understood as remaining valid regardless of whether Romania amends its general legal framework to impose higher or lower duties on the same raw materials during the specified period. Therefore, the certified investors were offered (and accepted as part of the *quid pro quo*) a guarantee of some stability of the legal regime within the scope of the incentives, as described in the PICs, for a specific time period.

458. Under both aspects of the second approach, therefore, the Tribunal would find that a legal obligation by Romania with respect to the Claimants exists. The mirror image of that legal obligation would be the Claimants' right to the incentives through 1 April 2009.[46]

459. The Tribunal has considered carefully both approaches and is conscious of the fact that their application would lead to different conclusions. The majority follows the first approach and concludes that the burden of proof lies with the Claimants and that the Claimants have not met that burden. The majority does not find that the Claimants have provided sufficient evidence and legal arguments on the content of Romanian law for the Tribunal to find the existence of an obligation protected by the umbrella clause. The majority accordingly dismisses the Claimants' umbrella clause claim, and the Tribunal will now address the Claimants' arguments in the context of their fair and equitable treatment claim, which spans the same injuries alleged by the Claimants under the umbrella clause.

[46] Arbitrator Alexandrov favors this approach.

B. FAIR AND EQUITABLE TREATMENT

460. Article 2(3) of the BIT provides:

> Each Contracting Party shall at all times ensure fair and equitable treatment of the investments by investors of the other Contracting Party and shall not impair the management, maintenance, use, enjoyment or disposal thereof, as well as the acquisition of goods and services or the sale of their production, through unreasonable or discriminatory measures.

461. This section addresses the Claimants' allegation that the Respondent has breached its obligations under this provision by failing to afford to their investments fair and equitable treatment.

462. To facilitate the discussion of the Parties' arguments with respect to the Claimants' fair and equitable treatment claim, the Tribunal will first set out a summary of the Parties' general positions (Section 1 below). It will then address the nature, interpretation and content of the fair and equitable treatment standard (Section 2 below). Finally, it will address the Parties' specific arguments with respect to each alleged breach of the standard (Sections 3 to 6 below).

1. Summary of the Parties' positions

a. The Claimants' position

463. The Claimants argue that the fair and equitable treatment standard, which is contained in Article 2(3) of the BIT, is an autonomous standard that is additional to general international law, and is thus not restricted by the international minimum standard contained in customary international law (C-SoC, ¶¶ 183-192, citing scholarly opinion, an UNCTAD study and the practice of international tribunals, in particular, *Tecmed v. Mexico*[47], *Azurix v. Argentina*[48]). The Claimants also contend that the fair and equitable treatment standard has a specific meaning, which is not to be confused with a decision *ex aequo et bono* (citing *ADF Group Inc. v. United States*[49], ¶ 184).

464. According to the Claimants, the interpretation of the treaty provision containing the fair and equitable treatment standard should start from the normal canons of treaty interpretation as contained in Articles 31 and 32 of the VCLT, which include the ordinary meaning of the treaty's terms, their context, and the object and purpose of

[47] *Técnicas Medioambientales Tecmed, S.A. v. United Mexican States* (ICSID Case No. ARB(AF)/00/2), Award, 29 May 2003 (hereinafter *"Tecmed v. Mexico" or "Tecmed"*).

[48] *Azurix Corp. v. Argentine Republic* (ICSID Case No. ARB/01/12), Award, 14 July 2006 (hereinafter *"Azurix v. Argentina"*).

[49] *ADF Group Inc. v. United States of America* (ICSID Case No. ARB(AF)/00/1), Award, 8 January 2003 (hereinafter *"ADF Group Inc. United States"* or *"ADF Group").*

the treaty, the preamble being of particular importance (C-SoC, ¶¶ 194-200, citing *Tecmed v. Mexico*, *MTD v. Chile*[50], *Azurix v. Argentina*, *Siemens v. Argentina*[51]).

465. Starting with the text of the provision, the Claimants note that the Oxford Dictionary defines "fair" as "free from bias, fraud or injustice; equitably legitimate"; the word "equitable" as "characterized by equity or fairness"; and the word "equity" as "the quality of being equal or fair; impartiality; even-handed dealing […] that which is fair and right" (C-SoC, ¶ 200, Exh. C-83).

466. With respect to the context of the provision, the Claimants argue that a comparison of the fair and equitable treatment standard with other standards of the BIT shows that, as opposed to standards that are relative (such as the national treatment or most-favored nation treatment standards), the fair and equitable treatment standard is an absolute standard that provides a fixed reference point. As a result, it is not a valid defense for Romania to argue that investors of Romanian nationality or investors from third countries were also adversely affected by the revocation of tax exemptions or other incentives (C-SoC, ¶¶ 201-203).

467. In addition, the Claimants submit that the fair and equitable treatment standard should be interpreted in the light of the object and purpose of the BIT as reflected in its Preamble.[52] As a result, any interpretation of the fair and equitable treatment standard should be generally favorable to the intensification of economic cooperation between the two countries, help promote and protect investments, be conducive to expanding the economic relations between the two countries and stimulate investment initiatives. In this regard, the Claimants argue that attracting investors through tax exemptions and other incentives that are promised for a certain period of time, and withdrawing these incentives unilaterally, is not conducive to the intensification of economic cooperation nor the stimulation of investment initiatives (C-SoC, ¶¶ 205-206).

468. As discussed in Section V(B) on Applicable Law, the Claimants deny that the interpretation of the BIT must take into consideration EU law (see 291 above *et seq.*).

469. The Claimants endorse the definitions of the fair and equitable treatment standard made by several international tribunals (including, among others, *Waste Management v. Mexico II*[53], *MTD v. Chile*, and *Saluka v. Czech Republic*[54]). Relying in particular

[50] *MTD Equity Sdn. Bhd. and MTD Chile S.A. v. Republic of Chile* (ICSID Case No. 01/7), Award, 25 May 2004 (hereinafter *"MTD v. Chile"*).

[51] *Siemens A.G. v. Argentine Republic* (ICSID Case No. ARB/02/8), Award, 6 February 2007 (hereinafter *"Siemens v. Argentina"* or *"Siemens"*).

[52] The Claimants note that the Preamble expresses the Parties' desire "to intensify economic cooperation to the mutual benefit of both States and to maintain fair and equitable conditions for investments by investors of one Contracting Party in the territory of the other Contracting Party" and recognizes "that the promotion and protection of such investments favour the expansion of the economic relations between the two Contracting Parties and stimulate investment initiatives..." (BIT, Preamble).

[53] *Waste Management Inc. v. United Mexican States* (ICSID Case No. ARB(AF)/00/3), Award, 30 April 2004 (hereinafter *"Waste Management v. Mexico II" or "Waste Management II"*).

on *Saluka v. Czech Republic*, the Claimants submit that the fair and equitable treatment standard "prohibits at least six different types of host state misconduct [...], including: (1) a government's violation of an investor's legitimate expectations; (2) inconsistent treatment of an investment by different organs or officials of the same government; (3) a lack of transparency that hampers the ability of an investor to operate its investment or understand what is required by the government in order for an investment to succeed; (4) failure by a government to provide adequate advance notice of measures that will negatively impact an investment; (5) governmental treatment of an investment that is in bad faith; and (6) discriminatory conduct" (C-Reply, ¶¶ 367; 374). In later submissions the Claimants group categories (2), (3) and (4) into one single category covering lack of transparency (C-PHB, ¶¶ 51-62). The Claimants also seem to suggest that the fair and equitable treatment standard requires the state to ensure a stable and predictable legal and business environment beyond the protection of an investor's legitimate expectations (C-SoC, ¶ 211, C-Reply, ¶¶ 424-430).

470. The Claimants contend that Romania's treatment of the Claimants' investments fell below the standard of treatment required by the fair and equitable treatment obligation of the BIT. Specifically, the Claimants submit that Romania (i) failed to provide a stable and predictable legal framework and violated the Claimants' legitimate expectations, (ii) failed to act transparently with respect to the Claimants' investments, and (iii) acted in bad faith with respect to those investments.

471. First, the Claimants contend that Romania breached the fair and equitable treatment standard by failing to provide a stable and predictable legal and business environment for the investment, and in particular by violating the Claimants' legitimate expectations with respect to that regulatory framework.

472. The Claimants submit that the core element of the fair and equitable obligation is to ensure a consistent and stable legal environment (C-SoC, ¶¶ 211-225; C-Reply, ¶¶ 424-430; C-PHB, ¶¶ 40-41). Numerous tribunals concur with this interpretation of the obligation (*Metalclad v. Mexico*[55]*, Tecmed v. Mexico, CMS v. Argentina, Eureko v. Poland, Bayindir v. Pakistan*[56]*, LG&E v. Argentina*, *Duke Energy v. Ecuador*[57], *PSEG v. Turkey*[58], *Enron v. Argentina*). The fair and equitable treatment standard extends to regulation in matters of taxation (*Occidental v. Ecuador*[59]). For this obligation to be

---

[54] *Saluka Investments BV (the Netherlands) v. Czech Republic*, UNCITRAL, Partial Award, 17 March 2006 (hereinafter *"Saluka v. Czech Republic" or "Saluka"*).

[55] *Metalclad Corporation v. United Mexican States* (ICSID Case No. ARB(AF)/97/1), Award, 30 August 2000 (hereinafter *"Metalclad v. Mexico"* or *"Metalclad"*).

[56] *Bayindir Insaat Turizm Ticaret Ve Sanayi A.S. v. Islamic Republic of Pakistan* (ICSID Case No. ARB/03/29), Decision on Jurisidiction, 14 November 2005 (hereinafter *"Bayindir v. Pakistan*).

[57] *Duke Energy Electroquil Partners and Electroquil S.A. v. Republic of Ecuador*, ICSID Case No. ARB/04/19, Award, 18 August 2008 (hereinafter *"Duke Energy v. Ecuador"*).

[58] *PSEG Global Inc. and Konya Ilgin Elektrík Űretím ve Tícaret Limited Şirketi v. Republic of Turkey* (ICSID Case No ARB/02/5), Award, 19 January 2007 (hereinafter *"PSEG v. Turkey"*).

[59] *Occidental Exploration and Production Company v. The Republic of Ecuador*, LCIA Case No. UN3467, Final Award, 1 July 2004 (hereinafter *"Occidental v. Ecuador"*).

breached, investors do not need to have a contract with the state containing a stabilization clause.

473. In particular, the Claimants argue that the fair and equitable treatment standard requires the state to protect the investor's legitimate expectations based on the legal framework at the time of the investment and on any undertakings and representations made explicitly or implicitly by the host state. The legal framework on which the investor is entitled to rely consists of legislation and treaties, and assurances contained in decrees, licenses and similar executive assurances, as well as in contractual undertakings. Relying on a number of investment cases, the Claimants argue that a state will violate the fair and equitable treatment standard if it reverses assurances that have resulted in the investor's legitimate expectations (C-SoC, ¶¶ 211-228, citing *Metalclad v. Mexico, Tecmed v. Mexico, CMS v. Argentina, Eureko v. Poland, Bayindir v. Pakistan, LG&E v. Argentina*, *PSEG v. Turkey,* and *Occidental v. Ecuador*).

474. The Claimants contend that Romania failed to provide a stable and predictable legal and business environment for their investment, and undermined their legitimate expectations with respect to the regulatory framework. Specifically, they argue that Romania created a special regulatory regime for disfavored regions that consisted of certain tax exemptions and other incentives promised for a 10 year period. This special regime instilled in the Claimants the legitimate expectation that the EGO 24 incentives would remain in place during the 10 year period that Ştei-Nucet was designated a disfavored region. The Claimants assert that this legitimate expectation was an essential basis for their investment, and without it the Claimants would not have invested in the manner that they did. Having enticed the Claimants to make substantial investments in reliance on these incentives, in February 2005 Romania changed its legislation and withdrew most of the EGO 24 incentives, four years before they were scheduled to expire. The Claimants argue that, by prematurely revoking the EGO 24 incentives, Romania failed to provide a predictable and stable legal framework for the Claimants to plan their investments, and in particular violated their legitimate expectation that these incentives would be in place for the promised 10-year period.

475. The Claimants clarify that the obligation to accord fair and equitable treatment does not mean that a state must completely freeze its regulatory regime (and the Claimants acknowledge that a stabilization clause would be needed to obtain that result). However, it does mean that, by entering into the BIT, Romania accepted limitations on its power to fundamentally alter the regulatory framework of the investment, particularly in ways that would be unfair, unreasonable and inequitable, including by undermining an investor's legitimate expectations (C-PHB, ¶ 40). As a result, Romania could not, consistent with the BIT, simply dispense with the legal framework it had put in place, but instead was required to meet its commitments with respect to investors. Specifically, the Claimants concede that Romania was entitled to revoke the incentives it had put in place if it grandfathered them for existing PIC holders (as it did with the Profit Tax Incentive).

476. Second, the Claimants contend that Romania breached its obligation to accord them fair and equitable treatment by acting in a manner that was not transparent.

477. The Claimants submit that the obligation to accord fair and equitable treatment requires that the state's conduct toward investors and its legal environment must be transparent (i.e., free from ambiguity and uncertainty). The Claimants rely on *Metalclad v. Mexico*, *Tecmed v. Mexico*, *Waste Management v. Mexico II*, *Saluka v. Czech Republic*, *Bayindir v. Pakistan*, *Occidental v. Ecuador, CMS v. Argentina*, *LG&E v. Argentina*, *PSEG v. Turkey*, and an UNCTAD study.[60] In particular, the *Tecmed* tribunal held that a foreign investor "expects the host state to act in a consistent manner, free from ambiguity and totally transparently in its relations with the foreign investor, so that it may know beforehand any and all rules and regulations that will govern its investments, as well as the goals of the relevant policies and administrative practices or directives, to be able to plan its investment and comply with such regulations." (*Tecmed*, ¶ 154). Similarly, the late Prof. Thomas Wälde noted that transparency requires "that government administration has to make clear what it wants from the investor and cannot hide behind ambiguity if it has created such ambiguity and contradiction itself."[61]

478. The Claimants contend that Romania acted in a manner that was not transparent. Specifically, they argue that Romania actively pursued two conflicting policies: on the one hand, it promoted the EGO 24 incentives, and at the same time it negotiated their revocation behind closed doors. In addition, they argue that Romania's conduct with respect to the validity of the EGO 24 incentives was contradictory and the manner in which they were revoked created uncertainty.

479. Third, the Claimants argue that Romania acted in bad faith with respect to the Claimants' investments. The Claimants contend that the fair and equitable treatment standard is breached if the host state acts in bad faith (C-SoC, ¶ 243, C-Reply ¶¶ 443-449). Although bad faith is not required for a violation of the standard to occur (*Tecmed v. Mexico*, *Mondev v. United States*[62], *Loewen v. United States*[63], *CMS v. Argentina)*, the Claimants argue that host state measures taken in bad faith against an investor violate the fair and equitable treatment standard (*Waste Management v. Mexico II*, *Tecmed v. Mexico, Bayindir v. Pakistan, Saluka v. Czech Republic*).

480. Finally, the Claimants contend that Romania's responsibility for violation of the fair and equitable treatment standard arises regardless of its motives, and irrespective of any showing of bad faith (although, as explained above the Claimants do argue that Romania acted in bad faith). Consequently, the Claimants do not need to show that

[60] UNCTAD Series on issues in international investment agreements, Fair and Equitable Treatment, p. 51 (1999) (Exh. C-74).

[61] T.W. Wälde, Energy Charter Treaty-based Investment Arbitration, 5 The Journal of World Investment 387 (2004), (Exh. C-94).

[62] *Mondev International Ltd. v. United States of America* (ICSID Case No. ARB(AF)/99/2), Award, 11 October 2002 (hereinafter *"Mondev v. United States" or "Mondev"*).

[63] *The Loewen Group, Inc. and Raymond L. Loewen v. United States of America* (ICSID Case No. ARB(AF)/98/3), Award, 26 June 2003 (hereinafter *"Loewen v. United States"*).

Romania acted with an improper motive in order to establish violation of the fair and equitable treatment standard. Conversely, a showing of good faith or legitimate cause on Romania's part does not excuse a violation of the fair and equitable treatment standard (C-SoC, ¶¶ 242-252, citing, *inter alia*, *Mondev v. United States*; *Tecmed v. Mexico*, *Loewen v. United States*, *Occidental v. Ecuador*, and *PSEG v. Turkey*).

481. Accordingly, the Claimants submit that, no matter how laudable or justifiable Romania's motives might have been, they do not excuse the fact that Romania breached the fair and equitable treatment standard. Whether Romania withdrew the incentives for fiscal reasons, for reasons of international economic policy or for other reasons of public interest, is irrelevant (C-SoC, ¶ 252). In particular, as discussed in Section V(B) above on Applicable Law, the Claimants contend that Romania's "EU law" defense does not immunize Romania from liability.

b. The Respondent's position

482. With respect to the content of the fair and equitable treatment standard, the Respondent does not dispute that many of the decisions cited by the Claimants can provide useful guidance to the Tribunal, subject to the general interpretative principles applicable to this dispute as explained in Section V(B) above on Applicable Law. Indeed, the Respondent concedes that "[m]ost of the general principles governing the interpretation of the fair and equitable treatment standard form common ground between the Parties" (R-CM, ¶ 101). In particular, the Respondent does not dispute that Article 2(3) of the BIT must be interpreted in accordance with Articles 31 and 32 of the VCLT, according to which the Tribunal must first look to the plain meaning or the language of the provision, and in the event of ambiguity construe the relevant provision in its context and in the light of the objective and purpose of the BIT (*Id.*). However, the Respondent disputes Claimants' actual interpretation of these terms.

483. With respect to the plain meaning of the provision, the Respondent accepts for present purposes the Claimants' definition of "fair and equitable" as "free from bias, fraud or injustice" and "even-handed dealing." The Respondent also concurs with the Claimants' reliance on *Waste Management v. Mexico II*, where the Tribunal concluded that:

> … fair and equitable treatment is infringed by conduct attributable to the State and harmful to the claimant if the conduct is arbitrary, grossly unfair, unjust or idiosyncratic, is discriminatory and exposes the claimant to sectional or racial prejudice, or involves a lack of due process leading to an outcome which offends judicial propriety …

484. The Respondent agrees that the preamble of the BIT reflects the signatories' goal of intensifying economic cooperation between Romania and Sweden. However, the BIT's preamble does not in itself indicate what interpretation of "fair and equitable treatment" is appropriate to achieve this goal. The proper approach depends upon the state parties' intentions with respect to the intensification of economic relations. The Respondent submits that this intention was to intensify economic relations in the context of Romania's integration into the EU (R-CM, ¶ 108).

485. In this regard, the Respondent argues that the BIT was signed pursuant to Article 74 of the Europe Agreement (to which both Sweden and Romania were parties), which calls for Romania to enter into investment protection agreements with EU Member States. The goal of the Europe Agreement was to establish close and lasting economic political integration between Romania and the EU, with the ultimate goal of EU accession. For this, Romania undertook to harmonize Romanian law with EU law (Articles 69 and 70 of the Europe Agreement). Accordingly, the Respondent submits that "the fair and equitable treatment standard contained in the [BIT] must therefore be interpreted consistently with any requirements for Romania's integration into the EU, including the elimination of impermissible State aid [...]"(R-CM, ¶ 109).

486. The Respondent further contends that, under the Europe Agreement, the Accession Agreement and the EC Treaty, Romania owed an obligation to Sweden to eliminate all state aid that did not conform to EU law and that distorted competition in the common market. As a result, Romania and Sweden could not have intended that Romania's obligation to afford fair and equitable treatment to Swedish investors would require the preservation of non-conforming State aid. In other words, "the object and purpose of the [BIT], and the context in which it was concluded as an integral part of Romania's integration into the EU, indicate that the [BIT] cannot be construed to sanction as 'unfair and inequitable' the adjustment of the Facilities in accordance with the requirements of the Europe Agreement and the *acquis communautaire*" (R-CM, ¶¶ 109-110).

487. Referring to the Claimants' division of the fair and equitable treatment standard into different "strands", the Respondent contends that the fair and equitable treatment clause of the BIT is not a laundry list, and there is no claim under the BIT for violating any particular "strand." Citing *Mondev v. United States*, the Respondent submits that whether a host state has treated an investment fairly and equitably must be assessed in view of all of the facts and circumstances. However, for analytical organization, the Respondent accepts that the Claimants' allegations may be grouped into three categories, corresponding to types of conduct where other international tribunals have found breaches of the fair and equitable treatment standard (R-PHB, ¶¶ 15-16):

a. Cases in which the state's action is alleged to have been substantively improper (for example because it was unreasonable, arbitrary, or discriminatory);

b. Cases in which the state's action is claimed to have violated a promise the state made to the investor, thus upsetting the investor's "legitimate expectations", and

c. Cases in which a state's action may be attacked as having been procedurally unfair, as in cases of denial of justice or lack of due process, retroactive or secret regulation, or inconsistent and non-transparent administration (although there are very few awards finding a violation of fair and equitable treatment solely on the basis of this class of allegations).

488. The Respondent denies having engaged in any of these types of conduct. It contends that, given the factual circumstances surrounding the investment, the

Claimants could have had no reasonable expectation that the incentives (facilities) would remain in force unchanged for ten years. The modification of the incentives was wholly predictable and equitable, and Romania conducted itself as consistently and transparently as possible given the historical context of economic transition and EU accession (R-CM, ¶ 100).

489. First, the Respondent denies having engaged in substantively improper conduct. The Respondent contends that, where an investor challenges general legislation that modifies existing general legislation, the question for an international tribunal is whether that legislation is grounded in reason (rather than being arbitrary) and enacted in pursuit of legitimate objectives (rather than for illicit purposes, such as discrimination). Relying on *Saluka v. Czech Republic*, the Respondent argues that for a state's conduct to be reasonable it must "bear a reasonable relationship to some rational policy" (*Saluka,* ¶¶ 309 and 460). This requirement was further developed in *AES v. Hungary,*[64] where the Tribunal found that "two elements" must be analyzed in judging whether a state acted reasonably: "the existence of a rational policy; and the reasonableness of the act of the state in relation to the policy" (*AES v. Hungary,* ¶ 10.3.7). According to that Tribunal, a policy is rational when the state adopts it "following a logical (good sense) explanation and with the aim of addressing a public interest matter" (*Id.*, ¶ 10.3.8), and an action is reasonable when there is "an appropriate correlation between the state's public policy objective and the measure adopted to achieve it" (*Id.*, ¶ 10.3.9).

490. In addition, for there to be a breach of the fair and equitable treatment standard, the state's conduct must be manifestly unreasonable. A state does not breach the standard merely by failing to adopt the optimal course of action. Citing *Glamis Gold v. United States,*[65] the Respondent contends that it is Claimants' burden to prove a manifest lack of reasons for the legislation.[66] (R-PHB, ¶ 33, fn. 50).

491. However, as explained further below, the Respondent argues that the Claimants do not allege that Romania engaged in any fraud, bias or discrimination, or that they were denied justice with respect to the Facilities. Nor do the facts show "grossly unfair, unjust or idiosyncratic" treatment (R-CM, ¶¶ 102-103). To the contrary, Romania argues that its conduct was fair and equitable under the circumstances.

492. Second, the Respondent denies having failed to provide regulatory stability or having violated the Claimants' legitimate expectations. The Respondent contends that the BIT does not require the Contracting States to tailor their laws and regulations to the preference of foreign investors, nor does it create liability for every regulatory change that has a negative impact on the foreign investors' businesses. To the contrary, investment protection treaties accord host States considerable deference in relation

[64] *AES Summit Generation Limited and AES-Tisza Erömü Kft. v. Hungary* (ICSID Case No. ARB/07/22), Award, 23 September, 2010 (hereinafter *"AES v. Hungary"* or *"AES"*).

[65] *Glamis Gold, Ltd. v. The United States of America*, UNCITRAL, Award, 8 June 2009 (hereinafter *"Glamis Gold v. United States")..*

[66] *Id.*, ¶ 803.

to regulatory policy (*El Paso v. Argentina;* [67] *S.D. Myers v. Canada;*[68] *Saluka v. Czech Republic*;[69] *Waste Management v. Mexico II;*[70] *Parkerings v. Lithuania;*[71] *Genin v. Estonia*[72]; *Methanex v. United States*[73]). This is a reflection of the fundamental rule of international law that a state's regulatory sovereignty can only be subject to the specific limitations that flow from the international legal obligations that it has voluntarily assumed (relying on *The Case of the S.S. Lotus (France v. Turkey)*[74]) (R-CM, ¶¶ 85-90).

493. As a result, the Respondent argues that where a state has exercised its sovereign powers to regulate in a general, non-discriminatory way to advance public welfare (including by legislative changes), international law will not characterize such conduct as "expropriation", "unfair and inequitable treatment", or otherwise in breach of the provisions of an investment protection treaty. International law (and the BIT) does not call for a regulatory standstill, and there is no warrant that a legal regime will remain unaltered. Laws are inherently liable to change, even when the original legislative intent was to create a permanent regime or a regime for a given period (*Continental Casualty v. Argentina*, ¶ 258). The Respondent concedes that international law will require observance of specific commitments about the stability of legislation, but contends that such commitments will not be lightly inferred, and are never to be found in general legislative texts. Rather, they may be found in stabilization terms specially bargained for with specific investors (R-CM, ¶ 91).

494. In the present case, it is undisputed that the modification of the Facilities that had been granted pursuant to EGO 24/1998 was a generally applicable act. Moreover, Romania was compelled to curtail the Facilities as an essential precondition for accession to the EU. Accordingly, in considering Romania's compliance with the substantive provisions of the BIT, Romania is entitled to the deference under international law (R-CM, ¶ 92). The modification of the Facilities was fair under the circumstances. In light of the plain meaning of Article 2(3), Romania argues that an examination of the Claimants' supposed expectations is unnecessary. In any event, Romania contends that the Claimants had no legitimate expectations that were undermined by the modification of the Facilities.

495. The Respondent agrees that the doctrine of legitimate expectations is part of the general duty to afford fair and equitable treatment. However, under this doctrine a

---

[67] *El Paso Energy International Company v. Argentine Republic* (ICSID Case No. ARB/03/15), Decision on Jurisdiction, 27 April 2006 (hereinafter *"El Paso v. Argentina"*), ¶ 70.

[68] *S.D. Myers, Inc. v. Government of Canada*, UNCITRAL, Partial Award, 13 November 2000 (hereinafter *"S.D. Myers v .Canada"*), ¶ 263.

[69] *Saluka v. Czech Republic*, ¶ 305.

[70] *Waste Management v. Mexico II*, ¶ 94.

[71] *Parkerings v. Lithuania*, ¶ 332.

[72] *Alex Genin and others v. Republic of Estonia* (ICSID Case No. ARB/99/2), Award, 25 June 2001 (hereinafter *"Genin v. Estonia"*), ¶ 370.

[73] *Methanex Corporation v. United States of America*, UNCITRAL, Final Award, 3 August 2005 (hereinafter *"Methanex v. United States"*), Part IV, Ch D, p 4, ¶ 7.

[74] *The Case of the S.S. "Lotus" (France v Turkey)*, PCIJ Series A No 10 (1927).

state would only violate this duty if it exercised its regulatory sovereignty in such a way as to create a legitimate expectation in an investor that the state will or will not act in a certain way in the future. In this way, the state itself derogates from its right and duty to change its regulations. Thus, the Respondent argues that an expectation of regulatory stability must be based on some sort of promise or at the very least, a proper representation made to the investor, on the part of the state. However, "if the state has not committed itself to freeze a particular area of regulation, or to shield an investor from regulatory change, the most an investor can legitimately expect is regulatory rationality and absence of arbitrariness" (R-Rejoinder, ¶ 169). The Respondent relies on *EDF v. Romania*[75] *and Parkerings v. Lithuania*. The Respondent's detailed position with respect to the standard of legitimate expectations is addressed in Section 3(b) below.

496. Third, the Respondent asserts it acted transparently and consistently. The Respondent appears to agree that transparency and consistency are a part of the fair and equitable treatment standard. For the Respondent, this "strand" refers to whether Romania complied with due process and fair administration. The Respondent notes that the UNCTAD report cited by the Claimants states the following:

> If laws, administrative decisions and other binding decisions are to be imposed upon a foreign investor by a host State, then fairness requires that the investor is informed about such decisions before they are imposed.[76]

497. According to the Respondent, this means that investors should be able to find out what the rules are and how to comply with them, and the rules should be administered in an even-handed and reasonably consistent fashion (R-PHB, ¶ 160).

498. In the present case, the Respondent argues, the Claimants do not contend that Romania was unclear about the rules and procedures they had to follow, or that the rules were applied inconsistently. Rather, the Claimants contend that they were not given enough information about ongoing diplomatic negotiations. The Respondent argues that there is no authority suggesting that international investment law requires a state to disclose its assessment of the likely outcome of such negotiations. As a result, the Respondent argues that "the Claimants' contentions are not only irrelevant as a matter of law but illogical as a matter of fact: if, as the Claimants seemed to suggest at the hearing, Romania should have publicly announced at the earliest possible date that it did not expect to obtain the EU's agreement to continue the EGO Facilities in force, the only possible difference is that the Claimants would have lost the benefit of the Facilities sooner" (R-Rejoinder, ¶ 161). Likewise, the Respondent argues that there is no need to warn investors of legislative changes, in particular in legal and political environments that are unpredictable and evolving (*Parkerings*, ¶¶ 341-342, 345).

---

[75] *EDF (Services) Limited v. Romania* (ICSID Case No. ARB/05/13), Award, 8 October 2009 (hereinafter *"EDF v. Romania"*).

[76] "Fair and Equitable Treatment", UNCTAD Series on Issues in International Investment Agreements (1999) 3 UNCTAD/ITE/IIT/11, Exh. C–527, quoted at ¶ 433 of the Claimants' Reply.

499. In view of the above, the Respondent submits that there are four propositions that the Claimants must prove in order for their fair and equitable treatment claim to succeed, and they have failed to prove them. These propositions are (Tr., Day 13, 45:1-20 (King)):

(i) First, the Claimants must prove that Romania's actions, and in particular the 31 August 2004 amendment of EGO 24, were manifestly unreasonable.

(ii) Second, the Claimants must prove that Romania promised them ten years of stabilization of the EGO 24 facilities.

(iii) Third, the Claimants must prove that they made investments in reasonable reliance on the legitimate expectation that the EGO 24 facilities would not change until 2009.

(iv) Fourth, the Claimants must prove that Romania acted in such a non-transparent and inconsistent way as to violate the fair and equitable treatment clause.

500. The Respondent has clarified that these propositions are not cumulative except (ii) and (iii). In other words, the Respondent's position is that the Tribunal could find a breach if the Claimant can prove that either proposition (i), propositions (ii) and (iii) jointly, or proposition (iv) are true (Tr., Day 13, 58:5-60:7).

501. In addition, as noted in paragraph 279 above, the Respondent argues as a general matter that the Claimants' case on fair and equitable treatment hinges on the testimony of their witnesses, which the Respondent contends is neither credible nor reliable. It also argues that, despite the Claimants' shift in focus, this is not and has never been a case about whether Romania acted transparently; it has only become so because the hearing undermined the Claimants' previous legal theories (Tr., Day 13, 19-43 (King)).

2. Nature, interpretation and content of the fair and equitable treatment standard

502. The Tribunal will now address the nature, interpretation and content of the fair and equitable treatment standard.

a. Interpretation and general contours of the standard

503. The Parties seem to agree on the basics of the fair and equitable treatment standard, with certain nuances. The Respondent does not contest the Claimants' portrayal of the standard as an autonomous one, different from the international minimum standard. Nor does it contest that the standard has specific meaning. Likewise, both Parties agree that the interpretation of Article 2(3) of the BIT should start from the normal canons of treaty interpretation as contained in Articles 31 and 32 of the VCLT. Romania is not a party to the VCLT, but it is common ground that the VCLT reflects

customary international law[77] and Romania relies on it as the appropriate method to interpret the BIT.[78]

504. To establish the content of the standard, the Tribunal must first turn to the plain meaning of the terms "fair and equitable." The plain meaning of these terms, however, does not provide much assistance. As noted by the tribunal in *MTD v. Chile*, "[i]n their ordinary meaning, the terms 'fair' and 'equitable' [...] mean 'just', 'even-handed', 'unbiased', 'legitimate'."[79] Similarly, the tribunal in *S.D. Myers v. Canada* stated that unfair and inequitable treatment meant "treatment in such an unjust or arbitrary manner that the treatment rises to the level that is unacceptable from the international perspective."[80] This Tribunal agrees with the *Saluka* tribunal in that "[t]his is probably as far as one can get by looking at the 'ordinary meaning' of the terms of Article 3.1 of the Treaty."[81]

505. The question is rather how those concepts should be applied to the facts. It is undisputed that an analysis of whether a state's conduct has been fair and equitable requires an assessment of all the facts, context and circumstances of a particular case. As stated in *Mondev v. United States:*

> When a tribunal is faced with the claim by a foreign investor that the investment has been unfairly or inequitably treated or not accorded full protection and security, it is bound to pass upon that claim on the facts and by application of any governing treaty provisions. A judgment of what is fair and equitable cannot be reached in the abstract; it must depend on the facts of the particular case.[82]

506. Similarly, the tribunal in *Waste Management II* said that "the standard is to some extent a flexible one which must be adapted to the circumstances of each case."[83] This has been echoed by several tribunals, including in *Lauder v. Czech Republic[84], CMS v. Argentina, Noble Ventures v. Romania[85], Saluka v. Czech Republic.*

507. That being said, as the Claimants point out and the Respondent does not contest, the content of the fair and equitable treatment standard does not depend on a tribunal's

---

[77] *See, e.g., Case Concerning the Territorial Dispute (Libyan Arab Jamahiriya v Chad),* [1994] ICJ Reports 6, ¶ 41 ("The Court would recall that, in accordance with customary international law, reflected in Article 31 of the 1969 Vienna Convention on the Law of Treaties, a treaty must be interpreted in good faith in accordance with the ordinary meaning to be given to its terms in their context and in the light of its object and purpose. Interpretation must be based above all upon the text of the treaty. As a supplementary measure recourse may be had to means of interpretation such as the preparatory work of the treaty and the circumstances of its conclusion.")

[78] *See, e.g.,* R-CM, ¶¶ 73-75.

[79] *MTD v. Chile*, ¶ 113.

[80] *S.D. Myers v. Canada*, ¶ 263.

[81] *Saluka v. Czech Republic*, ¶ 297.

[82] *Mondev v. United States*, ¶ 118. See also *M.C.I. Power Group L.C. and New Turbine, Inc. v. Republic of Ecuador* (ICSID Case No. ARB/03/6), Award, 31 July 2007, ¶ 370.

[83] *Waste Management v. Mexico II*, ¶ 99.

[84] *Ronald S. Lauder v. The Czech Republic*, UNCITRAL, Final Award, 3 September 2001 (hereinafter, *"Lauder v. Czech Republic"*).

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

idiosyncratic interpretation of the standard but "must be disciplined by being based upon state practice and judicial or arbitral case law or other sources of customary or general international law" (C-SoC, ¶ 193, citing *ADF Group,* ¶ 184). The tribunal in *Saluka* held:

> This does not imply, however, that such standards as laid down in Article 3 of the Treaty would invite the Tribunal to decide the dispute in a way that resembles a decision *ex aequo et bono*. This Tribunal is bound by Article 6 of the Treaty to decide the dispute on the basis of the law, including the provisions of the Treaty. Even though Article 3 obviously leaves room for judgment and appreciation by the Tribunal, it does not set out totally subjective standards which would allow the Tribunal to substitute, with regard to the Czech Republic's conduct to be assessed in the present case, its judgment on the choice of solutions for the Czech Republic's. As the tribunal in *S.D. Myers* has said, the "fair and equitable treatment" standard does not create an "open-ended mandate to second-guess government decision-making". The standards formulated in Article 3 of the Treaty, vague as they may be, are susceptible of specification through judicial practice and do in fact have sufficient legal content to allow the case to be decided on the basis of law. Over the last few years, a number of awards have dealt with such standards yielding a fair amount of practice that sheds light on their legal meaning.[86]

508. In any event, it is established that the state's conduct does not need to be egregious to violate the standard (*Mondev, ADF Group, Waste Management II – see* paragraph 524 below).

509. Further, both Parties agree that the fair and equitable treatment standard should be interpreted in the light of the object and purpose of the BIT as reflected in its Preamble. This was also the approach taken by the *Saluka* tribunal, which noted that "[t]he preamble thus links the 'fair and equitable treatment' standard directly to the stimulation of foreign investments and to the economic development of both Contracting Parties."[87] The Respondent further argues that the standard should be interpreted in the broader context of EU accession.

510. The Preamble of the BIT states that the Contracting Parties have agreed on the terms of the BIT:

> *desiring* to intensify economic cooperation to the mutual benefit of both States and to maintain fair and equitable conditions for investments by investors of one Contracting Party in the territory of the other Contracting Party,
>
> *recognizing* that the promotion and protection of such investments favour the expansion of the economic relations between the two Contracting Parties and stimulate investment initiatives, […]

511. The Parties agree that the Preamble reflects the BIT signatories' goal of intensifying economic cooperation between Romania and Sweden, but disagree on what interpretation of "fair and equitable treatment" is appropriate to achieve this goal. The

[86] *Saluka v. Czech Republic*, ¶ 284.

[87] *Id*, ¶ 298.

Claimants do not suggest a specific interpretation of the fair and equitable treatment standard in this context, other than to argue that attracting investors through tax exemptions and other incentives that are promised for a certain period of time, and then withdrawing those incentives unilaterally, is not conducive to the intensification of economic cooperation or to the stimulation of investment initiatives.

512. The Respondent for its part contends that the Contracting Parties' intention was to intensify economic relations in the context of Romania's accession to the EU. The Respondent argues that the BIT was signed pursuant to Article 74 of the Europe Agreement, which prompted Romania to sign investment protection treaties with EU member states. As the goal of the Europe Agreement was to integrate Romania and the EU at a political level, which carried with it the obligation to harmonize Romanian law to EU law, the goal of the BIT between Romania and Sweden must be interpreted in this context. Therefore, Romania's obligation to afford fair and equitable treatment to Swedish investors must be interpreted in such a way that it is consistent with EU law.

513. It is undisputed that the Europe Agreement predated the BIT and, indeed, promoted the conclusion of BITs such as the Sweden-Romania BIT. Despite the lack of express reference in the BIT to EU accession or the EU, the Tribunal has also found that the general context of EU accession must be taken into account when interpreting the BIT.

514. That being said, the Tribunal cannot conclude in the abstract (as Romania seems to suggest) that the revocation of the incentives is fair and equitable solely because it was undertaken pursuant to Romania's obligation under the Europe Agreement to harmonize its law with EU law. As previously stated, whether the state's conduct is unfair and inequitable must be assessed in view of all the facts and surrounding circumstances.

515. The Tribunal must bear in mind that the goal of the BIT is the "intensif[ication of] economic cooperation to the mutual benefit of both States" and, in this context, "to maintain fair and equitable conditions for investments by investors of one Contracting Party in the territory of the other Contracting Party", and that when the Contracting States set this goal they recognized "that the promotion and protection of such investments favour the expansion of the economic relations between the two Contracting Parties and stimulate investment initiatives." In this respect, the Claimants argue that the objective of the BIT was to help Romania raise its level of economic development so it could join the EU (Tr., Day 1, 181-184 (Gaillard)).

516. In view of these considerations, the Tribunal favors a balanced view of the goals of the BIT similar to that adopted by the *Saluka* tribunal:

> This is a more subtle and balanced statement of the Treaty's aims than is sometimes appreciated. The protection of foreign investments is not the sole aim of the Treaty, but rather a necessary element alongside the overall aim of encouraging foreign investment and extending and intensifying the parties' economic relations. That in turn calls for a balanced approach to the interpretation of the Treaty's substantive provisions for the

> protection of investments, since an interpretation which exaggerates the protection to be accorded to foreign investments may serve to dissuade host States from admitting foreign investments and so undermine the overall aim of extending and intensifying the parties' mutual economic relations.
>
> Seen in this light, the "fair and equitable treatment" standard prescribed in the Treaty should therefore be understood to be treatment which, if not proactively stimulating the inflow of foreign investment capital, does at least not deter foreign capital by providing disincentives to foreign investors. An investor's decision to make an investment is based on an assessment of the state of the law and the totality of the business environment at the time of the investment as well as on the investor's expectation that the conduct of the host State subsequent to the investment will be fair and equitable.[88]

517. Finally, the Tribunal agrees with the Respondent that the fair and equitable treatment standard is not a laundry list of potential acts of misconduct. Whether a state has treated an investor's investments unfairly and inequitably defies abstract analysis or definitions, and can only be assessed when looking at the totality of the state's conduct. As noted by the tribunal in *Total S.A. v. Argentina,*[89] "[s]ince this standard is inherently flexible, it is difficult, if not impossible, 'to anticipate in the abstract the range of possible types of infringements upon the investor's legal position'."[90]

518. Nonetheless, as noted by Professors Dolzer and Schreuer, one way to "gauge the meaning of an elusive concept such as FET" is "to identify typical factual situations to which this principle has been applied. An examination of the practice of tribunals demonstrates that several principles can be identified, which are embraced by the standard of fair and equitable treatment."[91] As noted by the *Total* tribunal, "[o]n the premise that a 'judgement of what is fair and equitable cannot be reached in the abstract; it must depend on the fact[s] of the particular case' and that 'the standard is to some extent a flexible one which must be adapted to the circumstances of each case', tribunals have endeavoured to pinpoint some typical obligations that may be included in the standard, as well as types of conduct that would breach the standard, in order to be guided in their analysis of the issue before them."[92]

519. According to Dolzer and Schreuer, tribunal practice shows that the concepts of transparency, stability and the protection of the investor's legitimate expectations play a central role in defining the FET standard, and so does compliance with contractual obligations, procedural propriety and due process, action in good faith and freedom

---

[88] *Saluka v. Czech Republic*, ¶¶ 304-309.

[89] *Total S.A. v. Argentine Republic* (ICSID Case No. ARB/04/01), Decision on Liability, 27 December 2010 (hereinafter *"Total S.A. v. Argentina"* or *"Total"*).

[90] *Total S.A. v. Argentina*, ¶ 107.

[91] R. Dolzer and C. Schreuer, Principles of International Investment Law, 2008, p. 133.

[92] *Total S.A. v. Argentina*, ¶ 109.

from coercion and harassment.[93] Cases reflecting these conclusions include *Bayindir v. Pakistan*[94] and *Total S.A. v. Argentina*.[95]

520. In this context, the Parties appear to agree that there are certain types of conduct that are usually deemed to violate the fair and equitable treatment standard, bearing in mind the facts of the particular case. For analytical purposes, the Tribunal will use the Respondent's distinction between (i) conduct that is substantively improper (because it is arbitrary, unreasonable, discriminatory or in bad faith), (ii) conduct that violates legitimate expectations relied upon by the investor (including here the Claimants' stability "strand"), and (iii) conduct that is procedurally improper. That being said, the Tribunal is not persuaded that the Claimants' claim that Romania acted non-transparently and inconsistently is based on an assertion that the violation is "procedural," so the Tribunal will not use the Respondent's terminology for that claim.

521. The Tribunal addresses the standard for substantively proper conduct in Section (b) below, the standard for determining when a legitimate expectation has arisen in Section (c) below, and the standard for transparency in Section (d) below.

b. Conduct that is substantively improper

522. There is no dispute that conduct that is substantively improper, whether because it is arbitrary, manifestly unreasonable, discriminatory or in bad faith, will violate the fair and equitable treatment standard. As stated by the *Waste Management II* tribunal:

> "[T]he minimum standard of treatment of fair and equitable treatment is infringed by conduct attributable to the State and harmful to the claimant if the conduct is arbitrary, grossly unfair, unjust or idiosyncratic, is discriminatory and exposes the claimant to sectional or racial prejudice, or involves a lack of due process leading to an outcome which offends judicial propriety—as might be the case with a manifest failure of natural justice in

---

[93] *Id.*

[94] *Bayindir v. Pakistan*, Award, 27 August 2009, ¶ 178 ("The Tribunal agrees with Bayindir when it identifies the different factors which emerge from decisions of investment tribunals as forming part of the FET standard. These comprise the obligation to act transparently and grant due process [*Metalclad v. Mexico*], to refrain from taking arbitrary or discriminatory measures [*Waste Management v. Mexico II, Lauder v. Czech Republic*], from exercising coercion [*Saluka v. Czech Republic*] or from frustrating the investor's reasonable expectations with respect to the legal framework affecting the investment [*Duke Energy v. Ecuador*].")

[95] *Total S.A. v. Argentina*, ¶¶ 109 ("A breach of the fair and equitable treatment standard has been found in respect of conduct characterized by 'arbitrariness' [*ELSI* case] and of 'acts showing a wilful neglect of duty, an insufficiency of action falling far below international standards, or even subjective bad faith' [*Genin v. Estonia*]. It has been also held that the standard requires 'treatment in an even-handed and just manner, conducive to fostering the promotion of foreign investment' [*MTD v. Chile*], thereby condemning conduct that is arbitrary, grossly unfair, unjust or idiosyncratic or that 'involves a lack of due process leading to an outcome which offends judicial propriety – as might be the case with a manifest failure of natural justice in judicial proceedings or a complete lack of transparency and candour in administrative process' [*Waste Management v. Mexico II*]. Awards have found a breach in cases of discrimination against foreigners and 'improper and discreditable' or 'unreasonable' conduct. [*Saluka v. Czech Republic*] This does not mean that bad faith is necessarily required in order to find a breach: 'A State may treat foreign investment unfairly and inequitably without necessarily acting in bad faith.' [*Mondev v. U.S.*]").

> judicial proceedings or a complete lack of transparency and candour in an administrative process. In applying this standard it is relevant that the treatment is in breach of representations made by the host State which were reasonably relied on by the claimant."[96]

523. On this subject, the *Saluka* tribunal stated:

> A foreign investor protected by the Treaty may in any case properly expect that the Czech Republic implements its policies bona fide by conduct that is, as far as it affects the investors' investment, reasonably justifiable by public policies and that such conduct does not manifestly violate the requirements of consistency, transparency, even-handedness and nondiscrimination. In particular, any differential treatment of a foreign investor must not be based on unreasonable distinctions and demands, and must be justified by showing that it bears a reasonable relationship to rational policies not motivated by a preference for other investments over the foreign-owned investment.[97]

524. That being said, it is well established that the state's conduct need not be outrageous to breach the fair and equitable treatment standard. In *Mondev v. United States*, the tribunal held that "[t]o the modern eye, what is unfair or inequitable need not equate with the outrageous or the egregious. In particular, a state may treat foreign investment unfairly and inequitably without necessarily acting in bad faith."[98] This finding was echoed by the tribunal in *Waste Management v. Mexico II*:

> Both the *Mondev* and *ADF* tribunals rejected any suggestion that the standard of treatment of a foreign investment set by NAFTA is confined to the kind of outrageous treatment referred to in the *Neer* case, i.e. to treatment amounting to an "outrage, to bad faith, to wilful neglect of duty, or to an in insufficiency of governmental action so far short of international standards that every reasonable and impartial man would readily recognize its insufficiency."[99]

525. With respect to the meaning of the term "unreasonable", both Parties appear to agree that "unreasonable" means lacking in justification or not grounded in reason (i.e., arbitrary), or not enacted in pursuit of legitimate objectives (C-Reply, ¶ 454; R-PHB, ¶ 33). The Respondent also proposes the formulation used by the *Saluka* tribunal: for a state's conduct to be reasonable, it must "bear a reasonable relationship to rational policies […]."[100] Although the definition is rather circular, the Tribunal finds it appropriate, with the specification made by the *AES* tribunal, namely that the determination of whether the state's conduct is reasonable requires the analysis of two elements: "the existence of a rational policy; and the reasonableness of the act of

[96] *Waste Management v. Mexico II*, ¶ 98. The Tribunal notes that, strictly speaking, this case refers to the minimum standard of treatment contained in NAFTA Article 1105. However, both Parties have relied on this definition in their submissions in this case, so the Tribunal understands that they accept that it is relevant for the fair and equitable treatment standard under the BIT.

[97] *Saluka v. Czech Republic*, ¶ 307.

[98] *Mondev v. U.S.*, ¶ 116.

[99] *Waste Management v. Mexico II*, ¶ 93. This paragraph has been cited by many different tribunals, including *Chemtura Corporation v. Government of Canada*, UNCITRAL, Award, 2 August 2010 (hereinafter, *"Chemtura v. Canada"*), ¶ 215. *See* Dolzer & Schreuer p. 129.

[100] *Saluka v. Czech Republic*, ¶¶ 309 and 460.

the state in relation to the policy" (*AES v. Hungary,* ¶ 10.3.7). As noted by the *AES* tribunal, a policy is rational when the state adopts it "following a logical (good sense) explanation and with the aim of addressing a public interest matter" (*Id.*, ¶ 10.3.8), and an action is reasonable when there is "an appropriate correlation between the state's public policy objective and the measure adopted to achieve it" (*Id.*, ¶ 10.3.9). In other words, for a state's conduct to be reasonable, it is not sufficient that it be related to a rational policy; it is also necessary that, in the implementation of that policy, the state's acts have been appropriately tailored to the pursuit of that rational policy with due regard for the consequences imposed on investors.

526. That is not to say that any conduct that is "reasonable" under this definition will be "fair and equitable". As stated above, the determination of what is fair and equitable cannot be made in the abstract: it requires the assessment of all the factual and legal circumstances surrounding both the state's conduct and an investor's investments. There are conceivably cases in which reasonable action by a state in pursuit of a rational policy may nonetheless be unfair with respect to certain investors.

c. Regulatory stability and legitimate expectations

527. The Claimants argue that Romania's obligation to afford them fair and equitable treatment means that Romania must ensure a stable and predictable legal and business environment, and must protect the Claimants' legitimate expectations. In turn, the Respondent submits that "[t]he default position in international law is that a state is free to adopt, change, and repeal regulations as it sees fit – so long as its actions are reasonably related to a legitimate public interest and are not discriminatory" (R-Rejoinder, ¶ 9). However, the Respondent concedes that its regulatory sovereignty is limited by the legitimate expectations the state has validly created in investors, provided that these expectations arise from specific assurances entered into by the state, are reasonable, and were the predicate of the Claimants' investments (R-CM, ¶¶ 111-135; R-Rejoinder, ¶¶ 169-172, 191).

528. The tribunal in *LG&E v. Argentina* stated that "the stability of the legal and business framework in the state party is an essential element in the standard of what is fair and equitable treatment", and found that it "was an emerging standard of fair and equitable treatment in international law."[101] This Tribunal agrees as a general matter.

529. However, the fair and equitable treatment obligation is not an unqualified guarantee that regulations will never change. Investors must expect that the legislation will change from time to time, absent a stabilization clause or other specific assurances giving rise to a legitimate expectation of stabilization. The BIT's protection of the stability of the legal and business environment cannot be interpreted as the equivalent of a stabilization clause. In the Tribunal's view, the correct position is that the state may always change its legislation, being aware and thus taking into consideration that: (i) an investor's legitimate expectations must be protected; (ii) the state's conduct must be substantively proper (*e.g.*, not arbitrary or discriminatory);

[101] *LG&E v. Argentina*, ¶ 125.

and (iii) the state's conduct must be procedurally proper (*e.g.*, in compliance with due process and fair administration). If a change in legislation fails to meet these requirements, while the legislation may be validly amended as a matter of domestic law, the state may incur international liability.

d. Transparency / Consistency

530. Professors Dolzer and Schreuer submit that "[t]ransparency means that the legal framework for the investor's operations is readily apparent and that any decisions affecting the investor can be traced to that legal framework." [102] They also state that by now the requirement of transparency is "firmly rooted in arbitral practice.[103]

531. This was also the view adopted by the tribunal in *Metalclad v. Mexico*, which stated as follows:

> The Tribunal understands [transparency] to include the idea that all relevant legal requirements for the purpose of initiating, completing and successfully operating investments made, or intended to be made, under the Agreement should be capable of being readily known to all affected investors of another Party. There should be no room for doubt or uncertainty on such matters. Once the authorities of the central government of any Party (whose international responsibility in such matters has been identified in the preceding section) become aware of any scope for misunderstanding or confusion in this connection, it is their duty to ensure that the correct position is promptly determined and clearly stated so that investors can proceed with all appropriate expedition in the confident belief that they are acting in accordance with all relevant laws.[104]

532. The Tribunal is also mindful that, when defining fair and equitable treatment, the *Tecmed* tribunal stated that:

> The foreign investor expects the host State to act in a consistent manner, free from ambiguity and totally transparently in its relations with the foreign investor, so that it may know beforehand any and all rules and regulations that will govern its investments, as well as the goals of the relevant policies and administrative practices or directives, to be able to plan its investment and comply with such regulations. Any and all State actions conforming to such criteria should relate not only to the guidelines, directives or requirements issued, or the resolutions approved thereunder, but also to the goals underlying such regulations.[105]

533. The Tribunal agrees with the general thrust of these statements. However, as noted by the *Saluka* tribunal, such propositions must be considered in the proper context; "taken too literally, they would impose upon host States obligations which would be inappropriate and unrealistic."[106] Whether a state has been unfair and inequitable by failing to be transparent with respect to its laws and regulations, or being ambiguous

[102] Dolzer & Schreuer, pp. 133-134 (citing the UNCTAD Series on Issues in International Investment Agreements, Fair and Equitable Treatment (1991) p. 51).
[103] *Id.*
[104] *Metalclad v. Mexico*, ¶ 76.
[105] *Tecmed v. Mexico*, ¶ 154.
[106] *Saluka v. Czech Republic*, ¶ 304.

and inconsistent in their application, must be assessed in light of all of the factual circumstances surrounding such conduct. For example, it would be unrealistic to require Romania to be totally transparent with the general public in the context of diplomatic negotiations. The question before the Tribunal is thus not whether Romania has failed to make full disclosure of or grant full access to sensitive information; it is whether, in the event that Romania failed to do so, Romania acted unfairly and inequitably with respect to the Claimants. The same applies to consistency: the question is not merely whether Romania has acted inconsistently; it is whether, in acting inconsistently, it has been unfair and inequitable with respect to the Claimants. This is a question that cannot be answered in a vacuum; it is highly dependent on the factual circumstances.

534. Whether a state acted in an ambiguous or inconsistent manner is also assessed taking into consideration that state's past conduct which is part of the context. As stated by the *Tecmed* tribunal, "[t]he foreign investor also expects the host State to act consistently, i.e. without arbitrarily revoking any preexisting decisions or permits issued by the State that were relied upon by the investor to assume its commitments as well as to plan and launch its commercial and business activities […]."[107] It also found that "the Claimant was entitled to expect that the government's actions would be free from any ambiguity that might affect the early assessment made by the foreign investor of its real legal situation or the situation affecting its investment and the actions the investor should take to act accordingly."[108] Consequently, the tribunal found that the investor's legitimate expectations were frustrated by the contradiction and uncertainty in Mexico's conduct, "which [were] prejudicial to the investor in terms of its advance assessment of the legal situation surrounding its investment and the planning of its business activity and its adjustment to preserve its rights." [109]

535. Following this reasoning, the Tribunal will thus now assess the Claimants' claims that Romania acted unfairly and inequitably.

3. Did Romania fail to provide a predictable and stable legal framework for the Claimants' investments? In particular, did it violate the Claimants' legitimate expectations of regulatory stability?

a. The Claimants' position

536. The Claimants contend that, by prematurely revoking the EGO 24 incentives, Romania failed to provide a predictable and stable legal framework for the Claimants to plan their investments. In particular, they argue that Romania violated their legitimate expectation that these incentives would be in place for the promised 10-year period (C-SoC, ¶¶ 211-228; C-Reply, ¶¶ 359-430; C-PHB, ¶¶ 36-50).

537. The Claimants address the stability and legitimate expectations "strands" of their fair and equitable treatment claim together in their Statement of Claim and Post-Hearing

[107] *Tecmed v. Mexico*, ¶ 154 (Emphasis added).

[108] *Id,* ¶ 167.

[109] *Id,* ¶¶ 172-173.

Brief, but treated the individual claims separately in their Reply. As discussed above, the Tribunal finds that the Claimants' arguments with respect to these two "strands" are closely interlinked, and will thus address them jointly. Indeed, as noted by the tribunal in *Duke v. Ecuador,* "[t]he stability of the legal and business environment is directly linked to the investor's justified expectations."[110]

i. The standard for determining whether there has been a breach of legitimate expectations

538. The Claimants argue that the threshold legal question is how a Tribunal should determine whether it was reasonable for an investor to rely on a particular expectation in a particular context. The Claimants rely on *Parkerings v. Lithuania* (at ¶ 331), where the Tribunal held that an investor's expectation is legitimate if:

   a. The investor received an explicit promise or guarantee as to particular legal or regulatory provisions;

   b. The investor received implicit promises or guarantees to that effect that it then took into account in making its investment; or

   c. Absent such assurances or representations, the circumstances surrounding the investment were such as to give rise to a legitimate expectation.

539. Contrary to the Respondent's allegations, the Claimants contend that explicit assurances or specific representations from the host state are not required to generate legitimate expectations (C-PHB, ¶ 38). The Claimants' argue this was the position adopted by the tribunals in *Saluka v. Czech Republic*, *Occidental v. Ecuador*, *MTD v. Chile*, and *PSEG v. Turkey*).

540. According to the Claimants, in determining whether an expectation was legitimate, the Tribunal must also consider whether the Claimants conducted due diligence and whether the expectations were reasonable in light of the circumstances (*Parkerings,* ¶ 333). Furthermore, according to the Claimants, whether an expectation was legitimate must be examined at the time the investment was made (*EDF v. Romania,* ¶ 41).

541. The Claimants submit that an investor's expectation must be legitimate at the time when the promise or assurance was made, and when the investors relied on that promise or assurance (Tr., Day 1, 176:3-8 (Gaillard)).

542. In this case, the Claimants argue that Romania made a promise or assurance to them that gave rise to a legitimate expectation (Section (ii) below); the Claimants relied on that assurance (Section (iii) below), and the Claimants' expectation was reasonable (Section (iv) below). They also argue that Romania breached that legitimate expectation when it revoked the EGO 24 incentives (Section (v) below).

[110] *Duke Energy v. Ecuador*, ¶ 340.

ii. Romania made a promise or assurance to the Claimants that gave rise to a legitimate expectation

543. The Claimants submit that Romania made a promise or assurance to the Claimants (i.e., that the EGO 24 incentives would remain in place during the 10 year period that Ştei-Nucet was a disfavored region) that gave rise to a legitimate expectation (C-Reply, ¶¶ 411-423; C-PHB, ¶ 42). As explained in Section A above with respect to the umbrella clause, the Claimants argue that EGO 24 and its implementing legislation (in particular GD 194/1999) gave investors benefiting from that regime through the issuance of a PIC, a right to receive all of the incentives created by EGO 24 until 1 April 2009. Furthermore, the Claimants argue, Romania had a corresponding obligation to grant all of those incentives, substantially unchanged, during that time period. In the event that the Tribunal finds that the legislation did not give rise to an obligation *stricto sensu*, the Claimants argue that the legislation at least constituted a representation or promise that gave rise to a legitimate expectation that those incentives would remain in place until 1 April 2009.

544. The Claimants assert that their legitimate expectation arose "upon the granting to them of their PIC, or in the case of European Food possibly at the time of the granting of its temporary certificate" (Tr., Day 12, 91 (Reed)). In other words, it arose for European Food at the earliest on 9 December 1999, and for Starmill and Multipack on 17 May 2002.

545. According to the Claimants, the promise or assurance that gives rise to their legitimate expectation satisfies the *Parkerings* criteria.

546. First, as explained in Section A above, the Claimants contend that, through the enactment of EGO 24 and its implementing legislation, and through the issuance of investor-specific PICs, Romania explicitly committed to make the incentives available to the Claimants in the Ştei-Nucet disfavored region until 1 April 2009 (C-SoC, ¶ 300; C-Reply, ¶¶ 467-468; C-PHB, ¶¶ 6-24; Tr., Day 12, 70-91 (Reed), 163-164 (Gaillard)).[111] This assurance was made to investors generally through EGO 24 and its implementing legislation, and to the Claimants in particular by means of the issuance of investor-specific PICs to each of the Corporate Claimants that explicitly granted these particular Claimants the benefits of the EGO 24 incentives regime for a period of 10 years. The Claimants argue that this assurance from the Respondent was evident from the language of the relevant regulations and the PICs, and was reinforced by Romania's conduct. The Claimants stress that these PICs constitute a specific assurance that gives rise to a legitimate expectation, regardless of whether the Tribunal finds that Romania did or did not enter into an obligation with the Corporate Claimants.

547. Second, even absent the express language in EGO 24 and the investor-specific commitments made in the PICs, the Claimants submit that Romania implicitly committed to maintain the incentives for ten years. By offering, reaffirming and

[111] This argument is also the core of the Claimants' umbrella clause claim.

maintaining for their designated durations various incentives to invest in disadvantaged regions during the 1990s, Romania demonstrated the reasonableness of relying on the stability of the EGO 24 incentives and the rights embodied in the PICs. In addition, the fact that Romania offered the Raw Materials Incentive in 1998 – three years after it subjected itself to EU state aid requirements – reflected Romania's own belief that the incentive was permissible under those requirements and its intent to maintain the incentives regime despite the ongoing EU accession negotiations. Moreover, when the Romanian Competition Council issued its findings in 2000 questioning the legality of the Raw Materials Incentive, the Government disagreed with and opposed those findings, which were ultimately dismissed by Romanian courts.

548. Third, the Claimants submit that the circumstances surrounding their investments demonstrate Romania's commitment to maintain the incentives for ten years. The Claimants argue that "this is not a case of an investor taking advantage of a legal regime that just happened to be in place at the time of investment, and then complaining when the host state legislated a new regime. Rather, the regime was specifically designed to attract investors like Claimants, so that they would spend money and create jobs in Romania's disadvantaged regions" (C-Reply, ¶ 421).

549. As a result, the Claimants submit that this interpretation is the only one that makes sense from a teleological standpoint. According to the Claimants, if the incentives could have been revoked at any time, they would have been ineffective in incentivizing investment, because investors would have lacked the certainty that they would have needed to commit funds.

550. The Claimants argue that Romania was successful in attracting investors, but revoked the incentives before the Claimants could achieve the benefits that had been used to attract them. In this context, Romania violated the Claimants' legitimate expectation of basic regulatory stability with respect to the incentives regime.

iii. The Claimants relied upon that promise or assurance

551. The Claimants argue that they relied upon Romania's promise or assurance when deciding to invest on the scale and at the speed they did in the Ştei-Nucet disfavored region. In particular, they allege that they had a ten-year plan for European Food to capitalize on the EGO 24 benefits. Although the Claimants acknowledge that Messrs. Micula's initial investments in Bihor County were made in reliance on previous incentive regimes (specifically, Law 35 and GD 27) (C-Reply, ¶¶ 62-124), they claim that they would not have invested in the manner, scale and speed that they did if they had not reasonably relied on the expectation that the EGO 24 incentives regime would remain in place for the full 10-year period (C-Reply, ¶¶ 161-170; C-PHB, ¶ 43; Third WS of I. Micula, ¶¶ 44-64; WS of M. Ban, ¶ 38).

552. The Claimants allege that their investments in Bihor County only made economic sense if they could count on the benefits of the Raw Materials' Incentive for the 10-year period. Absent that incentive, the Claimants would not have invested in the way

they did, and Romania would not have achieved the socioeconomic benefits in its disadvantaged regions that it sought (C-Reply, ¶ 422).

553. The Claimants contend that Romania is incorrect and misleading when it states that EGO 24 was neither the predicate for the Miculas' initial investment decision, nor the cause of any apparent change in their investment strategy (C-Reply, ¶¶ 62-68). The Miculas allege that they did not invest in Bihor County because of legislative "fluctuations" happening at the time (implying instability); rather, they relied on legislative changes that promoted investment. Prior to the implementation of EGO 24, the Miculas relied on two predecessor state aid regimes, Law 35 and GO 27, which illustrates the reasonableness of the Claimants' reliance on other incentive programs such as EGO 24. In any event, the Miculas did not create the fully integrated and complex facilities that include today's food production business until after 1998, in reliance on EGO 24.[112]

554. The Claimants argue that their reliance on the EGO 24 incentives is proven by the following facts (C-Reply, ¶¶ 165-170, 197-204; C-PHB, ¶ 43):

a. *The Claimants' decision to invest in Ştei-Nucet instead of Bucharest.* In 1997, the Miculas had planned to relocate from Bihor county to Bucharest, which would have meant considerable cost savings (given its location within Romania's largest market and proximity to the port of Constanţa). They had already purchased two companies and land in Bucharest in 1997 and had entered into a contract for bottling lines to be installed in Bucharest in January 1998. However, after learning of the EGO 24 incentives, the Miculas changed their mind and remained in Bihor County. On the understanding that the incentives would last for the full 10 years, they determined that the incentives outweighed the costs of investing in such a remote region (Third WS of I. Micula, ¶¶ 31-36; Third WS of V. Micula, ¶¶ 28-29; Tr., Day 2:211, Day 3:133,141,145-150, Day 4:72-73 (I. Micula); WS of M. Ban, ¶ 38; Exh. C-439; C-346; C-679; C-676-678).

b. *The Corporate Claimants were created specifically to benefit from the incentives.* The Articles of Incorporation of European Food state that the company was created "in accordance with the provisions of Law 20/15.01.1999 regarding the approval of EGO 24/1998…" (Exh. HEC-1). The Miculas used European Food to import the majority of the raw materials used by the business to take advantage of customs duties exemptions. Starmill was incorporated to establish integrated in-house grain milling facilities, which would also take advantage of the Raw Materials Incentive and create cost efficiencies. Multipack was incorporated to establish the packaging and labeling for nearly all of the companies' products, and also relied heavily on the Raw Materials Incentive. (Third WS of I. Micula, ¶¶ 47, 55, 59-67; WS of M. Halbac, ¶¶ 17-19; Exh. C-385).

[112] The Claimants note that Romania's timeline of the Claimants' investments in Romania (R-CM, Figure 1, page 7) shows the dates in which the relevant companies were incorporated, rather than the dates in which Messrs. Micula acquired the shares in the preexisting companies created by others. The Claimants include a "correct timeline" at C-Reply, page 25.

c. *The scale of the investments, the integration of the Claimants' business model and the Claimants' expansion into new markets such as food and beer, only made economic sense if the incentives were to last for the full 10-year period.* The Claimants allege that their business strategy depended on taking advantage of the incentives to achieve long-term profitability through the vertical integration of their facilities and the construction of cost-saving and revenue-generating capital projects. This would allow them to achieve economies of scale and reduce costs, which would allow them to maintain successful businesses after the expiration of the incentives. However, for this strategy to be successful, they needed sufficient time (and the cash savings provided by the incentives) to integrate their existing operations and construct these additional capital projects, as well as time to penetrate domestic and foreign markets. As explained in Section III.C.2 above, this business strategy contemplated two phases, each of which depended on the availability of the Raw Materials Incentive. The first phase consisted in penetrating the Romanian market with fast-moving consumer products. This would generate quick cash flows, which together with the incentive savings, would allow the companies to integrate vertically and achieve economies of scale, allowing them to save on operational costs and minimize waste and energy consumption. The second phase was to build a brewery and the so-called "Incremental Investments" (malt plant, canning plant and co-generation plant). The Claimants thus planned to use the EGO 24 incentives to expand their production facilities so that they would no longer be dependent on the incentives after their expiration on 2009 (Third WS of I. Micula, ¶¶ 44-46; ¶¶ 59--64, 83-84; Third WS of V. Micula, ¶ 33, 51-52).

d. *The fact that the obligations were to last for twice the period that the investors benefitted from the incentives.* As the obligations imposed by EGO 24 would last for twice the period that the Claimants benefitted from the incentives, the Claimants argue that they had to invest up-front so as to take advantage of the incentives to develop an integrated business that would be competitive and successful in the long term (Third WS of I. Micula, ¶¶ 59-64; Third WS of V. Micula, ¶¶ 33, 51-52).

e. *The availability of funding.* Due to the higher debt/equity ratio that would have existed but for the incentives, the Claimants argue that, without the promise that the incentives would last 10 years, it is unlikely that sufficient funding would have been available for the Claimants to invest the way they did (Second ER of C. Osborne, ¶¶ 7.18-7.21).

555. The Claimants argue that the lack of written business plans reflecting their reliance on Romania's assurances is irrelevant. They contend that family businesses such as the Miculas' do not generally prepare all the types of written documents that the Respondent claims should exist. Instead, the Tribunal must consider the actual evidence before it, which shows that the Miculas carefully considered the impact of the incentives, how they could take advantage of those incentives, and how the incentives could be weighed against the disadvantages of investing in a disfavored

region that lacked basic infrastructure and skilled workers, which ultimately led to their decision to invest (C-PHB, ¶¶ 44-45).

556. The Claimants contend that it is likewise irrelevant that the Claimants may have adapted their plans over time to respond to changes in the market; what matters is that the Miculas made specific investment decisions in reliance on the expectation that the incentives would remain in place for 10 years (C-PHB, ¶¶ 46).

iv. The Claimants' reliance was reasonable

557. The Claimants' argue that their reliance on the expectation that the EGO 24 incentives would last for the entire 10-year period was reasonable. According to the Claimants, the reasonableness of this expectation is proven by (a) the content of EGO 24 and of its enacting legislation; (b) the content of the PICs; (c) Romania's intimate involvement in the granting and monitoring of the EGO 24 incentives program; (d) Romania's promotion and support of the EGO 24 regime and previous incentive regimes, and (e) Romania's interaction with the Competition Council. In addition, the Claimants argue that, contrary to Romania's contentions, the Claimants' reliance was reasonable in light of Romania's impending accession to the EU.

(a) The purpose and content of EGO 24 and its enacting legislation

558. The Claimants submit that the very purpose and content of EGO 24 – and of its enacting legislation – gave rise to a legitimate expectation that the facilities would remain in place until 31 March 2009 (C-Reply, ¶¶ 211-221).

559. First, the Claimants argue that the language of EGO 24 and its implementing legislation were clear, and it was legitimate for the Claimants to rely on that language. In particular, Article 3 of GD 194/1999 declared Ştei-Nucet a disfavored region for a period of 10 years, while Article 4 stated that the incentives were available to investors during the existence of that disfavored region. GD 1199/2000, which amended GD 194/1999, increased the size of the disfavored region to include Drăgăneşti, confirmed that the region would be declared disfavored for 10 years, and did not amend Article 4 of GD 194/1999. GD 728/2001, which established the Methodological Norms for EGO 24, also stated that investors who had obtained a PIC would continue to benefit from the incentives until the lapse of the period during which the region was declared disfavored (Art. 5(3) of GD 728). Law 20, which enacted EGO 24, allowed this period to be extended (Art. I(5) of Law 20). In the light of these provisions, it was reasonable for the Claimants to believe that the incentives would be granted for the full 10 year period.

560. The Claimants further argue that EGO 24 was designed to induce long-term investments. To this end, Article 9 of EGO 24 required investors to continue to operate in the disfavored regions for twice the period for which they received the incentives, or they would have to repay the amounts they had received and/or saved. This meant that the Claimants had to ensure that their investments lasted for twenty years. Thus, the reciprocal nature of the obligations demonstrated the existence of a

quid pro quo between the investors and the state and instilled in the Claimants the reasonable expectation that both parties would comply with their obligations.

561. In addition, because the benefits applied only to new investments, any investor wishing to take advantage of them would either need to make a greenfield investment or reform an outdated facility. The Claimants also had to build their own utility support, which was nonexistent in the region. All of this necessitated significant commitments of capital which only made economic sense if the promised benefits were to last their full, 10-year term.

562. The Claimants further argue that the amendments made to the EGO 24 regime in the following years were made for a variety of reasons and did not give rise to an expectation that the regime would come to an end in early 2005 (C-Reply, ¶¶ 230-238). For example, EGO 75/2000 solved certain practical problems in the application of the incentives and even made some of them more readily available to investors. Although EGO 75/2000 repealed the "Components Facility", Law 625/2001 reinstated it. GD 1199/2000 extended the disfavored region to include Drăgăneşti. Law 345/2002 repealed the exemption from customs duties and VAT provided in Art. 6(1) of EGO 24, but did so in the context of a general taxation reform, not for the purpose of regulating state aid. Law 414/2002 repealed the profit tax exemption, but that exemption remained in place for investors (such as the Claimants) who had received PICs prior to 1 July 2002. Although another set of amendments passed in 2002 targeted the Raw Materials Incentive, it was clear from parliamentary debates and other contemporaneous sources that their purpose was to address problems in the meat industry, not the harmonization of Romania's law with EU law.

(b) The issuance and content of the PICs

563. The Claimants argue that the issuance and content of the PICs further enhanced their legitimate expectations that the facilities would remain in place for the entire period (C-Reply, ¶¶ 239-245). All of the Corporate Claimants' PICs expressly stated that they would be valid until 1 April 2009. The granting of the PICs and the fact that the Government allowed the Claimants to use them repeatedly to receive the benefits confirmed this belief. Further, the PICs confirmed all of the activities for which the Claimants could receive incentives (C-Reply, ¶¶ 156, 159).[113] Thus, the PICs explicitly and implicitly confirmed that the Claimants were entitled to benefit from the incentives until 1 April 2009.

564. According to the Claimants, Romania's attempts to minimize the importance of investor-specific PICs based on the language granting the incentives "in accordance with the provisions of EGO 24/1998" are unconvincing. That language merely reflects that EGO 24 had been amended prior to the date the PIC was granted. In any event, Multipack's PIC does not contain that language. Further, the PICs do not contain any language contemplating potential revocation of the incentives.

[113] The reference seems to be to Exh. C-638, which contains various versions of the PICs and a list of investment activities, but it is unclear to the Tribunal if this list was attached to the original PICs.

(c) Romania's intimate involvement in the granting of the EGO 24 incentives

565. The Claimants further submit that the reasonableness of their expectations was reinforced by the state's intimate involvement in the EGO 24 regime and close monitoring of the Claimants' receipt of the EGO 24 benefits (C-Reply, ¶¶ 171-196; 260-272).

566. In this regard, the Claimants allege that they underwent lengthy and detailed approval processes with different government agencies, which kept the Government fully apprised of the Claimants' investment plans and actual investments. Specifically, to obtain their Temporary Investment Certificates they needed to file and secure approval of their investment plan with the NW-RDA (e.g., European Food's investment plan of December 1999 is found at Exh. C-385). Each time they planned a new investment, they had to file updated versions of the investment plans for approval and obtain new, modified PICs that reflected the newly-approved investments. Similarly, to obtain their PICs, the Claimants had to undergo another approval process, including an on-site visit from the NW-RDA to verify that the companies qualified for EGO 24 benefits. In addition, to actually benefit from the incentives, the Corporate Claimants had to obtain approval from different regulatory bodies to verify that they met their EGO 24 requirements. Indeed, each time European Food wanted to import equipment or raw materials it had to submit very specific information regarding the machinery or raw materials it wished to import, as well as the investment purpose.

567. In addition to monitoring and regulating Claimants' activities via the PICs, the NW-RDA and the Oradea Customs Department closely supervised and controlled the Claimants' activities on a day-to-day basis via the continuous approvals processes in relation to the importation of equipment and raw materials. The Claimants' investments were also reviewed outside the approvals process, *e.g.*, through audits, biannual reviews, information obligations, and other monitoring activities.

568. The Claimants thus argue that, through the key role the Romanian authorities played at all levels of the EGO 24 incentives regime, these authorities provided explicit as well as implicit assurances to Claimants that the EGO 24 incentives would be available for their full term. These approval processes allowed the Government to track the amount and type of incentives the Claimants received under the EGO 24 program and ensured that the Claimants received incentives only for those business purposes for which they had obtained approval under their Temporary or Permanent Investor Certificates. Each approval by the Government agencies solidified the Claimants' expectation that the Government had every intention of complying with its obligations under EGO 24, which in turn encouraged the Claimants to continue with their investments.

(d) *Romania's promotion and support of the EGO 24 regime and previous incentive regimes*

569. The Claimants argue that the legitimacy of their expectations and the reasonableness of their reliance was further enhanced by Romania's contemporaneous statements and conduct with respect to the EGO 24 regime and previous incentive regimes.

570. The Claimants first allege that the Government actively promoted the EGO 24 incentives regime in order to induce investments in disfavored areas, and gave assurances as to its 10 year duration (C-Reply, ¶¶ 222-229). The Claimants cite, *inter alia*:

a. Presentations by Mr. Neculai Liviu Marcu, then President of the NARD, in which he explained the EGO 24 regime and its benefits for investors. In his witness statement submitted in this arbitration, Mr. Marcu states that "[o]n all of the occasions where I presented in disfavoured regions that had been declared as such for a 10 year period I explained that the benefits of the regime would last for the full 10 years" (WS of N. Marcu, ¶ 32);

b. Meetings with potential investors run by the NW-RDA and local government representatives (WS of M. Ban, ¶¶ 32-37);

c. The NW-RDA's annual reports (Exh. C-393, C-458);

d. The preparation of a CD-ROM for international promotion ("Romania – Your Business Partner 1999/2000" (Exh. C-563)).

e. Media reports of government initiatives (Exh. C-568 and C-630). In particular, the Claimants allege that the Government's June 2003 press release[114] noted the success of the EGO 24 program and, according to the Claimants, assured that the EGO 24 incentives would continue to be in place at least until Romania joined the EU (Exh. C-489).

f. Romania's National Program for Joining the EU, where the Claimants allege that the Government stated that the laws in force at the time would continue to be in place.[115]

571. Further, the Claimants contend that the success of the EGO 24 program – and Romania's public acknowledgement of this fact – reinforced the Claimants' legitimate expectation that the regime would remain in place for the stated term (C-Reply, ¶¶ 273-278). The EGO 24 program was enacted as part of Romania's attempts to address significant economic problems related to regional development and to further Romania's accession aspirations. The Claimants allege that the program was extremely successful in attracting investors to areas in need of capital, and this

[114] The Claimants refer to June 2002, but the date on Exh. C-489 is 18 June 2003.

[115] The Claimants mistakenly cite Exh. C-489. The correct reference appears to be Exh. HEC-7, which states at page 147 that "[t]he provisions of the normative acts on facilities granted for "D areas" will be maintained till the moment of Romania's accession to the European Union."

success was recognized and hailed by the Government. Romania continued to reaffirm the need for investment and reduction of unemployment in the disfavored regions, and continued to issue PICs and promote the EGO 24 scheme. In this context, it was reasonable for the Claimants to believe that Romania would remain committed to the EGO 24 program.

572. The Claimants also argue that it was reasonable for them to rely on the EGO 24 incentive program and its stated duration because Romania had previously offered and maintained other incentive regimes similar to the EGO 24 regime, including Law 35 and GO 27 (both of which had been implemented in the context of the Europe Agreement and were never challenged by the European Commission or the Government). The Government never revoked the incentives granted under these programs, and when Law 35 ended the incentives were "grandfathered" so that existing investors were able to benefit from them until their original expiration date. The Claimants thus argue that Romania's consistent pattern of conduct and the Miculas' successful experience with these previous incentive programs created a course of dealing between Romania and the Claimants that made it reasonable for the Claimants to expect that Romania would maintain the EGO 24 incentive program for its full stated term or at least grandfather its benefits.

573. In addition, the Claimants contend that, under Romanian law, the government was not allowed to revoke the incentives without grandfathering the provisions or compensating the investors. Relying on the testimony of Prof. Mihai, the Claimants argue that new legislation cannot affect acquired rights (Tr., Day 5:207-208, 210, 247 (Mihai)).

574. Finally, the Claimants contend that Romania never suggested to investors that reliance on the EGO 24 regime was inappropriate (C-Reply, ¶¶ 279-280). Romania argues that the Claimants should have somehow known that the EGO 24 regime would come to a premature end. However, until its revocation, the Claimants aver that the Government never suggested to, let alone informed, investors that the regime would not remain in place for the full ten-year period (Tr., Day 9, 21-23 (Juratowitch/Ban)). Instead, the Government continued to promote, apply and support the EGO 24 regime. When Romania finally started to indicate that the incentives could be terminated, Romania did not clearly state the timing and effects of that termination. In fact, Romania suggested that investors that relied on that regime would be protected or compensated.

(e) Romania's interaction with the Competition Council

575. The Claimants further argue that their expectation that the EGO 24 incentives would remain in place for the entire 10 year period was solidified by Romania's reaction to Decision 244 of the Competition Council (C-Reply, ¶¶ 246-259). In Decision 244 of 15 May 2000 (Exh. R-78), the Competition Council recommended alterations to EGO 24 (including the Raw Materials Incentive and the Machinery Incentive) after finding that the incentives distorted competition. However, the Government ignored Decision 244 and instead adopted EGO 75/2000, which did not implement the

recommendations of Decision 244. The Claimants argue that this suggests that the Government disagreed with Decision 244. Indeed, the Claimants submit that Romania's comments to the Commission's Written Submission in this arbitration suggest that Romania still considered the EGO 24 incentives to be compatible with state aid at that time (C-Reply, ¶ 60, citing Romania's letter of 16 November 2009).

576. The Claimants argue that the Government was right to disagree with Decision 244 for a number of reasons, in particular because it was flawed and was not based on EU competition law considerations. As explained by Prof. Dashwood, its findings were not supported by evidence and were not based on facts relating to the Claimants or their business. The Decision made no reference to the EU or the requirement for Romania to harmonize its laws with those of the EU, nor did it state that EGO 24 was incompatible with EU law. Decision 244 was also silent on whether EGO 24 fell under Article 87(3) of the EU Treaty, which exempts certain forms of state aid, especially aid designed to alleviate under-developed regions, from a general prohibition of aid that distorts competition (ER of A. Dashwood).

577. This disagreement generated a public debate between the Government and the Competition Council, which later led to a lawsuit brought by the Competition Council against the Government. The Government prevailed both in the first instance before the Bucharest Court of Appeal and on appeal before the High Court of Cassation and Justice (Exh. C-528 and C-643; ER of L. Mihai). In both instances the courts held that the Competition Council did not have the authority to challenge emergency government ordinances such as EGO 24, which are legislative acts.

578. According to the Claimants, the Romanian courts' decisions highlighted the Competition Council's lack of authority regarding EGO 24. The Claimants argue that under Law 143/1999 (Exh. R-18) the Competition Council was not authorized to scrutinize all state aid or order government agencies to stop granting aid. With respect to existing state aid (such as the EGO 24 incentives), the Competition Council was only authorized to request the aid provider to remove the incompatibility of the measures with the law, including through a recommendation for cancellation or amendment. But as shown by the Court decisions, the Government was not required to comply, and the Competition Council had no ability to challenge the legislation in court. Indeed, the Government did not comply with the Council's recommendation. This strengthened the Claimants' reasonable belief that the Government was committed to the EGO 24 program. This belief was confirmed by the fact that European Food was granted its PIC on 1 June 2000, only a few weeks after Decision 244 was rendered, and Starmill and Multipack were granted their PICs soon after the Supreme Court Decision was granted.

579. The Claimants further submit that the Government's support of the EGO 24 regime in the face of the opposition of the Competition Council was a strong indicator that the Government considered the EGO 24 regime to be lawful, and made the Claimants' reliance on that regime all the more reasonable. They argue that investors are entitled to assume that the government is acting lawfully, and if the government was acting as if EGO 24 was lawful, the Claimants were entitled to rely on that.

580. In addition, the Claimants conducted sufficient due diligence prior to investing. According to the Claimants, investors cannot be required to conduct a higher standard of due diligence than the government itself: it would be unreasonable to require the investors to know whether Romania would accede to the EU and what effect that would have on EGO 24, if Romania itself did not know that.

(f) The Claimants' expectations were reasonable in light of Romania's impending accession to the EU

581. As discussed in Section V.B on Applicable Law, in the Claimants' view EU law plays a different role with respect to the analysis of the Claimants' fair and equitable treatment claim than with respect to its expropriation and umbrella clause claims. With respect to these latter two claims, the Claimants argue that Romania's EU law defense can only be analyzed as a circumstance precluding wrongfulness, and thus should be assessed after the Tribunal has decided whether there is liability under the BIT. In contrast, the Claimants submit that with respect to the fair and equitable treatment claim, Romania's EU law defense is relevant to the determination of the wrongfulness itself; in other words, it is relevant to determining whether Romania has breached the fair and equitable treatment standard. Thus, Romania's EU law defense must be assessed during the Tribunal's analysis of whether the fair and equitable treatment standard has been breached (Tr., Day 1, 159-164, 170-174 (Gaillard)).

582. Specifically, the Claimants argue that EU law is part of the factual matrix against which the Tribunal must determine whether the Claimants' expectations were legitimate and, specifically, whether they were reasonable (Tr., Day 1, 176-177 (Gaillard)). The Claimants deny that, as argued by the Respondent, Romania's impending accession to the EU made their reliance unreasonable. To the contrary, the Claimants contend that their expectation that the Raw Materials Incentive would be afforded to them for 10 years was reasonable despite Romania's accession process. The Claimants stress that this analysis must consider the state of EU law and Romania's relationship with the EU at the time that the expectation arose and at the time the Claimants made their investments in reliance on this expectation (Tr., Day 1, 167 (Gaillard)).

583. First, the Claimants argue that, from a substantive standpoint, the incentives were compatible with EU law. At the very least, it would have been reasonable (from the time in which EGO 24 was enacted and until the incentives were revoked) for an investor to believe that the incentives were compatible with EU law. With the support of their expert in EU law, Prof. Dashwood, the Claimants assert that the incentives could have fallen within the scope of a valid exception to the EC Treaty's prohibition on state aid as provided in Article 87(3)(a) of the EC Treaty (formerly Article 92 of the Treaty establishing the European Economic Community, and incorporated into the Europe Agreement regime by Article 64 of the Europe Agreement), and could have validly constituted regional operating aid under the EU Guidelines on Regional Aid (ER of A. Dashwood, ¶¶ 43-55).

584. The "Implementing Rules" for the application of Article 64 of the Europe Agreement were adopted on 10 April 2001 through Decision 4/2000 of the EU-Romania Association Council (Exh. R-65; C-579).[116] Article 2(1) of the Implementing Rules provided that "[t]he assessment of compatibility of individual aid awards and programmes with the Europe Agreement, as provided for in Article 1 of these Rules, shall be made on the basis of the criteria arising from the application of the rules of Article 87 of the Treaty establishing the European Community [...]."

585. According to Prof. Dashwood, "the criteria applicable in respect of regional aid granted by the Romanian authorities under the regime of the [Europe Agreement] were those of the 1998 Guidelines [on Regional Aid] relating to areas covered by the Article 83(3)(a) derogation" (ER of A. Dashwood, ¶ 22). Prof. Dashwood explained that the Guidelines on Regional Aid distinguished between various types of state aid, and described the circumstances under which certain state aid could be granted. These circumstances included cases where the economic situation was extremely unfavorable in relation to the European Community as a whole, and the Guidelines specified the types of aid that could be granted as tax exemptions. In addition, although Prof. Dashwood acknowledges that while "operating aid aimed at reducing a firm's current expenditure is normally prohibited, the Guidelines recognise that, exceptionally, such aid may be granted in regions eligible under the derogation in Article 87(3)(a), subject to certain conditions" (ER of A. Dashwood, ¶ 11). Relying on Prof. Dashwood's expert opinion, the Claimants argue that EGO 24 incentives met all of the criteria for state aid permitted by Art. 87(3)(a). Accordingly, the Claimants argue that the EGO 24 incentives could have qualified under the Art. 87(3)(a) exemption.

586. Indeed, the Claimants argue that Romania itself appears to have believed that, at the time EGO 24 was enacted, the incentives were compatible with EU state aid requirements, noting that Romania itself has acknowledged this point in its submissions in this arbitration (*see* R-CM, ¶ 29; Respondent's Comments to the Commission's Written Submission, 16 Nov. 2009, ¶ 1(b)). Thus, the Claimants argue that any reasonable investor would have relied on Romania's own position that EGO 24 was compatible with EU law, and would have had no reason to expect the incentives to be prematurely revoked.

587. The Claimants reject Romania's suggestion that the Implementing Rules effective 2001 (Exh. R-65; C-579) explain why it viewed the incentives compatible with EU law in 1998, but incompatible in 2004 (R-CM, ¶ 20). According to the Claimants, there is nothing in the Implementing Rules to suggest this. Instead, the Implementing Rules clarified that "the procedural rules to ensure effective application of the criteria

[116] Article 4(1) of the Implementing Rules also extended the time period in which Romania would be considered an underdeveloped area pursuant to Article 64(4)(a) of the Europe Agreement:

> In accordance with and within the limits of Article 64(4)(a) of the Europe Agreement, Romania shall be regarded as an area identical to those areas of the Community referred to in Article 87(3)(a) of the Treaty establishing the European Community. (Article 4(1) of Decision 4/2000).

governing the compatibility of aid granted in Romania with the proper functioning of the [Europe] Agreement were left to be determined exclusively as a matter of Romanian law." (ER of A. Dashwood, ¶ 25). Given that Romania had entered into the Europe Agreement in 1993, it was well aware by 1998 which kinds of state aid it could provide. It is thus inappropriate for Romania to rely on the issuance of the 2001 Implementing Rules to try to argue that in 1998 there was little specific guidance as to whether particular incentive regimes would be permissible under EC state aid rules.

588. According to the Claimants, nothing after the issuance of EGO 24 affects this conclusion. The EC never requested that Romania repeal the EGO 24 incentives, and there was never a determination (by the EC) that the incentives did not qualify for an exemption of Art. 87(3)(a). The only body that examined whether the incentives in EGO 24 were compatible with EU law was the Romanian Competition Council through Decision 244 in 2001. In any event, the Competition Council's complaint against the Government for failure to apply Decision 244 was dismissed by Romanian courts.

589. Indeed, the Claimants contend that, as late as 2003, the EU was giving signals that it would accept existing aid schemes and would only require that the rules be changed for new entrants. In its Common Position of May 2003, the EU invited Romania to:

> […] provide information on individual benefits granted in the free zones and the disadvantaged areas and on any other individual tax benefits that have already been granted and which provide for tax benefits beyond Romania's target date for accession. The EU urges Romania to close incompatible aid schemes for new entrants with immediate effect. (EU Common Position, May 2003, Exh. EC-8, p. 5).

590. According to the Claimants, this document shows that, even at that late point in time, the EU was only requiring Romania to change the rules for new entrants, but it had no problem with grandfathering vested rights of existing investors (Tr., Day 1, 180:13-25 (Gaillard)).

> So even at that late point in time, the EU is saying: hey, change the rules for the new entrants. Frankly, I take issue with what I call the Commission's brief in this matter, because they fail to quote that. They quote the rest of the document but they forget conveniently this reference to the new entrants. So it was pretty clear, even at that late point in time, that the EU had no problem with granting -- grandfathering vested rights to existing entrants, existing investors, and that they would maybe insist that the rules are changed going forwards for the new entrants, as they should, because, frankly, the rule of law should mean something, even in Europe. (Tr., Day 1, 180:13-25 (Gaillard))

591. Second, the Claimants contend that, from a procedural standpoint, only Romania (and not the European Commission) had the competence to determine which forms of state aid qualified as permissible state aid. This is because during the relevant time Romania was a pre-accession regime, where the only applicable law was Romanian law. As opposed to a post-accession regime, where there is a duality of functions between the State's legal order and the European Commission, in pre-accession

Romania the European Commission and EU law played no role (Tr., Day 1, 178-179 (Gaillard); ER of A. Dashwood, ¶ 25).

592. Specifically, Prof. Dashwood states that the Europe Agreement said nothing about the procedural aspects of disciplining state aid. The Implementing Rules merely established rules for cooperation, consultation and problem solving between the European Commission and the Romanian monitoring authority (which was the Romanian Competition Office and Competition Council). Thus, Prof. Dashwood concludes that "[w]hat emerges clearly is that in the State aid regime of the [Europe Agreement] the procedural rules to ensure effective application of the criteria governing the compatibility of aid granted in Romania with the proper functioning of the Agreement were to be left to be determined exclusively as a matter of Romanian law" (ER of A. Dashwood, ¶ 25).

593. Prof. Dashwood further asserts that the substantive rules regarding State aid (in particular, Article 87 of the EC Treaty) cannot apply independently of the procedural rules in Articles 88 and 89 of the EC Treaty: "There has to be a concrete finding, by way of an individual Commission decision or legislation, that a particular aid, or aid of a certain type, is or is not compatible with the common market. It follows that the granting of the disputed aid could only be rendered unlawful under the [Europe Agreement] regime by a ruling compliant with the procedural requirements of that regime, finding that the aid satisfied all four of the criteria in Article 87 (1) [of the EC Treaty], while not qualifying as an exemption under Article 87(3)(a)" (ER of A. Dashwood, ¶¶ 32-33).]

594. Fourth, the Claimants contend that Romania contradicts itself when it asserts that the Miculas should have known that the incentives would disappear with Romania's accession to the EU. Indeed, Romania's acknowledged that it enacted the incentives legislation in order to advance its accession prospects. According to the Claimants, Romania admits (at R-CM, ¶ 29[117]) that EGO 24 was not incompatible with the Europe Agreement's provisions and Romania's accession obligations, and was, in fact, necessary for accession (C-Reply, ¶ 210).

595. The Claimants argue that there is a similar "element of schizophrenia" in the Commission's position. On the one hand, the EU urged Romania to take the measures necessary to improve Romania's economic and legal status, including negotiating BITs, so that it would be in a position to join the EU. Romania's economic situation at the conclusion of the Europe Agreement was so dire that the EU expressly stated that the whole of Romania should be considered an underdeveloped area for purposes of State aid (Art. 64(4)(a) of the Europe Agreement). Accordingly,

[117] "Especially given Romania's status as an 'underdeveloped area' within the meaning of Article 87(3)(a) of the EC Treaty, the government could reasonably conclude at the time that the EGO 24/1998 regime was not incompatible with the Europe Agreement's provisions. Furthermore, given the economic dislocation that existed at the time, measures to ameliorate conditions in the disfavoured regions were necessary. Romania was not alone among EU candidate States in making the policy choice to implement new economic-assistance measures based upon such an assessment of the legal position. For example, Poland passed similar legislation authorizing State aid for underdeveloped regions in 1994, while it was a candidate for EU admission" (R-CM, ¶ 29).

to “establish and improve a legal framework which favours and protects investment” and with the higher aim of achieving EU accession, the EU promoted the conclusion of bilateral investment treaties between Romania and EU member states (Art. 74(2) of the Europe Agreement), including the BIT that is the basis of the Tribunal’s jurisdiction. However, under the EC’s argument, once Romania had achieved the necessary economic development for accession, and once the Claimants had made their investments under the BIT, Romania then had to renege on its BIT obligations because revocation of the incentives was allegedly needed to obtain EU accession. As stated by the Claimants:

> Now, the last thing I will say about the European attitude is that if you were to believe them at face value and take at face value what they say regarding the alleged EU requirements which would oblige countries to renege on their commitments when they join the EU, even if you were to take that at face value, and I don't think you should because, frankly, it's an argument for the purposes of litigation, it's nothing which remotely resembles the true goals of the EU, and that's fortunate -- but even if you were to take that at face value, you would notice a certain element of schizophrenia in the EU position.
>
> Because, and this is the last thing I would like you to look at in my table, back on page 1 and page 2, and you will see that an element of the Europe agreement of February, which came into force in February 1995; an element is what? Look at page 2 of my chart, Article 74(2). You see that in plain words the EU is promoting what? Promoting the conclusion of bilateral investment treaties.
>
> They say, in plain words, the particular aims of the cooperation will be: "... for Romania ..." That's entered into with Romania, it's specific to Romania: "... for Romania to establish and improve a legal framework which favours and protects investment, the conclusion by the Member States and Romania of agreements for the promotion and protection of investment."
>
> So the very BIT which is the basis of your jurisdiction has been blessed, promoted by Europe itself. They told Romania: you are a very disfavoured region; the whole of Romania would qualify in terms of state aids for an exemption, the whole thing, because you are so way behind because of the history you suffered, you are so behind that you qualify all together. Please enter into BITs because that will help you catch up.
>
> Now, that is exactly what Romania has done. They entered into the BIT, which does protect the investment. So I am saying that if you were to give any credence to the current litigation argument of the Commission, which is: well, they shouldn't be liable because they had to give up all this after the fact; that would be in direct contradiction with what the EU at the time was requesting Romania to do. ***So if you were to follow that type of argument, I would say -- frankly, it's an argument which is pretty shocking because it means: well, thank you for having invested, thank you for having helped Romania to catch up and to be able to join in the first place the EU, but now that it has joined, we don't need you any more, so we can dump you, and the state should renege and should renege without compensation on its promises. There is no problem whatsoever.***
>
> (Tr., Day 1, 181:1-183:6 (Gaillard)) (Emphasis added)

596. The Claimants argue that the Commission’s position is wrong on four counts:

> It's wrong from a timing standpoint, because EU law has nothing to say before the accession; all these representations on the right side of the paper are compatible with our case.
>
> It's wrong from an EC law standpoint, because EC law is not that bad.
>
> It's wrong from a policy standpoint, because if that were true, no one could ever carry [sic] any policy, because if you were to listen to the EU litigation paper, you would have to say that investors, if they are in their right mind when representations are made to them, when they are given certificates, when they are given incentives, they shouldn't believe that that's valid; they should ignore that and invest elsewhere, in countries where they respect the rule of law I guess, and they should not invest in the places they are told to invest in, because EU law would somehow permit states to change their mind without carrying any consequence of that change.
>
> So that's wrong under EU law, but I would say for you the only thing which matters is that it's wrong from an international law standpoint: look at Articles 25 and 27 of the ILC Articles; and I would add just for the sake of the record that I find it wrong morally as well.
>
> (Tr., Day 1, 183:8-184:6 (Gaillard)).

597. In sum, the Claimants argue that:

> At the very least, it was reasonable for Claimants to expect, based on Romania's promulgation of the incentives regime in 1998 and its awarding the Corporate Claimants PICs in 2000 and 2002, that even assuming Romania entered the EU before April 1, 2009 (which was highly uncertain at the time), the Government would (1) wait for an official EC decision demanding the revocation of the Raw Materials Incentive before revoking it; (2) attempt to negotiate with the EC a disadvantaged-regions exception for the Raw Materials Incentive under Article 87(3) of the Europe Treaty; or (3) compensate Claimants or otherwise help to mitigate their damages as a result of revocation of the Raw Materials Incentive, perhaps by promulgating a new regulatory regime designed to meet EU requirements. But Romania did none of these things. Instead, having achieved the desired economic benefits from Claimants' investments in the country's disadvantaged regions and of EU membership, it unilaterally shifted all of the risks associated with EU accession to investors like Claimants. (C-Reply ¶ 419)

v. Romania violated this legitimate expectation

598. The Claimants argue that all the factors described above instilled in them the legitimate expectation that the EGO 24 incentives would remain in place for 10 years. The Claimants allege that, by prematurely revoking these incentives 5 years before they were due to expire, Romania violated that legitimate expectation, and consequently breached its obligation under the treaty to afford the Claimants fair and equitable treatment.

599. The Claimants acknowledge that not all incentives were revoked – indeed, the Profit Tax Incentive remained in place for the Claimants until the expiration of their PICs in April 2009. Nonetheless, they argue that the revocation of the Raw Materials Incentive was sufficient to constitute a breach of the BIT (C-PHB, ¶ 49). The Claimants also argue that leaving the Profit Tax Exemption in place until 2009

enabled Romania to keep the Claimants' obligations to maintain their investments in the disfavored region of eight years longer than if they had simply revoked all of the incentives (Tr., Day 12, 41-43 (Fleuriet)).

600. The Claimants contend that Romania's revocation of the incentives was unfair and inequitable, because:

a. Romania failed to provide alternatives or otherwise mitigate the effects of the revocation on investors through transitional periods or grandfathering the incentives for existing PIC holders. Nor did Romania provide any evidence that it attempted to negotiate any alternatives or transitional periods with the EU.

b. Romania failed to show how the incentives conflicted with EU law.

c. The Claimants' obligations under EGO 24 remain in place.

d. Romania failed to grandfather the incentives, in breach of Romanian Law. According to the Claimants, under Romanian law, grandfathering provisions are mandatory in all cases where an enactment of a new law affects legal relations established under an earlier statute and these relations are still in operation at the time the new law is enacted. (ER of L. Mihai, ¶ 6.1).

601. The Claimants summarize their legitimate expectations claim as follows:

> At its core, Claimants' story is a simple one: Romania attracted substantial investments from them on the basis of a Raw Materials Incentive granted to them through domestic legislation (EGO 24 and GD 194) and individual PICs until 2009; did so after subjecting itself to EU requirements, thereby representing to investors that the incentive was consistent with those requirements; successfully opposed its own Competition Council's determination to the contrary; achieved the desired benefits accruing from both Claimants' investments and EU accession; and then revoked the Raw Materials Incentive without waiting for an official demand from the EC, without attempting to negotiate an exception or transition period, and after it was too late for Claimants to modify their incentive-based business strategy pursuant to which they had invested hundreds of millions of dollars in the disadvantaged regions of northwestern Romania. As a result, Claimants have suffered significant damages that Romania has made no attempt to mitigate. When compared to leading BIT cases like *MTD* (in which the Tribunal found that the investor had failed to conduct proper due diligence) and *Saluka* (in which the Czech Government specifically refused to assure the investor of State aid), this case presents a classic instance of the violation of investors' legitimate expectations of minimal regulatory stability. (C-Reply, ¶ 423).

b. The Respondent's position

602. The Respondent denies that it has breached any legitimate expectation of the Claimants. It contends that the Claimants have not met any of the requirements necessary for the doctrine of legitimate expectations to apply. First, the Claimants received no assurance that could have created a legitimate expectation that the Facilities would remain in place for 10 years. Second, the Claimants did not invest in

reliance on that expectation. Finally, even if that had been the case, any such reliance would not have been objectively reasonable.

i. The standard for determining if a measure has undermined legitimate expectations

603. The Respondent agrees with the Claimants that the appropriate standard to evaluate whether a measure has undermined legitimate expectations is that set out in *Parkerings v. Lithuania* (R-PHB, ¶ 101). On the basis of this and other awards, the Respondent contends that for a legitimate expectation of regulatory stability to be protected, the following requirements must be met (R-CM, ¶¶ 111-135; R-Rejoinder, ¶¶ 170-173; R-PHB, ¶¶ 99-159):

i. There must be a contract, or at least a promise or specific representation that the law will remain unchanged, that created a subjective expectation.

ii. The expectation (or the reliance on that expectation) must have been objectively reasonable.[118] In particular, the investor must anticipate that the law may change, especially if the general legislative climate is in a state of flux (*Glamis Gold v. United States*, ¶ 767).

iii. The investor must have relied on that subjective expectation when it made its investment.

604. With respect to the first requirement, the Respondent submits that any claim based on the frustration of legitimate expectations requires the claimant to prove that the state created or reinforced the expectations through its own affirmative acts.[119] The practice of international tribunals shows that legitimate expectations may only be frustrated where the state has made "specific commitments" that particular laws or regulations would remain in place.[120] These specific commitments or assurances cannot be generated by inaction or generally applicable regulation. In addition, these specific commitments must be valid under domestic law.

605. Further, the Respondent contends that it is well established that a regulatory regime does not carry with it any promise that the law will remain unchanged indefinitely. Citing *Parkerings v. Lithuania*, the Respondent argues that "[a] State has the right to enact, modify or cancel a law at its own discretion", and "save for the existence of an agreement in the form of a stabilisation clause or otherwise, there is nothing

[118] In some briefs, the Respondent focuses on the reasonableness of the expectation, whilst in others on the reasonableness of the reliance. The Tribunal considers this to be the same argument, which goes to the legitimacy of the expectation.

[119] *Gami Investments, Inc. v. The Government of the United Mexican States,* UNCITRAL, Final Award, 15 November 2004 (hereinafter, *"GAMI v. Mexico"),* ¶¶ 90-110; *International Thunderbird Gaming Corporation v. The United Mexican States*, UNCITRAL, Arbitral Award, 26 January 2006 (hereinafter, *"International Thunderbird v. Mexico"*), ¶ 196; *CMS v. Argentina*), ¶¶ 78-82; *CME Czech Republic B.V. v. The Czech Republic,* UNCITRAL, Partial Award, 13 September 2001 (hereinafter "*CME v. Czech Republic"*), ¶¶ 610-611; *MTD v. Chile,* ¶ 167; *Tecmed v. Mexico,* ¶ 154.

[120] *CMS v. Argentina* (Award), ¶¶ 127-166; *Tecmed v. Mexico,* ¶ 154; *Metalclad v. Mexico,* ¶ 87; *Marvin Roy Feldman Karpa v. United Mexican States* (ICSID Case No. ARB(AF)/99/1), Award, 16 December 2012 (hereinafter *"Feldman v. Mexico"*), ¶ 111.

objectionable about the amendment brought to the regulatory framework existing at the time an investor made its investment" (*Parkerings v. Lithuania,* ¶ 332).[121]

606. Similarly, the Respondent notes that in *AES v. Hungary* the tribunal found that, absent a specific representation to the investor, such as a stabilization clause, an investor cannot have a legitimate expectation of legislative stasis, and any general entitlement to regulatory stability does not preclude legislative changes that are significant and even surprising (*AES v. Hungary,* ¶¶ 9.3.17-9.3.34). In the *AES* case, the investor did have a contract with the state. Although in that case the tribunal found that the state did not have a rational policy in modifying or eliminating its own contractual obligations, "this does not mean that the state cannot exercise it[s] governmental powers, including its legislative function, with the consequence that private interests – such as the investor's contractual rights – are affected. But that effect would have to be a consequence of a measure based on public policy that was not aimed only at those contractual rights" (*AES v. Hungary,* ¶ 10.3.13). Romania concludes that, *a fortiori*, where the investor has no contract with the state, it can have no legitimate expectation that generally applicable legislation will not affect it.

607. Second, the Respondent submits that, for an expectation to be legitimate and therefore protected under international law, it must be reasonable and justified in the circumstances.[122] According to the Respondent, it is well established that foreign investors must accept the conditions of the host state as they find them (*The Oscar Chinn Case*[123]). An investor cannot complain if its business suffers economically from laws or practices that were in place at the time of the investment (*MTD v. Chile,* ¶ 204). The investor must conduct its business in a reasonable manner, which includes undertaking due diligence with respect to the regulatory environment in which it operates and the likelihood that it may change and evolve (*Parkerings v. Lithuania,* ¶ 333). Indeed, investors are required to seek relevant professional advice in assessing the risks inherent in a particular host state (*Feldman v. Mexico,* ¶¶ 114, 132). An investor who fails to conduct such due diligence cannot invoke any legitimate expectations (ECJ jurisprudence). Citing *Maffezini v. Spain*[124], the Respondent submits that BITs "are not insurance policies against bad business judgments (*Maffezini v. Spain,* ¶ 64).

608. The Respondent adds that regulatory change must be anticipated all the more in regulatory environments where there is public and continuous scrutiny of the actions

[121] The Respondent cites, inter alia, *PSEG v. Turkey*, ¶ 241 ("Legitimate expectations by definition require a promise of the administration …"); *Metalpar S.A. and Buen Aire S.A. v. Argentine Republic* (ICSID Case No ARB/03/5), Award, 6 June 2008 (hereinafter *"Metalpar v. Argentina"*), ¶ 186 ("There was no bid, license, permit or contract of any kind between Argentina and Claimants"); *Plama Consortium Ltd v Republic of Bulgaria* (ICSID Case No ARB/03/24), Award, 27 August 2008 (hereinafter, *"Plama v. Bulgaria"*), ¶ 219 ("It does not appear that Bulgaria made any promises or other representations to freeze its legislation on environmental law to the Claimant or at all").

[122] *Parkerings,* ¶ 333; *Saluka v. Czech Republic,* ¶¶ 304 and 309; *Mondev v. U.S.,* ¶ 118; *Waste Management v. Mexico II,* ¶¶ 98-99; *Lauder v. Czech Republic,* ¶ 292.

[123] *The Oscar Chinn Case*, PCIJ Series A/B No 63 (1934), p. 25.

[124] *Emilio Agustín Maffezini v. The Kingdom of Spain* (ICSID Case No. ARB/97/7), Award, 13 November 2000 (hereinafter, *"Maffezini v. Spain"*).

of the state (e.g., *Methanex v. United States*, Part IV D, ¶ 10, *Glamis Gold v. United States, Chemtura v. Canada*), and in transition or otherwise unstable economies (*Olguín v. Paraguay,* ¶ 65(b),[125] *Generation Ukraine v. Ukraine,* ¶ 20.37,[126] *Parkerings v. Lithuania,* ¶¶ 335-338).

609. The Respondent asserts that, even if an expectation is reasonable, it will not be protected absent specific assurances to the investor. As stated by the tribunal in *Glamis Gold v. United States*, the inquiry is not whether the expectations were reasonable, but whether the State has made specific assurances to the investor in order to induce the investor's investment (*Glamis Gold v. United States,* ¶¶ 810-811).

610. Third, the Respondent argues that for a breach of legitimate expectations to violate the fair and equitable treatment standard, the investor must have relied on that expectation when it made the investment. The Respondent submits that "a legitimate expectation is protected only if, and to the extent that, it was the predicate upon which an investment was made. If an expectation, however legitimate, was not the predicate of an investment, there is nothing inequitable in the state's acting against it" (R-Rejoinder, ¶ 191). Specifically, "[w]here an investor claims that it was induced by a particular regulatory measure, it must demonstrate that the existing regulatory framework was the crucial factor in determining whether or not to invest in the host state and that, absent that measure, the investor would not have made the investment" (*Id.*, relying on *CMS v. Argentina,* ¶ 275).

611. In this case, the Respondent contends that it did not make a promise or assurance that could have created a subjective expectation that the Facilities would not change for 10 years (Section (ii) below); any expectation of regulatory stability would have been unreasonable (Section (iii) below), and the Claimants have not proven that they relied on a subjective expectation (Section (iv) below).

ii. Romania did not make a promise or assurance that could have created a subjective expectation

612. The Respondent contends that the Claimants have not proven that Romania made a promise or assurance that could have created a subjective expectation that the EGO 24 Facilities would remain unchanged for ten years. Romania never represented to the Claimants, or to anyone else, that the Facilities would be available to them for the entire 10 year period indicated in the PICs (R-CM, ¶¶ 113-117; R-Rejoinder, ¶¶ 169-189; R-PHB, ¶¶ 104-120).

613. As discussed in Section A above (umbrella clause), the Respondent denies that the EGO 24 framework gave rise to an actionable vested right to the Facilities for any particular period.[127] The Respondent also denies that it made a promise or assurance

[125] *Eudoro Armando Olguín v. Republic of Paraguay*, (ICSID Case No. ARB/98/5), Award, 26 July 2001 (hereinafter *"Olguín v. Paraguay"*).

[126] *Generation Ukraine, Inc. v. Ukraine* (ICSID Case No. ARB/00/9), Award, 16 September 2003 (hereinafter *"Generation Ukraine v. Ukraine"*).

[127] The Respondent focused on this argument in the context of the Claimants' umbrella clause claim, but it is also relevant to its defense to the Claimants' legitimate expectations case.

that could constitute the basis for a legitimate expectation, through the EGO 24 framework or elsewhere.

614. First, the Respondent argues that the Claimants have not proven that the State made a promise specifically to them. There is no evidence that any state organ made such a promise or representation to the Claimants. Nor do the Claimants or their witnesses claim to have received such an assurance from a State official. Mr. Ban's testimony (Tr., Day 9, 22–23 (Juratowitch/Ban)) only serves to highlight this: rather than admit that no one ever told him that the Facilities would be stabilized for 10 years, he stated that no one had explicitly warned him that the Facilities might not last that long. However, relying on *Parkerings v. Lithuania*, the Respondent argues that a state has no duty to warn investors that the law might change.[128] Even when a legislative change is sudden and radical, an investor has no claim for a lack of transparency or predictability unless there has been an "active inducement of a quasi-contractual expectation" (*Glamis Gold v. United States*, ¶ 799).

615. Similarly, the Respondent notes that Mr. Marcu never said he or anyone else ever spoke to any of the Claimants about EGO 24. In fact, his testimony about the NARD's general efforts to promote investment in disfavored areas showed that those efforts began after the Claimants' supposed decision to invest in the Ştei-Nucet region, rather than in Bucharest (Tr., Day 7, 49 (Marcu)). The two promotional activities he mentioned in 2000 were not attended by the Claimants, so anything Mr. Marcu may have said there is irrelevant. In any event, Mr. Marcu admitted that EGO 24 had been amended a number of times and that by the time of his presentations the Competition Council had already issued Decision 244. On this basis, the Respondent argues that it is difficult to see how Mr. Marcu could have said in his presentations that every EGO 24 Facility was locked in for 10 years.

616. Second, the Respondent contends that the Claimants have not proven that, through the EGO 24 framework or the issuance of the PICs, the State made a promise to investors in general. As discussed above, the Respondent argues that general regulation cannot generate a specific commitment of the kind needed to create a legitimate expectation. The Respondent argues:

> The Claimants contend that their legitimate expectation arose from unilateral acts taken by Romania which were general in scope, rather than specific assurances to the Claimants. Also, the Claimants' case relies extremely heavily on the PICs that the Corporate Claimants received in 2000 and 2002 – but they acknowledge that these were not individually negotiated documents. They were standard administrative certifications of eligibility that were received by thousands of beneficiaries of the EGO 24/1998 state aid scheme. The Claimants depend on the same government actions that any of those beneficiaries could cite, such as the terms of executive instruments implementing EGO 24/1998, which as we have seen (Chapter II) were necessarily subject to amendments to EGO 24/1998 itself. Overwhelmingly consistent authority suggests that it must be an extremely rare case when such general legislative acts, and

[128] *Parkerings v. Lithuania*, ¶ 345 ("The acts and omissions of the Municipality of Vilnius, in particular any failure to advise or warn the claimant of likely or possible changes to Lithuanian law, may be breaches of the Agreement but that does not mean they are inconsistent with the Treaty").

implementing regulations, can generate legitimate expectations that those acts will not be amended in future. (Rejoinder, ¶ 170).

617. In any event, as explained in Section A with respect to the umbrella clause, the Respondent argues that the relevant regulations did not promise that the Facilities would remain unchanged for a period of 10 years.

618. The Respondent also contends that, if Romania had decided to bind itself to regulatory stasis for 10 years, it would have done so in one clear instrument, through an appropriate organ, and that instrument would contain clear terms with respect to the promise of stability and its duration. However, the Claimants have not identified which regulation would embody this promise. It cannot be EGO 24, because that regulation lays out a general scheme and makes no reference to a 10 year time period. The Respondent concedes that "there is no doubt that EGO 24 set forth a generalized entitlement that could be claimed by qualifying investors" (Tr., Day 13, 85:7-10 (Petrochilos)). Article 4(c) of EGO 24 stated that a government decision would determine the facilities "provided by law" that would be granted to investors (which confirms that the source of the entitlement is EGO 24). But it contained no promise as to the length of time the facilities would remain available, nor any stabilization language (unlike its predecessor, Law 35, which did contain express stabilization language). The Respondent further argues that, under Romanian law, general laws such as EGO 24 do not confer individual vested rights (as was confirmed by the Romanian Constitutional Court in Decision 130/2003).

619. The Respondent notes that the Claimants appear to rely on GD 194/1999 and the PICs, which are lower ranking documents issued to implement and administer EGO 24 and Law 20/1999.[129] However, relying on the expert opinion of Prof. Baias, it argues that these were subsidiary normative or administrative instruments issued to implement and administer EGO 24 and Law 20/1999, which could not modify or contradict the authority of a government ordinance or a law, and as such could not have granted an entitlement beyond what EGO 24 authorized. In particular, they could not have imposed significant, long-term obligations on the state that the authorizing statute did not impose. As a result of the hierarchy of Romanian laws, the Government, implementing the law through the government decision, could not have bound the legislature not to change the law. And once EGO 24 was modified, GD 194/1999 could not have had a broader field of application than the modified EGO 24. Thus, no prudent investor in Romania could have understood that Annex 2 of GD 194/1999 as freezing the facilities there listed. For the same reason, because EGO 24 created no vested right but only a general entitlement, neither could GD 194/1999 or the PICs create such a vested right.

620. The Respondent also denies that the PICs could have been the source of an investor's right to the EGO 24 incentives. The Respondent argues that the PICs were

[129] The Respondent finds it notable that, considering that the nature of GD 194/1999 and the PICs has become the cornerstone of their expropriation, umbrella clause and fair and equitable treatment cases, Prof. Mihai (the Claimants' own expert in Romanian law) made no mention of either instrument in his expert report. Thus, the Respondent argues that the Claimants are left with no evidence to support an allegation that, under Romanian law, they had a right to the Raw Materials Facility until 2009.

merely administrative tools that certified the holders' eligibility to obtain the Facilities; the source of the right was EGO 24. Specifically, the Respondent argues that Article 5 of the GD 525/1999 published on 8 July 1999 (Exh. R-6),[130] which approved the 1999 Methodological Norms for the application of EGO 24, provided that the "incentives *provided by the law* shall be granted pursuant to the certificate of the investor in a disadvantaged region" (emphasis added). Such a certificate was to be issued by the relevant Regional Development Agency, upon an investor's request. According to the Respondent, the language of Article 5 makes it explicit that the PICs merely certified eligibility to "incentives provided by the law." That law was EGO 24, as approved by Law 20, neither of which contained any provision concerning their duration nor any restriction on the government's ability to amend or repeal them.

621. The Respondent contends that this conclusion was reaffirmed by a subsequent version of the Methodological Norms, adopted by GD 728/2001 (Exh. R-9). Article 4(1) of these Methodological Norms stated: "The *facilities provided by the law* are granted based on the certificate of the investor in the disfavoured area" (emphasis added). According to the Respondent, this demonstrates that the content of the facilities was established by law (i.e., EGO 24) and that PICs were an administrative tool attesting to eligibility to access facilities available under EGO 24.

622. In the Respondent's view, the language of the PICs themselves does not change this conclusion. All the PICs stated was that the titleholder was the beneficiary of the facilities granted under GD 194/1999, in accordance with the provisions of EGO 24 approved and amended by Law 20, and in accordance with the government decision approving the methodological norms. Accordingly, all the PICs did was certify that the titleholder was the beneficiary of the facilities granted by the law, whatever the law determined that those facilities were at any point in time.

623. The Respondent further argues that the PICs did not list any individual facilities, let alone purport to stabilize them for any particular period. The PICs only stated that they were valid until a given date. That only meant that they certified eligibility to whatever facilities were available under the law until that date.

624. The Respondent rejects the Claimants' argument that the PICs were the source of the right to the facilities because they had to present them every time that they wanted to benefit from them. The PICs were needed so that administrators did not have to evaluate eligibility on each occasion that a business applied for an exemption. This conclusion is also supported by the fact that it was not necessary to obtain a new PIC each time EGO 24 was amended; the PIC continued to certify eligibility to the remaining facilities in EGO 24, as amended. This was confirmed by the Claimants' expert, Prof. Mihai (Tr., Day 5, 215).

625. The Respondent also denies that the administrative process to qualify for a PIC was equivalent to a contractual negotiation, or that the PICs were tantamount to contracts. In the legal order in which that process occurred, the issuance of a PIC did not create

[130] The Respondent notes that GD 525/1999 replaced an earlier version of the Methodological Norms, contained in GD 907 of 1998, published on 22 December 1998.

a contract. Nor did the obligation to submit an investment plan amount to a bilateral deal; the investment plan was merely a requirement for the government to establish that investors met the qualifying criteria.

626. Similarly, the requirement to employ a certain number of unemployed persons and to have made certain investments were part of the criteria for eligibility; they do not establish the existence of a promise that the facilities would be available for a certain duration. The Respondent adds that it is misleading to suggest that these requirements show that EGO 24 was intended to foster capital intensive industries, because there was no threshold of magnitude for a qualifying investment, the employment requirement was met by employing ten persons, five of which had to be unemployed, and the eligible sectors covered a wide range of activities.

627. The Respondent also denies that EGO 24 created an obligation for investors to maintain their investments for twice as long as the investor is a recipient of the incentives. The Respondent alleges that it "has repeatedly stated that the obligation does not exist and that (therefore) it has no intention of enforcing it" (R-Rejoinder, ¶ 118). In any event, it argues that the alleged obligation is of only theoretical interest, because the Claimants have no desire to move the operations from Bihor county, and thus the State has never had the occasion to enforce the alleged obligation. However, it notes that Prof. Mihai did not address this matter in his expert opinion, and the Claimants have not cited any instances in which any investor has been subjected to the supposed obligation, or any Romanian court or agency has interpreted it in that fashion.

628. The Respondent further contends that neither the monitoring process to which the Claimants were submitted, nor the alleged promotion of the EGO 24 regime by government officials, could have given rise to a promise that the facilities would remain unchanged for any period of time.

629. Finally, the Respondent contends that the Romanian Constitutional Court disagrees with the Claimants' theory: when the profit tax exemption available under Law 35 of 1991 was repealed, the Constitutional Court found that the repeal of that exemption could not be construed as the termination of a contract, nor as an infringement of the right to property or of the investor's right to recover debt (Decision 130/2003). The Respondent notes that Prof. Mihai called this decision *ultra vires* at the hearing but did not discuss it in his expert report, while Prof. Baias confirmed the decision's relevance for this case. Thus, Romania submits that the Tribunal should afford this decision great weight and conclude that GD 194/1999, alone or together with the PICs, did not constitute a contractual or other obligation under Romanian law.

630. Finally, the Respondent argues that not only did Romania not make any specific commitments or representations that the Facilities would remain unchanged during the 10 year period indicated in the PICs, but:

> [T]he only indications that Romania offered were to the contrary. Six months before EGO 24/1998 was adopted, Romania publicly committed to harmonize its national law with the acquis, including competition law. This

> was consistent with the binding provisions of the Europe Agreement, to which Romania had been a party since 1995. Before any PICs were ever issued to the Corporate Claimants, Romania adopted Law 143/1999 on State aid, which expressly indicated that incentives like the Facilities (defined as "Existing Aid") could be subject to nullification or modification at any time. Within months after Law 143/1999 came into force, the responsible regulatory authority, the Competition Council, challenged the Facilities' validity in a public decision and, later, in the Romanian courts. Again, this public challenge was underway and reported in the Romanian media before European Drinks received a PIC in June 2000. The Claimants concede that by July 2000, the government had already begun restricting the Facilities, which in itself put all beneficiaries on notice that further modifications could be forthcoming. When Starmill and Multipack were established and obtained PICs in 2002, the European Commission was actively pursuing calls for the abolition of Romania's State aid programs, including specifically the EGO 24/1998 regime, and the dismantling of the Facilities was continuing apace. The PICs clearly reflected the evolution that was underway, and the lack of any undertaking by Romania to stop it: the benefits to be granted under the Facilities expressly depended in part upon the terms of EGO 24/1998 as amended. (R-CM, ¶ 116).

631. In any event, Romania's actions did not create a legitimate expectation that EGO 24 would not be amended, even substantially amended, before 2009 (Rejoinder, ¶¶ 173-188). According to the Respondent:

> 173. The doctrine of legitimate expectations is objective: the question is whether, in all the circumstances, the investor's claimed expectation is reasonable. To answer this, however, one first must know what the supposed subjective expectation was. In their Reply, the Claimants say they expected that "the Raw Materials Incentive would remain in place until 2009". However, in their Statement of Claim, the Claimants had asserted that it was the entire suite of EGO 24/1998 state aid that they legitimately expected would remain in force until 2009.
>
> 174. Indeed, that is what they must show: there is no logical or evidentiary basis for a supposed expectation that while all other Facilities were subject to change or repeal, the one Facility that the Claimants say they actually cared about had a special reason to remain unchanged. If the Claimants expected one EGO 24/1998 facility to last until 2009, there is no reason why they, and every other beneficiary, could not have expected all of the existing EGO 24/1998 facilities to have remained unchanged. There is no distinction between the Raw Materials Facility and the other Facilities, in terms of the state's conduct or statements with respect to each Facility, that would create a different regime of legitimate expectations.
>
> 175. In sum, the position is this. The Claimants are challenging a general legislative programme; if they are right, the repeal of any EGO 24/1998 facility was unfair and inequitable to every actual or prospective beneficiary. The Claimants must show, therefore, that there was a commitment or representation by Romania, binding on future Parliaments, that EGO 24/1998 would not be amended at all.
>
> (R-Rejoinder, ¶¶ 173-175)

iii. Any expectation of regulatory stability would have been unreasonable

632. In the Respondent's view, even if the Claimants had actually believed that the Facilities would remain unchanged for ten years (which the Respondent argues has not been proved), such an expectation would have been unreasonable, and thus irrelevant to the assessment of the fairness of Romania's conduct (R-CM, ¶¶ 118-126; R-Rejoinder, ¶¶ 176-189; R-PHB, ¶¶ 136-159).

633. As a preliminary matter, the Respondent contends that there is no reliable evidence of Messrs. Micula's reasoning. There are no documents, contemporaneous or otherwise, explaining the Claimants' reasoning at the time. The only evidence is the testimony of Messrs. Micula, which is unreliable. In any event, this testimony does not evidence reasonable reliance, but rather unreasonable expectations with no legitimate basis and reckless business conduct.

634. The Respondent's main argument is that any expectation that the Facilities would remain unchanged for ten years would have been unreasonable taking into consideration the regulatory framework in which the Facilities were granted, both from a Romanian law and an EU law perspective.

635. The Respondent argues that, as a general matter, the Miculas' alleged trust in the stability of Romanian law was misplaced. Ordinarily, an investor must take into account that the legislation will change. There were no representations or assurances that made this case an exception. Nor do the circumstances and context invoked by the Claimants change this basic principle.

636. In the context of EU accession, the Respondent argues that this alleged trust in the stability of Romanian law was even more misplaced. By 2000, it was public knowledge that the target date for EU accession was 1 January 2007 (as evidenced in Romania's first Position Paper on competition policy of August 2000, Exh. EC-1). As noted above, the Respondent submits that regulatory change must be anticipated all the more in regulatory environments where there is public and continuous scrutiny of the actions of the state, and in transition or otherwise unstable economies. In this case, the Claimants chose to invest in a transitional economy, and were fully aware of the risks associated with such a choice. Indeed, Mr. Ioan Micula testified that he and his brother were drawn to invest in Romania precisely because they sought to benefit from the rapid changes taking place in the local economy and regulatory system (Second WS of I. Micula, ¶ 7; Tr. Jur., Day 2, 53-54; 183). Messrs. Micula began to invest in Romania in 1991, and were fully aware of the risks of doing business in Romania during the transition period.

637. The Respondent rejects the Claimants' portrayal of themselves as *ingénues* who were oblivious to what was happening around them. Businessmen with substantial activity in Romania like the Miculas can have no excuse for their purported ignorance. It was public knowledge that Romania was undergoing significant regulatory changes to align itself with the *acquis.* Three reports shown during the hearing (Exh. HEC-6, HEC-7 and HER-1) show that over 100 draft laws were initiated (R-PHB, ¶ 144 and

Annex A). The Respondent contends that "[t]he fact that EU-accession changes would likely include Romania's state aid schemes was a fact readily knowable by anyone who cared to conduct even the most cursory research" (R-Rejoinder, ¶ 178).

638. With respect to the Facilities in particular, the Respondent contends that it would have been impossible for a rational investor not to perceive the risk that they could change or be withdrawn. Not only had they been changing since they were first enacted, but their continuing viability was seriously in doubt. Even the most optimistic business person would have known that the Facilities' continued existence was the subject of fierce political battle. Indeed, the Respondent submits that "[g]iven the political and economic environment in 2000 and 2002, when the Claimants obtained their PICs, it would have been impossible for a reasonable investor to expect any particular form of state aid to remain in place and unchanged. The only way one could entertain such an expectation is if the Competition Council or the European Commission had specifically approved EGO 24/1998. Both institutions, however, expressed views that were squarely contrary to any expectation of preservation of the Raw Materials Facility" (R-Rejoinder, ¶ 179).

639. In particular, the Respondent argues that Decision 244/2000 of the RCC was a clear warning signal that the Facilities were incompatible with Romania's current obligations under the Europe Agreement and future obligations under the EC Treaty. Although the Claimants try to characterize this decision as referring only to the pig farming industry, the Respondent asserts that it refers to the same Raw Materials Incentive and declared the entire aid scheme illegal.

640. The Respondent argues that, if the Claimants had conducted any legal due diligence, any competent lawyer would have advised them that EU accession would likely affect the Facilities. However, it notes that although the Claimants have alleged that they had a legal department of over 30 persons that was allegedly monitoring legislative changes (Third WS of I. Micula, ¶ 37), they have been unable to produce any evidence of contemporaneous due diligence on the subject.

641. The Respondent contends that, instead, the Miculas recklessly ignored obvious signs that the Facilities could change or be withdrawn. They paid no heed to the 2000 PWC Business Plan section on "Political Risk", which highlighted the possibility of legislative or regulatory change, or to all the PWC plans' note that Romania was "clamping down on incentives" even as early as 2000. Their attention and belief in the press was selective: when the reports were unfavorable, they simply did not believe them.

642. The Respondent also rejects the Claimants' suggestions that a particular statement in a government report, standing alone, could have led them to believe that the Facilities would be maintained until or after accession. First, as the Claimants profess ignorance of anything written or published about the future of the Facilities, any such statement is irrelevant, because they did not rely on it. But even if the Claimants had reviewed it, the Respondent contends that a diligent and prudent investor would not have been misled by that statement, because a diligent investor would have known

that each country had an independent monitoring authority (R-PHB, ¶ 156; Tr., Day 6, 127–8 (Petersen/Smith)). Even in the absence of EU requirements, under Romanian law it would have been unreasonable to expect that the Facilities would remain unchanged for any particular period of time. Contrary to the Claimants' allegations, the content and nature of EGO 24 did not make the Claimants' expectation of regulatory stability reasonable. Nor does the content of the PICs or the manner in which they were issued support that alleged expectation. As noted above, the Respondent argues that the PICs were administrative tools certifying eligibility to access facilities available under EGO 24. The source of the facilities was thus EGO 24, not the PICs. The PICs could not reasonably be read as anything more than confirmation that their holder was eligible for the EGO 24 Facilities, whatever those Facilities might happen to be at any particular time. EGO 24 had no stabilization clause or other clause of similar effect (unlike Law 35 which, as amended by Law 57/1993, promised that the changes would only affect investors if they were more favorable). The Claimants argue that there was no possibility of bargaining for a stabilization clause, suggesting that they were not at fault for failing to obtain one, but this cannot mean that the State is therefore impeded from amending its regulations.

643. In any event, the Respondent argues that the Claimants repeatedly contradict themselves as to the nature and significance of the PICs. At some points the Claimants assert that the PICs are the allegedly expropriated investment; at other times they state that the PICs "enhance" an expectation that has already arisen, while at others they are the instrument creating the expectation. The Claimants also state at that the PICs are administrative documents not subject to a bargain and whose terms were unilaterally imposed, while at other times describing them as akin to contracts. The Respondent submits that "[i]t is a claimant's burden to set out a coherent claim and then to prove it" (R-Rejoinder, ¶ 183).

644. The Respondent rejects the Claimants' remaining arguments with respect to the reasonableness of their expectation.

645. First, the Respondent argues that the Claimants' trust in the stability of the regulatory framework, based on the alleged stability of previous incentive schemes, was misplaced. Previous incentive regimes had been anything but stable. Indeed, the Claimants' trust seems to stem from the fact that they were not bothered by amendments to previous legislation. However, the Respondent argues that international law does not enshrine an investor's supposed faith that new legislation will always benefit him because he has had good fortune in the past.

646. Second, it was unreasonable for the Claimants to believe that if the Facilities were repealed they would get special treatment from the government in the form of grandfathering of benefits.

647. Third, the Respondent contends that the contemporaneous statements and actions by the Government or its officials are not sufficient to make their alleged expectation reasonable. In particular, the Respondent avers that:

a. The Government's Development Plan for 1998-2000 (Exh. C-567) does not mention tax customs or customs duty exemptions; it merely places Romania's regional development strategy within the country's general economic reform (the major objective of which was EU accession).

b. Although Mr. Marcu, then President of the body charged with administering EGO 24/1998, would have presumably been knowledgeable about EGO 24/1998, he had no authority to commit Parliament not to amend the law, and thus his statements would not have made the Claimants' alleged expectation reasonable. In addition, his remarks were so informal that there is no contemporaneous evidence of them. In the context of the public debates over the future of the Facilities, no reasonable investor could have taken Mr. Marcu's alleged oral statements as authority committing the state to leave the Facilities in place.

c. Although Mr. Ban alleges that he attended meetings hosted by government officials, he did not testify that those officials said specifically that all of the EGO 24/1998 facilities would remain unchanged, nor did he testify that he held any bilateral discussions with government officials in this regard or received particular assurances. In addition, there is no contemporaneous record of what any official purportedly did say in Mr. Ban's presence, whether at a meeting or otherwise.

d. The generic investment promotion materials cited by the Claimants (e.g. CD-ROM prepared by ANEIR, a non-governmental trade organization, Exh. C-563) do not highlight EGO 24/1998, nor do they make any representations as to its legislative future.

e. The two media reports (Exh. C-568 and C-630) cited by the Claimants are not attributable to the government, and it is not clear whether the reporters' words are direct quotations or narrative reporting.

f. The June 2002 government press release (Exh. C-489) was issued well after the Claimants' legitimate expectations are said to have arisen, their PICs obtained, and their supposed 10-year plan put into motion. In any event, the press release says the opposite of what the Claimants say it does:

> With view to joining the European Union, we are concerned with making the legislation of the disfavoured areas compatible as concerns the state aid … . The project for a norm to modify the Emergency Ordinance of the Government No. 24/1998 regarding the system of the disfavoured areas […].

g. The positive assessments of the incentive regime and their businesses by Government officials were not assurances that the Facilities would stay in place. The fact that the withdrawal of the Facilities could have negative social consequences for the region is not a reason to believe they would not be withdrawn. If there were policy reasons for adopting and maintaining the Facilities, a reasonable investor would also have considered that there may be other equally legitimate policies militating against them (e.g., pro-competition policies).

648. In any event, relying on *Saluka v. Czech Republic*, the Respondent contends that undocumented and informal remarks by government officials cannot generate legitimate expectations. Nor can road shows or general pronouncements create legitimate expectations on their own: citing *CMS v. Argentina*, the Respondent argues that, at best, such statements are confirmatory evidence of a legitimate expectation created by other, authoritative state actions.

649. Finally, the Respondent submits that the reasonableness of the Claimants' strategy (making decisions based on how to best run ahead of competitors with respect to customs duties) as the basis of a 20-year business plan is questionable.

650. In sum, considering all the circumstances, the Respondent argues that it would have been unreasonable for the Claimants to believe that they were guaranteed anti-competitive advantages until 2009. "In a legal system where everything was changing, sometimes dramatically, they adopted a fragile business model that depended on the stability of a customs policy and on state aid whose legality was publicly challenged and reported to be the subject of a fierce political battle. That things did not turn out as the Claimants would have wished does not give them a claim under the [BIT]" (R-PHB, ¶159).

iv. The Claimants have not proven that they relied on a subjective expectation that the facilities would not change for 10 years

651. Citing *CMS v. Argentina*, the Respondent argues that "[w]here a foreign investor claims that it was induced by a particular regulatory measure, it must normally demonstrate that the existing regulatory framework was the crucial factor in determining whether or not to invest in the host state and that, absent that measure, the investor would not have made the investment." It adds that "a legitimate expectation is protected only if, and to the extent that, it was the predicate upon which an investment was made. If an expectation, however legitimate, was not the predicate of an investment, there is nothing inequitable in the state's acting against it" (R-Rejoinder, ¶ 191).

652. The Respondent points out that the Claimants are not arguing that, had they known that EGO 24 would change over time, they would not have invested in Romania. Rather, they argue that they would have invested elsewhere in Romania, or in different sectors (R-Rejoinder, ¶ 192).

653. Nonetheless, the premise of the Claimants' case is that when they made the relevant investments, they expected the facilities to remain unchanged at least until 2009. Thus, the Respondent argues that they must prove that they had this subjective expectation at the time of the investments. It is insufficient to establish that they "relied on" the facilities that existed at the moment of any particular investment, in the sense that they took advantage of the tax and duty exemptions that were then available.

654. The Respondent contends that there is no evidence of that reliance. To the contrary, the evidence available suggests that the Claimants' business decisions had nothing

to do with the facilities or their duration. Indeed, the Respondent alleges that there is no contemporaneous record of the Claimants' supposed subjective belief that the EGO 24 facilities would remain in place and unchanged (R-CM, ¶¶ 128-135; R-Rejoinder, ¶¶ 177, 190-217; R-PHB, ¶¶ 121-135).

655. First, had the Claimants acted in reliance on any legitimate expectation, there would have been abundant contemporaneous evidence of such reliance in the form of business plans, possible press statements, legal advice about duration of the facilities, and decisions of the Corporate Claimants' Boards of Directors. Messrs. Micula's unsubstantiated and self-serving witness statements are not sufficient to prove reliance.

656. In particular, there is not a single contemporaneous record of the alleged "10-year business plan" to capitalize on the EGO 24 incentives. This is telling given that the Claimants' claim to have had many discussions with their management team and the shareholders and several analyses of market demand and the customs implications of different raw materials. The lack of contemporaneous evidence is also striking given the level of detail of the Claimants' alleged 10-year plan (supposedly consisting of two phases, beginning with food production and moving to "core capital expenditures", including a brewery, a malt plant, a canning plant and a co-generation plant).

657. The only "business plans" submitted by the Claimants do not prove reliance. None of the "feasibility studies" for the financing of the proposed investments mentions EGO 24. The 3 PWC business plans for 2000, 2002 and 2003 do not say that the incentives were stabilized for 10 years. To the contrary, they all noted that the government was "clamping down… on tax incentives") (Exh. R-215; R-204; R-214). The Miculas' explanation for these plans (that they were valuations prepared for a potential sale of all or part of EFDG) does not make sense: on one hand, it undermines the claim of a 10-year business plan, and on the other, if they truly were prepared for potential sale, the valuations would have included the existence of a 10-year guarantee of the facilities.

658. Indeed, according to the Respondent, the record suggests that the Miculas made decisions on an *ad hoc* basis, identifying good opportunities for short-term profit (Tr., Day 3, 37; Day 4, 161-163, 174; Day 5, 10 (I. Micula); Day 4, 214 (V. Micula)). Taking immediate advantage of whatever incentives happen to be available does not constitute reliance on a guarantee that those incentives will remain in place and unchanged for 10 years.

659. Significantly, the Respondent notes that Viorel Micula confirmed at the hearing that it was not true that the EFDG made sense only if they could count on the benefits of the Raw Materials Incentive for 10 years (Tr., Day 6, 279 (Petrochilos/V. Micula)).

660. Second, the Claimants' decision to base their businesses in Romania was motivated by their familiarity with their home country and their desire to profit from the rapid evolution of Romania's economic and regulatory system, not by the facilities (Tr. Jur.,

Day 2, 23, 32-33, 53-55). Indeed, Messrs. Micula began to develop their food and drinks business in Bihor County in 1991, long before EGO 24 was introduced, long before any of the Corporate Claimants were established, and long before any of the Corporate Claimants had obtained a PIC. When the Claimants invested in the 1990s, they did not even rely on the then-available incentives. Even considering that under Law 35/1991 they could have invested anywhere in Romania, from 1991 to 1998 they chose Bihor County for other reasons.

661. In fact, had the Claimants really wanted to establish businesses in Bucharest, as they claim they did, they could have taken advantage of the EGO 24 facilities there as well: there were a half-dozen disfavored areas far closer to Bucharest and the port of Constanţa.[131] Whatever led the Miculas to install new lines in the same place where they had always located their businesses, it was not EGO 24. If the cost savings of moving closer to their consumers were so significant, the Miculas could have gone to any of three disfavored areas within 90 km of Bucharest and enjoyed both those cost savings and the facilities.

662. Third, the timing of the investments confirms that these investments were not made in reliance of the facilities. The Claimants' investments made prior to the enactment of EGO 24 and the issuance of the PICs could not have been made in reliance on any expectation allegedly generated by the PICs. Starmill and Multipack were only incorporated in 2002, after Romania had begun to limit the facilities (a fact that the Claimants acknowledge, *see* SoC, ¶¶ 104-109). In addition, all three Corporate Claimants increased their investment activity after 2003, by which time Romania had already restricted or eliminated the Components Facility, the Machinery Facility, the Meat-Related Facility, and the Subsidies. More significantly, the Claimants continued to make substantial investments in Bihor County even after the revocation of the Raw Materials Facility; indeed, the Claimants invested a total of €182 million after the Raw Materials Facility was repealed (Second ER of D. Lessard, ¶ 128; Tr. Day 8, 69 (Lessard)). Each of the Corporate Claimants allegedly invested millions of Euro in 2005, and continued to invest more in 2007, allegedly pursuing the regional expansion of the EFDG. According to the Respondent, the Claimants continue to expand their economic activity today, boasting of increased turnover in 2006, 2007 and 2008.

663. Finally, there is no evidence that the Claimants relied on the specific document that they now claim incorporates a 10-year stabilization clause: GD 194. Indeed, the Miculas themselves always refer to EGO 24, which does not specify a period (R-PHB, ¶ 134).

---

[131] The Respondent argues that the Miculas could have invested in the following regions that were closer to Bucharest and Constanta than Bihor and had been granted disfavored region status for ten years: Comăneşti, Bacău County (Exh. C-412); Baraolt, Covasna County (see Exh. C-414); Filipeşti, Prahova County (Exh. C-410); Ceptura, Prahova County (Exh. C-411); Altân Tepe, Tulcea County (Exh. C-415); and Motru-Rovinari, Gorj County (Exh. C-399); Zimnicea, Teleorman County (Exh. C-416) (R-Rejoinder, fn. 345).

664. According to the Respondent, "[a]ll of this belies any suggestion that Messrs Micula made investment decisions relying upon a belief that the facilities would remain unchanged until 2009. Indeed, the investment expansions in 2005 and thereafter cannot possibly assist the Claimants' legitimate expectations arguments: they espoused, rather than avoided, Romania's regulatory framework" (R-CM, ¶ 131).

c. The Tribunal's analysis

i. The standard to determine whether a legitimate expectation has been breached

665. As the Respondent puts it, the key issue before the Tribunal is "who bore the risk of regulatory change: the state or the investors who benefitted from the existing regulatory regime" (R-Rejoinder, ¶ 9).

666. In the Tribunal's view, the fair and equitable treatment standard does not give a right to regulatory stability *per se*. The state has a right to regulate, and investors must expect that the legislation will change, absent a stabilization clause or other specific assurance giving rise to a legitimate expectation of stability. Thus, the Claimants' "regulatory stability" argument must be analyzed in the context of the protection of an investor's legitimate expectations.

667. Cases supporting the doctrine of legitimate expectations are numerous. As noted by Dolzer and Schreuer, the protection of legitimate expectations is by now "firmly rooted in arbitral practice."[132] Although the question of whether these legitimate expectations were breached is a factual one, an overwhelming majority of cases supports the contention that, where the investor has acquired rights, or where the state has acted in such a way so as to generate a legitimate expectation in the investor and that investor has relied on that expectation to make its investment, action by the state that reverses or destroys those legitimate expectations will be in breach of the fair and equitable treatment standard and thus give rise to compensation.[133]

---

[132] Dolzer & Schreuer, p. 134.

[133] See, e.g., *Saluka v. Czech Republic*, ¶¶ 302 (The standard of "fair and equitable treatment" is therefore closely tied to the notion of legitimate expectations which is the dominant element of that standard. By virtue of the "fair and equitable treatment" standard included in Article 3.1 the Czech Republic must therefore be regarded as having assumed an obligation to treat foreign investors so as to avoid the frustration of investors' legitimate and reasonable expectations"); *Tecmed v. Mexico,* ¶ 154 (where the tribunal found that the obligation to provide "fair and equitable treatment" meant "to provide to international investments treatment that does not affect the basic expectations that were taken into account by the foreign investor to make the investment"); *CME v. Czech Republic*, ¶ 611 (where the tribunal concluded that the Czech authority "breached its obligation of fair and equitable treatment by evisceration of the arrangements in reliance upon with the foreign investor was induced to invest"); *Waste Management v. Mexico II*, ¶ 98 ("In applying [the 'fair and equitable treatment'] standard it is relevant that the treatment is in breach of representations made by the host State which were reasonably relied on by the claimant."); *International Thunderbird v. Mexico*, ¶ 147 ("[t]he concept of 'legitimate expectations' relates, within the context of the NAFTA framework, to a situation where a Contracting Party's conduct creates reasonable and justifiable expectations on the part of an investor (or investment) to act in reliance on said conduct, such that a failure by the NAFTA Party to honour those expectations could cause the investor (or investment) to suffer damages")

668. The Parties agree that, in order to establish a breach of the fair and equitable treatment obligation based on an allegation that Romania undermined the Claimants' legitimate expectations, the Claimants must establish that (a) Romania made a promise or assurance, (b) the Claimants relied on that promise or assurance as a matter of fact, and (c) such reliance (and expectation) was reasonable.[134] This test is consistent with the elements considered by other international tribunals.[135]

669. In the Tribunal's view, elements (a) and (c) are related. There must be a promise, assurance or representation attributable to a competent organ or representative of the state, which may be explicit or implicit. The crucial point is whether the state, through statements or conduct, has contributed to the creation of a reasonable expectation, in this case, a representation of regulatory stability. It is irrelevant whether the state in fact wished to commit itself; it is sufficient that it acted in a manner that would reasonably be understood to create such an appearance. The element of reasonableness cannot be separated from the promise, assurance or representation, in particular if the promise is not contained in a contract or is otherwise stated explicitly. Whether a state has created a legitimate expectation in an investor is thus a factual assessment which must be undertaken in consideration of all the surrounding circumstances.

670. In this regard, the Tribunal subscribes to the view of the tribunal in *Duke Energy v. Ecuador* (quoted in *Bayindir v. Pakistan,* ¶ 179):

> The stability of the legal and business environment is directly linked to the investor's justified expectations. The Tribunal acknowledges that such expectations are an important element of fair and equitable treatment. At the same time, it is mindful of their limitations. To be protected, the investor's expectations must be legitimate and reasonable at the time when the investor makes the investment [*Tecmed,* ¶ 154; *Occidental,* ¶ 185; *LG&E,* ¶ 127]. The assessment of the reasonableness or legitimacy must take into account all circumstances, including not only the facts surrounding the investment, but also the political, socioeconomic, cultural and historical conditions prevailing in the host State. In addition, such expectations must arise from the conditions that the State offered the investor and the latter must have relied upon them when deciding to invest [*SPP v. Egypt*[136]*,* ¶ 82; *LG&E,* ¶¶ 127-130; *Tecmed,* ¶ 154].[137]

---

[134] In their final briefs, both Parties refer to the reasonableness of the reliance, although Romania at first had focused on the reasonableness of the expectation. In the Tribunal's view, both must be reasonable, but in particular the expectation itself.

[135] For example, the late Prof. Thomas Wälde explained that a claim of legitimate expectations required "an expectation of the investor to be caused by and attributed to the government, backed-up by investment relying on such expectation, requiring the legitimacy of the expectation in terms of the competency of the officials responsible for it and the procedure for issuing it and the reasonableness of the investor in relying on the expectation" (*International Thunderbird v. Mexico,* Separate Opinion of Thomas Wälde, 1 December 2005, ¶ 1). It must be noted that Prof. Wälde did not dissent on the standard, but rather on the application of that to the facts of the case).

[136] *Southern Pacific Properties (Middle East) Limited v. Arab Republic of Egypt* (ICSID Case No. ARB/84/3), Award, 20 May 1992 (hereinafter *"SPP v. Egypt"*).

[137] *Duke Energy v. Ecuador*, ¶ 340. *See also Generation Ukraine v. Ukraine*, ¶ 20.37 ("it is relevant to consider the vicissitudes of the economy of the state that is host to the investment in determining the investor's legitimate expectations").

671. This promise, assurance or representation may have been issued generally or specifically, but it must have created a specific and reasonable expectation in the investor. That is not to say that a subjective expectation will suffice; that subjective expectation must also have been objectively reasonable. As stated by the *Saluka* tribunal, "the scope of the Treaty's protection of foreign investment against unfair and inequitable treatment cannot exclusively be determined by foreign investors' subjective motivations and considerations. Their expectations, in order for them to be protected, must rise to the level of legitimacy and reasonableness in light of the circumstances."[138]

672. The Claimants must also have relied on that expectation when they made their investments. However, it is not necessary for the entire investment to have been predicated solely on such expectation. Businessmen do not invest on the basis of one single consideration, no matter how important. In the Tribunal's view, that expectation must be a determining factor in an investor's decision to invest, or in the manner or magnitude of its investments.

673. When the alleged legitimate expectation is one of regulatory stability, the reasonableness of the expectation must take into account the underlying presumption that, absent an assurance to the contrary, a state cannot be expected to freeze its laws and regulations. As noted by the *Saluka* tribunal, "[n]o investor may reasonably expect that the circumstances prevailing at the time the investment is made remain totally unchanged. In order to determine whether frustration of the foreign investor's expectations was justified and reasonable, the host state's legitimate right subsequently to regulate domestic matters in the public interest must be taken into consideration as well."[139] Accordingly, for a state to violate the fair and equitable treatment standard by changing the regulatory framework, the investor must have received a legitimate assurance that the relevant laws and regulations would not be changed in his or her respect. By legitimate assurance, the Tribunal refers to the considerations identified in paragraph 669 above.

ii. Did Romania make a promise or assurance that gave rise to a legitimate expectation?

674. In Section A on the umbrella clause, the Tribunal found that the EGO 24 framework, in conjunction with the PICs, created a specific entitlement for the Claimants, according to which they were entitled to receive the incentives until 1 April 2009. To recall, the Tribunal found that EGO 24 created a general scheme of incentives available to investors who fulfilled certain requirements, which were later "granted" to qualifying investors through a specific administrative act (the PIC). In other words, the legislation created a generalized entitlement that could be claimed by qualifying investors, but this general entitlement was later crystallized with respect to qualifying investors through the granting of the PICs, becoming from that moment on a specified entitlement with respect to specified investors.

[138] *Saluka v. Czech Republic*, ¶ 304.
[139] *Id*, ¶ 305.

675. Although the majority of the Tribunal found that it had insufficient evidence as to whether that entitlement gave rise to a legal obligation for purposes of the umbrella clause, it stated that the same set of facts could give rise to a breach of the fair and equitable treatment standard, if it found that the EGO 24 framework, in conjunction with the PICs, provided the Claimants with the legitimate expectation that they would be entitled to receive the incentives until 1 April 2009.

676. Another question remained open in the majority's analysis of the umbrella clause: whether there was an element of stabilization in the EGO 24 framework (in other words, whether PIC holders (including the Claimants) were entitled to receive the incentives in the same form (or substantially the same form) as when they were first given their PICs during the entire period, regardless of changes in the Romanian legislation). Although the majority of the Tribunal was not able to answer that question as a matter of Romanian law, it will do so now as a matter of fair and equitable treatment.

677. After a review of all of the facts and circumstances surrounding the Claimants' investment and Romania's enactment of EGO 24 and related legislation, the Tribunal (again by majority[140]) answers both questions in the affirmative. For the reasons set out below, it finds that, even from an objective standpoint the legislative framework in Romania between the years 1998-2002 (taking into consideration EU law, as it applied to Romania at the time), together with the PICs, instilled in the Claimants a legitimate expectation that they would be entitled to the EGO 24 incentives, in substantially the same form as when they received their PICs, until 1 April 2009. Specifically, the Tribunal finds that, through an interplay of the purpose behind the EGO 24 regime, the legal norms, the PICs, and Romania's conduct, Romania made a representation that created a legitimate expectation that the EGO 24 incentives would be available substantially in the same form as they were initially offered.

678. First, the purpose behind the EGO 24 regime was to attract investment in the disadvantaged areas, preferably long-term investment that created employment. In the context in which this legislation was passed, it is evident that Romania was eager to attract investment in order to boost its economy and work towards EU accession. If Romania had spelled out that it retained the right to eliminate the incentives at its discretion, despite the stated duration term for the incentives, Romania likely would not have achieved its objective of attracting investment. Investors require legal certainty, and Romania knew this full well, otherwise it would not have specified in several different documents that the incentives would be available during the period in which Ştei-Nucet was declared a disadvantaged area. Indeed, it is evident from Romania's conduct that it intended for the regime to remain in place until 1 April 2009 and, absent the EU's intervention, this is what would have happened, as discussed further below.

[140] Arbitrator Abi-Saab does not concur with this view, as expressed in his separate opinion.

679. Second, the regime required a certain *quid pro quo* from the investors. As specified in EGO 24 itself and in the Methodological Norms, investors had to fulfill certain requirements to obtain their PIC, and undertook certain obligations:

a. Investors were required to create employment. The 2001 Methodological Norms required 10 employees, 5 of which must have been previously unemployed (Article 4(4) of the 2001 Methodological Norms).

b. Investors were required to create new investments. In this regard, Article 6(1) of EGO 24 provided that the facilities would be granted to qualifying investors "for their new investments in [the disfavoured] regions." Only three of the Claimants' companies benefitted from the EGO 24 incentives, but the Claimants have argued (and Romania has not disputed) that for each new investment they had to submit an investment plan and amend their PIC.

c. PIC holders had to undergo substantial monitoring to continue receiving the incentives under their PICs (Articles 14 and 16 of the 1999 Methodological Norms, Articles 6, 8, 14 and 15 of the 2001 Methodological Norms). Indeed, the Claimants' witnesses have described audits and monitoring procedures that seem to go beyond what is provided in the Methodological Norms, but it is not surprising that actual administrative procedures were more detailed than the relevant norms set out. The Respondent has not challenged these descriptions.

d. Investors were required to maintain their investments in the disadvantaged area for at least twice the time they benefitted from the incentives (Articles 7 and 9 of EGO 24).

680. This last obligation was set out in Articles 7 and 9 of EGO 24, as follows:

> Art. 7. - If an investment which is benefiting from the provisions of the present Emergency Ordinance is ***voluntarily liquidated in a period of time shorter than twice the period of time in which they enjoyed the advantages*** granted through the Government Decision to create the underprivileged area, ***the liquidator(s) is/are obligated first to pay the funds related to the advantages*** granted in accordance with the provisions of the present Emergency Ordinance, to the State Budget, the State Social Insurance Budget and the Special Funds Budgets from the funds resulting from the liquidation procedure.
>
> Art. 9. - Businesses established in a disadvantaged area ***may voluntarily cease to operate in the respective area***, and those opening subsidiaries as legal entities in such an area may ***close them or move the location of their headquarters out of the disadvantaged area in a period shorter than the one provided in Art. 7 only if they pay the funds they owe*** to the State Budget, the State Social Insurance Budget and the Special Funds Budgets ***related to the advantages granted*** in accordance with the provisions of the present Emergency Ordinance. (Emphasis added)

681. Thus, Articles 7 and 9 of EGO 24 put investors on notice that, if they planned to benefit from the incentives for the full period they were offered, they had to be prepared to make long-term commitments and investments in the region, and make

sure that their investments would continue to be profitable without the incentives when the incentives were no longer available.

682. Third, the Respondent did not merely "trim down" the incentives, as the Respondent contends. It is true that the incentives were amended several times, and that by 2002 the Machinery Incentive had been eliminated and the Raw Materials Incentive could not apply to raw materials for the production, processing and preservation of meat. (The Profit Tax Incentive had also been eliminated but grandfathered for existing PIC holders). However, three of the original six incentives remained (four counting the grandfathered Profit Tax Incentive). These three remaining incentives (other than the Profit Tax Incentive) were eliminated by EGO 94/2004. Therefore, the incentives were virtually eliminated rather than simply modified or amended.

683. Specifically, Chapter II, Section 3, Article VI(2) of EGO 94/2004 provided (Exh. R-94):

> Art. VI. - Emergency Government Ordinance no. 24/1998 on Less-Favoured Areas, republished in the Official Gazette of Romania, Part I, Issue 545 of 8 November 1999, as subsequently amended and supplemented, shall be amended and supplemented as follows:
>
> 1. After paragraph (1) of Article 14^1 insert a new paragraph, paragraph (1^1) with the following content:
>
>   "(1^1) In calculating the intensity of State aid, eligible costs related to investments made before 15 September 2004 shall be taken into account."
>
> 2. Article 6(1)b)d) and e) shall be repealed within 90 days from the date of entry into force of this Ordinance."

684. As can be seen from the text of EGO 94/2004, the amendment eliminated the incentives and added rules for the calculation of the intensity of state aid. In turn, it left in place all remaining provisions of the regime, including its obligations, which is however disputed. In turn, this stripped EGO 24 of most of its practical content and reduced almost to nothing its advantages given that the purpose of the regime for disadvantaged areas was to attract investment in exchange for certain tax benefits. After EGO 94/2004, the only tax benefit that remained was the Profit Tax Incentive, and only for existing PIC holders. This is not a "trimming down" of the incentives. It was an outright termination.

685. The Tribunal thus finds that Romania's representation that the EGO 24 incentives would be available to PIC holders until 1 April 2009 meant that the Claimants would continue to benefit from substantially the same incentives that were available when the Claimants obtained their PIC.

686. As stated above, the Tribunal considers that, in determining whether the Claimants had a legitimate expectation, it must take account of the accepted principle that Romania is free to amend its laws and regulations absent an assurance to the contrary. However, in this case the Tribunal finds that Romania's conduct had included an element of inducement that required Romania to stand by its statements and its conduct. Romania launched a program directed to attract investors to the

disfavored regions. To obtain that investment, it offered certain tax benefits for a certain amount of time. In other words, Romania created the appearance of a ten-year tax holiday for investors who decided to invest in the disadvantaged area (and this appearance conformed to what Romania did in fact wish to enact). The Tribunal has noted in particular that the former president of the NARD, Mr. Neculai Liviu Marcu, testified that the incentives were to be understood to be granted for the full duration of the disadvantaged area (WS of Mr. N. Marcu, ¶¶ 28, 32; Tr., Day 7, 15:2-9 (Marcu)). In the Tribunal's view, Romania thereby made a representation that gave rise to the PIC holders' legitimate expectation that during this tax holiday they would receive substantially the same benefits they were offered when they committed their investments.

687. What is at stake is not Romania's regulatory sovereignty, which is not to be questioned. However, it cannot be fair and equitable for a state to offer advantages to investors with the purpose of attracting investment in an otherwise unattractive region, require these investors to maintain their investments in that region for twice the period they receive the investments, and then maintain the formal shell of the regime but eviscerate it of all (or substantially all) content.

688. The record shows that Romania itself shared that belief. It did all it could to preserve the incentives regime through its accession negotiations (*see* Section 4 below). Whether or not it felt committed to existing PIC holders, it certainly wished to maintain the regime for as long as possible and publicly stated so. Romania thereby created the legitimate expectation that the regime would not be repealed or fundamentally altered during the duration of each PIC.

689. Romanian officials also stated that investors would be compensated if the regime were repealed or fundamentally altered. In particular, in his interview in May 2004 (Exh. C-652), Prime Minister Nastase indicated that during its negotiations with the European Union, Romania would see if it was "able to obtain some transition periods" for PIC holders, as well as "some compensation packages, established during direct negotiations." The Prime Minister also stated that the government would talk to the investors, and "based on the conclusions of the negotiations of the Competition Chapter, we will negotiate with those who initially obtained these fiscal incentives" (Exh. C-652, pp. 7-9 of translation). These statements confirm that Romania itself understood that the EGO 24 regime was to last for 10 years, and that in repealing it prematurely Romania was undermining PIC holders' legitimate expectations and causing them to suffer damages.

iii. Was this expectation reasonable?

690. In broad terms, the Tribunal will analyze the reasonableness of the Claimants' expectation from two perspectives: (i) the legitimacy of the expectation in the context of Romania's accession to the EU, and (ii) the legitimacy of the expectation under Romanian law.

(a) Reasonableness in the context of Romania's Accession to the EU

691. After a careful review of the record, the Tribunal has come to the conclusion that between 1998 and late 2003 it was reasonable for the Claimants to believe that the EGO 24 incentives were compatible with EU law. The Tribunal agrees with Prof. Dashwood's conclusion that "a strong case can be made that the Romanian authorities were justified in treating the disputed aid as a valid regional operating aid, up until the moment when they abolished it" (ER of A. Dashwood ¶ 55).

692. There seems to be no dispute that, throughout the period during which the Claimants received the EGO 24 incentives (that is, from receipt of European Food's TIC in 1999 until the incentives were abolished in February 2005), the EGO 24 scheme was subject to the state aid regime of the Europe Agreement (which was the operative pre-accession treaty; ER of A. Dashwood, ¶ 31). As explained by Prof. Dashwood (with no convincing rebuttal by Romania's experts), under the Europe Agreement regime, the substantive rules to assess the compatibility of the EGO 24 incentives with the common market were the substantive rules of the EU state aid regime contained in Article 87 of the EC Treaty (through the operation of Article 64(2) of the Europe Agreement), as amplified by case law and Commission practice, and as subsequently clarified by the Implementing Rules that were annexed to Decision 4/2000 of the Romania-EU Association Committee (Exh. R-65; C-579).

693. Article 64 of the Europe Agreement provides in relevant part:

> 1. The following are incompatible with the proper functioning of this Agreement, in so far as they may affect trade between the Community and Romania: [...] (iii) any public aid which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods.
>
> 2. Any practices contrary to this Article shall be assessed on the basis of criteria arising from the application of the rules of Articles 85, 86, and 92 of the Treaty establishing the European Economic Community.
>
> 3. The Association Council shall, within three years of the entry into force of the Agreement, adopt the necessary rules for the implementation of paragraphs 1 and 2.
>
> 4. (a) For the purposes of applying the provisions of paragraph 1, point (iii), the Parties recognize that during the first five years after the entry into force of the Agreement, any public aid granted by Romania shall be assessed taking into account the fact that Romania shall be regarded as an area identical to those areas of the Community described in Article 92(3)(a) of the Treaty establishing the European Economic Community. The Association Council shall, taking into account the economic situation of Romania, decide whether that period should be extended by further periods of five years. [...]

694. Article 64 of the Europe Agreement incorporated Article 87 of the EC Treaty, which is the primary source of the EU's substantive rules on state aid. Article 87(1) of the EC Treaty contains the general principle that "any aid granted by a Member State or through state resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall,

in so far as it affects trade between Member States, be incompatible with the common market." However, Article 87(3)(a) (which replaced Article 92(3)(a) of the Treaty establishing the European Economic Community) expressly permitted "aid to promote the economic development of areas where the standard of living is abnormally low or where there is serious underemployment."

695. In turn, Art. 64(4)(a) of the Europe Agreement expressly stated that all of Romania would be considered an underdeveloped area for purposes of Article 87(3)(a) of the EC Treaty for the first five years after the entry into force of the Europe Agreement:

> For the purposes of applying the provisions of paragraph 1, point (iii), the Parties recognize that during the first five years after the entry into force of the Agreement, any public aid granted by Romania shall be assessed taking into account the fact that Romania shall be regarded as an area identical to those areas of the Community described in Article 92(3)(a) of the Treaty establishing the European Economic Community. The Association Council shall, taking into account the economic situation of Romania, decide whether that period should be extended by further periods of five years. [...] (Art. 64(4)(a) of the Europe Agreement).

696. Article 64(3) of the Europe Agreement provided that "[t]he Association Council shall, within three years of the entry into force of the Agreement, adopt the necessary rules for the implementation of paragraphes 1 and 2." With some delay, on 10 April 2001, the EU-Romania Association Council adopted Decision 4/2000 which contained these "Implementing Rules", Exh. R-65; C-579), which prescribed the manner in which Article 64 of the Europe Agreement would be implemented by Romania.[141]

697. Article 2(1) of the Implementing Rules provided that "[t]he assessment of compatibility of individual aid awards and programmes with the Europe Agreement, as provided for in Article 1 of these Rules, shall be made on the basis of the criteria arising from the application of the rules of Article 87 of the Treaty establishing the European Community, including the present and future secondary legislation, frameworks, guidelines and other relevant administrative acts in force in the Community, as well as the case law of the Court of First Instance and the Court of Justice of the European Communities and any decision taken by the Association Council pursuant to Article 4(3)."

698. The criteria applied by the European Commission when examining the Article 87(3)(a) exception were set down in the 1998 Guidelines on Regional Aid (first published in 1998 (Exh. RJ-9) and since replaced by a revised version for the years 2007-2013) (Exh. C-298).

---

[141] Article 4(1) of the Implementing Rules also extended the time period in which Romania would be considered an underdeveloped area pursuant to Article 64(4)(a) of the Europe Agreement:

> In accordance with and within the limits of Article 64(4)(a) of the Europe Agreement, Romania shall be regarded as an area identical to those areas of the Community referred to in Article 87(3)(a) of the Treaty establishing the European Community. (Article 4(1) of Decision 4/2000).

699. The Guidelines on Regional Aid distinguished between various types of state aid, and described the circumstances under which certain state aid could be granted, including where the economic situation was extremely unfavorable in relation to the Community as a whole. In such cases, the aid could be granted as tax exemptions. In addition, although operating aid aimed at reducing a firm's current expenses is normally prohibited, the Guidelines recognize that, exceptionally, such aid may be granted in regions eligible under the derogation in Article 87(3)(a), subject to certain conditions. Specifically, the 1998 EU Guidelines on Regional Aid (RJ-9) provided:

> Operating aid
>
> 4.15. Regional aid aimed at reducing a firm's current expenses (operating aid) is normally prohibited. Exceptionally, however, such aid may be granted in regions eligible under the derogation in Article 92(3)(a) provided that (i) it is justified in terms of its contribution to regional development and its nature and (ii) its level is proportional to the handicaps it seeks to alleviate (36). It is for the Member State to demonstrate the existence of any handicaps and gauge their importance.
>
> 4.16. In the outermost regions qualifying for exemption under Article 92(3)(a) and (c), and in the regions of low population density qualifying either for exemption under Article 92(3)(a) or under 92(3)(c) on the basis of the population density test referred to at point 3.10.4, aid intended partly to offset additional transport costs (37) may be authorised under special conditions (38). It is up to the Member State to prove that such additional costs exist and to determine their amount.
>
> 4.17. With the exception of the cases mentioned in point 4.16, operating aid must be both limited in time and progressively reduced. In addition, operating aid intended to promote exports (39) between Member States is ruled out.

700. The Tribunal agrees with Prof. Dashwood that the EGO 24 incentives appeared to meet most of the criteria for regional operating aid set forth in the 1998 Guidelines (ER of A. Dashwood, ¶¶ 52-53). Specifically:

a. EGO 24/1998 was created to contribute to regional development, and there is evidence that it did in fact contribute to such development.

b. The level of disputed aid appears to have been proportional to the handicaps of the disadvantaged areas that the aid was designed to alleviate, and the Romanian government could have been able to demonstrate this.

701. The only unsatisfied criterion would be its "non-degressive character" (i.e., the fact that the EGO 24 incentives were not meant to be progressive, as mandated by Article 4.17 of the 1998 Guidelines). However, given the level of unemployment in the Ştei-Nucet-Drăgăneşti area Prof. Dashwood did not consider it a determinative factor (ER of A. Dashwood, ¶ 54).

702. Neither the Respondent nor its experts contested Prof. Dashwood's conclusions persuasively, and the Tribunal finds Prof. Dashwood's assessment reasonable.

703. As a result, the Tribunal concludes that the EGO 24 incentives could have reasonably been thought (both by the Romanian government and the Claimants) to be valid regional operating aid under EU law. Indeed, Romania itself appears to have believed that, at the time EGO 24 was enacted, the incentives were compatible with EU state aid requirements. In its Counter-Memorial, Romania stated:

> Especially given Romania's status as an 'underdeveloped area' within the meaning of Article 87(3)(a) of the EC Treaty, the government could reasonably conclude at the time that the EGO 24/1998 regime was not incompatible with the Europe Agreement's provisions. Furthermore, given the economic dislocation that existed at the time, measures to ameliorate conditions in the disfavoured regions were necessary. Romania was not alone among EU candidate States in making the policy choice to implement new economic-assistance measures based upon such an assessment of the legal position. For example, Poland passed similar legislation authorizing State aid for underdeveloped regions in 1994, while it was a candidate for EU admission (R-CM, ¶ 29).

704. Similarly, in its comments to the Commission's Written Submission, Romania acknowledged that:

> The facilities in EGO 24/1998 appeared to be regional aid for economically disadvantaged areas. Thus, EGO 24/1998 was reasonably considered as falling within the exceptions in Article 87(3)(a) and 87(3)(c) EC Treaty. (Respondent's Comments to the Commission's Written Submission, 16 Nov. 2009, ¶ 2).

705. Romania's expert, Prof. Rudolf Streinz confirms the reasonableness of that position:

> In my opinion, in 1998 and particularly in the absence of effective State aid control and support from the European Commission, Romania could, in the exercise of its discretion, reasonably have considered that the EGO 24/1998 regime fell under one of the State aid exceptions of the EC Treaty [...]. For example, Romania, having been designated in its entirety in Article 64(4) of the Europe Agreement as underdeveloped within the meaning of Article 87(3)(a) of the EC Treaty, could have considered itself permitted to enact EGO 24/1998. EGO 24/1998 provided for State aid to foster economic development of areas – i.e. the whole of Romania – where the standard of living was abnormally low or where there was serious underemployment. Alternatively, Romania might have considered that the State aid granted pursuant to EGO 24/1998 was exempt under Article 87(3)(c), because the regime amounted to assistance of regions which are disadvantaged compared to the national average, based on national criteria (First ER of R. Streinz, ¶ 19).

706. As expressly acknowledged by Romania, many government officials maintained this "sincere belief" until after the Competition Council issued Decision 244 in 2000, and the Respondent's expert Mr. Petersen acknowledged that "Romanian politicians and officials who thought that EGO 24 was legal were incorrect, but they were not unreasonable, and they acted in good faith" (R-PHB, ¶ 174, Tr., Day 6, 111, 178). The Tribunal does not believe that investors should be held to a higher standard than the government. Investors are entitled to believe that the government is acting legally.

707. The question is when should the Claimants have realized that the incentives were (or became) vulnerable because they contravened EU law and, as a consequence, at what time they might be phased out. As late as June 2002, Romania's "National Programme for Accession of Romania to the European Union" (Exh. HEC-7) stated that "[t]he provisions of the normative acts on facilities granted for 'D areas' will be maintained till the moment of Romania's accession to the European Union" (p. 148). Mr. Orban testified that this was Romania's intention, and that it "battled a lot with the Commission to get this" (Tr., Day 8, 219-220 (Orban)). Indeed, when asked when it should have been clear to the public that the facilities would not survive, Mr. Orban testified that it could have been as late as April/May 2004 (Tr., Day 8, 12-14 (Orban)).

(b) Reasonableness under Romanian law

708. Determining whether the Claimants' expectations were reasonable under Romanian law is less straightforward. On the one hand, the Claimants argue that the purpose of EGO 24 and its enacting legislation, as well as the issuance and content of the PICs, made their expectations reasonable. Romania argues that, to the contrary, nothing in the regulation and the PICs themselves assured the Claimants that the incentives would remain in place for 10 years. However, the Tribunal has already found that the content of the legislation and the PICs themselves gave rise to a legitimate expectation that the incentives would last until 1 April 2009.

709. On the other hand, Romania argues that the regulatory framework as it existed at the time of the Claimants' alleged investment in reliance on Romania's assurances (from 2000 to 2004, if the issuance of European Food's PIC is taken as starting point) contemplated the possibility that the incentives could be subject to repeal. Romania argues that the incentives could have been revoked as a matter of general administrative law, or because in 1999, prior to the issuance of the PICs, Romania passed the Competition Law, which allowed the Competition Council to determine whether any existing aid was compatible with the Europe Agreement and, if it was not compatible, to recommend cancellation of such aid and request its repayment (Articles 12-13 of the Competition Law). In Romania's submission, the fact that Romanian legislation allowed the Competition Council to recommend the revocation of the incentives undermines the reasonableness of any expectation that these incentives would remain unchanged for 10 years. Indeed, Romania argues that this is exactly what the Competition Council did with Decision 244/2000.

710. In the Tribunal's view, two distinct but related issues must be analyzed: (i) the possibility that the incentives would be found incompatible with Romanian law, and (ii) Romania's interaction with the Competition Council with respect to Decision 244/2000.

711. With respect to the first point, the Respondent argues that, under the existing regulatory framework, the incentives were inherently subject to the Competition Council's review and possible cancellation. Thus, the fact that the fate of all existing legal aid could depend on a decision by the Competition Council weakens any reasonable belief that any incentives would remain unchanged for any particular

period of time. In other words, the Claimants should have known, when they obtained the PICs, that the incentives could be at any time declared by the Competition Council to be incompatible with Romanian law.

712. This proposition cannot be sustained. Any piece of legislation must comply with higher ranking norms. That does not change the fact that enacted rules are supposed to be valid and enforceable for so long as they have not been repealed or annulled. Law-abiding actors may not violate enacted laws or regulations because they question their validity or legality: they may know that such validity or legality is debatable, and seek appropriate relief in court or otherwise, but, in the meantime, they must obey the law. Romania has not argued that the incentives were illegal or that there were any doubts as to their legality. In other words, the possibility of cancellation of the incentives by order of the Competition Council is in itself not a valid argument.

713. With respect to the second point, on 15 May 2000, the Competition Council issued Decision 244/2000, which recommended that the Raw Materials Incentive be abolished. However, the Romanian Government (with the approval of the judiciary) overruled this decision, and thus confirmed the incentives' legality under Romanian law.

714. The Claimants' expectation that the incentives were compatible with Romanian law was particularly reasonable given the sequence of events with respect to the process surrounding Decision 244 and the granting of the Claimants' PICs. Decision 244 was rendered on 15 May 2000, European Food's PIC was issued on 1 June 2000, and EGO 75/2000 (which amended EGO 24 but maintained the Raw Materials Incentive) was enacted on 16 June 2000. The Competition Council brought a law suit against the Government, which the High Court of Cassation dismissed on admissibility grounds on 19 February 2002. Multipack and Starmill's PICs were issued on 17 May 2002.

715. In the Tribunal's view, given that the Government, in this case through Parliament, did not follow the Competition Council's recommendation to abolish the incentives, and decided instead to confirm them via new legislation (EGO 75/2000), and immediately afterwards issued the Claimants PICs confirming their eligibility for the questioned incentives, it was reasonable for the Claimants to believe that the Government considered that such incentives were legitimate and intended to maintain them for the stated period. The fact that the Competition Council sought to enforce Decision 244 in Romanian courts and that its action was dismissed by the original and appellate courts, further enhances the notion that the Government (at its legislative and judicial level) endorsed the legitimacy of the incentives. In other words, the Government implicitly confirmed the incentives' legality under Romanian law.

716. The fact that the court action was dismissed on admissibility grounds does not change this conclusion. Indeed, by determining that the Competition Council did not have the power to challenge legislative acts, the courts merely confirmed that, as a matter of Romanian law, the existence and legitimacy of the incentives depended on

Parliament, not on the Competition Council. And as a matter of Romanian law, the Claimants were entitled to rely on the assumption that the incentives were legal. The fact that Starmill and Multipack received their PICs after the challenge was dismissed further confirms that it was reasonable for the Claimants to believe that the incentives were legitimate.

717. In conclusion, the Tribunal finds that it was reasonable for the Claimants to believe that the incentives were legal under Romanian law and would be maintained for the full 10 year period.

iv. Did the Claimants in fact rely on that expectation?

718. There is no dispute that the Claimants invested in Bihor County, and that they made use of the incentives. However, it is also evident from the record that their initial investments were not made in reliance on the EGO 24 incentives, because they began to invest in the early 90s, before these incentives were created. Indeed, the Claimants concede that their initial investments were made in reliance on previous incentive regimes (R-Reply, ¶¶ 62-124). The Claimants have also stated that their expectation that the Raw Materials Incentive would be available for 10 years arose when the PICs (or TIC, in the case of European Food) were granted (Tr., Day 12, 91 (Reed)). In the Tribunal's view, a legitimate expectation could only have been crystallized at the time when the Corporate Claimants were granted their permanent investor certificates, not temporary certificates. A temporary certificate is, by its own nature, granted only for a limited time and does not necessarily guarantee that a permanent certificate will be issued. A TIC can give rise to an expectation that its beneficiary is temporarily entitled to some benefits but not that the permanent certificate will actually be issued as the beneficiary will have to prove that, in the meantime, it has satisfied some conditions. Thus, the only investments that could have been made in reliance on that expectation are those made after European Food obtained its PIC in June 2000, and after Starmill and Multipack obtained theirs in May 2002. Whether the Claimants relied on previous incentive programs neither proves their reliance on the EGO 24 incentives nor strengthens their reliance argument.

719. In addition, there is evidence that, further to the EGO 24 incentives, there were other reasons why the Miculas invested in Bihor County. The Tribunal recalls that, according to Mr. Viorel Micula's cross-examination, there were other reasons for the Claimants' investment in Bihor apart from the availability of the Raw Materials Facility for the planned 10 year period until 2009. Mr. Viorel Micula testified as follows:

> Q. Mr Micula, let's not beat around the bush. I will read out a proposition to you and you tell me if you agree. Your investment in Bihor in the European Food and Drinks Group only made economic sense if you could count on the benefits of the raw materials facility for the planned ten-year period until 2009, is that correct? Is it true to say that your investment makes economic sense only if you have the raw materials facility?
>
> A. It is wrong, Mr Petrochilos. I think no one, either myself or my brother who knew about this leverage had made such a mistake. That would have been a big mistake. Maybe you made that mistake.

(Tr., Day 6, 279 (Petrochilos/V. Micula)).

720. In addition, the Micula brothers were born in Bihor County and Ioan Micula conceded that that there was "a very emotional drive" behind their business initiative (Tr. Jur., Day 2, 23). However, he also stated that "it was not just a question of us being born there, it was also a question of long-standing facilities and exemptions that have been there for a very long time and many of them are still there" (Tr. Jur., Day 2, 54).

721. Taking all of this into consideration, it is clear that (i) not all of the Claimants' investments were predicated on the EGO 24 incentives; and (ii) even when the Claimants' took the EGO 24 incentives into account in making investment decisions, other factors also influenced the Claimants' decisions. However, the Tribunal is satisfied that a significant part of the Claimants' investments (from 2000 to 2004) were made in reliance on the incentives. In particular, the Tribunal is satisfied that the existence of the incentives was one of the reasons for the scale and manner of those investments. It is evident from the record that the Claimants built a large and complex platform for the production of food and drink products, and that its profits depended largely on the reduction of their operating costs resulting from the Raw Materials Incentive (Third WS of I. Micula, ¶¶ 44-67, 83-84; Third WS of V. Micula, ¶ 33, 51-52; WS of M. Ban ¶ 38; WS of M. Halbac, ¶¶ 12-61; First ER of D. Lessard, ¶¶ 32-42; ER of R. Boulton, Sections 4 and 5; ER of C. Osborne, ¶¶ 1.11-1.15; Section 4; Exh. C-385, C-987). Accordingly, the Tribunal is satisfied that the Claimants in fact relied on the incentives to build and develop their investment in the manner in which it stood at the date of the revocation of those incentives.

722. It goes without saying that the BIT only protects investments made in reliance on legitimate expectations (*see* paragraphs 667 to 673 above). It does not protect investments made after such an expectation has been destroyed. The Tribunal has found that the Claimants' expectations arose in June 2000, with the granting of European Food's PIC. This expectation was shattered once it became clear that Romania would revoke the incentives without compensation, which, as discussed further below, occurred on 31 August 2004, with the issuance of GO 94/2004. Although Prime Minister Nastase publicly announced the termination of the regime for the first time in January 2004, it was still uncertain at that time whether PIC holders would be compensated (*see* Section 4 below). Accordingly, the BIT can only protect the Claimants' investments made between 1 June 2000 and 31 August 2004.

723. The Tribunal does not ignore the fact that the Respondent has challenged the credibility and reliability of the Claimants' witnesses, in particular with respect to the question of whether, in making their investment decisions, the Claimants' relied on an expectation that the incentives would remain in place for 10 years, and with respect to their damages case.

724. The Tribunal will address the Respondent's arguments with respect to damages in due course. With respect to Claimants' legitimate expectations, however, the Tribunal is not persuaded that the testimony of the Claimants and their witnesses is unreliable. The key issue before the Tribunal is whether and to what extent the

Claimants relied on the EGO 24 incentives to make and develop their investments, and if that reliance was reasonable. It is evident from the documentary record that the Claimants did in fact rely on the EGO 24 regime to expand their business (*see* paragraph 721 above). The Tribunal has also found that the Claimants' expectation that the EGO 24 regime would be in place for 10 years was objectively reasonable. It was also reasonable to rely, at least until 31 August 2004, on the survival of that regime.

* * *

725. For the reasons set out above, the majority of the Tribunal finds that Romania violated the Claimants' legitimate expectations with respect to the availability of the EGO 24 incentives.

726. Although the majority of the Tribunal has found a breach of legitimate expectations, in order to provide a complete ruling on Romania's compliance with its obligation to provide fair and equitable treatment, the Tribunal will address the Parties' remaining arguments with respect to this standard. The Tribunal will next address Romania's defense that it acted reasonably (Section 4 below). It will then address whether Romania acted in bad faith (Section 5 below). Finally, it will address the Claimants' argument that Romania failed to act transparently and consistently (Section 6 below).

4. Did Romania act unreasonably?

727. The Respondent's main defense with respect to the Claimants' fair and equitable treatment and unreasonableness claims is that it acted reasonably when it terminated the EGO 24 incentives regime. It thus argues that it did not engage in what it has called "substantively improper conduct", and it should not be made to compensate for reasonable general regulation. Although the Respondent has acknowledged that the Tribunal may find a breach of the BIT if it finds that Romania promised that the incentives would remain unchanged for ten years and the Claimants reasonably relied on that expectation (see paragraph 500 above, Tr., Day 13, 19-43 (King)), the Respondent devoted considerable time and effort to establishing that it acted reasonably.

728. The Claimants have not addressed this defense directly in the context of their fair and equitable treatment claim, other than to argue that Romania's subjective motivation is irrelevant to determine if it has breached the fair and equitable treatment standard. However, in the context of their claim for "impairment by unreasonable or discriminatory measures" under the second section of Article 2(3) of the BIT (the "impairment clause"), the Claimants also argue that Romania acted unreasonably when it repealed the EGO 24 incentives. When discussing unreasonableness in the context of fair and equitable treatment, the Tribunal will thus refer to the arguments made by the Claimants on that issue in the context of the impairment clause.

a. The Claimants' position

729. The Claimants argue that Romania acted unreasonably by:

a. Actively promoting and extending the EGO 24 regime and encouraging investors to participate in that scheme (at least until 2003), despite the fact that behind closed doors it was negotiating for the scheme's early termination.

b. Revoking the incentives regime prematurely without being required to do so by any competent legal authority, without attempting to negotiate with the EU or the Claimants to mitigate the damages caused by the revocation, and in contradiction of its repeated statements over the years that the regime was legal and satisfied EU requirements.

c. Revoking the benefits of the incentives regime while maintaining the investors' obligations under that regime (in particular the obligation to maintain the investments for 20 years). In the Claimants' view, "a government's decision unilaterally to continue to reap the full benefits of a deal with investors while denying those investors the originally-promised benefits is a textbook example of unreasonableness" (C-Reply, ¶¶ 459-460; C-PHB, ¶¶ 65-66).

730. In terms of the relevant case authority, the Claimants argue that Romania deprived the Claimants of their legitimate rights under circumstances that are contrary to the rule of law (relying on the ICJ's decision in *ELSI*[142]). They further contend that there was no factual justification for the withdrawal of the tax exemptions and incentives (*Lauder v. Czech Republic*). In addition, they argue that the reversal of Romania's position upon which the Claimants had relied was not merely surprising but outrageous (*Pope & Talbot*[143]). Finally, they argue that the measures affecting the Claimants' position were not based on rational decision-making or any consideration of the effects on foreign investments, and did not balance the interests of the state with the burden imposed on Claimants' investments (*LG&E*).

b. The Respondent's position

731. The Respondent submits that the central question in this case is whether Romania acted reasonably in amending EGO 24 in August 2004. The Respondent argues that where an investor challenges general legislation that modifies existing general legislation, the question for an international tribunal is whether that legislation is grounded in reason (rather than being arbitrary) and enacted in pursuit of legitimate objectives (rather than for illicit purposes, such as discrimination). The Claimants have not argued that Romania acted in a discriminatory fashion; the question is thus whether Romania acted unreasonably. The Respondent contends that, to show that Romania acted unreasonably, the test is to determine whether, in light of all of the surrounding circumstances, what Romania did was reasonably connected to a rational policy (R-CM, ¶¶ 167-174; R-Rejoinder, ¶¶ 108-117; R-PHB, ¶¶ 33-98; Tr., Day 13, 45-50 (King)).

[142] *Case Concerning Elettronica Sicula SpA (ELSI) (United States of America v Italy)*, 20 July 1989 (hereinafter *"ELSI"*), [1989] ICJ Reports 15.

[143] *Pope & Tablot Inc v. The Government of Canada,* UNCITRAL, Award in Respect of Darnaqes, 31 May 2002, 41 ILM 1347 (2002), ¶ 64.

732. The Respondent argues that it is the Claimants' burden to prove that Romania's action in withdrawing the facilities was manifestly unreasonable (as stated in *AES v. Hungary*). The Respondent submits that the Claimants have not met that burden. Rather, the Claimants speculate about possible transitional measures or possibly delaying the withdrawal of the facilities, and other things Romania might have done. In the Respondent's view, such speculation is not sufficient to prove that Romania's actions were manifestly unreasonable. The Respondent submits that the Claimants' burden is to prove, not merely that Romania could have made better decisions, but rather that the decisions that it did make were so poor and so arbitrary, that they lacked any reasonable relationship to a rational policy goal.

733. In any event, according to the Respondent the record shows that Romania, over a 4 year period of negotiations with the EU, did endeavor to salvage what it could of the EGO 24 facilities. However, the Member States were adamant about the need to eliminate nonconforming state aid, not just by the date of accession but before the negotiations on Chapter 6 (the competition policy chapter of the EU accession negotiations) could be closed and the accession treaty signed. This was especially true of operating aid, and aid that would have been inconsistent with the rules of the customs union, which is what the raw materials exemption would have been.

734. More specifically, the Respondent argues that (i) its motivation in amending EGO 24 was to comply with EU accession; (ii) it acted reasonably in pursuit of conflicting policies, and (ii) none of the Claimants' contentions about what Romania could or should have done differently proves that Romania acted unreasonably.

i. The Respondent's motivation in amending EGO 24 was to comply with EU accession

735. The Respondent argues that its subjective motivation in amending EGO 24 was to address the EC's concerns over state aid. Romania alleges that it gradually repealed the facilities, not irrationally or unreasonably, but in response to increasing pressure from the Commission and the Member States, and in pursuit of the universally accepted national policy priority of joining the EU. According to the Respondent, the facts "indicate that the measures were based upon a rational decision-making process, related directly to the dual (and competing) policy goals of support for disadvantaged regions and admission to the EU" (R-CM, ¶ 173).

736. Specifically, the Respondent alleges that in 2000, Romania announced that the target for EU accession was 2007, and that was public knowledge. During the next three years, Romania, the Commission and the Member States talked with each other about state aid. The Respondent argues that there was a particular focus on EGO 24, especially once the EU was informed that in May 2000 Romania's Competition Council had found certain facilities to be incompatible with the *acquis* on state aid.

737. The Respondent contends that, as a result, Romania began to "chip away" at the customs duty exemptions. In 2002, it eliminated the Machinery Facility, and then the meat-related Raw Materials Facility. Also in 2002, it repealed the Profit Tax

Exemption but grandfathered it for existing PIC holders. Ultimately Romania managed to persuade the EU to accept the grandfathering of the Profit Tax Exemption.

738. The Respondent argues that, by 2004, time was running out if it was to meet its longstanding 1 January 2007 target date for accession. For that to happen, negotiations had to be closed in 2004 and the Accession Treaty had to be signed in 2005. So in June 2004 Romania placed maximum intensity caps on the EGO 24 facilities, but that was not enough for the EU. Finally, in August 2004 the Romanian Parliament passed GO 94/2004, withdrawing the remaining facilities. Romania communicated this fact to the EU in November 2004, and the very next month Chapter 6 was provisionally closed. The revocation of the EGO 24 facilities took effect on 22 February 2005, and two months later Romania and Bulgaria signed the Accession Treaty with the existing member states. Even then, the Accession Treaty imposed on Romania a probationary period regarding state aid, which it did not impose on Bulgaria.

739. The Respondent contends that the EU's position was clear: the EGO 24 incentives had to be terminated and, as confirmed by the Commission representatives during the hearing, the Commission and the Member States were inflexible on this point. According to the Respondent, the documentary record demonstrates that the EU insisted on the revocation of the Raw Materials Incentive and other types of illegal state aid. It argues that the Claimants' attempt to read the EU documents as leaving room for Romania to maintain the EGO 24 facilities ignores the structure of the accession negotiations. The Respondent points out that in its first Position Paper on competition policy of August 2000, Romania confirmed that it accepted the competition *acquis* in full. In light of Decision 244/2000 of the Competition Council in May 2000, this could not have been reasonably interpreted to mean that Romania believed that EGO 24 complied with the *acquis*. Nor does the fact that the EU did not expressly object to EGO 24 at that time mean that the EU accepted the regime; it merely meant that the EU did not yet know all the details of EGO 24.

740. In particular, the Respondent argues that in its Common Position of 2003 (Exh. EC-8) the EU invited Romania to "bring all incompatible aid measures in line with the *acquis* without delay and to continue to provide information on the progress made towards this goal." The Respondent argues that, despite the "diplomatic language" used by the EU, the message was strong: Romania must repeal the facilities as promptly as possible. Likewise, the EU's request that Romania "close incompatible aid schemes for new entrants with immediate effect" cannot negate other statements that made clear that such schemes must be removed for all beneficiaries. The Commission representatives confirmed at the hearing that EGO 24 had to be terminated immediately both for existing and new entrants.

741. In this respect, the Respondent argues that EU law is particularly hostile to operating aid in the form of customs duty exemptions. This is because operating aid reduces the recipient's operating costs, creating an artificial (even if temporary) ability to undersell competitors as long as the aid continues to flow. Romania asserts that this was confirmed by the Commission at the hearing (Tr., Day 5, 157-157 (Commission)).

742. In addition, the Respondent argues that the Raw Materials Facility is, by its very nature, contrary to the Customs Union, as it would create a hole in the metaphorical wall around the EU created by the Common Customs Tariff. This is illustrated by the Claimants' business model: taking advantage of the Raw Materials Facility enabled the Claimants to purchase their raw materials for a price substantially lower than their competitors outside the disfavored regions. This did not simply lower the cost of operations in the disadvantaged region; it gave the Claimants a chance to become sugar dealers (at least if the Claimants' quantum case is to be believed) by importing far more duty-free sugar than needed for their own operations, minimally processing it, and then selling it outside the disfavored region. According to the Respondent, this is exactly the type of situation that the EU's policies against operating aid are trying to prevent.

ii. Romania reasonably balanced conflicting policies

743. The Respondent contends that it reasonably balanced conflicting policies when negotiating the state aid aspects of Chapter 6. Romania states that "[t]he government, including a majority of Parliament, favoured the policy underlying subsidies for disadvantaged areas. But EU accession was also a crucial policy supported across the government (and among the Romanian people). As the conflict between those two policies became increasingly apparent, Romania had to balance conflicting policy objectives, as must any democratic state in which diverse constituencies pursue divergent interests" (R-PHB, ¶ 40). This balancing was made difficult by the differing and sometimes opposing views of various state organs and officials, as exemplified by the differing positions of Mr. Marcu (who was president of the NARD) and Mr. Orban (who was negotiating EU accession).

744. Even once the legal and political difficulties surrounding EGO 24 had become evident, Romania contends that it actively sought to maintain the facilities. Indeed, it argues that many of its actions during the accession negotiations can be explained by its intention to prolong the facilities as long as possible. According to Mr. Orban, this is why Romania was sometimes slow in providing information to the EU about the EGO 24 regime (Tr., Day 8, 205 (Orban)). This is also why Parliament refused to comply with the Competition Council's decision and why it gradually repealed the facilities in response to new demands by the EU.

745. The Respondent argues that whether Romania accurately assessed the EU's position is irrelevant. As Mr. Orban confirmed, Romania acted on the basis of its good-faith understanding of the EU's demands.

746. The Respondent further argues that it could not bargain with the EU from a position of strength. It contends that in EU accession negotiations, candidate countries had very little bargaining power, and that this was particularly true of competition policy.

747. Nonetheless, Romania notes that it obtained substantial concessions from the EU to the benefit of investors in the disfavored areas. Specifically, Romania was able to obtain (i) the grandfathering of the Profit Tax Exemption (for a maximum period of

three years after accession); (ii) a delay of the repeal of the Raw Materials Facility until February 2005; and (iii) a favorable formula to calculate the maximum state aid intensity that investors could receive, which excluded from the cap aid received prior to 1 January 2001. The Respondent asserts that all of these concessions were very real and useful solutions for many companies.

iii. None of the Claimants' contentions about what Romania could or should have done differently prove that Romania acted unreasonably

748. The Respondent denies that Romania could have obtained concessions from the Commission and EU Member States that would have allowed the incentives to remain in place. According to the Respondent, the Claimants must prove that Romania's actions were not reasonably related to its rational policy objectives; it is irrelevant whether Romania got the best possible deal. In the Respondent's view, none of the Claimants' contentions about what Romania could or should have done differently prove that Romania acted unreasonably.

749. First, the Respondent contends that the Claimants have not proven that Romania could have maintained the Raw Materials Facility after EU accession. Indeed, the Claimants have not proven that the Raw Materials Facility was legal under Article 87(3) of the EC Treaty. Nor is there any plausible basis to believe that the EU would have granted derogation, and the Claimants have not cited a single comparable instance in which this has happened.

750. Second, the Respondent argues that none of the alternatives to maintaining the Raw Materials Facility suggested by the Claimants (i.e., a delay in the repeal of the Raw Materials Facility, the grandfathering of the Raw Materials Facility, or the payment of compensation to PIC holders) were feasible. The Respondent contends that Romania kept the Raw Materials Facility in place for as long as possible without delaying accession. Mr. Orban testified that the Commission was very displeased when Parliament delayed the repeal of the Raw Materials Facility to February 2005.

751. Similarly, the Respondent argues that Romania could not have persuaded the EU to agree to grandfather the Raw Materials Facility or agree to other transitional arrangements. Because the Raw Materials Facility constituted incompatible state aid, Romania could not have included it in the list of aid it wished to continue after accession. The Respondent concedes that in its 2001 Common Position the EU invited Romania to submit "a list of those existing aid measures which the Competition Council considers as compatible with the *acquis*", stating that "Romania may continue to operate any aid which is included in the list and against which the Commission has not objected for the period for which the aid was approved by the Competition Council." However, Romania argues that by definition it could only include measures that the Competition Council considered compatible, which was not the case for the Raw Materials Facility.

752. The Commission confirmed at the hearing that to operate incompatible state aid beyond accession, Romania would have needed a special provision in the Accession

Treaty (Tr., Day 5, 90-91 (Gaillard/Commission)). Because the Raw Materials Facility involved an exemption from certain customs duties, grandfathering would have created a hole in the "wall" around the Customs Union. Relying on the Commission's testimony, the Respondent contends that, because of the characteristics of the EGO 24 scheme, grandfathering any facility other than the Profit Tax Exemption "would not have been agreed in the context of accession negotiations" (Tr., Day 5, 174 (Commission)). An exception was made for the Profit Tax Exemption because it constituted investment aid rather than operating aid.

753. Finally, the Respondent contends that the Claimants have not proven that Romania could (let alone, should) have paid compensation to all PIC holders. As Mr. Orban and the Commission testified, any compensation paid to the beneficiaries of the incentives would have been seen as incompatible state aid, and the Commission would have requested reimbursement (Tr., Day 5, 45-46 (Commission); Day 8, 216-217 (Orban)). Thus, the Commission and Member States would not have agreed to the payment of compensation to PIC holders.

754. Even if the Claimants could prove that Romania could have implemented these alternatives, the Respondent contends that that would not establish a breach of the BIT. For a breach to be established, the Respondent argues that the Claimants must show that the judgments made by Romania were not reasonably related to a legitimate policy, i.e., that Romania's judgment of how to balance the policies and interests at stake in the accession process was not merely incorrect, but unreasonable. The Respondent denies that the Claimants have proven this.

c. The Tribunal's analysis

755. Before addressing the Parties' arguments, the Tribunal will first summarize the relevant facts to establish whether Romania did indeed act in pursuit of a rational policy, as it asserts (Section (i) below). It will then turn to the question of whether Romania acted reasonably in pursuit of that policy and will review the Claimants' specific allegations of unreasonable conduct (Section (ii) below).

i. Did Romania act in pursuit of a rational policy?

756. As discussed in paragraphs 691 to 707 above, the Tribunal has found that, given Romania's status as an "underdeveloped area" within the meaning of Article 87(3)(a) of the EC Treaty, it was reasonable for Romania to believe that the EGO 24 incentives could qualify under the operating aid exception contemplated in the 1998 Community Guidelines on Regional Aid.

757. Romania's conduct suggests that, during the first years of the accession negotiations, this was indeed the belief of a significant part of the Romanian Government. The evolution of the government views on the compatibility of EGO 24 with EU law is described by Romania as follows:

> In August 2000, when Romania submitted its first position paper on competition issues to the EU, most officials (outside the Competition

> Council) apparently still believed that EGO 24 was legal. When Romania received the Member States' response in October 2000, more Romanian officials began to realise that EGO 24 might be incompatible with EU state aid rules. Even then, there was considerable support for the EGO 24 Facilities outside the Competition Council and the negotiating team. For example, after the Court of Appeal rejected the Competition Council's litigation against EGO 75/2000, Parliament reinstated the one Facility that EGO 75/2000 had eliminated. (R-PHB, ¶ 175).

758. The exchange of position papers between Romania and the EU suggests that there may have been an initial miscommunication as to the nature of the EGO 24 regime.

759. In its first Position Paper 6 (Competition Policy) dated August 2000 (Exh. EC-1). Romania stated that it "accepts the entire *acquis communautaire* in force on 31 December 1999, does not request transition periods or derogations and declares that it will be able to entirely implement it upon accession." However, it also stated that:

> Regarding the state aid rules and agreeing to the principles provided for in Art. 87 and 88 of the Treaty establishing the European Community, ***it is necessary to grant state aids to the sensitive sectors of economy and the deprived areas*** due to the difficulties confronting the Romanian economy during the transition to a market economy.
>
> It is also obvious that, after accession, Romania's development level will not exceed the EU average, and, consequently, ***the whole territory of Romania will comply with the conditions laid down in Art. 87(3) of the Treaty*** establishing the European Community.
>
> (Emphasis added).

760. In that same Position Paper, Romania provided a description of EGO 24, as amended by EGO 75/2000. However, it did not mention Decision 244/2000 of the Competition Council, which had recommended the revocation of the Raw Materials Incentive.

761. This suggests that in 2000 Romania believed that the EGO 24 regime was compatible with the *acquis,* or at least that Romania hoped to be able to negotiate to maintain the EGO 24 aid after accession. It may very well be that the "full acceptance" of the *acquis* was a classic formula, as Mr. Orban testified (Tr., Day 8, 188-189 (Orban)), but Romania still appears to have been stating that it nonetheless required state aid for deprived areas to continue its economic development, and that it understood that Romania was considered underdeveloped for this purpose. In other words, Romania appeared to have been saying that it believed it fell into the Article 87(3)(a) exception. This conclusion was confirmed by Mr. Orban, who testified that, at the time Romania submitted its first position paper, the Government believed that the EGO 24 facilities were permissible state aid consistent with Romania's obligations under the *acquis*, and thus believed no derogations from the *acquis* would be needed (Tr., Day 8, 188-189; 196-197 (Orban)).

762. Romania argues that, because of the Competition Council's decision in 2000, Romania's acceptance of the *acquis* cannot be reasonably interpreted to mean that Romania believed that the EGO 24 regime complied with the *acquis*. The Tribunal disagrees. First, Romania expressly acknowledges that many government officials

maintained the "sincere belief" that the EGO 24 regime complied with *acquis* even after the Competition Council issued Decision 244 in 2000 (R-PHB, ¶ 174). Second, Mr. Orban testified that the Government believed that the EGO 24 regime complied with the *acquis*. Thus, if that belief was unreasonable, then Romania was being unreasonable. Third, the fact that the legislature refused to follow the Competition Council's recommendation and instead confirmed the EGO 24 incentives via new legislation (EGO 75/2000) suggests that the Government (at least as a body even if some of its members possibly disagreed) verily believed that these incentives were compatible with the *acquis*.

763. Moreover, Romania omitted any mention of the Competition Council's decision in its first Position Paper. This suggests, as one alternative, that Romania did not see the link between the Competition Council decision and EU state aid law (indeed, the decision made no mention of EU state aid rules). Another possible reason was that Romania did not believe it needed to inform the EU of this decision, perhaps because it considered that under domestic law Parliament had overruled that decision. The omission of any mention of the Competition Council's decision could also suggest that Romania preferred not to raise thorny issues with the EU, because it wanted to maintain the incentives. Any of these interpretations suggests that Romania believed that the EGO 24 incentives were compatible with the *acquis*, or at least that it might be able to negotiate to maintain them.

764. The EU did not immediately ask Romania to revoke the EGO 24 regime. In its first Common Position ("EU Common Position 2000", Exh. EC-2), it underlined that "the 'acquis' under chapter 6, in accordance with the Europe Agreement, has to be applied by Romania already now." However, it also invited Romania to "provide details regarding existing aid measures", and "provide a more detailed analysis of the aid facilities in the so-called D-areas", in particular "what action, in light of the Community Guidelines on Regional Aid, the Competition Council has taken with regard to the Government Ordinances providing for these aid facilities."

765. In February 2001, Romania issued a Complementary Position Paper on Chapter 6 (Competition Policy) (Exh. EC-3). In this position paper, Romania provided further information with respect to EGO 24, but, as confirmed by Mr. Orban, not the detailed analysis that the EU had requested (according to Mr. Orban, this detailed analysis was not made until 2004 (Tr., Day 8, 203-204)). Romania also provided a brief summary with respect to the Competition Council's decision of 244/2000 of 8 May 2000, noting that it had been "overlooked" by EGO 75/2000, but did not explain whether the Competition Council had assessed EGO 24 in light of the Community Guidelines on Regional Aid. It appears that no such study was ever undertaken (there is none in the record).

766. In its next common position (the "2001 EU Common Position", Exh. EC-5), the EU's language became stronger:

> The EU further notes that there are a number of existing as well as new incompatible aid schemes which have not been brought into line with the *acquis*. The EU notes that such schemes include in particular [...] facilities

> provided under Emergency Ordinances no. 24/1998 and 75/2000 in the so-called "D-areas". The EU urges Romania to align the existing incompatible aid schemes without delay. (2001 EU Common Position, p. 4)

767. The Claimants argue that this request to "align" EGO 24 did not imply that EGO 24 necessarily had to be terminated. They further note that the 2001 EU Common Position also invited Romania to draw up a list of existing aid measures that it wished to operate beyond accession. Specifically, the EU stated that:

> With regard to aid which Romania wishes to operate beyond the date of accession, the EU invites Romania to draw up a list of those existing aid measures which the Competition Council considers as compatible with the *acquis*. The EU invites Romania to transmit this list to the Commission; Romania may continue to operate any aid which is included in the list and against which the Commission has not objected for the period for which the aid was approved by the Competition Council. A reference to the existing aid list and to the procedure for its establishment will be included in the Accession Treaty. (2001 EU Common Position, p. 4)

768. In view of these statements, it is not evident to the Tribunal that the EU was requesting the revocation of the EGO 24 incentives, and the record shows that it was not evident to Romania either. Mr. Orban testified that it was not necessary for the EU to expressly say that EGO 24 had to be eliminated, because in his opinion "the first position paper of the Union was very clear: every scheme incompatible with the *acquis* has to be eliminated immediately", but "it was the duty of the national authority in the competition policy to exactly define" what schemes were compatible with the *acquis* and which were not (Tr., Day 8, 212 (Orban)). However, he also confirmed that the Romanian Government continued to enact legislation and regulations that maintained the EGO 24 regime, because the Government still believed it to be a compatible scheme (Tr., Day 8, 213 (Orban)). Mr. Orban also testified that "it was a gradual process of learning" for the Romanian Government, that "a significant number of members of the government were not aware about the requirements of the [accession] process", that there was a "lack of expertise" within the Government, but also "a certain confidence that Romania would be able to get [...] a lot from the accession process, which finally proved to be wishful thinking" (Tr., Day 8, 208-209 (Orban)).

769. By June 2002, however, Romania apparently understood that the EGO 24 regime constituted incompatible aid, but believed that it could "align" it with the *acquis* by converting it into compatible aid. The Romanian Government's "Report on the progress in preparing for the accession to the European Union September 2001-May 2002", dated June 2002 (Exh. HEC-6) stated that:

> All existing State aid measures will be assessed, establishing their compatibility with the acquis in order to suggest measures eliminating or transforming the incompatible ones in compatibles aids, taking into account the legal and economic implication of the modification of any incompatible schemes on the already granted specific allocations.
>
> This approach will be made according to the European Commission recommendation and will take into consideration following three steps: (i) closing the incompatibles schemes in order to stop potential future

> allocations; (ii) the modification of these scheme[s] to reach the compatibility with the acquis; (iii) the identification of the solutions for the economic agents that received the State aid under the present schemes (e.g. Free areas, deprived areas etc). […] (p. 132)

770. More specifically with respect to EGO 24, it stated that:

> Regarding the "D areas", the State aid granted in the present ***must to [sic] be converted into a compatible State aid.*** The Ministry of Development and Prognosis started the technical debates with the beneficiary associations in order to identify solutions and to make, in 2 months, proposals for alteration of the present system of facilities. (p. 133. Emphasis added).

771. At the same time, Romania's "National Programme for Accession of Romania to the European Union" dated June 2002 (Exh. HEC-7) stated that "[t]he provisions of the normative acts on facilities granted for 'D areas' will be maintained till the moment of Romania's accession to the European Union" (p. 148). Mr. Orban testified that this was Romania's intention, and that it "battled a lot with the Commission to get this" (Tr., Day 8, 219-220 (Orban)).

772. In November 2002, Romania provided the Commission with Additional Information on Chapter 6 – Competition Policy (Exh. EC-6). With respect to EGO 24, Romania merely informed the Commission that state aid for the D-areas was regulated by Law 621/2001, which approved EGO 75/2000, and explained the amendment to the VAT and the repeal of the profit tax incentive (noting that it had been grandfathered for PIC holders) (*see* paragraph 232 above).

773. On 7 April 2003, the Mission of Romania to the EU sent a communication to the Romanian Minister for European Integration and other state officials, including Mr. Orban and Mr. Berinde (Communication No. 1480, Exh. R-93). It stated:

> Community officials stated clearly that the ***negotiations on this chapter may be closed if, and only if, the following conditions*** (relating primarily to State aid, which was found to have the highest potential to distort the Internal Market) ***are met:*** new aid must comply strictly with the acquis, ***existing aid must be aligned or in the process of being aligned*** (including in terms of duration; the granting of transition periods may be considered depending on the outcomes of discussions between the competent institutions in' Romania and the relevant operators), and ALL cases of non-notified State aid must be analysed and resolved.
>
> […]
>
> The Commission stated that it had asked all of the candidate countries to bring their tax breaks into line with the acquis communautaire, including those granted in Free Zones or ***Less Favoured Areas***, which entails either their withdrawal or their conversion into compatible aid. In the latter case, ***negotiations with a view to converting them into compatible schemes must be pursued directly by the Competition Council with the economic operators concerned.*** Only once this has occurred can the companies for which transition periods may be negotiated with the EU be identified.
>
> (Emphasis added)

774. In its Common Position dated 28 May 2003 (EC-8), the EU's language also became stronger:

> The EU recalls that all fiscal aid provisions, (for example those included in the VAT Law; the ***Law on customs duties exemptions*** - including benefits for transactions undertaken by firms located in industrial parks, free zones and ***disadvantaged areas*** […]) ***should be subject to the approval by the Competition Council. In cases where the Competition Council assesses the respective measures to be incompatible with the State aid rules, the EU invites Romania to either end the measures or to align them with the acquis.***
>
> The EU invites Romania to bring all incompatible aid measures in line with the acquis without delay and to continue to provide information on the progress made towards this goal. […]
>
> The EU moreover invites Romania to provide information on individual benefits granted in the free zones and the disadvantaged areas and on any other individual tax benefits that have already been granted and which provide for tax benefits beyond Romania's target date for accession. ***The EU urges Romania to close incompatible aid schemes for new entrants with immediate effect.***
>
> In this context Romania is further invited to present a ***plan outlining how it intends to convert the benefits that are incompatible with the acquis*** and to hold further technical consultations with the Commission to explore the possibilities for this conversion.
>
> […]
>
> With regard to aid which Romania wishes to operate beyond the date of accession, the EU recalls it's invitation to Romania to draw up a list of those existing aid measures which the Competition Council considers as compatible with the acquis and to transmit this list to the Commission. The EU recalls that Romania may continue to operate any aid which is included in the list and against which the Commission has not objected for the period for which the aid was approved by the Competition Council. A reference to the existing aid list and to the procedure for its establishment will be included in the Accession Treaty.
>
> The EU recalls that the ***existing aid measures*** are subject in accordance with Article 88(1) of the EC Treaty to the ***appropriate measures procedure***, under which the Commission can, in cooperation with the (future) Member State, propose changes to an aid measure for the future. To the extent that Romania wishes to benefit from this mechanism, the EU invites Romania to present the following to the Commission, every six months as from 1 January 2002, and up until the date of accession:
>
> (a) a list of all existing aid measures (both schemes and ad hoc aid) (i) which have been assessed by the Competition Council and (ii) which it found to be compatible with the *acquis*; (b) any other information which is essential for the assessment of the compatibility of the aid measures referred to under (a).
>
> Details on the precise format for this reporting have been provided by the Commission.
>
> The EU underlines that all aid measures in Romania which are considered State aid according to the acquis and which are not included in this list

> shall be considered as new aid upon Romania's accession. After that date, application of such an aid measure will be conditional upon Romania's notification of it pursuant to Article 88 of the EC Treaty, and a decision of the Commission that the aid measure in question is compatible with the Common Market. As regards individual aid, no measures which continue to have effects after accession and which are incompatible will be acceptable.
>
> (Emphasis added)

775. The Claimants argue that at this point the EU was still inviting Romania to "align" incompatible aid schemes, and the request for immediate termination was only for new entrants. They also argue that Romania could have included the EGO 24 scheme in the list of aid it wished to operate beyond accession.

776. The Respondent rejects these interpretations, arguing that, despite the "diplomatic language" used by the EU, the message was strong: Romania had to repeal the facilities as promptly as possible. Likewise, the EU's request that Romania "close incompatible aid schemes for new entrants with immediate effect" cannot negate other statements that made clear that such schemes had to be removed for all beneficiaries.

777. Although the EU had not expressly ordered, in so many words, that the EGO 24 scheme had to be terminated, at that point the message was clear for Romania. It appears that Romania interpreted that message to be diplomatic in language and adamant in substance. Mr. Orban testified that, from the technical consultations in 2003 "it was absolutely obvious [...] that for Custom duties exemptions there will be no, not at all, any chance to get, not only a transition period, but we were obliged to stop as soon as possible", and that "it was absolutely clear that for such kind of facilities, there is no room for manoeuvre" (Tr., Day 8, 229-230 (Orban)).

778. Nor could the revocation have been delayed until accession. Asked whether it would have been possible to keep the Raw Materials Facility until the entry into force of the Accession Treaty, Mr. Orban replied "[m]y clear answer is no. It was a very clear condition formulated by the Commission to stop, to repeal these facilities, the Customs duties exemptions, before the conclusion of the accession negotiation process" (Tr., Day 8, 232:6-9 (Orban)).

779. The Commission representatives confirmed during the hearing that the Commission's message was that the EGO 24 incentives had to be terminated:

> During the accession negotiations with Romania, the EU […] made clear through a number of common positions and other documents which we have submitted to this Tribunal that ***Ordinance No. 24/1998 involved illegal state aid and therefore would have to be revoked prior to accession***. In its reaction to this unambiguous position of the EU, Romania proceeded with the successive abolition of the incentives foreseen in the ordinance. (Tr., Day 5, 45 (Commission); Emphasis added)

780. Indeed, despite the difference in language in the EU's 2003 Common Position, the Commission representatives confirmed at the hearing that EGO 24 had to be terminated immediately both for existing and new entrants:

> So the EU does two things. It says, first of all: end your incompatible aid schemes, and that of course mean[s] also for existing entrants; but then the EU also says: stop them with immediate effect for new entrants, because of course allowing new entrants then creates further problems, deepens further the distortions of competition which arise from the scheme.
>
> So there are, in fact, several exhortations here. Now, this may all not seem very structured or logical; it's a diplomatic document which set out a number of desiderata that the Union had to formulate at the time towards Romania in the context of the accession negotiation. But I think the overall thrust is quite clear: the EU wanted that the aid scheme for disadvantaged areas be terminated. (Tr., Day 5, 156-157 (Commission))

781. Notwithstanding Mr. Orban's testimony, the record suggests that in early 2004 Romania was still attempting to prolong the incentives until the date of accession or negotiate transitional periods. In particular, in an interview on national television on 12 January 2004 (Exh. C-651), Prime Minister Nastase announced that the EGO 24 regime would be terminated due to EU requirements. However, he also stated that the Government was examining whether some of the incentives would remain in place until 2007, noting that the Government had negotiated some transition periods with the EU and that they were trying to find "elegant solutions." When asked to confirm if certain investors could benefit from the program until 2007, Minister Nastase stated that they would try to negotiate an agreement on that point. When asked what would happen to investors who had invested significant sums, the Minister stated that the Government was negotiating with each investor.

782. Notably, in its Complementary Position Paper III on Chapter 6 – Competition Policy dated 24 March 2004 (Exh. EC-9), Romania did not state that the EGO 24 regime would be terminated. Instead, it stated that PIC holders would be subject to maximum permitted intensity thresholds. Romania also highlighted that the EGO 24 incentives had been "significantly diminished" by the elimination of the Raw Materials Facility for the production, processing and preservation of meat. It also stated that investors who had obtained a PIC prior to 1 July 2003 would benefit from the Profit Tax Incentive, which would be grandfathered for the entire duration of the deprived area.[144] This suggests a final attempt by Romania to convince the EU that the EGO

[144] Specifically, Romania's Complementary Position Paper III on Chapter 6 – Competition Policy dated 24 March 2004 (Exh. EC-9) stated: "The Ministry of Administration and Interior elaborated a draft law for completing the Government Emergency Ordinance no. 24/1998 on the regime of deprived areas. The draft provides that the facilities the undertakings that have an investor certificate and operate in deprived areas benefit from, will be granted below the maximum admitted intensity foreseen in the Regulation on regional aid. At present, the draft normative act is under inter-ministerial endorsement procedure.

By entering into force of the Fiscal Code, the fiscal facilities have been significantly diminished. In fact, the undertakings with investor certificate in the deprived areas will benefit from the exemption from the payment of the taxes perceived for changing the destination or removing from the agrarian circuit of certain fields designated to achieving the investment as well as the exemption from the custom duties payment for raw materials and imported components, excepting the import of the raw material for meat production, processing and preserving. Also the undertakings that obtained before 1 July 2003 the permanent certificate of investor in the deprived area, will benefit from exemption from the profit tax payment related to the new investment, during the whole existing duration of the deprived area" (Emphasis added).

24 incentives could be aligned with the *acquis* without outright termination, or at least that the incentives could be prolonged until the date of accession.

783. Prime Minister Nastase confirmed this view in public statements. In an interview in Oradea, Bihor County in May 2004 (Exh. C-652), Prime Minister Nastase indicated that ***"[s]ubsequent to 2007***, when we want to be accepted in the European Union, these disfavored areas will no longer exist in Romania" (emphasis added). When asked about compensation to investors in those areas, the Prime Minister answered that Romania would discuss these matters during its negotiations with the European Union and they would see if Romania was "able to obtain some transition periods for them." The Prime Minister specified that "there will be no fiscal incentives, there will be some compensation packages, established during direct negotiations." The Prime Minister also stated that the Government would talk to the investors, and "based on the conclusions of the negotiations of the Competition Chapter, we will negotiate with those who initially obtained these fiscal incentives" (Exh. C-652, pp. 7-9 of translation).

784. However, by August 2004 Romania must have understood that no transitional periods or compensation packages were possible. On 31 August 2004, through GO 94/2004 (Exh. R-94), Romania repealed Article 6(1)(b)(d) and (e) of EGO 24/1998, thus revoking the incentives provided under EGO 24/1998, including the Raw Materials Incentive, with the exception of the Profit Tax Exemption. The repeal was originally to become effective 90 days from the date of entry into force of GO 94/2004 (that is, on 3 December 2004). However, the date of repeal was subsequently extended to 22 February 2005 by means of Law No. 507/2004 of 22 November 2004 (Exh. C-52), which approved and amended GO 94/2004.

785. Despite this strict position, Romania obtained certain concessions from the EU to the benefit of investors in the D-areas. Specifically, as previously mentioned, Romania was able to obtain (i) the grandfathering of the Profit Tax Exemption (for a maximum period of three years after accession), (ii) a delay of the repeal of the Raw Materials Facility until February 2005, and (iii) a favourable formula to calculate the maximum state aid intensity that investors could receive, which excluded from the cap aid received prior to 1 January 2001.

786. From the documentary and oral evidence described above, the Tribunal draws two broad conclusions. First, at the beginning of the accession negotiations Romania believed that the EGO 24 incentives were compatible state aid. This belief must have ended at least by 2002, when the Romanian government acknowledged in its report on the progress for accession that the EGO 24 regime constituted incompatible state aid and had to be converted into compatible state aid. However, only in mid-2003 did it become clear to Romania that the incentives must be revoked (see paragraph 777 above). That being said, it appears that by as late as May 2004 Romania still believed that it could negotiate transitional periods or compensation packages.

787. As acknowledged by Romania's expert in EU competition law, Mr. Petersen, Romania's belief that the EGO 24 regime constituted compatible state aid was incorrect, but it was not unreasonable:

> Q. [D]o you have any opinion on whether Romania thought as of 1999 that EGO 24 was fully compliant with its obligations under the Europe agreement?
>
> A. I have no knowledge about it. But I could understand that they have a certain good faith, I'm not doubting the good faith, because they were pursuing an objective which was definitely in line with the European Community's cohesion objective.
>
> Q. Do you think that view of the Romanian Government as of that time would have been reasonable?
>
> A. As to that policy, yes […].
>
> (Tr., Day 6, 111 (Smith/Petersen)).

788. Second, it is plain that Romania revoked the incentives in order to comply with EU competition regulations and, in particular, to obtain EU accession. Romania would not have been able to sign the Accession Treaty in 2005 if it had not brought the incentives into compliance with EU competition law. Although it is true that there does not appear to have been an official determination from the European Commission that the incentives constituted incompatible state aid, by mid-2003 it should have been quite clear to the Romanian government that the EGO 24 incentives were impermissible state aid under EU standards.

789. The EU did not explicitly order the revocation of the incentives in the Common Positions; rather, it requested the *alignment* of incompatible state aid regimes (such as EGO 24). However, Mr. Orban testified that in 2003 it became absolutely clear that this was the EU's position, and this was confirmed by the Commission. Indeed, the Commission confirmed during the hearing that, in its view, EGO 24 constituted incompatible state aid:

> Emergency Ordinance 24/1998 involved state aid which was not compatible with EU rules on regional aid. In particular, the various measures did not respect the basic EU rules on eligible costs, which exclude in particular that mere operating costs may not be compensated. Moreover, the limits on maximum aid intensities were not respected either. (Tr., Day 5, 45:10-16 (Commission)).

790. The Commission representatives also explained at the hearing that, because the Raw Materials Incentive constituted operating rather than investment aid, it could not have been transformed into compatible aid without substantially changing their nature. In response to questions from the Tribunal, the Commission testified as follows:

> THE PRESIDENT: […] Is there any way to read EGO 24/1998 specifically with respect to the raw material duty, Customs duty exemption which would make it compatible with EU law now?
>
> A. (By PROFESSOR MARTENCZUK) I find that somewhat difficult to see. There are, of course, various grounds in EU law which allow state aid to be

declared compatible. These grounds are contained in Articles -- today they are Article 107, paragraphs 2 and 3, of the Treaty on the Function of the European Union; at the material time, they were paragraphs 2 and 3 of 87 of the EC treaty.

Essentially you need to have a legitimate objective. Such a legitimate objective could, of course, be, for instance, to further regional development. The EU has rules under which member states can grant aid to help the regional development of certain defined particularly disadvantaged regions. And presumably many of the regions in Romania that are at issue here qualify as such areas; that's not contested.

However, in general the EU, as a matter of competition policy, has formulated limits to that. One of these limits is, for instance, that regional aid should always be granted in the form of investment aid. The reason for that is that it is felt that aid towards investment creates a more durable effect in the development of the underdeveloped region than aid which purely goes towards operating cost. It alleviates an undertaking which otherwise may already be there, and operating maybe inefficiently, of its normal running costs.

It would seem to me that one of the problems precisely with the exemptions that were at issue here is that they essentially are operating aid: they alleviate the undertaking from operating costs. And therefore I think it would have been very difficult to find a ground on which to find these aids compatible, and that is -- and that also doesn't seem to have been, in the end, pursued in the accession negotiations.

THE PRESIDENT: I just want to make clear. You said it would have been very difficult, and I will come back to that question, but much later.

My question right now is: right now, would it be possible, if the Romanian State just for any reason was to enact right now EGO 24/1998, which would be called EGO something/2010, would there be any way to read it which would make it compatible with the EU law now?

A. (By PROFESSOR MARTENCZUK) Unfortunately I am not here in the company of our competition law experts from DG Competition who might be able to provide more direct expertise on that. But my tentative response would be: probably not.

(Tr., Day 5, 158-160 (Tribunal/Commission)).

791. In response to further questions, the Commission added:

THE PRESIDENT: […] Taking Professor Alexandrov's question [on the possibility of redress for investors], what would have been your answer if -- if it had been possible to consider that the goal of the investment was compatible? That is the contrary, I think he said incompatible, and really what I was also interested in is knowing: what if it had been compatible?

A. (By PROFESSOR MARTENCZUK) Well, if the aid scheme by its nature had been such that it was compatible with – or capable of being compatible with EU law, then the correct approach for Romania would have been to include it in the list of compatible existing aid schemes which were adopted at the time of the accession treaty, and which in fact constitutes, if you like, the list of grandfathered existing aid schemes which the Commission sometimes under a number of conditions allows, and which may continue to be applied by Romania without requiring any further -- a new approval by the Commission which would otherwise be necessary.

> Now, however, because of the characteristics of the aid scheme, and with the exception of the profit tax exemption, Romania made no -- as far as I am aware, at least, made no such request, and that's why – and probably if it had made such a request, given the characteristics of the scheme, it would not have been agreed in the context of the accession negotiations.
>
> And that's why, if you like, these aid schemes did not find themselves on the positive list unless [*recte:* unlike] other schemes.
>
> THE PRESIDENT: Such kind of incentive as the Customs duties exemption on the import of raw material, is it totally incompatible with European law, even if it's for disfavoured areas and for a limited duration?
>
> A. (By PROFESSOR MARTENCZUK) I would believe that it would be, I'm at least not aware of any examples of such types of aid. There may be -- there may be specific rules, but I would -- that is something I would have to verify for -- there are some more specific regimes for what is called the ultra-peripheral regions of the European Union. This is for instance the DOM-TOM français, and so forth. For ultra-peripheral regions --
>
> THE PRESIDENT: Angola?
>
> A. (By PROFESSOR MARTENCZUK) For those regions, there are in fact possibilities to grant under more lenient conditions operating aid. I have a suspicion that you might find things there. But that's really just for those specific regions, and the regions that we are talking about here in Romania don't fall under any specific category.
>
> (Tr., Day 5, 173-175 (Tribunal/Commission)).

792. Other than these last comments, neither in its submission nor at the hearing did the Commission explain why the EGO 24 incentives could not have been covered by an exception to operating aid requirements under the 1998 Community Guidelines on Regional Aid (Exh. RJ-9). As noted above, both sides' experts agree that, as an underdeveloped region in meaning of Article 87(3)(a) of the EC Treaty, Romania could have been exceptionally allowed to grant operating aid.

793. The Tribunal cannot speculate as to why the Commission refused to consider the EGO 24 regime as permissible operating aid under the 1998 Community Guidelines on Regional Aid. The fact is that the EU (in particular, the Commission) wanted the EGO 24 regime terminated, and this termination was made a pre-condition for accession.

794. It also seems clear that Romania could not have included the EGO 24 incentives in the list of aid it wished to operate beyond accession. In its 2001 Common Position the EU invited Romania to submit "a list of those existing aid measures which the Competition Council considers as compatible with the *acquis*", stating that "Romania may continue to operate any aid which is included in the list and against which the Commission has not objected for the period for which the aid was approved by the Competition Council." It then reiterated this invitation in its 2003 Common Position. However, as is evident from the language of that invitation, for any state aid to be included in this list, it had to be approved by the Competition Council, and such approval was not given for the Raw Materials Incentive. The Commission confirmed

that this was probably the reason why Romania had not made this request (Tr., Day 5, 174 (Commission)).

795. Finally, the Tribunal notes that the Substantiation Note accompanying the repeal of the EGO 24 incentives stated that

> In order to meet the criteria in the Community rules on state aid, and also to complete the negotiations under Chapter No. 6 – Policy it is necessary to eliminate all forms of State aid in national legislation incompatible with the *acquis communautaire* in this area and, in this respect, it is proposed to repeal […] the provisions of Article 6 paragraph (1), letter (b), letter (d) and letter (e) of the Emergency Government Ordinance no. 24/1998 on the disadvantaged areas […]
>
> (Substantiation Report accompanying EGO 94/2004, 26 August 2004, Exh. R-95, pp. 12-13).

796. Under those circumstances, it is clear that Romania was under considerable pressure from the EU to terminate the EGO 24 regime. Thus, there is no doubt in the Tribunal's mind that Romania's repeal of the EGO 24 incentives was motivated by the EU's demands.

ii. The Claimants' specific allegations of unreasonable conduct

797. The Tribunal will now turn to the question of whether, in pursuit of its objective to join the EU, Romania acted reasonably and, in that context, will address the Claimants' specific allegations of unreasonable conduct.

(a) The Claimants' allegation that Romania actively promoted and extended the EGO 24 regime, while at the same time negotiating for the scheme's early termination

798. The Claimants first argue that Romania acted unreasonably by actively promoting and extending the EGO 24 regime, and (at least until 2003) encouraging investors to participate in that scheme, while at the same time it was negotiating for the scheme's early termination.

799. The Tribunal rejects this argument. As discussed above the record shows that, until mid-2003, Romania believed that the incentives were compatible with EU law and believed they could be maintained after accession. The record suggests that, after realizing that the incentives were incompatible aid, Romania tried to maintain the incentives for as long as possible, but there is no evidence to suggest that during that period after mid-2003 it actively promoted the regime. Romania has not been able to establish clearly when or how it began to inform stakeholders that the incentives would be terminated, but Mr. Orban confirmed that the public should have known at least by May 2004. This is consistent with the fact that Prime Minister Nastase announced the termination of the scheme in January and May 2004.

800. Accordingly, the record shows that Romania did not at the same time promote the EGO 24 regime and seek its early termination. During the time it promoted the regime, it sought to maintain the incentives. After it became clear that this would not

be acceptable to the EU, it announced that the incentives would be revoked. Thus, the factual basis for the Claimants' allegation is incorrect.

(b) The Claimants' allegation that Romania revoked the incentives regime prematurely, without being required to do so by any competent legal authority and without attempting to mitigate damages

801. The Claimants also argue that it was unreasonable for Romania to revoke the incentives regime prematurely without being required to do so by any competent legal authority, without attempting to negotiate with the EU or the Claimants to mitigate the damages caused by the revocation, and in contradiction of its repeated statements over the years that the regime was legal and satisfied EU requirements.

802. The Tribunal rejects this argument. Applying the standard enunciated in paragraph 525 above, the Tribunal does not find that Romania acted unreasonably. Romania did not act arbitrarily; to the contrary: it is evident that Romania's repeal of the EGO 24 incentives was done in response to conditions imposed by the EU for accession. It is true that the EU did not explicitly order the revocation of the incentives; rather, it requested the alignment of incompatible state aid regimes (such as EGO 24) with the *acquis*. However, as discussed above, the EU's demand must be interpreted as a request for termination of the incentives as a pre-condition for accession, and Romania understood that sometime in 2003. Thus, the repeal of the EGO 24 incentives was reasonably related to a rational public policy objective (i.e., EU accession), and there was an appropriate correlation between that objective and the measure adopted to achieve it (i.e., the repeal of the EGO 24 incentives). However, as will be seen, it does not follow of necessity that such repeal was fair and equitable to the Claimants.

803. As to the Claimants' argument that this termination was not ordered by a "competent legal authority", the demands were issued by the Commission on the behalf of the EU itself during accession negotiations. Given Romania's goal of accession, it was not unreasonable for Romania to comply with the EU's demands, even if such demands were not formally issued by a "competent legal authority" if that should have been the case. Even if the Claimants were correct as a matter of law that the termination was not ordered by a competent legal authority, it is not for this Tribunal to decide whether Romania properly understood the point at the time or whether it would have been opportune for Romania to raise the point in its negotiations with the EU.

804. Indeed, the "competent legal authority" appears to have been the Romanian Competition Council, which did in fact recommend the revocation of the Raw Materials Incentive in Decision 244/2000. The Claimants (relying on Prof. Dashwood) have argued that, from a procedural standpoint, during the pre-accession regime only Romania (and not the European Commission) had the competence to determine which forms of state aid qualified as permissible state aid (Tr., Day 1, 178-179 (Gaillard); ER of A. Dashwood, ¶ 25). This appears also to have been the position of the EU, which in its Common Positions repeatedly stated that the determination of whether aid was compatible with the *acquis* depended on the local Competition

Council. It is unclear whether Decision 244/2000 was premised on EGO 24's incompatibility with EU law (indeed, the decision makes no mention of EU law at all). However, to the extent that the Claimants argue that Romania eliminated the Raw Materials Incentive without a finding by a "competent legal authority", they may be technically incorrect.

805. What matters, however, is that, both at the EU and Romanian levels, there was some exhortation to end the EGO 24 scheme because of its capacity to distort competition. This, in addition to the fact that revocation of the Raw Materials Incentive was a pre-condition for accession, shows that Romania's decision to repeal the EGO 24 incentives was not irrational, arbitrary, or based on preference. It was a decision logically related to, narrowly tailored, and necessary for, the pursuit of a legitimate and rational policy.

806. The Claimants also contend that it was unreasonable for Romania to revoke the incentives without attempting to negotiate with the EU or the Claimants to mitigate the damages caused by the revocation. It is true that there is no convincing evidence that Romania tried to negotiate alternative solutions with the EU, such as a delay in the revocation date, a transition period, or payment of compensation. However, as became abundantly clear at the hearing, it would have been extremely difficult (perhaps even impossible) to obtain agreement from the EU on any of these alternative solutions.

807. First, the EU would not have allowed the revocation to be delayed until the date of accession. The Commission representatives testified that the Commission's unambiguous message was that "Ordinance No. 24/1998 involved illegal state aid and therefore would have to be revoked ***prior*** to accession" (Tr., Day 5, 45 (Commission), emphasis added). As mentioned above, when he was asked whether it would have been possible to keep the Raw Materials Facility in place until the entry into force of the Accession Treaty, Mr. Orban replied "[m]y clear answer is no. It was a very clear condition formulated by the Commission to stop, to repeal these facilities, the Customs duties exemptions, before the conclusion of the accession negotiation process" (Tr., Day 8, 232 (Orban)). He also testified that the Commission was very displeased when Parliament delayed the repeal of the Raw Materials Facility to February 2005 (*Id.*).

808. Second, the EU would not have accepted a transitional period or grandfathering for the Raw Materials Incentive. The Commission confirmed at the hearing that to operate incompatible state aid beyond accession, Romania would have required a special provision in the Accession Treaty itself (Tr., Day 5, 90-91 (Gaillard/Commission)). The Commission also confirmed that, because of the characteristics of the EGO 24 scheme, grandfathering any facility other than the Profit Tax Exemption "would not have been agreed in the context of accession negotiations" (Tr., Day 5, 174 (Commission)). As noted above, Mr. Orban testified that, from the technical consultations in 2003 "it was absolutely obvious [...] that for Custom duties exemptions there will be no, not at all, any chance to get, not only a transition period, but we were obliged to stop as soon as possible", and that "it was absolutely clear

that for such kind of facilities, there is no room for manoeuvre" (Tr., Day 8, 229-230 (Orban)).

809. There is some logic to the Commission's inflexibility, at least with respect to transition periods beyond accession. The Respondent is right in that, because of the very nature of the Raw Materials Facility, grandfathering it would have created a "hole in the wall" around the Customs Union. This would only have been the case after accession, not before. However, the Tribunal is not assessing whether the Commission was being reasonable when it imposed these conditions; the Tribunal's mandate is to determine whether Romania acted reasonably in the factual context in which it found itself.

810. Third, Mr. Orban and the Commission confirmed very clearly that any compensation paid to PIC holders would have been seen as incompatible state aid, and the Commission would have requested its reimbursement (Tr., Day 5, 45-46 (Commission); Day 8, 216-217 (Orban)). Thus, the Commission and Member States would not have agreed to the payment of compensation to PIC holders.

811. Given Romania's uncertain chances to obtain any of these alternative arrangements, its lack or, at least, weakness of bargaining power before the Commission, and the Commission's inflexible stance, the Tribunal does not find that it was unreasonable for Romania to revoke the incentives without making more efforts to maintain them. In addition, a negotiation involves many considerations and trade-offs. It is not for a Tribunal subsequently to second-guess decisions which are within the realm of diplomatic bargaining if there are no objective circumstances allowing and requiring such an evaluation.

812. Finally, the Tribunal finds that any contradiction in Romania's statements as to the legitimacy of the EGO 24 regime or its compatibility with EU state aid regulations in the earlier years of the accession process was based on a good faith lack of knowledge and an overly optimistic initial assessment of its bargaining power vis-à-vis the EU.

(c) The Claimants' allegation that Romania revoked the benefits of the incentives regime for investors, while maintaining the investors' obligations under that regime

813. The Claimants argue that it was unreasonable for Romania to revoke the benefits of the incentives regime for investors like the Claimants, while preserving the investors' obligations under that regime, in particular the obligation to maintain the investments for twenty years.

814. There is some dispute among the parties as to the content and length of this obligation. The Claimants argue that under Articles 7 and 9 of EGO 24 (republished version of November 1999, Exh. R-68) investors were required to maintain their investments for twice the period during which they benefitted from the incentives provided under EGO 24. However, relying on Article 1(f) of the 2001 Methodological Norms (GD 728/2001, Exh. R-69), the Claimants argue that the period in which an

investor is deemed to have benefitted from the incentives, for purposes of Articles 7 and 9 of EGO 24, is calculated as "the period between the moment when the certificate of investor in the disfavoured area was obtained and the moment when the disfavoured area ceases to exist."

815. Because Articles 7 and 9 of EGO 24 have not been repealed, and because the revocation did not affect the Profit Tax Exemption, the Claimants argue that European Food must maintain its investments until 2018. They argue that this was confirmed by both Prof. Baias and Prof. Mihai. In this respect, the Claimants argue that "Romania has acted like it did [the Claimants] a big favour by leaving the profit tax exemption in place until 2009, but in reality that was what enabled Romania to keep the obligations on [the Claimants] in place for eight years longer than they would have been otherwise if Romania had simply revoked all the incentives in early 2005." As a result, the Claimants "are effectively hostage in the [Ştei-Nucet-Drăgăneşti] region and they will be until 2018 or until they go bankrupt" (Tr., Day 12, 41-43 (Fleuriet)).

816. The Claimants further allege that Romania is still monitoring their compliance with EGO 24 to this day, and "still carrying out audits and inspections to make sure that Romania gets its benefit from its side of the bargain in terms of employment" (Tr., Day 12, 43 (Fleuriet)). In any event, the Claimants argue that, due to the nature of their investments, they cannot simply move them to another area of Romania (Tr., Day 12, 40-44).

817. In its Post-Hearing Brief, Romania argued that it "has repeatedly stated that the obligation does not exist and that (therefore) it has no intention of enforcing it." As the alleged 20-year obligation is non-existent, Romania argues that there is no merit to the Claimants' assertion of unfairness (R-PHB, ¶ 120).

818. However, Romania took a different position in its closing argument. First, it argued that the Claimants are not hostages in the Ştei-Nucet-Drăgăneşti region; they can leave whenever they wish. It explained that "the obligation is to repay the value of exemptions that have been received if a decision is made by an investor voluntarily to leave the deprived area", and that "[t]he state is not empowered to force a business to stay in the deprived area, nor does it wish to do so." Thus, "[t]his a business decision to be made by an individual investor"; "[i]t is just a money decision" (Tr., Day 13, 128-129 (Petrochilos)).

819. Second, relying on Prof. Baias, Romania argued the period for which the investments must be maintained is twice the period in which the investor actually enjoyed the facility, not twice the period between the issuance of the investment certificate and the termination of the designation of the region as disfavored. In this respect, the Respondent noted that the Claimants have conceded that they stopped receiving the Profit Tax Exemption in 2006 (ref. to Tr., Day 12, 42 (Fleuriet)). In any event, the Respondent argued that Claimants' arguments are irrelevant, because the Claimants have never sought to leave Bihor county (as confirmed by Mr. Ban, Tr., Day 9, 13), and thus they have never been threatened by an obligation to repay the benefits they have received (Tr., Day 13, 131-2 (Petrochilos)).

820. The Parties agree that the obligations set forth in Articles 7 and 9 of EGO 24 have not been repealed. Despite Romania's initial allegation that the obligation does not exist, Prof. Baias confirmed at the hearing that some form of obligation to maintain investments did indeed exist. His position was that the period for which investors were obliged to stay in the disfavored area was twice the period during which they had actually benefitted from the program (Tr., Day 5, 267-273).

821. Articles 7 and 9 of EGO 24 provide:

> ART. 7
>
> In the situation in which ***an investment*** that benefits [sic] from the provisions under the present expeditious ordinance ***is voluntarily liquidated in a period smaller than double the period in which it had enjoyed the facilities*** granted by the Government decision for the setting up of the deprived zone, ***the liquidator/liquidators shall compulsorily pay***, with priority, to the state budget, to the state social insurance budget and to the special funds budgets ***the amounts of money relating to the facilities*** granted in accordance with the provisions under the present expeditious ordinance, from the amounts of money resulting from the liquidation.
>
> ART. 9
>
> The trading companies set up in a deprived zone ***may voluntarily cease their activity in the respective zone***, and those that open branches with legal personality in such a zone may liquidate them or change their head-office from the deprived zone, ***in a shorter period than the one provided under Art. 7, only under the sanction of paying the debts*** to the state budget, state social insurance budget and special funds budgets, ***relating to the facilities*** granted in accordance with the provisions of the present expeditious ordinance.
>
> (Emphasis added)

822. In turn, Article 1(f) of the 2001 Methodological Norms (GD 728/2001, Exh. R-69) defines:

> f) the period in which it benefited from the facilitations granted by the Government Decision designating the area as disfavored, as specified under Art. 7 and 9 of the ordinance - the period between the moment when the certificate of investor in the disfavored area was obtained and the moment when the disfavored area ceases to exist; in the case of the provisional certificate of investor, followed by the procurement of the certificate of investor in disfavored area, the period is calculated from the moment the provisional certificate of investor is obtained until the disfavored area ceases to exist;

823. Prof. Baias insisted that Article 1(f) of the 2001 Methodological Norms contradicted the higher norm, which was Article 7 of EGO 24, and thus in his opinion the 2001 Methodological Norms should be ignored on this point.

824. The Tribunal does not find that the duration of the Claimants' obligation makes in itself a difference for purposes of assessing the reasonableness of Romania's conduct. The point is that Romania repealed the Raw Materials Incentive while at the

same time maintaining all of the Claimants' obligations under the scheme, including the obligation to maintain their investments for twice the period they received the incentives, or twice the period between the issuance of the certificate and the end of period in which the region is designated as disfavored, depending on the interpretation. The Tribunal finds that either scenario is unreasonable. The obligation to maintain investments had no rational justification after the incentives were terminated. The survival of the Profit Tax Exemption is not sufficient justification for the maintenance of investments made in reliance on the legitimate expectation that customs duties exemptions such as the Raw Materials Incentive would be available, just as the Profit Tax Exemption would not have been sufficiently attractive on its own to encourage investment in the disfavored region. Indeed, the maintenance of the Profit Tax Exemption ensured that, despite the absence of the Raw Materials Incentive, the Claimants would continue to be tied to the EGO 24 regime for as long as they made a profit. And, as the Claimants argue, the Profit Tax Exemption would have been useless for companies not making a profit, which could easily have been the case for businesses premised on the existence of operating aid such as the Raw Materials Incentive.

iii. Conclusion

825. For the reasons stated above, the Tribunal finds that, with one exception, Romania did not act unreasonably. Romania's decision to revoke the incentives was reasonably tailored to the pursuit of a rational policy (specifically, EU accession), and there was an appropriate correlation between that objective and the measure adopted to achieve it (i.e., the repeal of the EGO 24 incentives). The question is whether Romania could have negotiated a transition period for the incentives or their conversion into compatible aid. However, even if it could have done more, but failed to do so, objectively speaking the Tribunal does not find that it acted unreasonably. Even if Romania could have done more to maintain the incentives, its failure to negotiate transitional periods or compensation was not arbitrary, but appears justified under the specific circumstances of the accession negotiations.

826. The exception to this conclusion was Romania's decision to maintain the investors' obligations despite the repeal of the incentives. It is not for this Tribunal to say what would have been the right decision (i.e., possibly shortening the period or diminishing in other ways the obligations imposed upon the investors), but it was not reasonable for Romania to maintain as a whole the investors' obligations while at the same time eliminating virtually all of their benefits.

827. In other words, with the exception noted in the preceding paragraph, Romania's repeal of the incentives was a reasonable action in pursuit of a rational policy. That being said, this conclusion does not detract from the Tribunal's holding in Section 3(c) above that Romania undermined the Claimants' legitimate expectations with respect to the continued availability of the incentives until 1 April 2009. As a result, Romania's actions, although for the most part appropriately and narrowly tailored in pursuit of a rational policy, were unfair or inequitable vis-à-vis the Claimants. In

addition, the Tribunal finds that Romania could have been more transparent with PIC holders, as discussed in Section 6 below.

5. Did Romania act in bad faith?

828. The Tribunal now turns to the Claimants' arguments on bad faith.

a. The Parties' positions

829. The Claimants argue that Romania breached its fair and equitable treatment obligation by acting in bad faith when it repealed the EGO 24 incentives. Specifically, the Claimants argue that "Romania acted in bad faith by (1) reneging on its oft-repeated defense of the legality of the incentives regime within the EU accession framework by ultimately revoking the incentives prematurely without a decision from any competent legal authority requiring it to do so; (2) neglecting to negotiate with the EU in order to secure an exception to any potentially-violated State aid rules; (3) failing to negotiate with Claimants in order to protect them from premature revocation of the incentives regime via measures that would be acceptable to the EU; and (4) reaping the benefits from Claimants' investments in the Stei-Nucet-Drăgăneşti disadvantaged region, and in particular accepting fulfillment of Claimants' various obligations under the incentives program as described above, before revoking the incentives four years before the promised date, refusing to compensate Claimants, and thereby failing to fulfill its own obligations under the program" (C-Reply, ¶ 449).

830. The Respondent does not directly address the Claimants' arguments on bad faith. However, the Tribunal presumes that the Respondent's arguments as to the reasonableness of its actions (as discussed in Section 4 above) are applicable.

b. The Tribunal's analysis

831. Good faith is a standard that is flexible. A requirement of good faith is prevalent in all fields of the law and will arise in various matters, such as the interpretation of treaties (Article 31 of the VLCT), the prohibition to abuse rights, and the protection of legitimate expectations. As such, it eludes any strict definition. However, as a minimum, good faith would require that any party would not consciously conduct itself in such a way that should contradict the implications of that party's earlier behavior, a concept akin to the prohibition of estoppel.

832. The concept of bad faith is likewise difficult to define with precision. Black's Law Dictionary defines bad faith as "dishonesty of belief or purpose."[145] The commentary to Section 205 of the American Law Institute's *Restatement (Second) of Contracts* (1981) states with respect to good faith in the performance of an obligation:

> *d. Good faith performance*. Subterfuges and evasions violate the obligation of good faith in performance even though the actor believes his conduct to be justified. But the obligation goes further: bad faith may be overt or may consist of inaction, and fair dealing may require more than honesty. A

[145] Black's Law Dictionary, Ninth Edition (2009), p. 159.

> complete catalogue of types of bad faith is impossible, but the following types are among those which have been recognized in judicial decisions: evasion of the spirit of the bargain, lack of diligence and slacking off, willful rendering of imperfect performance, abuse of a power to specify terms, and interference with or failure to cooperate in the other party's performance.[146]

833. In the treaty context, Bin Cheng notes that "[t]he principle that treaty obligations should be fulfilled in good faith and not merely in accordance with the letter of the treaty has long been recognised by international tribunals and is reaffirmed by the United Nations as an 'act of faith.'"[147] Similarly, citing a string of investment arbitration cases, the *Europe Cement* tribunal noted that "it is well accepted in investment arbitrations that the principle of good faith is a principle of international law applicable to the interpretation and application of obligations under international investment agreements."[148]

834. According to Bin Cheng, "[p]erformance of a treaty obligation in good faith means carrying out the substance of this mutual understanding honestly and loyally."[149] International investment tribunals confirm this interpretation. For instance, in *Canfor and Terminal Forest v. USA*, the tribunal stated that "a fundamental principle of international law that States Party to a treaty must perform treaty obligations in good faith and, therefore, would not intentionally take steps that would undermine performance of those obligations."[150] Similarly, the *Waste Management II* tribunal held that "[a] basic obligation of the State under Article 1105(1) [which sets out NAFTA's minimum standard of treatment] is to act in good faith and form, and not deliberately to set out to destroy or frustrate the investment by improper means."[151]

835. The Tribunal notes that the Claimants' allegations of bad faith are virtually identical to their arguments with respect to Romania's allegedly unreasonable conduct. The Tribunal understands that the difference between both sets of allegations is that the Claimants are arguing here that not only was Romania's conduct unreasonable (i.e., not justified by the reasonably tailored pursuit of a rational objective), but that it was intentional or at least conscious in its unreasonableness.

836. The Tribunal has already found that Romania's conduct was, with one exception, a reasonable action in pursuit of a rational policy. But even with respect to that one

[146] Restatement (Second) of Contracts § 205 cmt. d (1981).

[147] Bin Cheng, General Principles of Law as Applied by International Courts Tribunals (1953, 2006), p. 114.

[148] *Europe Cement Investment & Trade S.A. v. Republic of Turkey* (ICSID Case No. ARB(AF)/07/2), Award, 13 August 2009 (hereinafter *"Europe Cement v. Turkey" or "Europe Cement"*), ¶ 171, citing *Amco Asia Corporation and others v. Republic of Indonesia* (ICSID Case No. ARB/81/1), Award, 20 November 1984; *Plama v. Bulgaria*; *Inceysa Vallisoletana S.L. v. Republic of El Salvador* (ICSID Case No. ARB/03/26), Award, 2 August 2006; *Phoenix Action Ltd v. Czech Republic* (ICSID Case No. ARB/06/5), Award, 15 April 2009.

[149] Bin Cheng, p. 115.

[150] *Canfor Corporation v. United States of America, Tembec Inc. et. al. v. United States of America* and *Terminal Forest Products Ltd. v. United States of America*, UNCITRAL, Decision of on Preliminary Question, 6 June 2006.

[151] *Waste Management v. Mexico II*, ¶ 138.

exception (maintaining investors' obligations after terminating the incentives), the record does not include any indication that Romania acted in bad faith. Accordingly, the Tribunal rejects this argument.

6. Did Romania fail to act transparently or consistently?

837. The Tribunal now turns to the Claimants' allegation that Romania failed to act transparently or consistently.

a. The Claimants' position

838. In addition to failing to provide stability of the legal framework and violating their legitimate expectations, the Claimants argue that Romania breached its obligation to accord fair and equitable treatment by acting in a manner that was not transparent or consistent (C-SoC, ¶¶ 229-241; C-Reply, ¶¶ 440-442; C-PHB, ¶¶ 51-62). The Claimants argue that this was acknowledged by Romania's own witness, Mr. Orban (Tr., Day 8, 208-209, 221 (Orban)).

839. Specifically, the Claimants contend that Romania acted in a manner that was not transparent by actively pursuing two conflicting policies: on one hand, it promoted the EGO 24 incentives, and at the same time it negotiated their revocation behind closed doors. The Claimants allege that, at least until 2003, Romania actively promoted and supported the EGO 24 regime (as evidenced by the Government and Parliament's disagreement with the Competition Council on Decision 244 and the adoption of the Methodological Norms). However, at the same time Romania was secretly negotiating the revocation of these incentives. The Claimants also assert that there is no evidence that the government met with the Claimants to inform them that the incentives were likely to be prematurely revoked.

840. The Claimants further submit that Romania acted inconsistently when it repeatedly proclaimed that the incentives were compatible with the requirements of the *acquis*, but ultimately decided to revoke them prematurely based on their alleged incompatibility with those same requirements. The Claimants also allege that officials within the Romanian government took inconsistent positions with respect to the compatibility of EGO 24 with EU law. According to the Claimants, as explained above the evidence suggests that until 2004 Romania thought that EGO 24 was permissible state aid under EU law.

841. In addition, the Claimants argue that the manner in which Romania revoked the incentives created uncertainty. The Claimants state that the incentives were subject to a string of contradictory measures that repealed some of the incentives, partially reintroduced some of them, and then repealed them again. In particular, the Claimants note that Romania repealed the incentives from EGO 24, but it did not amend GD 194/1999, which states that investors in the Ştei-Nucet-Drăgăneşti region will benefit from the incentives for ten years. The Claimants argue that this led to insecurity and confusion, and as a result the investors could not plan their business in a rational way.

842. In any event, the Claimants contend that Romania did not align its measures with the various goals and policies behind EGO 24 and similar incentives programs granted to investors over the years (which pursued the goals of attracting capital, reducing unemployment, etc). In that context, the Claimants invoke *Tecmed*, as quoted in paragraph 534 above.

b. The Respondent's position

843. The Respondent denies that Romania treated the Claimants' investments in an inconsistent and non-transparent manner (R-PHB, ¶¶ 160-184).

844. As noted above, the Respondent understands that the transparency and consistency "strand" of the fair and equitable treatment standard requires Romania to comply with due process and fair administration. In particular, it means that Romania should conduct itself in such a way that investors are able to find out what the rules are and how to comply with them, and the rules should be administered in an even handed and reasonably consistent fashion.

845. However, the Respondent argues that the situation here is different. The Claimants do not contend that Romania was unclear about the rules and procedures they had to follow, or that the rules were applied inconsistently. Rather, the Claimants contend that they were not given enough information about ongoing diplomatic negotiations. According to the Respondent, international investment law does not require a state to disclose its assessment of the likely outcome of such negotiations. As a result, the Respondent argues that "the Claimants' contentions are not only irrelevant as a matter of law but illogical as a matter of fact: if, as the Claimants seemed to suggest at the hearing, Romania should have publicly announced at the earliest possible date that it did not expect to obtain the EU's agreement to continue the EGO Facilities in force, the only possible difference is that the Claimants would have lost the benefit of the Facilities sooner" (R-Rejoinder, ¶ 161). Likewise, the Respondent argues that there is no need to warn investors of legislative changes (*Parkerings*, ¶ 345).

846. The Respondent also contends that the Claimants' consistency and transparency allegations fail on the evidence. It asserts that Romania's conduct "was entirely fair and reasonable, particularly in a context in which its negotiating partners insisted on a degree of confidentiality and there were—legitimately and unsurprisingly—differing views among different government officials and constituencies as to the best approaches and the most likely outcomes" (R-PHB, ¶ 162). In any case, the Respondent argues that the Claimants knew or should have known (given their duty to conduct due diligence, and given their alleged strong political connections) that the future of the facilities was uncertain. The Respondent also denies that the Claimants were in fact misled by any of the supposedly inconsistent or non-transparent Government statements or omissions.

847. More specifically, Romania argues that (i) its balancing of confidentiality and openness was reasonable, (ii) it complied with any standard of consistency or transparency that could reasonably be imposed in the context of complex or politically

sensitive legislation and negotiation, and (iii) it was common knowledge that the facilities were vulnerable.

i. Romania's balancing of confidentiality and openness was reasonable

848. Romania asserts that some measure of confidentiality and discretion was necessary during the accession negotiations. Romania alleges that this discretion was important "if Romania was to have any hope of obtaining transitional provisions or delayed repeal of the Facilities", but also to comply with confidentiality conditions imposed by the EU. In this regard, Mr. Orban testified that

> We tried to inform as much as possible, but in a discreet way, because we were bound by the clear conditions of conducting accession negotiation process not to express publicly some of the conclusions which were already derived at that time from the negotiations with the Union (Tr., Day 8, 233 (Orban)).

849. Despite the confidentiality constraints imposed by the EU and the need to protect its bargaining position, Romania argues that it pursued a policy of openness. It asserts that the government disseminated information about its progress through governmental websites, the Official Gazette and national media, including detailed reports on the country's progress towards accession. Although the Claimants may criticize the way Romania made information available, Romania contends that the legislative process need not be perfect nor perfectly transparent (*AES v. Hungary,* ¶ 9.3.73).

850. Relying on Mr. Orban's testimony, the Respondent argues that "from the technical consultations in 2003, it was absolutely clear that for such kind of facilities [customs duty exemptions] there is no room for manoeuvre" (Tr., Day 8, 229-230 (Orban)). This conclusion was announced gradually rather than immediately to different stakeholders (mainly through non-public discussions) because Romania was "not in a position to make a public statement" (Tr., Day 8, 230 (Orban)). Romania argues that, as the EU's opposition to the facilities became increasingly apparent, Romania "sought to convey this information to stakeholders in a way that would not undermine its negotiating position with the Commission and Member States" (Tr., Day 8, 223-224 (Orban)).

851. In particular, the Respondent asserts that the Competition Council organized extensive discussions with stakeholders and provided them with copies of state aid documents, such as the EU guidelines on regional aid. With respect to the Claimants' suggestion that the Miculas had not been included in these discussions, Romania argues that it is implausible that businessmen with the Miculas' level of political access and experience could have been deprived of information made available to smaller stakeholders, or that they would not have insisted on being privy to that information. The Respondent notes that the Miculas have boasted about their political connections, and argues that the Romanian government has been responsive to the Miculas' concerns in the past (citing as an example the Parmalat affair, where it alleges that the Miculas were able to use their political influence to overturn a court judgment that was against their interests). Indeed, given the

Claimants own testimony about frequent contacts with government officials, Romania argues that the Claimants cannot prove that they were excluded from the consultative process. In any event, Romania argues that this information was public.

ii. Romania complied with any standard of consistency or transparency that could reasonably be imposed in the context of complex or politically sensitive legislation and negotiation

852. The Respondent contends that it complied with any standard of consistency or transparency that could reasonably be imposed in the context of complex or politically sensitive legislation and negotiation.

853. The Respondent asserts that "various agencies and individuals connected to the Government held differing views about the Facilities' future", which it argues "is normal for any state, and it certainly is to be expected of a state undergoing massive changes in its legal and political culture" (R-PHB, ¶ 173). The Respondent first highlights Romanian officials' lack of expertise in the enactment of EGO 24, noting that Mr. Orban described the EGO 24 program as a "non-professional" attempt by Romania to achieve its objective of regional development, passed "with an incredible lack of expertise in terms of how the regional policy is developed at the European Union level" (Tr., Day 8, 178-180 (Orban)).

854. In addition, the Respondent acknowledges that, at the time of EGO 24's enactment and even after the Competition Council issued Decision 244, a significant part of the government believed that the EGO 24 facilities were legal. Citing Mr. Marcu's testimony at the hearing, the Respondent alleges that "it was this sincere belief that motivated Romania to enact EGO 75/2000, which only partially implemented the Competition Council's decision" (R-PHB, ¶ 175, citing Tr., Day 7; 20-21(Marcu)). Relying on Mr. Petersen's testimony, the Respondent argues that "Romanian politicians and officials who thought that EGO 24 was legal were incorrect, but they were not unreasonable, and they acted in good faith" (R-PHB, ¶ 174, Tr., Day 6, 111, 178).

855. The Respondent argues that it was in this environment that Romania promulgated the 2001 Methodological Norms (GD 728/2001). This was the document on which Mr. Orban was being cross-examined when he admitted that Romania was not being particularly transparent to investors and was also acting inconsistently in terms of the availability of EGO 24 (Tr., Day 8, 208-209 (Smith/Orban)). However, the Respondent contends that when this document was promulgated, "the Government was publicly at odds with the Competition Council regarding the legality of several of the EGO 24 Facilities", and "[a]s Mr. Orban explained, any inconsistency in the position taken by different agencies resulted from different levels of knowledge and sophistication and different assessments (or even 'wishful thinking') of what might be obtained", which "is natural and unavoidable in any state" (R-PHB, ¶ 177).

856. In any event, the Respondent argues that the 2001 Methodological Norms did not say that any particular Facility would stay in place for any period of time. Rather, Article 5

of GD 728/2001 provided that PIC holders "shall continue to benefit from facilities under the law, until the expiry of the period for which the disfavored area was declared." The Respondent points out that the Claimants and other PIC holders did indeed continue to benefit from the facilities under EGO 24 [as amended] until 2009.

857. Similarly, any ambiguity in reports to the public regarding Romania's progress towards accession (Exh. HEC-6 and HEC-7) "can be explained by the quandary in which Romania found itself." (R-PHB, ¶ 178). Relying on Mr. Orban's testimony, Romania argues that single statements in the reports (such as statements saying that the provisions on the facilities granted in the D-areas would be maintained until the moment of Romania's accession) should not be taken at face value, but rather interpreted in context with other sections stating that the issue of state aid was a sensible subject in the negotiating process. For instance, the Respondent cites to the following testimony by Mr. Orban:

> Q. And in this public document in June 2002, anyone who took the time to read this would have been told by the government that the provisions on the facilities granted in the D-areas would be maintained until the moment of Romania's accession; correct?
>
> A. Yes, this was the intention, and this is why we battled a lot with the Commission to get this.
>
> Q. So any investor reading this report in June 2002 would be led to believe that these facilities under EGO 24 would be in place for -- the shortest period of time would be 2007; correct?
>
> A. No. Because -- once again, I don't want to repeat my previous answer, but at that time it was clear that this is a subject, a delicate subject in the accession negotiation process with not a very clear ending.
>
> Q. What's unclear about "will be maintained until the moment of accession"?
>
> A. No, you have to read all the documents, not only this sentence. Because it was clear, you mentioned the previous document, the report, where it is mentioned clearly at page -- so it's 9, okay, it's the negotiation on state aid control on Romania focused, pages 132, on the following sensible topics concerning the assessment of the fiscal aid.
>
> So it was clearly mentioned that this is a sensible subject in the accession negotiation process.
>
> (Tr., Day 8, 219:21-220:21 (Smith/Orban)).

858. The Respondent also contends that the June 2002 programme (Exh. HEC-7) was equivocal about the facilities' future, as confirmed by Mr. Orban:

> Q. [...] You were looking at page 148. You were directed to go to the second highlighted passage at the beginning. It says:
>
> "The provisions of the normative acts on facilities granted for 'D areas' will be maintained till the moment of Romania's accession to the European Union."

You were asked about this, you were asked about the import of this statement and what one would make of it. I think in fairness I want you to read the next two sentences, where it is said:

"In conformity with the commitment assumed within the Complementary Position Paper of Chapter 6 'Competition Policy', the Ministry of Development and Prognosis worked out a study analysing the activities carried out in D-areas since July 1999 till June 2001. This study showed that the facilities within deprived areas might be maintained."

I wanted to read out this passage and direct your attention to it, so that I can elicit your comment.

A. So, as I told you, I haven't seen this study. So it clearly shows that the study was made by the Ministry of Development and Prognosis. But here the formulation is not -- how to say? -- has presented some doubts about the possibility of preserving these facilities until the end of the -- until before the accession to the European Union.

(Tr., Day 8, 240:13-241:13 (Petrochilos/Orban)).]

859. The Respondent also denies the Claimants' accusation of deliberate adoption of contradictory positions, arguing that it is unsupported by the evidence. The Respondent contends that "[t]he state may be a unitary entity for purposes of international law, but in judging allegations of bad faith and intentional action, reality must prevail." The Respondent argues that "[d]ifferent officials—in any state—have different roles, different expertise, different levels of legal sophistication, and different opinions", and that "[i]n a period of transition, the diversity of knowledge and views is inevitably greater" (R-PHB, ¶ 179). Citing authors Newcombe and Paradell, the Respondent submits that "[i]n the case of a large investment that involves the jurisdiction of several government ministries and agencies and multiple levels of government, a host state cannot be held to a standard of strict or absolute liability whereby any degree of inconsistency, ambiguity or lack of transparency breaches fair and equitable treatment."[152]

860. According to the Respondent, the only conclusion that can be reached from the record is that the Romanian Government was unsure what would happen with the facilities. It submits that, "[o]n the totality of the record, no reasonable investor could have concluded that the Government was certain that the facilities would remain intact until accession, let alone until 2009. There was doubt, and there is nothing illegal about that, particularly in the context of a state making the transition to EU membership. Investors may choose to invest in conditions of greater uncertainty, in search of greater returns—but also taking on, knowingly, the greater risk that comes with it" (R-PHB, ¶ 180).

[152] A. Newcombe, L. Paradell, Law and Practice of Investment Treaties: Standards of Treatment (2009), Exh. RL–365, p 294.

iii. It was common knowledge that the facilities were vulnerable

861. As explained in detail in Section 3 above, the Respondent argues that it was common knowledge that the facilities would be scaled back or withdrawn, and the Miculas knew or should have known of that risk. The Respondent contends that the fair and equitable treatment standard does not require more than that. Relying on *Parkerings v. Lithuania*,[153] the Respondent argues that it was not required to advise the Claimants of future modifications of the law. Referring to the four points addressed by the *Parkerings* tribunal, the Respondent contends that (R-PHB, ¶ 182):

    a. The record does not show that Romania "deliberately neglected to advise the Claimant[s] of the possible amendment of the law". There was a diversity of views among Romanian officials at different times about what was likely to happen and what was desirable. Particularly at the time when the Claimants say that they committed themselves to a 10- or 20-year investment program (circa 1988-2000) it would be highly unrealistic to say that the Romanian state "knew" that the facilities would be withdrawn before 2009. There is no evidence that this information was intentionally withheld from the Claimants; to the contrary, the evidence is that the Claimants were in frequent contact with many different officials, including the chief negotiator in the accession negotiations.

    b. Moreover, "the political environment was changing at the time… and the Claimant[s] should have known that the legal framework was unpredictable and could evolve."

    c. The fact that Romanian officials knew that the facilities might have to be changed or withdrawn does not mean that they knew exactly what was going to happen or when, particularly at the times relevant to the Claimants' case.

    d. The Claimants and their legal advisors were entirely capable of perceiving that the facilities were "in play" and there was a significant chance of amendment or repeal before 2009.

862. In addition, the *Parkerings* tribunal held that, while the municipality of Vilnius might well have breached a contractual obligation of disclosure, that would not amount to a

[153] *Parkerings v. Lithuania*, ¶¶ 341-342: "[T]he City of Vilnius was in possession of information, prior to the conclusion of the Agreement, concerning possible modifications of the Law on Self-Government and omitted to advise the Claimant ...

However, first, the record does not show that the Respondent deliberately neglected to advise the Claimant of the possible amendment of the law. Second, as described above, the political environment was changing at the time of the negotiation of the Agreement and the Claimant should have known that the legal framework was unpredictable and could evolve. Third, the fact that the City of Vilnius knew the intention of the legislator to modify certain laws, does not mean that the City of Vilnius knew the substance of the modification. Indeed, the record does not show that the City of Vilnius was in possession of any specific information which indicated that the Agreement would be affected by a modification of the law. Fourth, the Claimant failed to demonstrate that any investor or at least a qualified law firm was unable to get the information about the amendment process. Therefore, the Tribunal sees no reason why, in the circumstances, the alleged contractual obligation of the Municipality to inform BP of the future modification of the law is constitutive of a legitimate expectation for the Claimant."

breach of the relevant BIT. The Respondent notes that here there is no question of a contractual or other municipal law obligation requiring the Government to disclose to the Claimants the details of the accession negotiations or warn them that the law might change.

863. In view of the above, the Respondent argues that "[t]he Claimants' allegations about transparency and consistency are red herrings. The plain fact is that, no matter what calumnies the Claimants wish to direct at Romania's conduct, the Claimants could not reasonably have believed that the facilities were guaranteed to remain in place and unchanged until 2009. There is no evidence that they were in fact duped or misled by anything the Government said (or failed to say)—because they were not" (R-PHB, ¶ 184).

c. The Tribunal's analysis

864. It is evident from the record that, as the Respondent itself puts it, Romania was in a quandary whilst trying to balance two conflicting policies, *i.e.*, first, the continuation of the facilities regime and the protection of the interests of PIC holders in the disfavored regions, and, second, EU accession. The Tribunal has already found that Romania's actions, including its choice to terminate the EGO 24 regime in order to obtain EU accession, were not undertaken in bad faith. However, it finds that the manner in which Romania carried out that termination was not sufficiently transparent to meet the fair and equitable treatment standard.

865. The Tribunal cannot fail to note that the Respondent's own witness, Mr. Orban, who was Romania's Deputy Chief Negotiator for EU accession from 2001 to 2004, conceded that Romania acted inconsistently, non-transparently and ambiguously in terms of the availability of the EGO 24 program and the information given to PIC holders as late as 2002 (Tr., Day 8, 208-209, 221 (Orban)). For example, Romania's official reports regarding its progress towards EU accession were ambiguous (and perhaps even misleading, even if unintentionally) with respect to the duration of the EGO 24 regime. Specifically, Romania's "National Programme for Accession of Romania to the European Union" (Exh. HEC-7) stated that "[t]he provisions of the normative acts on facilities granted for 'D areas' will be maintained till the moment of Romania's accession to the European Union" (Exh. HEC-7, p. 148). Mr. Orban's protests that this document should not be interpreted literally (Tr., Day 8, 219:21-220:21 (Smith/Orban), cited above at paragraph 857) are unpersuasive: an ordinary reader would not have understood that, because the assessment of fiscal aid was a "delicate subject" in the accession negotiations, these statements should not be taken literally.

866. The Tribunal has already found that, until sometime in 2003, any inconsistencies in Romania's statements as to the compatibility of the EGO 24 regime with EU state aid regulations were based on a good faith lack of knowledge and an overly optimistic initial assessment of its bargaining power vis-à-vis the EU (*see* Section 4 above). In addition, although for purposes of attribution the state is one single entity, when it comes to assessing transparency one cannot ignore the reality that the state is made

of different departments which may hold conflicting views as to how to implement a particular policy. However, once it became clear to Romania that the incentives would have to be abolished (sometime in 2003, according to Mr. Orban), Romania should have made PIC holders aware of this fact. This was the position taken by the tribunal in *Metalclad*:

> The Tribunal understands [transparency] to include the idea that all relevant legal requirements for the purpose of initiating, completing and successfully operating investments made, or intended to be made, under the Agreement should be capable of being readily known to all affected investors of another Party. There should be no room for doubt or uncertainty on such matters. ***Once the authorities of the central government of any Party*** (whose international responsibility in such matters has been identified in the preceding section) ***become aware of any scope for misunderstanding or confusion in this connection, it is their duty to ensure that the correct position is promptly determined and clearly stated so that investors can proceed with all appropriate expedition in the confident belief that they are acting in accordance with all relevant laws***.[154] (Emphasis added)

867. Romania argues that it was bound by confidentiality obligations imposed by the EU. However, there is no evidence of such requirements, other than Mr. Orban's testimony. While the Tribunal does not discount this testimony (and finds Mr. Orban generally to be a credible witness), it seems unlikely that the EU would object to Romania informing affected parties of steps taken by Romania in order to align incompatible aid with the *acquis*, when such alignment was exactly what the EU was requesting Romania to do since the conclusion of the Europe Agreement. Even if confidentiality was required, or Romania preferred to keep the negotiations with the EU confidential for other reasons, Romania then had to make a choice and accept the consequences of maintaining such confidentiality.

868. Moreover, the Tribunal finds Romania's argument that it had to keep the negotiations confidential to maintain its "bargaining position" with the EU unconvincing. If, according to Mr. Orban, "from the technical consultations in 2003, it was absolutely clear that for such kind of facilities [customs duty exemptions] there is no room for manoeuvre" (Tr., Day 8, 229-230 (Orban)), then Romania had no bargaining position to speak of. Romania could be referring to negotiations to obtain transitional periods on the EGO 24 incentives, but there is no evidence whatsoever that Romania even attempted to negotiate transitional periods for the customs duty exemptions.

869. Thus, the Tribunal finds that Romania should have alerted PIC holders reasonably soon after it became clear that the EGO 24 incentives would be abolished. The statements made by Prime Minister Nastase on national television in January and May of 2004 were of a general nature (as befitting their context), and thus insufficient. Given the importance of the EGO 24 program and how intensely it was discussed in the context of Romania's EU accession, it was reasonable to expect that the Government would have given to the participants a formal advance notice of the program's anticipated termination. Prime Minister Nastase had also stated that the

[154] *Metalclad v. Mexico*, ¶ 76 (Emphasis added).

incentives would be in place until the date of accession,[155] and that the government would try to negotiate transitional periods or that there would be compensation packages for PIC holders (*see* paragraph 689 above), so the actual situation was unclear to PIC holders. Nor has the Respondent pointed to any evidence of discussions with stakeholders organized by the Competition Council or other government agencies.

870. As a result, the Tribunal finds that the Respondent breached the fair and equitable treatment obligation by failing to inform PIC holders in a timely manner that the EGO 24 regime would be ended prior to its stated date of expiry (1 April 2009).

871. The Tribunal finds the Claimants' remaining claims on lack of transparency or inconsistency unsubstantiated. Although perhaps the manner in which Romania offered, amended and then finally revoked the incentives could give rise to some confusion, it did not rise to the level of a breach of the fair and equitable treatment obligation. The fact that the Government repealed the incentives from EGO 24 but made no amendment to GD 194/1999 (which states that investors in the Ştei-Nucet-Drăgăneşti region will benefit from the incentives for ten years) likewise could not have created the level of uncertainty that could rise to the level of a breach of the fair and equitable treatment standard.

* * *

872. The Tribunal concludes that, by repealing the EGO 24 incentives prior to 1 April 2009, Romania did not act unreasonably or in bad faith (except that the Respondent acted unreasonably by maintaining investors' obligations after terminating the incentives). The Tribunal, however, concludes by majority that Romania violated the Claimants' legitimate expectations that those incentives would be available, in substantially the same form, until 1 April 2009. Romania also failed to act transparently by failing to inform the Claimants in a timely manner that the regime would be terminated prior to its stated date of expiration. As a result, the Tribunal finds that Romania failed to "ensure fair and equitable treatment of the investments" of the Claimants in the meaning of Article 2(3) of the BIT.

[155] In an interview in Oradea, Bihor County in May 2004 (Exh. C-652), Prime Minister Nastase indicated that ***"[s]ubsequent to 2007***, when we want to be accepted in the European Union, these disfavored areas will no longer exist in Romania" (Emphasis added).

C. THE CLAIMANTS' REMAINING CLAIMS

873. In addition to their claims under the umbrella clause and their fair and equitable treatment claims, the Claimants assert that the Respondent has breached the second part of Article 2(3) of the BIT by impairing the management, maintenance, use, enjoyment and disposal of their investments through unreasonable or discriminatory measures; and Article 4(1) of the BIT by expropriating their right to receive the incentives (as well as their entire investment) without compensation.

874. In light of the Tribunal's conclusion that, by prematurely revoking the EGO 24 incentives in the manner that it did, the Respondent breached its obligation to treat the Claimants' investments fairly and equitably, the Tribunal does not need to address the Claimants' remaining claims. Indeed, each of those claims arises from the same facts as the fair and equitable treatment claim, and the Claimants claim the same compensation in each instance (see Section VII below). Thus, even if the Tribunal were to find in favor of the Claimants with respect to these claims, this would not impact the Tribunal's calculation of damages. As a result, any legal findings on these matters are unnecessary.

VII. DAMAGES

875. Having found a breach of the BIT, the Tribunal now turns to the Claimants' requests for reparation.

876. During the hearing on the merits, the Respondent argued that the Claimants had amended their case on damages. As a result, the Tribunal directed the Claimants to clarify their final request for relief, which they did on 20 December 2013 with their Revised Request for Relief and later confirmed in their Post-Hearing Brief and closing arguments. The Respondent had several opportunities to comment on this Revised Request for Relief, and submitted its own prayers for relief in response. The Tribunal has focused exclusively on the Parties' formal prayers for relief, namely the Claimants' prayers for relief as set out in their Revised Request for Relief,[156] and the Respondent's response in its Post-Hearing Brief.[157] The Tribunal has also considered that the Parties' additional requests for relief made in the context of their submissions on provisional measures fall under the category of formal prayers for relief. All arguments have been considered, but the Tribunal sees no need to decide on some of the arguments the Parties have made during the course of the proceedings where they are not necessary to the Tribunal's decisions on the actual requests themselves.

877. The Tribunal will first provide an overview of the Claimants' damages case and the Respondent's position in this respect (Section A below). It will then address certain preliminary matters (Section B below), before analyzing the Claimants' specific claims for damages (Section C below). The Tribunal will turn next to the Respondent's defense that EU accession benefitted the Claimants (Section D below), followed by the Claimants' request that damages be awarded net of taxes (Section E below). Finally, the Tribunal will address the question of who should be the beneficiaries of the Award (Section F below).

A. OVERVIEW

1. Overview of the Claimants' damages case

878. The Claimants' damages case has evolved over time, as described below.

a. The Claimants' original damages case

879. In their Statement of Claim, relying on ILC Articles 34 to 36, the Claimants articulated their damages case as follows:

---

[156] At the end of their Post-Hearing Brief, the Claimants "request an award granting them the relief set out in the Revised Request" (C-PHB, ¶ 279).

[157] At the end of its Post-Hearing Brief, the Respondent requests that the Tribunal "(a) DISMISS the Claimants' claim in their entirety; and (b) ORDER the Claimants to pay in their entirety the costs of this arbitration […] (R-PHB, ¶ 354). Although the Respondent submitted a Supplementary Post-Hearing Brief commenting on the Claimants' Revised Request for Relief, it did not articulate a formal prayer for relief in that submission.

> "378. […] Claimants are entitled to restitution of the legal framework that would have prevailed had Romania not withdrawn the tax exemptions and other incentives. In addition, Claimants are entitled to consequential damages arising as a consequence of Romania's illegal acts.
>
> 379. In the alternative, if the Tribunal finds that restitution is impossible or constitutes a disproportionate burden, the Claimants are entitled to full damages for the loss suffered as a consequence of Romania's illegal acts. This includes damages for the direct loss suffered as a consequence of the impermissible withdrawal of the tax exemptions and other incentives. It also includes consequential damages for the loss suffered as a consequence of the loss of the cash flow and loss of opportunity."
>
> (C-SoC, ¶¶ 378-379)

880. On this basis, the Claimants requested the following:

   a. "[R]estitution of the legal framework as in force at the time of the approval of the EGO 24/1998, alternatively adequate compensation for the losses suffered up to the amount of EUR 450,000,000; plus lost profits and any further losses suffered by Claimants as a consequence of Respondent's actions described above. The exact amount will be specified at an appropriate point during the proceedings" (C-SoC, ¶ 381).

   b. "[R]eimbursement of their costs and expenses including the costs of the present proceedings" (C-SoC, ¶ 382), and

   c. "[I]nterest compounded quarterly on all monetary claims with the precise rate of interest to be specified at an appropriate time during the proceedings" (C-SoC, ¶ 383).

b. The Claimants' damages case in their Reply

881. In their Reply, the Claimants abandoned their request for restitution (C-Reply, ¶¶ 583, 666, fn. 960). From this point forward, their case focused on compensation.

882. The Claimants submit that, to determine the compensation owed by Romania for its breaches of the BIT, the Tribunal should apply, in the first instance, any *lex specialis* in the BIT. In the absence of any *lex specialis*, the Tribunal must apply the rules of customary international law. The Claimants note that the only *lex specialis* found in the BIT with respect to compensation is in Article 4, which sets out the standard of compensation for a "lawful" expropriation (i.e., an expropriation that meets the requirements of Article 4). However, the BIT is silent with respect to the standard of compensation for "unlawful" expropriations and other breaches of the BIT's substantive protections, such as those alleged by the Claimants in this arbitration. In these cases, the Claimants contend that the appropriate standard for compensation under customary international law is the principle of "full compensation", as articulated by the Permanent Court of International Justice (PCIJ) in the *Factory at Chorzów*

case.[158] According to the Claimants, this principle is supported by the ILC Articles and by an overwhelming majority of cases and authorities. The Claimants add that the generally accepted view is that they are entitled to be fully compensated irrespective of the breach or breaches of the BIT that the Tribunal may find (C-Reply, ¶¶ 575-588).

883. The Claimants argue that they can only be fully compensated by being placed in the position in which they would have been had Romania not breached the BIT. This includes in particular the lost profits that the Claimants would have made had the Raw Materials Incentive not been repealed. The Claimants further submit that the Tribunal has wide discretion in calculating damages (C-Reply, ¶¶ 589-609).

884. In their Reply, the Claimants requested an award of compensation for the damages described in Professor Lessard's First Expert Report, in the amount of €613.7 million for the following categories of damages (R-Reply, ¶¶ 611-655):

a. Increased costs for imported raw materials;

b. Lost sales of products containing sugar free of customs tax;

c. Financial penalties incurred to the state for delays in tax payments and that could have been avoided with cash available from the incentives and the lost product sales;

d. Lost opportunities to complete or initiate incremental investments (malt, can and cogeneration plants) that would have created cost savings and incentive payments for green energy; and

e. Lost incremental sales of private-label beer that would have been profitable with completion of the cost-saving investments.

885. The damages sought were broken down as follows (C-Reply, ¶ 653):

[158] *Case Concerning Factory at Chorzów (Germany v. Poland),* Judgment 13, Permanent Court of International Justice, 13 Sept. 1928 (hereinafter *"Factory at Chorzów" or "Chórzow Factory"*) (1928 PCIJ, Series A. No. 17).

Summary of Damages Including Incremental Sales
(Present Value at September 30, 2009 in Millions of RON unless Otherwise Noted)

	Damage	Grossed-Up For Tax on Award	
	(Million RON)	(Million RON)	(Million EUR)
Increased Costs on Raw Materials	139.8	166.4	39.6
Lost Sales of SCPs to Industrial Users	524.4	624.3	148.7
Incremental Margin from Lost Sales of Finished Goods	98.5	117.3	27.9
Penalties Avoided	46.9	55.8	13.3
Malt Plant	28.0	33.3	7.9
Cogeneration Plant	591.8	704.5	167.8
Can Plant	734.9	874.8	208.4
Total	2,164.3	2,576.5	613.7

886. The Claimants added that, in any event, their injury could not be found to be inferior to the amount that they invested in reliance upon Romania's undertaking to provide the incentives for a period of 10 years. The Claimants provided an "evaluation of that amount" in the expert reports of Chris Osborne of (FTI) (C-Reply, ¶ 655). Specifically, Mr. Osborne calculated this amount to be RON 811 million.[159]

887. In addition to the damages sought, the Claimants requested post-award compound interest (C-Reply, ¶¶ 657-665), and costs and expenses associated with this arbitration proceeding, including attorneys' fees (C-Reply, ¶¶ 656).

c. The Claimants' revised request for relief

888. On 20 December 2010, the Claimants submitted a revised request for relief ("Claimants' Revised Request for Relief"). In their Post-Hearing Brief submitted on 13 May 2011, the Claimants explained this Revised Request in detail, and set out three alternative methods (Methods A through C) according to which the Tribunal could calculate the damages sought. They stressed however that "it is not their contention that the three methods listed below, or the itemized injuries that comprise the elements of the three methods, must be strictly adhered to in the ultimate calculation of an award" (C-PHB, ¶ 96).

889. The Claimants explain that Methods A and B are "alternative expectation scenarios that are offered to demonstrate the value of the integrated and flexible factory platform that the Claimants could have expected to derive had the Incentives not been revoked" (C-PHB, ¶ 97).

[159] In his second expert Report, Mr. Osborne places the value of the Claimants' pre-EGO 24 business in "a valuation range of approximately Euro 340 million to Euro 450 million" (¶ 7.60), settling for a final estimation of Euro 400 million (¶ 1.38); see also C-PHB, ¶ 228. However, Mr. Osborne then deducts €100 million to take into account factors other than revocation that may have affected the Claimants' financial situation, arriving to a final estimation of €300 million (at the time, RON 811 million) (Second ER of C. Osborne, ¶ 1.43).

890. According to the Claimants, **Method A** “represents the expected returns from continuation of the ten year plan that Claimants undertook in reliance on the Incentives, a plan intended to both capitalize on the Incentives themselves during their duration, and to complete a platform that would have performed profitably after the Incentives statutorily expired” (C-PHB, ¶ 97).

891. Specifically, in Method A the Claimants request an award of **RON 2,655.35 million** (before interest) (at the date of this Award, approximately **€597 million**) representing the total of each of the following itemized injuries: [160]

No.	***Claim***	***Amount claimed before interest (RON)***	***Approximate equivalent in Euro***	***Interest applies from***
1.	Increased cost of sugar	RON 85.1 million	€ 19.1 million	1 March 2007
2.	Increased cost of PET	RON 6.3 million	€ 1.4 million	1 March 2007
3.	Increased cost of raw materials other than sugar and PET	RON 17.5 million	€ 3.9 million	1 March 2007
4.	Lost opportunity to stockpile sugar in 2009	RON 62.5 million	€ 14 million	1 July 2010
	Subtotal	**RON 171.4 M**	**€38.5 M**	
5.	Financial penalties incurred but not yet paid	RON 63.65 million (unless waived by Respondent)	€ 14.3 million	N/A
6.	Financial penalties paid between 1 April 2005 and 30 September 2010	RON 40 million	€ 9 million	1 July 2007
7.	Lost profits on sales of finished goods	No less than ROM 427 million	€ 96 million[161]	1 May 2008
8.	Lost profits on sales of SCPs	RON 492.3 million	€ 110.7 million	1 July 2007[162]
9.	Lost profits from inability to complete a malt plant	RON 28 million	€ 6.3 million	30 Sept. 2009
10.	Lost profits from inability to complete a canning plant	RON 720.4 million	€ 161.9 million	30 Sept. 2009
11.	Lost profits from inability to complete a co-generation plant	RON 712.6 million	€ 160.2 million	30 Sept. 2009
	TOTAL	**RON 2,655.35 M**	**€597 M**	

[160] Claimants’ Revised Request for Relief, ¶¶ 2.1 to 2.5. The tables set out in this section are based on the tables included in pages 42-43 of the Claimants’ Post-Hearing Brief. As the Parties have done in some of their respective submissions, the Tribunal has added, for indicative purposes only, the Euro equivalent of the amounts claimed rounded up to the nearest hundred thousand at the exchange rate of 9 December 2013 of 4.4482 RON/EUR, source: European Central Bank.

[161] Mr. Boulton’s valuation was originally made in Euro, for an amount of “in excess of €100 million” (ER of R. Boulton, ¶ 5.99).

[162] In his expert reports, Mr. Osborne had proposed that interest be computed as of 1 March 2007. However, during the hearing on closing arguments, the Claimants circulated a letter from Mr. Osborne dated 7 June 2011 in which he made an adjustment to the calculation of this claim in order to take into account working capital needs (Tr., Day 13, 6-7, 293 (Schwartz)). This adjustment involved a delay of 120 days for computing interest, which meant that interest should be computed from 1 July 2007 (Letter from Mr. Osborne dated 7 June 2011).

892. As an alternative to Method A, the Claimants propose **Method B**, which they argue "represents the expected returns from the platform that the Claimants actually constructed, had the Claimants been able to maintain their respective market shares in their existing and proven product lines." The Claimants argue that they "have a proven track record of constructing flexible, cost-efficient, and integrated factories, and of successfully and profitably penetrating markets and building market share." They further contend that "[g]iven this track record, and the Claimants' known reliance on state investment incentives in building this track record, it was reasonably foreseeable to the Respondent that revocation of the Incentives at issue here would result in the losses reflected by either Methods A or B" (C-PHB, ¶ 97).

893. Specifically, in Method B the Claimants request an award of **RON 2,698.25 million** (before interest) (at the date of this Award, approximately **€606.5 million**) representing the total of each of the following itemized injuries:[163]

No.	***Claim***	***Amount claimed before interest (RON)***	***Approximate equivalent in Euro***[164]	***Interest applies from***
1.	The subtotal of items 1 through 6 of Method A	RON 275.05 million	€ 61.8 million	N/A
2.	Lost profits on sales of finished goods as calculated by BCG	RON 2,423.20 million[165]	€ 544.7 million	15 Aug. 2007
	TOTAL	**RON 2,698.25 M**	**€ 606.5 M**	

894. In the alternative to the expectation losses set out in Methods A and B, the Claimants have proposed **Method C**, a reliance damages calculation. According to the Claimants, Method C "is a means by which the Tribunal can measure the consequences of the Respondent's unlawful act by calculating the value of the investment actually made by the Claimants in reliance on the promised, ten-year duration of the Incentives, and which has been lost" (C-PHB, ¶ 98).

895. Specifically, in Method C the Claimants request an award of **RON 874.65 million** (before interest) (at the date of this Award, approximately **€196.6 million**), representing each of the following itemized injuries:[166]

[163] Claimants' Revised Request for Relief, ¶ 2.6.

[164] At the exchange rate of 9 December 2013 of 4.4482 RON/EUR, source: European Central Bank.

[165] Although the Claimants' final prayer for relief is made in RON, the Parties have also expressed this claim in different Euro amounts. These differences appear to stem from the fact that BCG's calculations were done in Euros, while the Claimants have expressed their claims in RON, and the fluctuations in the exchange rate since the submission of the BCG report have affected the Euro amount at which the Parties have referred to this claim. Specifically, BCG's second report calculates the lost profits at €722 million (Second ER of BCG, p. 17), while in its Supplementary Post-Hearing Brief the Respondent values this claim at €590 million (R-SPHB, p. 15).

[166] Claimants' Revised Request for Relief, ¶ 2.7.

No.	Claim	Amount claimed (before interest)	Equivalent in Euro[167]	Interest applies from
1.	Financial penalties incurred but not yet paid	RON 63.65 million (unless waived by Respondent)	€ 14.3 million	N/A
2.	Loss of value incurred in investing in reliance on the Incentives	RON 811 million[168]	€ 182.3 million	1 Jan. 2002
	TOTAL	**RON 874.65 M**	**€196.6 M**	

896. The Claimants further request interest and costs (Revised Request for Relief, ¶¶ 3 and 5), as described in Sections VIII and X below. The Claimants also request that "[t]he total amount of damages payable by the Respondent comprising the amounts set out in paragraphs 2, 3 and 5 [that is, all damages, interest and costs requested] to be received net of any tax obligations imposed by Romania on the proceeds" (Claimants' Revised Request for Relief, ¶ 4).

897. In addition, the Claimants have requested that "[a]ny damages payable, including interest and costs, should be awarded to the individual Claimants, Ioan Micula and Viorel Micula, to be divided between them on a 50:50 basis. In the alternative, any damages payable, including interest and costs, should be awarded to all five Claimants" (Revised Request for Relief, p. 1). This request was later confirmed in the Claimants' prayer for relief included at the end of their Post-Hearing Brief: "the Claimants request an award granting them the relief set out in the Revised Request" (C-PHB, ¶ 279).

898. Finally, in the context of their applications for provisional measures, the Claimants have also requested post-award injunctive relief, as described in Section IX.B below, as well as a declaration that the Respondent is not allowed to set off any damages awarded to the Claimants against the EFDG's tax debts (as described in Section IX.A below).

2. Overview of the Respondent's position

899. The Respondent argues that the Claimants' damages case is speculative and unsupported (R-Rejoinder, ¶¶ 259-288, R-PHB ¶¶ 207-210; R-SPHB, ¶¶ 1-6; Tr., Day 1, 191; Day 2, 137-138).

900. The Respondent contends that the Claimants' quantum case has changed substantially over the course of the proceedings. It notes that this claim began as an

[167] At the exchange rate of 9 December 2013 of 4.4482 RON/EUR, source: European Central Bank.

[168] Mr. Osborne's final valuation for the reliance claim was €300 million (at the time, RON 811 million) (Second ER of C. Osborne, ¶ 1.43). In line with this final valuation, in their Revised Request for Relief and in their Post-Hearing Brief, the Claimants requested RON 811 million for this claim (Revised Request for Relief, ¶ 2.7; C-PHB, ¶¶ 228-231). Although in their Closing Statements the Claimants stated that they disagree with this discount and therefore the claim remained within the range between €350-400 million (Tr., Day 12, 123-125 (Reed)), the Tribunal will disregard this latest argument. It is far from certain that the Claimants could purport to amend their sought relief at this late juncture and actually did.

unparticularized claim for €450 million "plus lost profits and any further losses", but was transformed substantially when the Claimants submitted their Reply. From that point forward, the Claimants' case has centered on direct losses for approximately €33 million, which they have "snowballed" into indirect losses for approximately €600 million. Specifically, the Claimants allege that the loss of the Raw Materials Incentive caused them to lose cash flows totaling approximately €33 million (mostly related to the higher cost of purchasing sugar), which have allegedly prevented the Claimants from pursuing a purported "10-year plan", causing the Claimants to forgo hundreds of million Euro in hypothetical lost profits (most of them relating to investments they never made or businesses they never developed). The Respondent also notes that the Claimants blame this "cash crunch" and their subsequent inability to expand for having prevented them from paying Romanian taxes in a timely manner, resulting in interest and penalties which they now claim as losses.

901. The Respondent also complains that the Claimants have instructed an army of experts, made conflicting damages calculations and constantly changed positions. For example, until the hearing their damages claims were mostly supported by Prof. Lessard's expert reports; however, in their Post-Hearing Brief the Claimants rely on Mr. Osborne's calculations. The Claimants have also advanced an alternative reliance losses claim on the basis of Mr. Osborne's expert reports. The Respondent also complains that the Claimants submitted expert reports from Mr. Juhász of BCG and Mr. Boulton of LECG, and that the status and relevance of these reports remained unclear to Respondent even after the hearing. However, the Claimants rely on both of these reports in their Revised Request for Relief.

902. The Respondent further argues that the Claimants' damages case is fundamentally flawed, and should be dismissed, for the following reasons.

903. <u>First</u>, the Respondent argues that all of the claimed categories of damages are barred by legal standards. The Respondent does not dispute the general applicability of the *Chorzów Factory* standard of compensation under international law, upon which the Claimants rely. However, it argues that "the 'full compensation' principle does not create an entitlement to collect a windfall based on damages not suffered, not proven, and not causally connected with a violation of a treaty obligation", which in the Respondent's view is what the Claimants seek here (R-Rejoinder, ¶ 277).

904. More specifically, the Respondent argues that the Claimants (i) have not met their burden of proof, in particular with respect to claims of lost profits, and (ii) have failed to prove causation.

905. With respect to ***burden of proof***, the Respondent argues that the Claimants bear the burden of proving every element of their claim, and have failed to do so. Even with respect to heads of damages where there is some evidence, the Respondent submits that it is incomplete and insufficient. The Respondent thus argues that the Tribunal should dismiss the Claimants' claims on this basis (R-PHB, ¶ 216).[169] In addition, the

[169] The Respondent's specific comments as to the lack of evidence of each head of claim are provided in Section C below.

Respondent contends that the Claimants must also meet the specific legal standard with respect to lost profits (discussed in Section VII.C.3 below), which it argues they have not done (R-PHB, ¶¶ 217-221, R-Rejoinder, ¶¶ 297-300).

906. With respect to ***causation***, the Respondent submits that a state's actions must be the direct and proximate cause of the damages suffered (R-Rejoinder, ¶¶ 316-321). The Claimants must prove that breaches of the BIT by Romania were the "underlying" or "dominant" cause of each head of damage claimed. The causal connection must not be too remote, and there can be no intervening causes breaking the chain of causation.

907. In the Respondent's view, this rule disposes of the Claimants' entire damages claim, leaving only the claim for alleged direct losses for payments of customs duties. The Respondent argues that all but the direct losses claim are premised on the theory that the Claimants had insufficient funds (or cash flows) to undertake other activities because of the repeal of the Raw Materials Facility. If the Tribunal were to consider that this "cash crunch" had other causes, or that the Claimants might have obtained alternative funds from other sources, then the chain of causation has been broken. As explained further below, Romania argues that the hearing exposed the Claimants' rapidly deteriorating financial position before repeal of the Raw Materials Facility and their own business decisions as the real causes of the Claimants' alleged losses, severing the causal link between repeal of the Raw Materials Facility and the claimed damages. The Respondent adds that, if the Claimants really had been able to convert €30 million of cash flow into more than €600 million, there would have been no shortage of lenders and equity investors ready to provide the funding.

908. In addition, the Respondent contends that the Claimants must also establish the causal link between each alleged breach of the BIT and the specific damages caused by such breach. The Respondent notes that the Claimants have consistently refused to do so, including in the Revised Request for Relief. As a result, the Respondent contends that no assumptions can or should be made about which damages flow from each alleged treaty breach. It would be wrong to expect the Tribunal to simply assume that all of the heads of damages claimed flow directly from all of the alleged treaty breaches. In particular, the Respondent argues that it would be wrong to assume that the same damages would flow from an expropriation than from a breach of other treaty standards. In this respect, the Respondent argues that the Claimants have not even purported to identify the fair market value of the assets expropriated (their alleged vested right to enjoy the Raw Materials Facility).

909. Second, the Respondent argues that every category of the Claimants' quantum case (with the exception of the direct losses claim) is based on two assumptions for which there is no evidentiary support:[170]

a. That the Claimants had a "10-year plan" that they would have implemented but for the withdrawal of the Raw Materials Facility, and

[170] The Respondent's arguments on the assumptions identified above (including arguments on evidence) are addressed in the analysis of each of the Claimants' claims in Section C below.

b. That, but for that withdrawal, the Claimants would have started selling SCPs to industrial customers (at about the time of revocation) and would have cornered the Romanian sugar market, thereby generating the cash flows necessary to undertake the Incremental Investments.

910. In addition, the Respondent argues that no award of damages can be made in respect to losses incurred by non-Claimant companies, nor for the diminution in value of the Individual Claimants' direct or indirect shareholdings in such companies, because they fall outside the jurisdiction of this Tribunal. In this regard, it argues that the Tribunal accepted jurisdiction over the Claimants' shareholdings only over the Corporate Claimants (R-PHB, ¶ 314).

911. Further, the Respondent opposes the Claimants' request that all damages be awarded to the Individual Claimants.

912. In view of the above, at the end of its Post-Hearing Brief the Respondent requests the Tribunal to award the following relief:[171]

> "(a) DISMISS the Claimants' claim in their entirety; and
>
> (b) ORDER the Claimants to pay in their entirety the costs of this arbitration […] (R-PHB, ¶ 354).

913. Finally, in the context of its application for the revocation of provisional measures, the Respondent requested the Tribunal to "explicitly provide in the Award that any amount awarded to any of the Claimants, whether as damages, arbitration costs, or otherwise, is subject to set-off by Romania against the tax debts of all eleven EFDG companies, including lawful interest and penalties" (Respondent's Revocation Application, ¶ 87(c)).

B. PRELIMINARY MATTERS

914. Before turning to the Claimants' specific claims for damages, the Tribunal will address certain preliminary matters, in particular legal standards (Section 1 below), and the Respondent's claim that certain of the Claimants' claims fall outside of the jurisdiction of this Tribunal (Section 2 below).

1. Legal Standards

915. A substantial part of the Respondent's arguments on quantum relates to the legal standards applicable to an award of damages. Accordingly, before addressing the quantification of the Claimants' claims, the Tribunal will address these standards.

916. The basis for the Claimants' expectations damages claims is the principle of full reparation enshrined in Article 31 of the ILC Articles,[172] which provides:

[171] Although the Respondent submitted a Supplementary Post-Hearing Brief commenting on the Claimants' Revised Request for Relief, it did not articulate a prayer for relief in that submission.

> Article 31. Reparation
>
> 1. The responsible State is under an obligation to make full reparation for the injury caused by the internationally wrongful act.
>
> 2. Injury includes any damage, whether material or moral, caused by the internationally wrongful act of a State.

917. As articulated by the PCIJ in the *Factory at Chorzów* case, "reparation must, as far as possible, wipe out all the consequences of the illegal act and reestablish the situation which would, in all probability, have existed if that act had not been committed."[173] This principle has been generally understood to mean that the claimant must be placed back in the position it would have been "in all probability" but for the international wrong. In most cases, this involves the payment of compensation (ILC Articles 34 and 36).[174]

918. The Respondent does not dispute the principle of full reparation. Rather, it contends that the Claimants have not met their burden of proof with respect to the damage suffered, and have failed to prove that the damages alleged were caused by Romania's breaches of the BIT.

919. The Respondent also argues that the Claimants must prove both the existence of the damage for which they request compensation, as well as the existence of a causal link between the breaches of the BIT found by the Tribunal and the damage alleged.

920. Article 36(2) of the ILC Articles provides that "compensation shall cover any financially assessable damage including loss of profits ***insofar as it is established.***" The Parties do not dispute the general principles on burden and standard of proof, except when they relate to lost profits. The Tribunal addresses the standard for an award of lost profits together with the analysis of the Claimants' specific claims for lost profits in Section C.3 below.

---

[172] The Tribunal is aware that Part Two of the ILC Articles, which sets out the legal consequences of internationally wrongful acts, may not apply, at least directly, to cases involving persons or entities other than States, such as in investment disputes as is the case here. In particular, it is aware that Comment (3) to Article 28 states that "[…] while Part One applies to all the cases in which an internationally wrongful act may be committed by a State, Part Two has a more limited scope. It does not apply to obligations of reparation to the extent that these arise towards or are invoked by a person or entity other than a State. In other words, the provisions of Part Two are without prejudice to any right, arising from the international responsibility of a State, which may accrue directly to any person or entity other than a State, and article 33 makes this clear." That being said, the ILC Articles reflect customary international law in the matter of state responsibility, and to the extent that a matter is not ruled by the treaties applicable to this case and that there are no circumstances commanding otherwise, the Tribunal will turn to the ILC Articles for guidance. The Tribunal further notes that the Claimants have cited to the ILC Articles and the Respondent has not objected.

[173] *Factory at Chorzów*, p. 47.

[174] Article 34 of the ILC Articles (forms of reparation) provides that "[f]ull reparation for the injury caused by the internationally wrongful act shall take the form of restitution, compensation and satisfaction, either singly or in combination, in accordance with the provisions of this chapter."

Article 36 of the ILC Articles (compensation) provides: "1. The State responsible for an internationally wrongful act is under an obligation to compensate for the damage caused thereby, insofar as such damage is not made good by restitution. 2. The compensation shall cover any financially assessable damage including loss of profits insofar as it is established."

921. With respect to causation, the Respondent argues that the Claimants must not only prove causality in fact (which has been defined by the *Biwater v. Tanzania* tribunal as "the sufficient link between the wrongful act and the damages in question"[175]), but must establish that causation is proximate (i.e., not too remote or inconsequential). According to the Respondent, to prove proximate causation, it would not be enough for the Claimants to demonstrate that the repeal of the Raw Materials Facility had a detrimental impact on their business activities; they must also prove that the breaches of the Treaty were the "underlying" or "dominant" cause of each element of compensation that they seek. The Respondent relies (among others) on the *ELSI* case, where the International Court of Justice found that, despite the fact that there were several causes that led to the ELSI disaster, "the underlying cause was ELSI's headlong course towards insolvency,"[176] and on *GAMI v. Mexico*, where the tribunal found that the damages suffered by the claimant had been largely the result of market forces[177] (R-Rejoinder, ¶¶ 317-320). In addition, the Respondent contends that the Claimants must show a direct causal link between each violation of the BIT and the specific damages caused (see paragraph 908 above). Finally, relying on *Lauder v. Czech Republic*,[178] the Respondent argues that there must be no intervening cause for the damage (R-Rejoinder, ¶ 319).

922. The Claimants do not dispute the principles on causation described by the Respondent. Citing *Biwater v. Tanzania*,[179] the Claimants simply assert that "for each item of damage claimed, there is a 'sufficient link between the wrongful act and the damage in question'", and that "the Respondent's actions were the 'underlying' or 'dominant' cause of the Claimants' losses" (C-PHB, ¶ 100). The Claimants provide further details on these alleged causal links in the description of each claim.

923. The ILC Articles emphasize the need for a causal link between the internationally wrongful act and the injury for which compensation is due. Article 31(1) provides that "[t]he responsible State is under an obligation to make full reparation for the injury ***caused*** by the internationally wrongful act." Article 31(2) goes on to say that "[i]njury includes any damage, whether material or moral, ***caused*** by the internationally wrongful act of a State." Commentary (9) to Article 31 explains that

> "It is only '[i]njury … caused by the internationally wrongful act of a State' for which full reparation must be made. This phrase is used to make clear that the subject matter of reparation is, globally, the injury resulting from and ascribable to the wrongful act, rather than any and all consequences flowing from an internationally wrongful act."

924. Commentary (10) adds that "[t]he allocation of injury or loss to a wrongful act is, in principle, a legal and not only a historical or causal process", and that "causality in fact is a necessary but not a sufficient condition for reparation. There is a further

---

[175] *Biwater Gauff (Tanzania) Limited v. United Republic of Tanzania* (ICSID Case No ARB/05/22), Award, 24 July 2008 (hereinafter *"Biwater v. Tanzania"*), ¶ 785.

[176] *ELSI*, ¶¶ 100 and 101.

[177] *GAMI v. Mexico*, ¶ 85.

[178] *Lauder v. Czech Republic*, ¶¶ 234-235.

[179] *Biwater v. Tanzania*, ¶ 785.

element, associated with the exclusion of injury that is too 'remote' or 'consequential' to be the subject of reparation." The commentary explains that "in international as in national law, the question of remoteness of damage 'is not a part of the law which can be satisfactorily solved by search for a single verbal formula'", but notes that international tribunals have used the criteria of directness, foreseeability or proximity to establish this, and that other factors may also be relevant.

925. With respect to the concept of directness, the Tribunal notes that under the ILC Articles not every event subsequent to the wrongful act and antecedent to the occurrence of the injury will necessarily break the chain of causation and qualify as an intervening cause. Indeed, the commentary to the ILC Articles explains that, in cases where "the injury in question was effectively caused by a combination of factors, only one of which is to be ascribed to the responsible State, international practice and the decisions of international tribunals do not support the reduction or attenuation of reparation for concurrent causes, except in cases of contributory fault" (Comment 12 to Article 31 of the ILC Articles). The only other exception seems to be cases "where an identifiable element of injury can properly be allocated to one of several concurrently operating causes alone", "[b]ut unless some part of the injury can be shown to be severable in causal terms from that attributed to the responsible State, the latter is held responsible for all the consequences, ***not being too remote***, of its wrongful conduct" (Commentary 13 to Article 31 of the ILC Articles. Emphasis added).

926. Thus, an intervening event will only release the State from liability when that intervening event is (i) the cause of a specific, severable part of the damage, or (ii) makes the original wrongful conduct of the State become too remote. Unless they fall under either of these categories, cases of contributory fault by the injured party appear to warrant solely a reduction in the amount of compensation.[180]

927. Therefore, the question seems to be whether the intervening event is so compelling that it interrupts the causal link, thus making the initial event too remote. Accordingly, when assessing the impact of an intervening cause, the Tribunal will first focus on whether the damage can be properly attributed to the cause cited by the Claimants, or rather to the intervening cause.

928. Finally, the Respondent has argued that the Claimants must show a direct causal link between each violation of the BIT and the specific damages caused. In this particular case, however, all of the violations of the BIT alleged by the Claimants arise from the same fact: the premature revocation of the incentives or in direct connection with that premature revocation. Even if the Respondent's argument were correct, the damages claimed by the Claimants arise from one and the same set of facts, irrespective of the specific treaty breach alleged.

[180] Article 39 of the ILC Articles provides that "in the determination of reparation, account shall be taken of the contribution to the injury by willful or negligent action or omission" of the injured party. Commentary 5 to Article 39 explains that the phrase "account shall be taken" "indicates that the article deals with factors that are capable of affecting the form or reducing the amount of reparation in the appropriate case".

2. Does the Tribunal have jurisdiction over claims for damages relating to the non-claimant companies of the EFDG?

929. During the course of this arbitration, it has become evident that all of the damages calculations provided by the Claimants (be it under Methods A, B or C) refer to the damages suffered by the entire EFDG.[181] In the Claimants' view, the Individual Claimants are entitled to all of the damages suffered by all of the companies in the EFDG because they assert that "all of the main companies [in the EFDG] are 100% owned, or virtually 100% owned, by the Micula brothers" (Tr., Day 11, 105 (Reed)).

930. The Respondent argues that no award of damages can be made with respect to losses incurred by non-Claimant companies, nor for the diminution in value of the Individual Claimants' direct or indirect shareholdings in such companies, because they fall outside the jurisdiction of this Tribunal. In this regard, they argue that the Tribunal accepted jurisdiction over the Claimants' shareholdings only over the Corporate Claimants (R-PHB, ¶ 314).

931. The Tribunal makes two observations in that regard. First, in its Decision on Jurisdiction and Admissibility, the Tribunal found that it had jurisdiction "over the dispute submitted to it in this arbitration" (Decision on Jurisdiction and Admissibility, ¶ 170), after having found that it had jurisdiction *ratione personae*, *ratione materiae*, and *ratione temporis* over the Claimants' claims.[182] The Tribunal did not state that it accepted jurisdiction only with respect to the Individual Claimants' shareholdings over the three Corporate Claimants. The Tribunal noted that, at that juncture, "it need only determine whether there is an investment for the purpose of Article 25 of the ICSID Convention and Article 7 of the BIT" (Decision on Jurisdiction and Admissibility, ¶ 123). The Tribunal was satisfied that the investments made by the Corporate Claimants, as well as the shareholding of Messrs. Micula in the Corporate Claimants, qualified as investments (Decision on Jurisdiction and Admissibility, ¶ 125.) However, the Tribunal did not exhaustively determine what the Claimants' investments were nor hold that those were the only investments out of which the dispute arose. For example, the Tribunal concluded that it did "not need to establish at this stage whether the incentives as such are considered investments capable of expropriation" (Decision on Jurisdiction and Admissibility, ¶ 128).

932. Further, in their Statement of Claim, the Claimants stated that this dispute arose "out of investments made by Claimants in the Romanian areas Stei-Nucet and Drăgăneşti village", adding that "[t]hese investments comprise various facilities for the production of food and related services" (SoC, ¶¶ 32-33). The Claimants did not specify that all of those facilities were owned directly by the Individual Claimants or the Corporate Claimants, although they did suggest in a fashion (*see* SoC, ¶¶ 45-168). During the

[181] *See, e.g.,* First ER of D. Lessard, ¶¶ 72-73; Tr., Day 8, 118-121 (Lessard); First ER of C. Osborne, fn. 1 and Appendix 2 (definition of "Companies"); ER of R. Boulton, p. i (definition of "Companies"); Second ER of BCG, p. 2; Tr., Day 10, 88-89 (Osborne).

[182] In particular, the Tribunal found that the Corporate Claimants' physical assets and the Individual Claimants' shares in the Corporate Claimants qualified as investments for purposes of the ICSID Convention and for purposes of the BIT (Decision on Jurisdiction and Admissibility, ¶¶ 124-128).

course of the arbitration, the Claimants have explained that their food production facilities are owned and operated through a group of Romanian companies, the EFDG, which they allege is ultimately owned by the Individual Claimants. The fact that part of the Claimants' business is channeled through Romanian companies that may be owned by the Individual Claimants, which was not brought to the Tribunal's (or the Respondent's) attention during the jurisdictional phase, does not negate the Parties' consent to ICSID arbitration, nor the Tribunal's competence and the Centre's jurisdiction over the dispute. Finally, it is not disputed that the claims related to the investments in non-claimant companies of the EFDG, which are within the competence of the Tribunal, were made in a timely fashion as they were raised at the latest in the Claimants' Reply.

933. Second, in the Tribunal's view, the question whether an award of damages can be made in respect to losses incurred by non-Claimant companies owned by the Individual Claimants is not a question of jurisdiction, that is, whether the Parties have consented to this Tribunal and to ICSID as the appropriate forum to adjudicate the dispute. The question is rather whether it is permissible for the Individual Claimants to seek remedy for losses suffered by companies owned by them but that are not claimants in this arbitration. Thus, the issue is whether the Individual Claimants are entitled to a remedy if neither of them personally suffered the prejudice directly suffered by corporations in which they are shareholders but which are not claimants in this arbitration.

934. In their Statement of Claim, the Claimants requested "adequate compensation for the losses suffered up to the amount of EUR 450,000,000; plus lost profits and any further losses suffered by Claimants as a consequence of Respondent's actions", the exact amount to be specified at an appropriate point during the proceedings (SoC, ¶ 381). The Claimants did not at that stage specify that the Individual Claimants' losses stemmed exclusively from their investment in the Corporate Claimants. The Respondent does not dispute that the Individual Claimants have standing to bring claims related to their investments in shares of corporations.[183]

935. Thus, to the extent that the Individual Claimants can prove their ownership of the other (Romanian) companies in the EFDG and can prove that they have been affected in this regard by the Respondent's breaches of the BIT, the Tribunal finds that claims for losses suffered by the Individual Claimants through those other companies are within the scope of permissible damages claims.

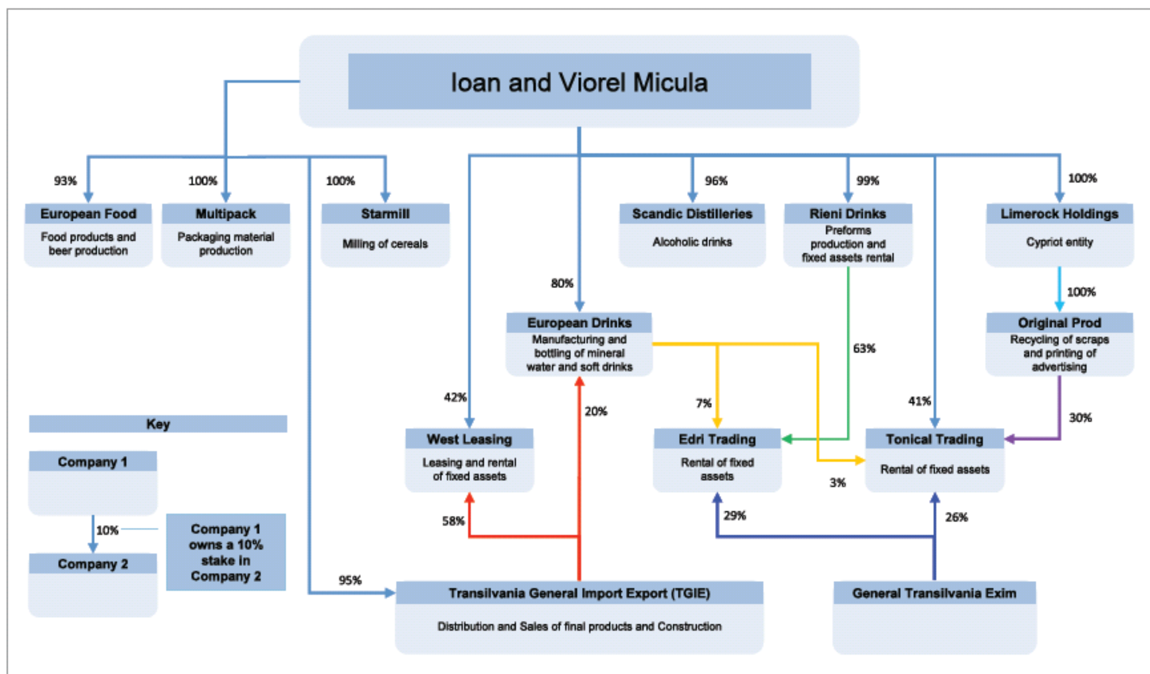
936. Although the Claimants provided surprisingly little documentary evidence of the Individual Claimants' ownership of the non-claimant companies of the EFDG, the evidence in the record (most of it provided by the Respondent) confirms that the

[183] Indeed, the Respondent does not dispute that the Individual Claimants could have chosen to bring a case by themselves, without joining the Corporate Claimants. That being said, the Respondent contends that, had the Individual Claimants done so, "they would have been entitled (assuming liability) only to damages they had suffered" (R-PHB, ¶ 338). This is a different issue which the Tribunal addresses in Section VII.F below.

Individual Claimants are jointly the owners of at least 99.96% of the companies in the EFDG that have allegedly suffered the losses claimed in this arbitration.

937. Mr. Osborne identified the following companies as part of the EFDG (Second ER of C. Osborne, ¶ 10.3, Figure 64): the Corporate Claimants (European Food, Multipack and Starmill), European Drinks S.A. ("European Drinks"), EDRI Trading S.R.L. ("EDRI Trading"), Original Prod S.R.L. ("Original Prod"), Rieni Drinks S.A. ("Rieni Drinks"), Scandic Distilleries S.A. ("Scandic Distilleries"), Transilvania General Import-Export S.R.L. ("TGIE"), Tonical Trading S.R.L. ("Tonical Trading"), West Leasing S.R.L ("West Leasing"). Mr. Osborne also provided a diagram of the ownership structure of these companies with an indication at Figure 3 of his First Expert Report (p. 57). However, he did not cite the source of the information shown. Figure 3 is reproduced below, together with Mr. Osborne's explanations:

> The Miculas are majority shareholders in most of the Companies, and the remainder are controlled by companies that are in turn owned by the Miculas. The diagram below shows the ownership structure of the 11 companies plus Limerock holdings, a Cypriot entity that owns Original Prod, and General Transilvania Exim. Some minor shareholdings have been omitted from the diagram for the sake of clarity, but shareholders not included are primarily other family members including Mrs Eeva Micula and Mrs Doina Micula.
>
> **Figure 3: The Companies' Major Shareholdings**



938. As recorded in the Decision on Jurisdiction and Admissibility, during the jurisdictional phase the Claimants provided evidence of their shareholdings in the Corporate Claimants in 2008, as follows:

a. "Claimant 3 [European Food] is a Romanian joint stock company established on 30 November 1989. Respondent does not dispute that Claimant 3 was held on 1 February 2007 (Exh. C-25) at more than 93% by Messrs. Micula. The rest of the shares were held by Rieni Drinks SA, a Romanian company (6.5%). The excerpt from the Register of the Ministry of Justice dated 27 May 2005 (Exh. C-7) shows that the Miculas each held 46.7289% and Rieni Drinks 6.5415%" (Decision on Jurisdiction and Admissibility, ¶ 112).

b. "Claimants 4 [Starmill] and 5 [Multipack] were established as Romanian limited liability companies on 21 February 2002. Claimants 1 and 2 each hold 50% of the shares (Exh. C-7, dated 27 May 2005)" (*Id.*, ¶ 113).

c. "On 31 July 2008 Counsel for Mr. Ioan Micula and the Corporate Claimants submitted, for each of the three Corporate Claimants, excerpts from the Romanian commercial registry showing the status of each of these three companies as of 25 June 2008, as well as their corporate biographies from 1 July 2005 on. These documents confirm the above conclusions" (*Id.*, ¶ 113).

939. The Claimants did not provide updated information of the Individual Claimants' shareholdings in the Corporate Claimants during the merits phase. However, the Respondent has not disputed these shareholdings or suggested that there has been any change in them. In addition, an excerpt from the Bihor Trade Registry dated 9 December 2008 provided by the Respondent (Exh. R-60) shows that Ioan Micula holds 50.65% of Rieni Drinks, while Viorel Micula holds 49.34%, which would put their joint shareholding at 99.99%. Mr. Osborne confirmed this in Figure 3 of his First Expert Report, which showed Rieni Drinks as 99% owned by the Individual Claimants (although he did not cite the source for this affirmation). Accordingly, the Tribunal deems that all three Corporate Claimants are virtually 100% owned by the Individual Claimants, whether directly or indirectly.

940. By contrast, the Claimants have provided no documentary evidence of their shareholding in the remaining companies of the EFDG. They simply assert that most of the companies in the EFDG are "directly or indirectly wholly owned by the Micula brothers", with the exception of Original Prod, Tonical Trading, and EDRI Trading. However, with respect to those three companies, they also state that "[n]one of these companies has any real claim to any of the damages claimed in this case" (Tr., Day 1, 146 (Reed)). Accordingly, the Tribunal will disregard the three companies named above for purposes of its damages analysis. However, this statement also suggests that, in addition to the Corporate Claimants, there are five other companies within the EFDG (namely, European Drinks, Rieni Drinks, Scandic Distilleries, TGIE and West Leasing) that have suffered part of the damages claimed in this case. As a result, the Tribunal must determine whether they are indeed owned by the Individual Claimants.

941. The Tribunal shares the Respondent's frustration at the lack of evidence submitted by the Claimants. As noted by Mr. Ellison, it is difficult to understand why the Individual Claimants did not, of their own initiative, provide evidence of their shareholdings in the EFDG. It is the Individual Claimants' burden to prove that they are the owners of

the companies they assert they own and that have suffered the damages they now claim. It is not fair to impose upon the Respondent (or, for that matter, the Tribunal) the burden of searching through the Romanian Registry of Commerce in order to assess whether the Claimants' assertions are true. Like Mr. Ellison, the Tribunal cannot help but to find the Claimants' approach to this matter "bizarre" (Tr., Day 11, 100-105 (Reed/Ellison)).

942. That being said, the evidence submitted by the Respondent (in particular, an excerpt from the Bihor Trade Registry dated 9 December 2008 (Exh. R-60) and from the Orbis Commercial Database (Exh. R-61, date unclear), indicates that, at the date the information was collected, the shareholding of the remaining EFDG companies was as follows:[184]

   a. **Rieni Drinks**: Ioan Micula with 50.65%, Viorel Micula with 49.34%, European Drinks with 0.001%, and Intermark S.R.L. with 0.00002%. In other words, Rieni Drinks is 99.99% owned directly by the Individual Claimants.

   b. **TGIE**: Ioan Micula with 47.50%, Viorel Micula with 47.50%, and Rieni Drinks 5%. Considering that Rieni Drinks is 99.99% owned directly by the Micula brothers, the Tribunal deems this company owned 99.99% by the Individual Claimants.

   c. **European Drinks**: Ioan Micula with 39.94%, Viorel Micula with 39.94%, and TGIE with 20.05%, Rieni Drinks with 0.05% and Edri Trading with 0.02%. Considering that, with the exception of Edri Trading, all the companies that have shareholdings are 99.99% owned directly by the Micula brothers, the Tribunal deems that European Drinks is 99.98% owned by the Individual Claimants.

   d. **Scandic Distilleries**: Ioan Micula with 48.12%, Viorel Micula with 48.12%, Rieni Drinks with 0.05%, Intermark S.R.L. with 0.05%, European Drinks with 0.05%, and World Brands Production S.A. with 3.61%. Considering that, with the exception of Intermark and World Brand Productions S.A., all the companies that have shareholdings are at least 99.98% owned by the Micula brothers, the Tribunal deems that European Drinks is 99.96% owned by the Individual Claimants.

   e. **West Leasing**: Ioan Micula with 21.25%, Viorel Micula with 21.25%, and TGIE with 57.50%. Considering that TGIE is 99.99% owned by the Micula brothers, the Tribunal deems this company owned 99.99% by the Individual Claimants.

943. These shareholdings are roughly consistent with the shareholdings shown by Mr. Osborne in Figure 3 of his First Report. Accordingly, although the evidence reviewed by the Tribunal is from December 2008, the Tribunal accepts Mr. Osborne's assertions and deems that the companies in the EFDG identified above are at least 99.96% owned by the Individual Claimants. Accordingly, the Individual Claimants can claim for damages that they have suffered by virtue of the harm to those companies as well as the harm to the Corporate Claimants.

[184] Numbers have been rounded up to the nearest hundredth.

C. ANALYSIS OF THE CLAIMANTS' DAMAGES CLAIMS

1. General comments

944. As discussed above, the Claimants have advanced two expectation damages computations (Methods A and B) and one reliance damages computation (Method C). Method A quantifies the increased costs and lost profits that the Claimants would have made had they been allowed to develop their business the way they allege they had planned to do, in particular by implementing the Incremental Investments and the sale of SCPs to third parties. Method B quantifies the increased costs and lost profits that the Claimants would have made had they continued operating their existing platform. Method C presents a reliance damages scenario, which quantifies the value of the losses incurred by the Claimants in investing in reliance on their expectation that the incentives would remain in place for ten years. The Claimants have emphasized that the Tribunal need not adhere strictly to either of these three methods or the injuries itemized therein in order to make an award (C-PHB, ¶ 96).[185]

945. For the reasons set out below, the Tribunal will focus its attention on Method A.

946. First, Method A is the Claimants' primary expectation damages scenario. The Claimants have devoted most of their efforts to Method A and have identified Methods B and C as "alternative" damages scenarios. In their Reply, the Claimants focused almost exclusively on the damages listed in Method A, as calculated by Prof. Lessard (and partly on the reports of Dr. Fry and Prof. Steenkamp). In their Revised Request for Relief, the Claimants continue to rely heavily on Method A, although some of the claims are now calculated by Mr. Osborne and Mr. Boulton.

947. Second, the Tribunal rejects Method B, for the following principal reasons:

   a. Compared to Method A, the BCG Report (which quantifies the main head of claim under Method B) was subject to much less rigorous scrutiny in the proceedings. The Respondent repeatedly requested clarification as to the role of that report in the Claimants' quantum case, but this was only made clear with the Claimants' Revised Request for Relief. Although the Respondent had an opportunity to comment on that Revised Request (the Tribunal allowed it to submit a Supplementary Post-Hearing Brief), the Tribunal finds that it has a less complete and less well tested record as to Method B than Method A.

   b. The Tribunal has serious concerns regarding the methodology used by BCG. The flaws in BCG's First Report seem to have caused concern to the Claimants themselves, who requested Mr. Boulton to assist BCG and supervise the preparation of BCG's Second Report. However, as the Respondent pointed out, despite the changes in methodology and assumptions, the quantification of the

[185] The Claimants stated expressly: "Claimants' Revised Request for Relief submitted on 20 December 2010 is summarized below. Claimants wish to stress, however, that it is not their contention that the three methods listed below, or the itemized injuries that comprise the elements of the three methods, must be strictly adhered to in the ultimate calculation of an award" (C-PHB, ¶ 96).

Claimants' losses proposed by BCG's Second Report (€722 million present value of EBITDA, Second ER of BCG, p. 17) does not differ greatly from that proposed in its First Report (between €757-796 million present value of EBITDA, First ER of BCG, p. 14).

c. The BCG Report purports to quantify lost profits for sales of finished goods that the Claimants would have allegedly earned but for the revocation on the basis of the Claimants' existing production platform at the time of the revocation. But despite the fact that Claimants' platform at that time did not have the benefit of the Incremental Investments, BCG's calculations yield a higher result for only the sales of finished goods (quantified by the Claimants as RON 2,423 million) than all of the lost profits claims included in Method A combined (i.e., lost profits deriving from sales of finished goods calculated by Mr. Boulton, lost profits deriving from the sale of SCPs and lost profits deriving from the Incremental Investments, which combined amount to RON 2,380 million). In stark contrast to BCG's calculations, Mr. Boulton (on whose report the Claimants rely under Method A) quantified lost sales of finished goods at €100 million. Although part of the difference in their results can be attributed to the fact that Mr. Boulton excluded export markets in his calculations, the Tribunal finds that this further calls into question the credibility of the assumptions and methodology used by BCG. Accordingly, as explained in Section 3(b) below, the Tribunal relies on Mr. Boulton's analysis of lost profits on sales of finished goods rather than the analysis of BCG.

d. Although the Claimants specify that certain amounts calculated by Mr. Osborne in relation with Claims 1-4 of Method A (specifically, section 4 of Mr. Osborne's First Report and in section 3 of Mr. Osborne's Second Report) must be subtracted from the amount calculated by BCG (C-PHB, ¶¶ 204), the Claimants do not provide a final calculation that takes into account this subtraction. Indeed, the RON number claimed by the Claimants does not appear to consider any deductions at all, since BCG's valuation of the losses at € 722 million has simply been claimed in RON (*see* C-PHB, ¶ 206, note 305, where the Claimants simply state that "RON 2,423.2 million is the [sic] RON €722 million").

e. Finally, the Tribunal notes that the Claimants devote a mere three paragraphs to the BCG Report in their Post-Hearing Brief (C-PHB, ¶¶ 204-206). The least that can be said is thus that the Claimants did not build the core of their arguments and claims on the BCG Report.

948. Third, the Tribunal rejects Method C. Method C provides an alternative reliance approach to the calculation of the Claimants' losses, in which Mr. Osborne attempts to "value the business absent the investments made in reliance on the Incentives" (C-PHB, ¶ 332; Tr., Day 10, 36-37 (Osborne)). The Tribunal does not see any reason to deviate from the Claimants' primary expectation damages approach which, in the Claimants' own submission, should place them in the position that they would have been but for Romania's breach of the BIT, and is thus consistent with the full compensation principle articulated in the *Chórzow Factory* case.

949. The Claimants' claims under Method A are summarized in paragraph 891 above. For purposes of the analysis, the Tribunal will divide them into three main groups: the Claimants' claims for actual / realized losses (*damnum emergens*) as a result of the increased cost of raw materials (addressed in Section 2 below), the Claimants' claims for lost profits (addressed in Section 3 below), and the Claimants' claims for tax penalties (addressed in Section 4 below).

2. Increased cost of raw materials

950. The Claimants had previously presented this claim as a single claim, but in their Post-Hearing Brief they divided it up into claims for increased costs of sugar, PET, other raw materials and sugar stockpile. Each sub-claim is addressed below.

a. Increased cost of sugar

951. The Claimants claim losses for the increased cost of sugar in the amount of RON 81.5 million, based on:

a. The calculations contained in section 4 of Mr. Osborne's first report, and paragraphs 4.9 to 4.16 and 4.23 to 4.24 in particular;

b. The calculations contained in section 3 of Mr. Osborne's second report, and paragraphs 3.1 to 3.28 in particular; and

c. The evidence referred to in those sections, including exhibits CO-1.18, CO-1.19, CO-2.1 and CO-9.1 (C-PHB, ¶¶ 101-110).

952. Although in their Post-Hearing Brief the Claimants rely on Mr. Osborne's figures, they submit that the differences with the calculations made by Prof. Lessard (on whose report they relied on for this same claim prior to the hearing) are minimal. In particular, they argue that working capital does not impact the calculation of these damages. Mr. Osborne explains that the reason for the nominal differences between both calculations is the different approaches to estimating the volume weighted actual transport premium (Second ER of C. Osborne, ¶ 3.21).

953. For the reasons set out below, the Tribunal accepts this claim. Both the existence of the damage and the causal link between the revocation of the incentives and the damage suffered have been adequately proved. There is no dispute that, as a result of the revocation of the Raw Materials Incentive, the Claimants were required to pay an increased amount for the sugar they purchased after February 2005. The Respondent's expert, Mr. Ellison, accepts that this is the case, subject to certain criticisms and exclusions (First ER of J. Ellison, ¶ 6.2.24), as discussed further below.

954. The Tribunal is also satisfied with the quantification of this claim, which is based on reliable documentary evidence. In his second report, Mr. Osborne reconciled the sugar purchase data used by him and Prof. Lessard, and reconciled his work with the raw material audit work carried out by BDO. Mr. Ellison recognized and accepted these reconciliations, noting that "the reconciliation now appears valid" (Second ER of

J. Ellison, ¶ 2.2.16). Mr. Ellison also confirmed that BDO checked all 2,586 sugar invoices in the process of conducting their audit (Tr., Day 11, 96-97 (Ellison/Reed)).

955. Mr. Ellison contends that these damages should exclude sugar purchases by non-Claimant EFDG companies after revocation of the incentives (RON 64.7 million, approximately €14.9 million, about 75% of the losses claimed) (First ER of J. Ellison, ¶¶ 6.2.9-6.2.12; Second ER of J. Ellison, ¶¶ 5.1.4, 5.3.1-5.3.5). Mr. Ellison notes that, before revocation, European Food was making substantially all the sugar imports for the entire group and selling it to its affiliates; however, after revocation, each EFDG company started importing its own needs for sugar. The Claimants and their experts argue that this exclusion is perverse: after the revocation, there was no incentive for the sugar purchases to be channeled through the Claimant companies, because they no longer had a right to the customs duty exemption and thus there was no cost advantage for them or their affiliates that are not parties in this arbitration. Had the incentives remained in place, the Claimants would have continued to purchase sugar through European Food (Second ER of C. Osborne, ¶¶ 1.3, 3.13-3.17; Second ER of D. Lessard, ¶ 138). The Respondent argues that this is irrelevant, because there is no legal basis upon which the Corporate Claimants could be compensated for an outlay from someone else's pocket (R-PHB, ¶ 313).

956. The Tribunal has difficulty with the Respondent's argument. European Food lost the opportunity to buy cheaper sugar, and as a result the Claimants were forced to buy more expensive sugar, incurring an additional cost. That this more expensive sugar was bought by a different company of the group does not eliminate the loss to the Individual Claimants, who the Tribunal has confirmed are the ultimate shareholders of the entire group.

957. As previously noted, the Respondent also argues that no award of damages can be made with respect to losses incurred by non-Claimant companies, nor for the diminution in value of the Individual Claimants' direct or indirect shareholdings in such companies, because they fall outside the jurisdiction of this Tribunal. As discussed in Section B.2 above, the Tribunal rejects this argument: this argument does not turn on jurisdiction, but rather whether it is permissible for the Individual Claimants to seek remedy for losses suffered by companies 99.96% owned by them that are not claimants in this arbitration. As set out in paragraph 943 above, the Tribunal has found that claims for losses suffered by the Individual Claimants through those other companies are within the scope of permissible damages claims.

958. Mr. Ellison also excludes the loss of the benefit to European Food of the arm's-length transactions by which it sold intermediate sugar products to European Drinks and Rieni Drinks. The documentary evidence appears to confirm (and Mr. Ellison conceded at the hearing) that the transactions were indeed at arm's length (Tr., Day 11, 59-63 (Ellison/Schwartz). The Tribunal understands the Claimants to be saying that, prior to the revocation, European Food bought the sugar duty-free and then sold the intermediate products to other EFDG companies at the same price it would have sold them to third party companies. The Claimants' argument seems to be that

European Food lost that "business" as a result of the revocation. The Tribunal sees no reason to exclude this loss from the calculation.

959. Finally, the Respondent argues that, because the Claimants cannot establish that they would have been entitled to import sugar duty free after 1 January 2007, no damages should be awarded for that period. Mr. Caspari, the Respondent's sugar expert, testified that the Claimants could not possibly have imported duty free sugar into the EU after accession (even absent the repeal), as such activity would have fundamentally undermined the EU sugar regime and threatened the stability of the EU sugar market (ER of C. Caspari, ¶ 26; Tr., Day 11, 261 (Caspari)). According to the Respondent, this warrants a reduction of RON 18.1 million (or 19.4 million, if adjusted to account for Mr. Osborne's approach) (R-PHB, ¶ 320, fn. 703).

960. The Claimants' sugar expert, Dr. Fry, seemed to recognize this problem but assumed that Romania would have negotiated with the European Commission a specific derogation allowing the Claimants to import duty free sugar into the EU. However, he conceded that he had no evidentiary basis for this assumption, and that such a derogation would have been unprecedented in EU history (Tr., Day 11, 234-236 (Fry)).

961. The Tribunal agrees with the Respondent that it is uncertain whether the Claimants could have imported sugar duty free after Romania's accession to the EU, even if the facilities had remained in place. However, the Respondent has not established that the Claimants could not have done so. The Claimants argue that the EU could have granted exemptions if Romania had negotiated such exemptions, and there is no evidence that Romania even tried to negotiate such exemptions. The Tribunal has found that Romania breached the Claimants' legitimate expectation to benefit from the Raw Materials Incentive until 31 March 2009. In these circumstances, the Tribunal considers that the Claimants are entitled to all losses regarding increased cost of sugar until that date.

962. For the foregoing reasons, the Tribunal accepts the Claimants' claim for increased cost of sugar, for a total amount of RON 85.1 million.

b. Increased cost of PET

963. The Claimants claim losses caused by the increased cost of PET in the amount of RON 6.3 million, based on:

a. The calculations contained in section 4 of Mr. Osborne's first report, and paragraphs 4.17 to 4.24 in particular;

b. The calculations contained in section 3 of Mr. Osborne's second report, and paragraphs 3.29 to 3.35 in particular; and

c. The evidence referred to in those sections, including the witness statement of Mr. Halbac dated 22 December 2009 and exhibits CO-1.18, CO-1.19, CO-2.1 and CO-9.1 (C-PHB, ¶¶ 111-115).

964. The Tribunal rejects this claim. It is undisputed that the Claimants never benefitted from the Raw Materials Facility in respect of PET imports because their PET equipment was not located in the Stei-Nucet region (R-PHB, ¶ 318; C-PHB, ¶ 112; First WS of M. Halbac, ¶ 42; First ER of D. Lessard, ¶ 83, Exh. C-681, C-686). Although Mr. Halbac testified that the Claimants did have PET equipment in Drăgăneşti as far back as 2002, it is unclear whether they benefitted from the incentives. The Claimants do not expressly say so, and Mr. Ellison testified that he found invoices for PET in 2002 that had duty on them (See C-PHB, ¶¶ 112-115; Second WS of M. Halbac, fn. 53; C-680; Tr., Day 10, 195 (Ellison)).

965. In fact, the Claimants' claim for PET is based on their alleged intention to relocate their PET equipment in late 2004 or early 2005 to the disfavored region precisely for the purpose of taking advantage of the incentives. As the Respondent states, "[i]n effect, this claim is for a hypothetical future lost opportunity to save money on the purchase of raw materials, rather than any claim for actual losses" (R-PHB, ¶ 318). The claim is thus not for actual losses, but for future losses. The Tribunal agrees with the Respondent: the Claimants have not met their burden to prove the existence of a lost opportunity; therefore, they cannot claim a loss for increased cost of PET if the repeal of the Raw Materials Facility did not in fact cause them to incur greater costs in purchasing PET.

966. In addition, the Claimants have not proven that they would have indeed relocated their PET equipment to the disfavored region. This claim appears to rely entirely on Mr. Halbac's oral testimony, which the Tribunal did not find convincing in this respect. Although he cites some contemporaneous documents (Exh. C-681, C-686), Mr. Osborne appears not to have considered them in his report (Tr., Day 11, 147-148). In any event, these documents are not sufficient to prove that alleged intention:

a. Exh. C-681 is an invoice dated 1 September 2004 cited as evidence for moving Husky PET Equipment from Rieni to Drăgăneşti. However, the document merely appears to list "Works of wiring within Drăgăneşti Complex, Hall 11, Plugs Machine - HUSKY, as per the work status due to May 2004" with respect to an "AGREEMENT 748/15th of July 2002". This does not clearly evidence a purported move of that equipment. In addition, the agreement that appears to serve as basis for those works was signed in July 2002, but it is undisputed that the equipment had not been moved by the time the incentives were repealed in February 2005. This raises questions with respect to the intent to move that equipment and the timing of that alleged move, as discussed further below.

b. Exh. C-686 is a drawing of a layout of the Multipack facilities showing where PET equipment would allegedly be installed. However, the Tribunal has no way of knowing when this drawing was made, how concrete of a project it embodied and what its intended use would have been.

967. In addition, the modest scale of the cost and effort allegedly required to move the equipment undermines the credibility of the claim. Mr. Halbac stated that the move would have cost only 250,000 RON (approx. €50,000) and taken approximately only 2

months to complete (see First WS of M. Halbac, ¶ 42). In these circumstances, and considering that Exh. C-681 cites an agreement dated July 2002, it is unclear why the Claimants had not moved that equipment before the date of the revocation of the incentives.

968. For all these reasons, the Tribunal rejects the Claimants' claim for increased cost of PET.

c. Increased cost of other raw materials

969. The Claimants claim losses caused by the increased cost of raw materials other than sugar or PET in the amount of RON 17.5 million, based on:

a. The calculations contained in section 4 of Mr. Osborne's first report, and paragraphs 4.17 to 4.24 in particular; and

b. The evidence referred to in that section, including exhibits CO-1.18, CO-1.19 and CO-2.1 (C-PHB, ¶¶ 116-120).

970. The Claimants base their claim on Mr. Osborne's calculations, but note that the differences with Prof. Lessard's results are nominal (Prof. Lessard calculates RON 17.37 million). They thus state that the Tribunal may choose either calculation.

971. The Tribunal accepts this claim, as calculated by Mr. Osborne. As in the case of sugar, it is undisputed that following the revocation of the incentives, the Claimants were required to pay more for the other raw materials they purchased, including tomato paste, juice concentrates, wheat and corn flower, vegetable fats, and potato flakes and granules. The Respondent's expert, Mr. Ellison concedes that losses from these higher costs were incurred by the Claimants, and does not dispute the prices used by their experts (which the Claimants argue are conservative and understated, because they switched to cheaper products, and because the experts were unable to find benchmark prices to estimate but for prices).

972. That being said, Mr. Ellison argues that the total loss should be discounted to RON 14.5 million (or RON 11.2 million if one counts only damages suffered until the date of accession) for two reasons: first, that only 20% of the amount claimed is supported by documentary evidence, and second, that much of these increased costs were paid by non-Claimant companies within the EFDG (First ER of J. Ellison, ¶¶ 6.3.1-6.3.5; Appendix JMHE-4C).

973. The Tribunal dismisses Mr. Ellison's second argument for the reasons set out in paragraphs 956 to 958 above. With respect to Mr. Ellison's first argument, the Tribunal understands that the documentary evidence cited by the Claimants (Exh. C-166, C-167, C-218, C-220 and C-222, which contain between them 43 customs declaration forms with customs duties amounting to RON 3.6 million) is a sample. Given the nature of the Claimants' business, the Tribunal does not expect the Claimants to provide an invoice for every item they ever imported, and thus accepts that a sample of customs declaration forms is an appropriate evidentiary means. In

addition, the Respondent has given no compelling reasons why that sample is not representative of the total. As a result, the Tribunal rejects Mr. Ellison's first argument.

974. For the reasons stated above, the Tribunal accepts this claim for a total of RON 17.5 million.

d. Lost opportunity to stockpile sugar

975. The Claimants claim losses for the lost opportunity to stockpile sugar in the amount of RON 62.5 million, based on:

a. The calculations contained in section 4 of Mr. Osborne's first report, and paragraphs 4.13 to 4.16 in particular;

b. The calculations contained in section 4 of Mr. Osborne's second report;

c. The calculations contained in the expert reports of Dr. Fry of December 2009 and July 2010; and

d. The evidence referred to in the abovementioned sections, including the witness statements of Mr. Balog dated 22 December 2009 and 30 July 2010 (C-PHB, ¶¶ 121-130).

976. The Claimants argue that, because the incentives were going to end in 2009, they planned to buy large quantities of sugar ahead of that and thus avoid paying higher sugar prices for some months. The stockpile would thus help them to maintain the effects of the incentives for a longer period of time. The Claimants assert that, in late 2004/early 2005, after they heard that the incentives would be revoked, they stockpiled what they could, but not as much as they would have liked to do.

977. Mr. Osborne includes this claim in his calculation of increased cost of raw materials, as follows:

> "4.1 The early termination of the EGO 24/1998 incentives has had a clearly detrimental effect on the Claimants. That effect comes in part from an impact on their costs – and therefore on their ability to earn a satisfactory return on the investments that they have made. […]
>
> 4.2 The first impact on the Claimants arises because of the increase in the effective cost of raw materials purchased for their own use – including sugar, fruit and tomato concentrates, and potato products. This applies both in respect of purchases that the Companies have made and ***purchases that the Companies would have made in creating a stockpile of sugar in 2009 to extend the period in which it could benefit from reduced sugar costs.***
>
> 4.3 In the latter case, the reason for including the effect of stockpiling in 2009 is that the Companies would, had the EGO 24/1998 incentives continued, have undoubtedly sought to create a stockpile of sugar in 2009 – in essentially the same way as was actually done in 2004/2005. On that basis it seems reasonable also to assume that equivalent amounts would or should have been negotiated by way of

> compensation in the alternative scenario in which the EGO 24/1998 incentives continued only to the point of EU accession. To ensure symmetry, the calculations treat the beneficial effects of the stockpile actually created in 2005 as reducing the losses suffered by the Claimants." (First ER of C. Osborne, ¶¶ 4.1-4.3, emphasis added).

978. In preparing his calculations, Mr. Osborne assumed that, if the Claimants had time to properly organize and prepare for the termination of the incentives, they would have built an optimal stockpile, based on, among other things, sugar price forecasts, storage costs, the cost of capital and the EFDG companies' sugar consumption (First ER of C. Osborne, ¶ 4.10). According to Mr. Osborne, this optimal stockpile would have been around 75,000 tonnes. The Claimants argue that they were prevented from amassing this optimal stockpile because (i) they did not have enough time to properly plan for the optimal stockpile, and (ii) in 2004/2005 they had not put funds aside for this purpose. Instead, they amassed around 30,000 tonnes. Mr. Osborne calculates damages based on the optimal stockpile, not the actual stockpile amassed by the Claimants.

979. The Respondent argues that including any stockpiling in the direct damages claim is impermissibly speculative, transforming this part of the case into yet another "lost opportunity" claim. The Respondent contends that there is no way of knowing what the Claimants would have done in 2009 had the Raw Materials Facility remained in place. In particular, would they have had the funds to purchase and store vast quantities of sugar? Would it have been permissible to stockpile at that time? The Respondent also notes that Prof. Lessard did not incorporate a stockpile in his original calculations (R-PHB, ¶¶ 315-316).

980. That being said, Mr. Ellison appears to accept this claim from an economic perspective, subject to proof that (i) the large quantities purchased in late 2004 and early 2005 were indeed a stockpile, and not, e.g., a period of intensified production or a seasonal issue, and (ii) that this stockpiling activity was a direct response in anticipation of revocation (and in this respect differed from the increased purchasing in 2003) and not, e.g., EFDG taking advantage of a particularly good price (beyond the discount provided by the incentives) and/or the replenishment of previously run-down stock levels and/or seasonal issues (Second ER of J. Ellison, ¶¶ 6.2.22-6.2.21).

981. The Tribunal concludes that it is established that the Claimants did in fact stockpile 30,000 tonnes in 2004/2005. Mr. Balog testified and Mr. Gamecho confirmed that the Claimants had purchased enough duty-free sugar to delay the economic effect of the repeal until the second half of 2006 (First WS of C. Balog, ¶ 7; Tr., Day 4, 28 (Gamecho)). Mr. Ellison accepts that large quantities of sugar were purchased in late 2004 and early 2005, although as described above he questions whether these purchases were meant to create a stockpile.

982. In contrast, evidence of the Claimants' intention to stockpile in the future is limited:

a. The Claimants contend that "Mr Balog has given clear and unchallenged evidence that upon hearing about the revocation of the Raw Materials Incentive in 2004, the Claimants set about building as large a sugar stockpile as possible

[WS of C. Balog dated 30 July 2010, ¶ 12]. It is safe then to assume that had the incentives lasted for the promised 10 year period, at the end of that period the Claimants would have built a sugar stockpile, and in fact, Mr. Ellison has accepted that a sugar stockpile would have been made at that time [Tr., Day 10, 196]. The real issue in dispute is therefore over the size of the stockpile that would have been built" (C-PHB, ¶ 123). However, the Respondent points out that Mr. Balog's testimony purports to describe what the Claimants did in response to the announcement of the repeal of the Raw Materials Facility, and that it does not directly support the suggestion that the Claimants ever intended to (or could have) stockpiled vast amounts of sugar in 2009 (R-SPHB, ¶¶ 12-13).

b. Mr. Osborne also relies on Mr. Viorel Micula's assertion that "we had planned to purchase and stock-pile a large amount of sugar on a customs duty free basis prior to the incentives coming to an end" (Third WS of V. Micula, ¶ 68; First ER of C. Osborne, ¶ 4.10, third bullet point).

983. Despite the absence of hard evidence on the Claimants' future intentions, the Tribunal considers that the Claimants' established past practice of stockpiling provides sufficient certainty that, but for the revocation, the Claimants would have stockpiled sugar in early 2008 in anticipation of the expiry of the incentives. In 2004, the stockpiling was organized as a reaction to the allegedly unforeseen occurrence of the early termination of the incentives. Indeed, the stockpiling was to be planned and organized closer to the scheduled expiry of the incentives and in preparation for such expiry, so there was no need for such stockpiling before the latter became looming. Other than Mr. Viorel Micula's testimony, the record does not show that the Claimants had planned for either event. However, this is understandable as the need for the actual stockpiling appears to have caught the Claimants off guard, and the scheduled expiry of the incentives was to occur almost 4 years after the revocation. In view of these considerations, the Tribunal finds that it is sufficiently certain that the Claimants would have acted in 2008/2009 as they actually did in 2004/2005. Indeed, Mr. Ellison conceded that, "on the basis that in early 2008, the claimants would probably have started preparing a stockpile, knowing that […] expiry was coming along" (Tr., Day 10, 196).

984. The Tribunal is also satisfied that there is a sufficient causal link between the damage asserted and the revocation of the incentives. The Respondent has not provided a plausible alternative explanation as to why the Claimants would have stockpiled sugar in late 2004/2005 if it was not in anticipation of the revocation of the incentives. Having accepted the causal link in 2004/2005, the Tribunal is satisfied that the same causal link would apply in 2008/2009 with respect to the scheduled expiry of the incentives.

985. However, the Tribunal agrees with Mr. Ellison that this loss should be circumscribed to the volumes actually stockpiled in 2004/2005. The "optimal stockpile" calculated by Mr. Osborne must be rejected because the size of such an optimal stockpile is too speculative. As Mr. Ellison points out, "the way [Mr. Osborne's] formula works is that he has used 2009 prices and forecasts to work out what would have been the best

stockpile to create in 2008. And the way commodities work, of course, you don't normally have that advantage of being able to look a year ahead and see actual prices" (Tr., Day 10, 197 (Ellison)).

986. Instead, it is more reasonable to use as counterfactual data the 30,000 tonnes that were actually stockpiled in 2004/2005 (Tr., Day 10, 196 (Ellison)). Using these volumes, Mr. Ellison recalculates the loss at RON 18,133,229 (approximately €4.3 million at the exchange rate of 30 September 2009 used by Mr. Ellison),[186] as follows:

> "6.2.20 I have recalculated the potential loss resulting from a higher price for white sugar. I have assumed a stockpile of 30,000 tonnes would have been assembled over the period 1 April 2008 to 31 March 2009, in line with the stockpiled volume possibly amassed in 2004 and 2005 (see paragraph 6.2.17 above). (Although whether there was any stockpiling in 2004/2005 is not entirely clear). In the absence of any contemporaneous documentation establishing the decision process undertaken by EFDG in 2004 and 2005 (or, indeed, any contemporaneous evidence that the volumes purchased were in fact a stockpile), this is a more reasonable approach than to pick an optimal stockpile with the benefit of hindsight.
>
> 6.2.21 I therefore calculate the impact of allowing for a delay in the (assumed) stockpiling patterns until 2008/2009, but at the volumes asserted to have been stockpiled in 2004/2005. My calculation of the loss for the Sub-Head of Claim relating to sugar therefore increases by approximately €4.3 million."
>
> (Second ER of J. Ellison, ¶¶ 6.2.20-6.2.21)

987. The Tribunal agrees with Mr. Ellison's methodology and calculations. As a result, the Tribunal accepts the Claimants' claim with Mr. Ellison's reductions (i.e., for RON 18,133,229).

988. By contrast, the Tribunal rejects Mr. Ellison's alternative calculation on the basis of the assumption that the incentives would only have been available until the date of accession, for the reasons set out in paragraph 961 above.

3. The Claimants' claims for lost profits

989. The Claimants advance five claims for lost profits under Method A. The Tribunal has grouped them into three categories: the Claimants' claim for lost profits on the sale of finished goods (Section (b) below); the Claimants' claim for lost profits on the sale of sugar-containing products (SCPs) (Section (c) below), and the Claimants' claim for lost profits due to the inability to complete the Incremental Investments (Section (d) below). Before addressing each of these claims, the Tribunal will address the standard for an award of lost profits (Section (a) below).

[186] Appendix JMHE-4C.

a. Standard for an award of lost profits

990. As noted above, Article 36(2) of the ILC Articles provides that "compensation shall cover any financially assessable damage including loss of profits insofar as it is established." The Respondent argues that the standard of proof for an award of lost profits is more restrictive than for an award of other losses, and the Claimant has responded to these arguments. As a result, the Tribunal will first address the Respondent's position, and will then turn to the Claimants' comments.

i. The Respondent's position

991. The Respondent contends that, for their claims for lost profits to succeed, the Claimants must meet a specific legal standard with respect to lost profits (R-PHB, ¶¶ 217-221, R-Rejoinder, ¶¶ 297-300).[187]

992. Specifically, the Respondent argues that international law requires a claimant to demonstrate lost profits with "reasonable" or "sufficient" certainty. The Respondent contends that a claimant must adduce probative evidence that lost profits are "probable" and not "merely possible".[188] If there is no proof that the alleged profit-making activity would have been undertaken at all, the standard has not been met. According to the Respondent, this disposes of the Claimants' claim in respect of the Incremental Investments and the alleged SCP opportunity, which together amount to more than €450 million.

993. Indeed, the Respondent argues that most of the Claimants' alleged lost profits claims (in particular the claims related to the Incremental Investments and sale of SCPs) constitute claims of lost opportunities, rather than lost profits. As none of these activities were ever undertaken in fact, the Claimants seek compensation for the loss of a hypothetical chance to profit, not for the loss of profit itself. According to the Respondent, in these circumstances international law does not recognize an entitlement to compensation for mere opportunities. The only circumstances in which international tribunals have accepted claims for lost opportunities are situations in which the lost opportunities had intrinsic value, which the Respondent argues is not the case here (R-Rejoinder, ¶¶ 278-288, citing *S.D. Myers v. Canada, Merrill & Ring v. Canada*[189]*, Sapphire v. NIOC*[190]).

994. But even where there is no doubt that an investment would have been undertaken, the Respondent submits that the reasonable certainty standard cannot be satisfied in the absence of a going concern and a proven record of profitability. Citing a string of cases including *Aucoven v. Venezuela*[191]*, PSEG v. Turkey, Metalclad v. Mexico and*

---

[187] This is in addition to a causal link between the international wrong and the profits allegedly lost. The Respondent's position on causation is addressed in the context of each specific claim.

[188] M.M. Whiteman, Damages in International Law, Vol. 3 (1937), Exh. RL–313, p. 1837.

[189] *Merrill & Ring Forestry L.P. v. The Government of Canada*, UNCITRAL, Award, 31 March 2010.

[190] *Sapphire International Petroleum Ltd v National Iranian Oil Company*, Award, 15 March 1963 (hereinafter *"Sapphire v. NIOC"*).

[191] *Autopista Concesionada de Venezuela, CA v. Bolivarian Republic of Venezuela* (ICSID Case No ARB/00/5), Award, 23 September 2003 (hereinafter *"Aucoven v. Venezuela"*).

AAPL v. Sri Lanka, the Respondent contends that arbitral tribunals have consistently rejected lost profits claims where such a record of profitability could not be proven, noting that any compensation awarded in such circumstances has generally been limited to proven investment expenditures.

995. In this respect, the Respondent argues that international law precludes any award of prospective damages for projects that have not commenced. The Respondent submits that "no tribunal adjudicating an investment treaty dispute has ever awarded lost profits where, as here, the claiming party had not made the investment that allegedly would have generated the profits" (R-Rejoinder, ¶ 290). The Respondent cites *Aucoven v Venezuela*, where the Tribunal refused to award lost profits for the operation of a bridge that was never built or put into operation, despite the fact that it was undisputed that the bridge would have been built and would have been a profitable venture.[192] This tribunal also noted that "ICSID tribunals are reluctant to award lost profits for a beginning industry and unperformed work", adding that this reluctance is confirmed by the practice of the Iran-U.S. Claims Tribunal.[193] Romania also cites *Himpurnia California Energy Ltd. v. PLN*, where the tribunal held that "it would be intolerable … to uphold claims for lost profits from investment not yet incurred".[194]

996. Similarly, the Respondent argues that mere projections of future profits made by investors or draft contracts that were never finalized are insufficient to prove lost profits. In particular, the tribunal in *PSEG v. Turkey* held that "[r]elying on cash flow tables that were a part of proposals that did not materialize does not offer a solid basis for calculating future profits."[195]

997. In addition, the Respondent argues that "even claims for the lost future profits of existing investments have been disallowed where the investment had no track record of profit generation. An award to the contrary would be inherently speculative, and therefore contrary to the dictates of international law" (R-Rejoinder, ¶ 290). The Respondent cites a string of cases where tribunals have rejected such claims, notably:

   a. *AAPL v. Sri Lanka*, where the tribunal found, in connection with a newly formed company that had no record of profits and was undercapitalized, that neither the "goodwill" of the company nor its "'future profitability' [...] could be reasonably established with a sufficient degree of certainty".[196]

   b. *Metalclad v. Mexico,* where the tribunal held that "where the enterprise has not operated for a sufficiently long time to establish a performance record or where it

---

[192] *Id.,* ¶ 357, cited with approval in *PSEG v. Turkey*, ¶ 310.
[193] *Id.*, ¶ 360.
[194] *Himpurnia California Energy Ltd v PLN,* UNCITRAL, Final Award, 4 May 1999, ¶ 330.
[195] *PSEG v. Turkey*, ¶ 313.
[196] *AAPL v. Sri Lanka*, ¶ 106.

has failed to make a profit, future profits cannot be used to determine going concern or fair market value."[197]

c. *PSEG v. Turkey*, where the tribunal found that compensation for lost profits "is normally reserved for the compensation of investments that have been substantially made and have a record of profits, and refused when such profits offer no certainty."[198]

d. Several decisions of the Iran–US Claims Tribunal (see R-Rejoinder, fn. 446).

998. The Respondent argues that in such circumstances, international tribunals have "repeatedly held that damages should be limited to proven, net out-of-pocket expenditures (or "sunk costs") that the claimant has incurred in advancing the project" (R-Rejoinder, ¶ 291). For example, in *Biloune v. Ghana*, the tribunal concluded that "[g]iven the nature of the project, and its early interruption by the respondents (…), the most appropriate method for valuing the damages to be paid [for expropriation] will be to return to Mr. Biloune the amounts he invested".[199]

999. The Respondent argues that, in the Claimants' case, there was no going concern with respect to the Incremental Investments or the sale of SCPs to third parties, and thus no proven record of profitability. As a result, the Respondent submits that the Tribunal need not even consider the evidence submitted with respect to the alleged lost opportunities. Even if the Tribunal were convinced of the Claimants' intention to "complete" the Incremental Investments and to engage in the sale of SCPs to third party industrial customers, it is undisputed that none of these ventures was ever launched, let alone earned profit (See, e.g, Tr., Day 8,33–38 and 45–46 (Lessard); Tr., Day 8, 10:66–67 (Osborne)). Thus, the Respondent argues that no award of damages for the Incremental Investments or the sale of SCPs to third parties can be contemplated in the present case as a matter of law. The Respondent's specific comments on the evidence submitted with respect to the sale of SCPs and the Incremental Investments is set out in Sections (c) and (d) below.

ii. The Claimants' position

1000. The Claimants do not contest the standard offered by the Respondent for an award of lost profits (that is, that the claim must have "sufficient certainty") (C-PHB, ¶ 145).[200] However, they offer a different interpretation of how this "sufficient certainty" must be established (C-PHB, ¶¶ 145-150; C-Reply, ¶¶ 604-609).

---

[197] *Metalclad v. Mexico*, ¶ 120.

[198] *PSEG v. Turkey*, ¶ 310.

[199] *Biloune & Marine Drive Complex Ltd v Government of Ghana,* UNCITRAL, Award, 30 June 1990 (hereinafter *"Biloune v. Ghana"*), pp. 228 and 229.

[200] Indeed, the Claimants concede that tribunals have traditionally been less willing to award compensation for lost profits than for other losses due to the inherently speculative nature of a lost profits claim. However, relying on the ILC Articles and an article by Prof. John Gotanda, they contend that such damages should be awarded where the claim for them has sufficient certainty. (See ILC Articles, Art. 36, and John Y Gotanda, Recovering Lost Profits in International Disputes, 36 Georgetown Journal of International Law 61, 111 (2004), Exh. C-603).

1001. Citing *Gemplus and Talsud v. Mexico*, the Claimants contend that the concept of certainty is both "relative and reasonable in its application". The Claimants argue that, in that case, the tribunal rejected the argument that the claimants had failed to prove their lost profits claims because their quantification was uncertain or difficult. The tribunal also emphasized that the assessment of a claim of lost profits was not an exercise in certainty but in "sufficient certainty", noting that "[i]t is not always possible for a claimant to prove that a future event could or could not happen with certainty; and a tribunal can only evaluate the chances of such a future event happening."[201] The *Gemplus and Talsud* tribunal was also more lenient with respect to the claimants' burden of proof, having concluded first that "the Claimant's evidential difficulties in proving their claim for loss of future profits [were] directly caused by the breaches of the BITs by the Respondent responsible for such loss."[202] The Claimants also rely on *Sapphire v. NIOC,*[203] *SPP v. Egypt,*[204] and *Lemire v. Ukraine*[205] for the proposition that the uncertainty in the amount of damages should not be an obstacle to an award of lost profits.

1002. The Claimants argue that, in the present case, the fact of injury from revocation of the incentives is not disputed; only the amount of the injury is in dispute. The Claimants also contend that the legal wrong giving rise to those injuries has been established beyond question. Relying on the cases cited above, the Claimants argue that the Respondent is therefore not entitled to invoke an unattainable burden of proof as to the amount of compensation for the Claimants' losses that would compound the Respondent's wrongs and unfairly defeat the Claimants' claim for compensation.

1003. With respect to the Respondent's arguments regarding the need for a proven record of profitability, citing *Sapphire v. NIOC*, *SPP v. Egypt* and *Lemire v. Ukraine,* the Claimants argue that tribunals have awarded damages to un-established businesses or businesses still in their infancy (C-PHB, ¶ 149). The Claimants note that in these cases the tribunals awarded damages despite the fact that the claimant was unable to

---

[201] *Gemplus S.A., SLP S.A. and Gemplus Industrial S.A. de C.V. v. United Mexican States* and *Talsud, S.A. v. United Mexican States* (Conjoined ICSID Cases Nos. ARB (AF)/04/3 and ARB(AF)/04/4), Award, 16 June 2010 (hereinafter *"Gemplus and Talsud v. Mexico" or "Gemplus and Talsud"*), ¶ 13-91.

[202] *Id.,* ¶ 13-92.

[203] *Sapphire v. NIOC,* pp. 187-188, ("It is not necessary to prove the exact damage suffered in order to award damages. On the contrary, when such proof is impossible, particularly as a result of the behaviour of the author of the damage, it is enough for the judge to be able to admit with sufficient probability the existence and extent of the damage.").

[204] *SPP v. Egypt*, ¶ 215 (where the tribunal held that the inability to assess damages with certainty is not alone a reason not to award them when a loss has been suffered).

[205] *Joseph C. Lemire v. Ukraine* (ICSID Case No. ARB/06/18), Award, 28 March 2011 (hereinafter *"Lemire v. Ukraine"*), ¶ 246 ("The Tribunal agrees that it is a commonly accepted standard for awarding forward looking compensation that damages must not be speculative or uncertain, but proved with reasonable certainty; the level of certainty is unlikely, however, to be the same with respect to the conclusion that damages have been caused, and the precise quantification of such damages. Once causation has been established, and it has been proven that the *in bonis* party has indeed suffered a loss, less certainty is required in proof of the actual amount of damages; for this latter determination Claimant only needs to provide a basis upon which the Tribunal can, with reasonable confidence, estimate the extent of the loss.").

prove the exact amount of damage suffered. However, these cases do not specifically address the situation where the claimant has not made the investment that would have allegedly generated the profits.

1004. In any event, the Claimants contend that the successes enjoyed by the Miculas' businesses from the early 1990s until the time of revocation of the incentives should satisfy the Tribunal to the requisite degree of certainty that, had the incentives remained in place, those successes would have continued. The Claimants emphasize that their business was not in its infancy; to the contrary, it was a very successful drinks and food business with large market shares at the time the incentives were revoked (C-PHB, ¶ 149).

1005. Accordingly, the Claimants argue that the Tribunal should have no hesitation in accepting the Claimants' claims for lost profits, and awarding them full compensation so as to put them in the position they would have been in had Romania not breached the BIT by prematurely terminating the incentives.

iii. The Tribunal's analysis

1006. Article 36(2) of the ILC Articles provides that "compensation shall cover any financially assessable damage including loss of profits ***insofar as it is established***." As discussed above, the Respondent submits that lost profits must be proved with "sufficient certainty". The Respondent argues that this means that they must at least be "probable", and "not merely possible."

1007. The Claimants do not dispute that lost profits must be established with sufficient certainty, but rather argue that the Tribunal must be more lenient in determining whether that standard has been met. In particular, the Claimants submit that once the fact of damage has been established, a claimant should not be required to prove its exact quantification. They argue that this is especially true where the conduct of the author of the damage has made that proof difficult or impossible.

1008. The Tribunal understands that any future damage is difficult to prove and is willing to take that into account. There remains nevertheless a requirement to show sufficient certainty as speculation is not the same as prediction. Indeed, the cases cited by the Claimants call for leniency in the assessment of the *amount* of damage, not of its existence. The Tribunal agrees with the tribunal in *Lemire v. Ukraine* when it states that "[o]nce causation has been established, and it has been proven that the *in bonis* party has indeed suffered a loss, less certainty is required in proof of the actual amount of damages; for this latter determination Claimant only needs to provide a basis upon which the Tribunal can, with reasonable confidence, estimate the extent of the loss."[206]

1009. The Tribunal also notes that the commentary to the ILC Articles limits compensation to "damage actually suffered as a result of the internationally wrongful act, and excludes damage which is indirect or too remote" (Comment 5 to Article 34 of the ILC

[206] *Lemire v. Ukraine*, ¶ 246.

Articles). In the case of lost profits, this can only mean that the claimant must have been deprived of profits that would have actually been earned but for the internationally wrongful act. Accordingly, before they are entitled to request a more lenient application of the standard of proof, the Claimants must first prove that they would have actually suffered lost profits, i.e., that they have been deprived of profits that would have actually been earned. In the Tribunal's view, this requires proving (i) that the Claimants were engaged in a profit-making activity (or, at the very least, that there is sufficient certainty that they had engaged or would have engaged in a profit-making activity but for the revocation of the incentives), and (ii) that that activity would have indeed been profitable (at the very least, that such profitability was probable).

1010. In the Tribunal's view, the sufficient certainty standard is usually quite difficult to meet in the absence of a going concern and a proven record of profitability. But it places the emphasis on the word "usually." Depending on the circumstances of the case, there may be instances where a claimant can prove with sufficient certainty that it would have made future profits but for the international wrong. This might be the case, for example, where the claimant benefitted from a long-term contract or concession that guaranteed a certain level of profits or where, as here, there is a track record of similar sales. This must be assessed on a case by case basis, in light of all the factual circumstances of the case. That is what the Tribunal will now do with respect to the Claimants' specific claims for lost profits.

b. Lost profits on sales of finished goods

1011. The Claimants claim no less than RON 427 million (originally calculated by Mr. Boulton as an amount "in excess of €100 million", ER of R. Boulton, ¶ 5.99) for lost profits on sales of finished goods, based on:

a. The calculations contained in section 5 of Mr. Boulton's report dated 30 July 2010 and paragraphs 5.24 to 5.70 and 5.95 to 5.99 in particular; and

b. The evidence referred to in the abovementioned section, including exhibits RB-2 and RB-4 (C-PHB, ¶¶ 151-161).

1012. Mr. Boulton carries out a very specific lost profits analysis: he focuses on the impact of the increased cost of raw materials on sales of the EFDG companies' branded goods, and that consequent impact on profits.[207] Mr. Boulton's analysis starts from the premise that the revocation of the incentives caused an increase in the cost of the Claimants' products, which in turn caused the Claimants to raise their prices. That price increase in turn caused the Claimants to lose market share, preventing them from making sales they otherwise would have made. This in turn caused a loss in profits.

[207] In his Expert Report, Mr. Boulton also makes comments on the expert reports submitted by the Respondent's experts Dr. Robinson (on the effect of Romania's accession to the EU on the Claimants) and Mr. Ellison (on quantum in general). He also comments on the First Expert Report submitted by BCG on behalf of the Claimants and provides his own calculation of the impact of price increases on the Claimants' sales of branded products in Romania. It is on this latter analysis that the Claimants rely for this claim.

1013. Mr. Boulton's empirical analysis focuses on the relationship between increased prices and loss of market share. Mr. Boulton does not carry out an empirical analysis of the first two causal links (that revocation caused an increase in costs, and that this increase in costs caused the Claimants to raise their prices), but rather appears to accept them through a combination of reliance on evidence rendered by the Claimants (including Mr. V. Micula's Witness Statement) and of conclusions based on his experience (i.e., his expert opinion) as explained in more detail below.

1014. Mr. Boulton's calculation overlaps with:

a. Prof. Lessard's quantification of lost profits for the EFDG's incremental sales at RON 97.3 million, which on 30 September 2009 was approximately €28 million when grossed up for taxes (Prof. Lessard's Updated Summary of Damages distributed at the merits hearing), and

b. BCG's quantification of the EFDG's lost profits on sales of finished goods at RON 2,423.20 million, which at the date of BCG's Reply Report (30 July 2010) was approximately €722 million (Second ER of BCG , p. 17).

1015. Mr. Boulton's methodology and conclusions can be summarized as follows:

a. Mr. Boulton focused on the relationship between price and market share (ER of R. Boulton, ¶¶ 5.25-5.70; Appendix 5.1). He first identified eleven factors that may have an impact on market share.[208] Out of these, he identified six that could have been affected by revocation (including cost structure and price decisions). Mr. Boulton stated that the factor with "most obvious" impact on market share was cost structure,[209] but testified that he had only quantified the effect of price decisions, because it was the only one for which he had sufficient empirical data:

> "[A]t a high level, what I did was say: is there a relationship between price and market share? And the answer to that is statistically "yes". I then cross-checked that statistics to make sure it made sense with what third-party research shows, which it does. I then sought to identify what price rises were made in response to revocation. And having done that, I quantified: what was the impact of those price rises on sales? And then [...] having identified the lost sales, you identify how much margin was lost and what profits have been lost." (Tr., Day 9, 159 (Boulton))

b. Mr. Boulton's empirical analysis only focused on lost sales for the Claimants' "own branded soft drinks products". Mr. Boulton identified five products within this larger "soft drinks" category: carbonated sugar drinks (CSDs), mineral water,

[208] These eleven factors were: macroeconomic factors, market structure, barriers to entry, competitive behavior, price decisions, cost structure, existing knowledge of the market, an established distribution network, market share of other products, marketing and availability of working capital (ER of R. Boulton, ¶ 5.24).

[209] With respect to cost structure, Mr. Boulton explained: "Of course, if the price of sugar goes up, then that changes the cost structure of the claimants' businesses for CSDs. That in turn is likely to affect price decisions and/or the ability to respond to competitive behaviour. It's much harder to maintain a price positioning below most of your competitors if you've lost your cost advantage." (Tr., Day 9, 157-158 (Boulton)).

still drinks,[210] nectars and juices. Of these five products, he then narrowed the analysis down to three: CSDs, nectars and juices. According to his testimony, these were the only products for which he was able to obtain sufficiently reliable and detailed price and market share data (relying on AC Nielsen data which the expert found trustworthy). In particular, Mr. Boulton excluded from his calculations losses related to mineral water where, in his submission, there is an element of government control that impacts price, as well as losses related to still drinks (i.e., soft drinks other than those identified above, for which he had insufficient historical price data)[211] (ER of R. Boulton, ¶¶ 5.36-5.70; Tr., Day 9, 167-168).

c. Mr. Boulton calculated that, over the period 2004-2009, lost profits for loss of market share for CSDs, juices and nectars amounted to €88 million. After netting out the effect of the higher margin obtained from raising prices, Mr. Boulton concluded that the net effect on the Claimants was a loss of €28 million (RON 119.3 million at the time of his report) (ER of R. Boulton, ¶¶ 5.36-5.70, Tr. Day 9, 168).[212]

d. To do this, Mr. Boulton calculated a "but for" market share: as he explained it, he used "the results of [his] regression analysis to say: if the price increases hadn't been made, what sales would have been achieved -- they would have been higher -- and then putting that back in as what would they then have been as a proportion of the total market." His conclusion was that "the claimants' market share would have declined more slowly over the period, converging when the sugar stockpile ran out in 2011. So I have assumed that there is no benefit after 2011." For this calculation, he assumed that the Claimants would have had the advantage of a sugar stockpile that would have allowed the Claimants to continue without increasing their prices (about 18 months) (Tr., Day 9, 169-171 (Boulton)).

e. Mr. Boulton then extrapolated the profits lost with respect to the Claimants' soft drinks business (€28 million) to all the EFDG companies' products, using a ratio based on what percentage soft drinks sales had in the total group's sales (in Mr. Boulton's submission, soft drinks accounted for 42% of the total value of sales made by the EFDG[213]). The exact result of this extrapolation would have been €66 million, but he rounded it down to €60 million (RON 255.7 million), because not all the products have the same sugar inputs (he stated that he did not have the data to make an exact calculation). This number is based solely on sales of

[210] In some places, Mr. Boulton refers to still drinks simply as "soft drinks", which may lead to confusion (see, e.g., Mr. Boulton's Presentation at the Merits Hearing, Slide 19). In this section the Tribunal refers to them as "still drinks", which was the terminology used by Mr. Boulton in his expert report.

[211] For these last two categories, Mr. Boulton stated that "price rises may still have been made in response to the Revocation, but I have not included any losses as a result in my calculations" (Mr. Boulton's Presentation at the Merits Hearing, Slide 19). See also Tr., Day 9, 218-219, where Mr. Boulton repeats that he has quantified no loss for mineral water.

[212] This reflects the corrected figures submitted by Mr. Boulton on 17 August 2010 (Letter from the Claimants to the Tribunal of 18 August 2010 and attachments).

[213] Mr. Boulton refers to Appendix 5-1 of his report.

the Claimants' products within Romania, and based only on the effect of price increases (ER of R. Boulton, ¶ 5.70; Appendix 5.1; Tr., Day 9, 177 (Boulton)).

f. After arriving at this €60 million number, Mr. Boulton's overall conclusion (which he acknowledged was his subjective "expert opinion") was that the Claimants suffered a loss "in excess of €100 million" (ER of R. Boulton, ¶ 5.99; Tr., Day 9, 177 (Boulton)). He justified this increase because in the original calculation:

   i. He did not take into account the impact of revocation on other factors that could affect market share, such as marketing, market share of other products, and the availability of working capital.

   ii. He used data from AC Nielsen, a well known global marketing company, which "almost certainly understates the size of the whole market", making his calculations "very conservative".

   iii. He ignored export markets, which were included in the much higher BCG calculation (Tr., Day 9, 178 (Boulton)).

g. The €100 million refers to losses over the period running from January 2005 through mid-2011. Mr. Boulton explained that "[i]t's certainly a convergence period post when the incentives would have ended, but on the assumption that there would have been a significant stockpile of sugar and prices would have come down and converged. But the vast majority of those losses are 2005-2009" (Tr., Day 9, 221-222).

1016. As a general matter, the Tribunal agrees with Mr. Boulton's analysis, if not with his full calculation. It seems difficult to dispute that the increased cost of raw materials caused by the revocation of the incentives would have an impact on the prices of the Claimants' products, thereby probably leading to a decrease in market share and lost sales, and consequently lost profits. As explained below, on the facts, the Tribunal finds that this has indeed been the case.

1017. First, this claim focuses on profits deriving from a business that the Claimants were actually engaged in, and is calculated on the basis of profits actually made in the past. The Claimants had a proven record of profitability regarding the sale of their own branded goods.

1018. The Respondent's main criticism has rather to do with causation. Romania argues that Mr. Boulton's report is premised on the assumption that the repeal of the Raw Materials Facility caused the Claimants to raise the prices of their finished goods, which in turn caused them to lose market share. But this, according to Romania, is false.

a. First, Romania argues that the prices of EFDG products were rising as early as January 2004, long before revocation (which took place in February 2005), so there could be no causal link with revocation (R-PHB, ¶ 300). Mr. Boulton accepts that the rise in prices predated revocation (starting in 2004), but states

that his "understanding is the price decisions made in 2004 were a response to first of all the rumours and then the announcement of revocation" (Tr., Day 9, 200). Romania argues that Mr. Boulton admitted that this assumption was based entirely on the Claimants' witness evidence, which Romania argues is unreliable, but this is not entirely accurate. Mr. Boulton did not state that he relied exclusively on the Claimants' witness evidence; he also drew a conclusion (or an inference) from the evidential pattern and timing of the price increase. In addition, he noted that the loss of market share was not due only to an increase in prices in 2004, but to an inability to reverse them after revocation (Tr., Day 9, 200, 210-212 (Rubins/Boulton)).

b. Second, Romania argues that price increases in 2004 could not have been a response to rumors or announcements of revocation, because the Miculas testified that in January 2004 they still did not believe that the incentives would be revoked. In fact, Ioan Micula testified that he first became concerned with the revocation at the beginning of 2004 after Prime Minister Nastase's interview on TV in January 2004, so the timing of the price increase is not inconsistent with his testimony (Tr., Day 2, 220 (I. Micula)). It is true however that Viorel Micula testified that he was not certain that the incentives would be withdrawn until the fall of 2004 (Tr., Day 4, 199 (V. Micula)).

c. Third, Romania argues that the price increases in 2004 could not have been a response to rumors or announcements of revocation because Mr. Balog testified and Mr. Gamecho confirmed that the Claimants had purchased enough duty-free sugar to delay the economic effect of the repeal until the second half of 2006 (see First WS of C. Balog, ¶ 7, Tr., Day 4, 28 (Gamecho)). Romania is correct: the witnesses did say that, and Mr. Boulton accepted that, if that was correct it "must follow" that the actual cost of sugar to the claimants wouldn't have risen until the end of 2006 (Tr., Day 9, 195-196).

1019. The Tribunal has considered Romania's arguments on causation. But absent another, more plausible explanation for this increase in prices, the Tribunal has difficulty rejecting the causation sequence used by Mr. Boulton. It is undisputed that the revocation of the incentives had an impact on the Claimants' costs. It cannot be seriously disputed that this cost increase eventually would have had an impact on their prices. The increase in the Claimants' prices started in January 2004, which coincides with Prime Minister Nastase's announcement of the revocation. Even if the Claimants had a stockpile that lasted them through 2006, they may have increased their prices to anticipate future losses or smooth out the rise of their prices. In any event, as Mr. Boulton testified, the issue is not just the increase in prices in 2004, but the Claimants' inability to lower them in the future. In any event, while this is a different question, Mr. Boulton only quantified damages after revocation (to be accurate, from January 2005) (Tr., Day 9, 196-197 (Rubins/ Boulton)).

1020. As a result, the Tribunal finds that, with respect to this particular claim, the Claimants have proved with sufficient certainty that, as a result of the revocation of the

incentives, they were deprived of profits that they would otherwise have earned. The question that remains is: what is the value of this loss?

1021. The Tribunal accepts Mr. Boulton's first step in the quantification of this claim, that is, his quantification of lost profits related to lost sales of soft drinks for €28 million. It finds Mr. Boulton's methodology and conclusions reliable and conservative to this point. In particular:

a. Mr. Boulton did not conclude that, but for revocation, the Claimants would have maintained their entire market share. Mr. Boulton conceded that there has been a significant fall in market share over the last five years.[214] As a result he concluded that "about half of that is referable to revocation, and about half of it is referable to all of the other competitive forces in the market and would have happened anyway" (Tr., Day 9, 155 (Boulton)).

b. Although he looked at prices that increased in 2004, he did not quantify damages prior to 1 January 2005. Indeed, he rejected the suggestion that he should have calculated damages since 2004 (when revocation was almost certain), stating:

> "Yes, I think my clients would fairly put to me that I am being overly cautious. They would believe that a greater magnitude of the price increases were their response to revocation. I am seeking always to try to maintain, where things are uncertain, as much caution in my figures as I can." (Tr., Day 9, 167)

c. Mr. Boulton used AC Nielsen data, which was lower than the Claimants' figures and the Euromonitor figures relied upon by BCG, and which may have understated the size of the market. This was because, in his view, AC Nielsen was the only data provider that gave him a full data set of the Claimants' sales and prices and their competitors, and to be rigorous he had to use this data consistently. However, he stated that this had a significant impact on his calculations: according to Mr. Boulton, if he had used Euromonitor, his calculation would have been more than €10 million higher every year (Tr., Day 9, 175-176 (Boulton)).

d. Mr. Boulton ignored export markets in preparing his calculations, which the Tribunal finds appropriate considering that it is difficult to predict how the Claimants' products would have fared in export markets after EU accession.

1022. The Tribunal also finds Romania's additional criticisms of Mr. Boulton's report, to the extent that they refer to the first step of his analysis, unfounded. In particular, Romania argues that "even if there had been an anti-temporal causal link between repeal in 2005 and increased prices in 2004, Mr Boulton's analysis would still be deeply flawed", because he assumed that EFDG's entire loss of market share resulted from rising prices, and ignored the other 10 factors he identified that could

[214] Mr. Boulton testified that the fall in market share started in 2004, not in 2002 (Tr., Day 9, 164 (Boulton)). The Tribunal thus understands that, when Mr. Boulton states that market share has fallen "over the last five years", he is referring to the period 2004-2009.

affect market share" (R-PHB, ¶ 303). Mr. Boulton admitted that he has only quantified the effect of price increases, but denied that he has ignored the other factors or that this makes his quantification inaccurate. Specifically, Mr. Boulton explained: "What I have done is calculate by how much the fall in market share was attributable to the relative price increases, and that is the pink line. Therefore, I am not ignoring, as has been suggested, all of the other factors that affect market share, because they are all in that line. They are all in the actual line and they are also all in my adjusted actual. All I have done is adjust for the effect of price increases" (Tr., Day 9, 169, referring to slide 15 of his presentation). The Tribunal is satisfied with Mr. Boulton's response.

1023. The second and third steps of Mr. Boulton's analysis are however less straightforward.

1024. To recall, Mr. Boulton's second step in the analysis was to extrapolate the profits lost with respect to the Claimants' soft drinks business (€28 million) to all the EFDG companies' products, using a ratio based on what percentage soft drinks sales had in the total group's sales (42%). The exact result of this extrapolation would have been €66 million, but Mr. Boulton rounded it down to €60 million (RON 255.7 million), because not all the products have the same sugar inputs (he stated that he did not have the data to make an exact calculation) (Tr., Day 9, 177 (Boulton)).

1025. After arriving at this number, Mr. Boulton went a step further, and concluded that the Claimants actually suffered a loss of at least €100 million. Mr. Boulton justified this increase in the original calculation (which he acknowledged was his subjective "expert opinion") because in the original calculation:

   a. He did not take into account the impact of revocation on other factors that could affect market share, such as marketing, market share of other products, and the availability of working capital.

   b. He used AC Nielsen data, which "almost certainly understates the size of the whole market", making his calculations "very conservative".

   c. He ignored export markets, which were included in the much higher BCG calculation (Tr., Day 9, 178 (Boulton)).

1026. The Respondent criticizes both of these steps. First, Romania argues that Mr. Boulton extrapolated his estimate of €28 million for soft drinks across the EFDG's entire business, arriving at €60 million, but in so doing he included products (such as beer) which use no sugar. Mr. Boulton defended his position as follows:

> "Q. Given that discussion we've just had, isn't it fair to say that €60 million extrapolated by a direct ratio, even rounded down, is bound to be an overstatement within the bounds of this calculation?
>
> A. Well, I think that's a fair question to put, because it's something I have worried about in thinking about how to get to those numbers.

The reason that I was comfortable with the conclusion I came to is partly because my five products include some for which I found nil effect. So if you like, if you look at my slide 18, the bottom-left quadrant includes big categories like alcohol and beer where the incentives would not have a big effect. But my top-left box from which I am extrapolating includes mineral water. So I haven't just chosen the products that are affected, like CSDs and extrapolated to all products; I have chosen a mix of products, including mineral water, for which I've quantified no loss, and extrapolated that across all products.

So it's not, I think, as open to criticism as you are suggesting. It is uncertain; I tried to say that. It's why I round it down.

The other factor is, of course, the price increases may have been put through on other products, even where there wasn't the direct raw material cost impact coming through. Essentially pricing decisions were made in response to revocation, even where there wasn't that raw material impact.

So could I argue that 60 million was definitely a better number than 50 million? No. Am I comfortable that I considered the relevant factors in coming to my conclusion? Yes.

Q. When you say "comfortable", you think it's probable that that's the right number, that is the amount, €60 million?

A. That would be my best estimate of what the loss was across these 14 categories, before taking into account the other factors that I look at about total size of the market and other impacts of revocation on market share."

(Tr., Day 9, 218-219)

1027. Romania also argues that Mr. Boulton "inflated" his €60 million figure to a level in excess of €100 million "without any support or explanation" (R-PHB, ¶ 304), adding that this €100 million figure is a "guess, based on no calculations whatsoever" (R-PHB, ¶ 214).

1028. The Tribunal has duly noted Romania's objections. However, it is evident to the Tribunal that the Claimants' losses under this claim are not limited to €28 million lost in relation to soft drinks. It is undisputed that the Claimants sold other products that did contain sugar, whose prices would have been affected by the increased cost of sugar. As noted in paragraph 1008 above, once the fact of damage has been established, the Tribunal has wide discretion to establish its exact amount, provided that the Claimants have provided a basis for that calculation.

1029. In the absence of exact data related to other sugar-containing products, the Tribunal accepts that an extrapolation may be appropriate. However, Mr. Boulton's analysis is premised on the assumption that an increased cost of sugar caused an increase in prices of certain products. It is thus not reasonable to extrapolate the profits lost on soft drinks containing sugar to products that do not contain sugar. The Tribunal is not fully satisfied with Mr. Boulton's explanation, cited above, as to why that extrapolation was reasonable. For the same reason, the Tribunal cannot agree with Mr. Boulton's

conclusion that €28 million accurately reflects the losses related to an increased cost of sugar for 42% of the Claimants' total sales, because that 42% includes mineral water, which does not contain sugar.[215] According to the table provided on page 5 of Appendix 5-1 to Mr. Boulton's report, sugar-containing soft drinks (that is, CSDs, other soft drinks and juices/nectars) account for 32.76% of the Claimants' total sales over the period 2004-2008).[216] The Tribunal therefore rejects the specific calculations in the extrapolation carried out by Mr. Boulton.

1030. Instead, and in the exercise of its discretion in the calculation of damages, the Tribunal will extrapolate the Claimants' losses in sugar-containing soft drinks to the Claimants' other sugar-containing products. In the absence of an exact breakdown of what products contain sugar, the Tribunal has assumed that the following categories of products identified in Table A5-1.1 of Appendix 5-1 of Mr. Boulton's report contain sugar in some measure: soft drinks, juices and nectars, alcoholic drinks, biscuits, tomato sauce/ketchup, co-extruded products, breakfast cereals, and sticks. Based on the information provided in Table A5-1.1 of Mr. Boulton's report, the Tribunal has concluded that sugar-containing soft drinks account for approximately 54% of the EFDG's total sales in sugar-containing products (which amount to approximately 850 million over a period between 2004 and 2008). If the losses calculated by Mr. Boulton for sugar-containing soft drinks (i.e., €28 million) are then extrapolated to the remaining sugar-containing product line, the result is €51.6 million.[217]

1031. The Tribunal now turns to Mr. Boulton's third step, in which he concludes that the Claimants actually suffered a loss of at least €100 million. Mr. Boulton conceded that he was unable to quantify this step, which is testimony to his professional integrity; however, the Tribunal is not prepared to accept an increase of €40 million (equivalent to 67% of the amount he arrives to for the entire product line) solely on the basis of Mr. Boulton's "subjective expert opinion" (Tr., Day 9, 177 (Boulton)). In addition, the Tribunal finds that the arguments advanced by Mr. Boulton in order to reach this number are not satisfactory for the following reasons:

a. The fact that Mr. Boulton used conservative data, such as AC Nielsen data, should not be used as a reason to inflate the results by 67%. If the use of conservative figures is deemed warranted and justified, this approach should not be reversed subsequently, especially on the basis of assumptions, even where – as in this case – the assumptions are based on the expert's professional experience.

---

[215] The Tribunal understands that Claimants' entire soft drinks business (including the five categories identified by Mr. Boulton in para. 1018(b) above) account for 42% of the Claimants' total sales. See Table A5-1.1 in Appendix 5-1 of Mr. Boulton's report, p. 5.

[216] The Tribunal notes that this table does not distinguish between CSDs and still drinks, so it assumes they both categories fall under the label "soft drinks".

[217] The Tribunal will not set out in detail its calculations. It suffices to say that the results of the Tribunal's calculations are confirmed by the fact that 54% (i.e., the percentage of sugar-containing soft drinks in the EFDG's total sales of sugar containing products) of €51.6 million (the Tribunal's calculation of overall losses in sugar-containing products) is €28 million (Mr. Boulton's calculation of losses in sugar-containing soft-drinks).

b. Similarly, Mr. Boulton himself stated that he was unable to quantify exactly the impact of the revocation on other factors that could affect market share, such as marketing, market share of other products, and the availability of working capital. In these circumstances, there is no sufficient factual basis for Mr. Boulton's final number, and an increase of 67% appears unjustified.

c. Given the uncertainties that the Claimants' business would have faced after Romania entered the EU, the Tribunal does not believe that it would be appropriate to consider export markets in its calculation of damages.

1032. That being said, although Mr. Boulton has failed to prove that the Claimants have suffered a loss of €100 million, the factors outlined in the preceding paragraph suffice to convince the Tribunal that the Claimants have lost profits in excess of €51.6 million as a result of lost sales of finished goods. In particular, the Tribunal is satisfied that the revocation of the incentives must have had an impact on other factors that could affect market share, such as marketing, market share of other products and the availability of working capital, an impact which Mr. Boulton was unable to quantify. The Tribunal is not well-positioned to quantify the economic impact of factors that the expert himself was unable to quantify, however, it is satisfied that an additional damage was indeed suffered. Having reached that conclusion, and in the exercise of its discretion to quantify damages, the Tribunal is prepared to return to the initial figure proposed by Mr. Boulton in his second step, that is, €60 million.

1033. For these reasons, the Tribunal values the lost profits suffered by the Claimants for lost sales of finished goods at €60 million. In his report, Mr. Boulton calculates this to be equivalent to RON 255.7 million at the exchange rate of the date of his report (ER of R. Boulton, ¶ 5.70).[218] The Claimants have made their claims in RON; as a result, the Tribunal finds that it would be improper to use a different exchange rate and will in particular derive the consequences from this finding when it comes to compute the interest on the claims. Thus, the Tribunal values the lost profits suffered by the Claimants for lost sales of finished goods in RON, namely at RON 255.7 million.

c. Lost profits on sales of sugar containing products (SCPs)

1034. In addition to their claim for lost profits on sales of finished goods, the Claimants claim lost profits on sales of sugar containing products ("SCPs") following the revocation of the incentives, in the amount of RON 492.3 million (C-PHB, ¶¶ 162-170). This claim is cumulatively based on:

a. The calculations contained in section 4 of Mr. Osborne's first report and paragraphs 4.25 and 4.31 in particular;

[218] Indeed, although Mr. Boulton quantifies the claim in Euro, his model was principally denominated in RON. Mr. Boulton explains that "[w]ith the exception of transportation and distribution costs, my model is denominated in RON. I have converted the RON values into Euros on a monthly basis in my model. However, for illustrative purposes here, I have used the 30 July 2010 €:RON exchange rate [equivalent to 1:4.26179, as noted in ¶ 5.69] to convert my Euro denominated calculations back into RON" (ER of R. Boulton, fn. 125, p. 54).

b. The calculations contained in section 5 of Mr. Osborne's second report;

c. The calculations contained in Dr. Fry's reports of December 2009 and July 2010; and

d. The evidence referred to in the abovementioned sections and reports, including paragraph 69 of Mr. Viorel Micula's witness statement dated 22 December 2009, paragraphs 82 and 124 of Mr. Halbac's witness statement dated 22 December 2009, paragraph 17 of Mr. Halbac's witness statement dated 30 July 2010, and exhibits CO-1.19 and CO-13.1.

1035. This claim can be summarized as follows. Relying on the evidence cited above, the Claimants assert that, from 2005, they planned on manufacturing SCPs and selling those SCPs to industrial third parties. They further assert that, as a result of the revocation of the incentives, they were unable to do so. As a result, they now claim for the lost profits they would have allegedly made had they been able to sell SCPs to third parties.

1036. For the quantification of this claim, the Claimants rely on the expert reports prepared by Dr. Fry (of LMC International) and Mr. Osborne (of FTI). In fact, the quantification analysis is carried out by Dr. Fry; Mr. Osborne has adopted his estimates, added interest and grossed-up for taxes (First ER of C. Osborne, ¶ 4.31; Second ER of C. Osborne, ¶ 5.3, 1.19).

1037. Specifically, Dr. Fry asserts that the SCP opportunity would have been worth €131 million to the Claimants had they been able to take advantage of it (Second ER of J. Fry, p. 5). Dr. Fry's quantification is based on the following main assumptions (some of which are the result of his own expert opinion):

a. That, with the price advantage the Raw Materials Incentive would have given the Claimants, they would have been able to capture 90% of the Romanian SCP market (excluding sales of SCPs from domestic sugar beet production, with about half of the market captured in 2005). The Claimants argue that Dr. Fry has successfully responded to all criticisms leveled at this conclusion (see C-PHB, ¶ 164).

b. That the Claimants, in taking advantage of the SCP opportunity, would not have undermined or come into conflict with the EU's sugar regime. This is because the EU's sugar regime defends a reference price and in so doing provides the Commission with mechanisms to deal with all kinds of events (see C-PHB, ¶ 165).

1038. In addition, the Claimants assert that "[a]t no stage of the proceedings has the Respondent ever alleged that sales of SCPs to industrial third parties would have been unlawful under Romanian law or outside what was permitted pursuant to the EGO 24 regime" (C-PHB, ¶ 168).

1039. Finally, the Claimants argue that "the additional capacity to enable the Claimants to engage in sales of SCPs would have attracted a premium in the valuation of the European Food and Drinks Companies prior to Revocation. This capacity gave the Claimants an option to generate incremental cash from a structural cost advantage relative to other sugar suppliers in the market and as such, would definitely have had a value" (C-PHB, ¶ 170). However, they do not attempt to give a value to this premium.

1040. The Respondent criticizes this claim for the following reasons (R-PHB, ¶¶ 244-254; R-SPHB, ¶¶ 19-23):

a. First, the Respondent argues that there is no evidentiary support for this claim. It notes that, in the five years during which the Claimants had access to the Raw Materials Incentive, no SCPs were ever marketed or sold to an industrial third party. Likewise, the Respondent notes that there is no contemporaneous evidence in the record reflecting the alleged intention to pursue the SCP opportunity. The Respondent argues that this claim is premised solely on Mr. Viorel Micula's and Mr. Halbac's testimony, which it characterizes as unreliable.

b. Second, for this same reason, the Respondent argues that there is no evidence of the scale upon which the SCP opportunity would have allegedly been pursued.

c. Third, the Respondent argues that the assumptions that underlie Dr. Fry's calculations are unreasonable. In particular, the Respondent contends that it is unreasonable to assume that the EFDG would have captured 90% of the Romanian market, on the further assumption that the EFDG's competitors (including Coca-Cola) would have been willing to purchase SCPs from EFDG and that all sugar producers capable of producing SCPs would have allowed their businesses to be wiped out (with the exception of sugar beet producers, who would have been able to survive on break-even margins). The Respondent also argues that it is unreasonable to assume that this strategy would have been legal as a matter of Romanian and EU law, or that Romania would have been able to maintain the customs duty exemption until March 2009 (R-PHB, ¶ 247).

1041. After analyzing the evidence before it, the Tribunal rejects this claim. In particular, it finds that the Claimants have not proved with sufficient certainty that, but for the revocation, they would have earned profits as a result of sales of SCPs to industrial third parties. First, it is undisputed that the Claimants never sold SCPs to industrial third parties (Section (i) below). Second, the Claimants have not proven that they would have in fact engaged in the business of selling SCPs to industrial third parties (Section (ii) below). The Tribunal therefore does not need to address the quantum of the alleged lost profits.

i. The Claimants never sold SCPs to industrial third parties

1042. It is uncontested that the Claimants never sold SCPs to industrial third parties. Mr. Osborne stated in his first report and confirmed at the hearing that "[t]he opportunity to sell sugar-based products is not one that was ever pursued. The objective of the

Micula brothers had rather been to build higher value-added businesses including manufacturing finished goods" (First ER of C. Osborne, ¶ 4.26; Tr., Day 10, 66-67 (Osborne)).

1043. In this respect, Mr. Halbac and Mr. Osborne both acknowledged that European Food only sold SCPs to other members of the EFDG. Specifically:

  a. Mr. Osborne states that "[p]rior to revocation, European Food was processing sugar and selling intermediate sugar products to industrial users, in the way posited by LMC, although primarily to European Drinks" (Second ER of C. Osborne ¶ 5.5). Mr. Osborne cites Exh. CO-19.1, but this exhibit only reflects sales of SCPs from European Food to other EFDG companies (specifically, European Drinks and Original Prod SRL).

  b. Mr. Halbac states that "European Food has been selling intermediate sugar products to industrial users since 2000, when it first began selling sugar syrup" (Second WS of M. Halbac, ¶ 3), but then he clarifies that "[w]hile many of European Food's customer's [sic] were EFDG related companies, this does not change the fact that European Food was well versed in selling intermediate products. Further, European Food had been selling these products to unrelated third party customers for some time before revocation, contrary to Romania's position" *(Id.*, note 3). But Mr. Halbac does not say that European Food sold *SCPs* to industrial third party customers.

  c. Indeed, Mr. Halbac was not able to cite to a single invoice clearly reflecting sales of SCPs to industrial third party customers. All invoices cited refer either to sales of SCPs to other EFDG companies, or sales of other intermediate products (not SCPs) to third parties. Specifically:

    i. Exh. C-840, C-841, C-842 and C-839 contain invoices for sugar syrup sales from European Food to European Drinks from 2002 to 2005.

    ii. Exh. C-954 to C-958 are all bulk sales invoices for wafers, cocoa, and other sugar products from European Food to TGIE (another member of the EFDG) from 2002 to 2005.

    iii. Mr. Halbac cites one invoice that could refer to sales to third parties, but the names are illegible and no translation was provided (Exh. C-959). In any event, most of the products may not be SCPs (e.g., tomato paste, ketchup, mustard, cereals), although there appears to be some reference to products containing cocoa, which presumably could involve SCPs. Importantly, there appears to be no mention of sugar syrup. The Tribunal cannot confirm, especially as the document is in Romanian.

1044. Given that no sales of SCPs to industrial third parties were proven to have been made, it also was not proven that the Claimants ever earned profits as a result of this activity. Thus, there is no proven record of profitability to support the Claimants' lost profits claim. As stated at paragraph 1010 above, the absence of a proven record of

profitability need not necessarily be fatal to a lost profits claim. However, in this particular case the Claimants have not met their burden of proving that they would have in fact engaged in the business of selling SCPs to industrial third parties, as discussed below.

ii. The Claimants have not proven that they would have in fact engaged in the business of selling SCPs to industrial third parties

1045. The evidence in the record does not support, with the requisite degree of certainty, a finding that the Claimants would have in fact pursued the SCP opportunity. None of the Claimants' experts could identify any contemporaneous evidence of an intention to pursue the SCP opportunity (Tr., Day 8, 46 (Lessard); Tr., Day 10, 66–70 (Osborne); Tr., Day 11, 224–225 (Fry)). The Claimants rely heavily on witness evidence, in particular by Mr. Viorel Micula and Mr. Halbac, but the Tribunal finds this evidence unconvincing.

1046. Mr. Viorel Micula simply asserts that "[f]rom 2005, we had planned on manufacturing from raw sugar, sugar-based products such as sugar syrup, and then selling these sugar-based products to industrial third-parties" (Third WS of V. Micula, ¶ 69). Mr. Viorel Micula does not cite any documentary evidence.

1047. In his second witness Statement, Mr. Halbac testifies that the Claimants intended to sell SCPs to third party industrial consumers (Second WS of M. Halbac, ¶¶ 23-24). In that statement, he links the expansion of the chocolate cream line, done in December 2004 (although according to him it was planned since 2002) to an increased capacity to process sugar and produce SCPs, thus allegedly allowing for sales of SCPs. He also suggests that EFDG was already selling SCPs to industrial consumers (Second WS of M. Halbac, ¶¶ 3-7), but as stated above, this only referred to customers within the EFDG. Mr. Halbac also testifies that EFDG had the capacity to produce, sell and distribute SCPs to third parties (Second WS of M. Halbac, ¶¶ 25-55).

1048. The Tribunal has several comments on Mr. Halbac's statements. First, it is puzzling that Mr. Halbac did not mention sales of SCPs to third parties in his First Witness Statement. There Mr. Halbac referred only to the internal use of SCPs by EFDG companies (First WS of M. Halbac, ¶¶ 14-17; 81-120). Mr. Halbac did make one statement at paragraph 118 of his First Witness Statement that could potentially have referred to sales of SCPs (specifically, chocolate cream) to third parties, but this is unclear.[219] In any event, in his First Witness Statement he makes no mention of sugar syrup, which is a crucial aspect of the Claimants' SCP claim.

1049. Second, Mr. Halbac's statements do not prove that the Claimants had the capacity to sell SCPs to third parties at the scale assumed by Dr. Fry, Prof. Lessard and Mr. Osborne. Indeed, although Mr. Halbac's statements could support the assertion that

[219] Specifically, Mr. Halbac stated that "[w]hen we extended the chocolate cream line, we were planning for future developments such as the chocolate tablet line, the cream filled biscuit line, and the bulk delivery of chocolate cream for patisseries or other food producers. However, these projects were never realized due to the fact that we lost the EGO raw materials incentive" (First WS of M. Halbac, ¶ 118).

the December 2004 expansion of the chocolate cream line was sufficient to sell chocolate cream to industrial third parties, it does not support the conclusion that this expansion gave the Claimants sufficient capacity to sell powdered sugar or sugar syrup to industrial customers.

a. With respect to sugar syrup, Mr. Halbac states that "[b]efore the December 2004 expansion, we did not have the capacity to sell powdered sugar to industrial consumers. To prepare for these sales, we expanded our handling system with additional Reimelt and Wiener equipment. This equipment is identified in the attached diagram" (Second WS of M. Halbac, ¶ 23). However, the "attached diagram" (Exh. C-848) is an unsigned diagram in English, dated 09.04.03, that does not prove that the equipment was actually bought and installed.

b. Similarly, neither Mr. Halbac's statements nor the evidence cited prove that the Claimants had the capacity to sell sugar syrup to third party industrial customers. Mr. Halbac merely states that "[i]n addition to powdered sugar products and chocolate cream, EFDG planned to extend its sale of sugar syrup to third party industrial consumers. As previously stated, European Food was already selling significant amounts of sugar syrup to European Drinks for the soft drink production. These sales were processed just as they would be if European Food sold sugar syrup to a completely unrelated company, and each sale was invoiced." (Second WS of M. Halbac, ¶ 24). There is no reference to how the 2004 expansion of the chocolate cream line could have impacted the production of sugar syrup. Perhaps the implication is that the Claimants already had that capacity. However, as stated above, European Food never did sell sugar syrup to industrial third parties. If this was such a profitable venture and the Claimants already had the capacity to do so, it is difficult to understand why they did not pursue this opportunity before. There is no credible contemporaneous evidence that the Claimants contemplated or made any preparatory work for the sale of sugar syrup or significant quantities of SCPs to third-party industrial users, be it in or outside Romania. One would for instance have expected some internal correspondence or exchanges of memos as to the abandonment or alteration of such plans in relation to the repeal of the incentives.

1050. In turn, Mr. Osborne's position seems to be that the SCP opportunity was possible and valuable for the Claimants, and given their financial constraints he concludes that they would have "undoubtedly" pursued it. Specifically, Mr. Osborne makes the following statements:

a. "With the EGO 24/1998 raw materials incentive in place, the Claimant Companies ***could have made*** additional sales of sugar-based products to industrial users of sugar outside of the Companies controlled by the individual Claimants, in the same way that it does to Companies that are controlled by the Claimants. Post revocation of the raw materials incentive however, its cost advantage in the purchase of sugar for processing into such products had been removed." (First ER of C. Osborne, ¶ 4.25, emphasis added)

b. “The opportunity to sell sugar-based products is not one that was ever pursued. The objective of the Micula brothers had rather been to build higher value-added businesses including manufacturing finished goods. Given the financial constraints that the Companies are now under, however, the opportunity ***would have been valuable***, and ***would undoubtedly have been exploited***” (First ER of C. Osborne, ¶ 4.26; emphasis added).

c. “Selling intermediate sugar products to industrial customers that were not under common ownership was not the brothers’ primary strategy from the outset of the EGO 24/1998 investment programme. However, it was an ***obvious potential source of significant incremental cash flow*** should the risks they were taking in investing in new businesses and new facilities crystallise on the downside, as they did” (First ER of C. Osborne, ¶ 5.1, emphasis added).

d. “During 2004 when the EBITDA contribution of European Food and soft drinks declined, and the import duty on refined sugar was doubled to 90%, the brothers were preparing to process and sell intermediate sugar products in large quantities to third parties. ***The brothers believed that this would allow them to avoid financial constraints*** within the corporate Claimants, and any negative effects on the other companies they owned” (Second ER of C. Osborne, ¶ 5.2. Mr. Osborne relies here on the Third WS of V. Micula, ¶ 69, emphasis added).

e. “Given the value of the opportunity, as set out by LMC, it appears to me that ***the natural assumption is that the opportunity would have been pursued***, at least at the point at which it became important to the financial well-being of the Companies” (Second ER of C. Osborne, ¶ 5.6).

f. “The EGO 24/1998 incentives allowed the corporate Claimants to sell intermediate sugar products to industrial customers. In fact sales of such products were only ever made to companies under common ownership, but ***there was scope to sell to third parties had the need arisen***. This could have been highly cash generative, especially towards the end of the original incentives period after Romania’s accession to the EU” (Second ER of C. Osborne, ¶ 7.28).

1051. The Tribunal cannot accept Mr. Halbac’s or Mr. Osborne’s statements as proof with sufficient certainty that the Claimants would have in fact sold SCPs to third parties. Even if the Claimants had the capacity to do so, capacity alone does not provide sufficient certainty that an opportunity would have been pursued and that it would have been profitable. Nor can Mr. Osborne’s assertions as to the reasonableness of this plan establish with sufficient certainty that the Claimants would have in fact pursued the SCP opportunity. Reasonable and viable as it may have been, Mr. Osborne is only speculating. In the Tribunal’s view, this does not meet the standard of sufficient certainty. Excellent prospects of profitability may contribute to prove that an opportunity would have existed, especially from the vantage point of retrospective view rather than actual prediction, but this is still a far cry from demonstrating that this opportunity could and would have been availed of.

1052. The Tribunal is likewise not persuaded by the Claimants' explanations for the lack of documentary evidence. Relying on Mr. Boulton, the Claimants argue that it is "completely unrealistic" to treat the EFDG companies as though they are quoted public companies with documents prepared for every single decision, plan and aspect of the business. Although this may be true, this does not dispense with the requirement of proving their lost profits case with sufficient certainty. The Claimants also quote Prof. Lessard, who stated that "as an economic matter, the fact that Claimants invested to develop this capacity and the related product standards and permits is stronger evidence of their intent than would be internal memoranda, corporate resolutions, or other formalities" (Second ER of D. Lessard, ¶ 57). The Tribunal also accepts that in theory this could be true. However, it has found no convincing evidence that the Claimants indeed invested specifically with the purpose of developing this capacity. Although there is evidence that they invested to expand the chocolate cream line, it is unclear whether this gave them the capacity to sell SCPs (especially sugar syrup and powdered sugar) to industrial third parties at the scale that they allege. And even if they had this capacity, this is not in itself proof that they intended to produce different types of SCPs in large quantities to sell to industrial third parties.

1053. The Tribunal is also troubled by the fact the timing of the alleged SCP opportunity. In particular, if this opportunity was so attractive, why did the Claimants not pursue it earlier?

1054. The Claimants argue that there are "proper explanations as to why the SCP opportunity was not pursued prior to the unlawful premature revocation of the Incentives" (C-PHB, ¶ 167). According to the Claimants:

a. The evidence shows, and both Professor Lessard and Mr. Osborne explained during the course of the hearing, that the reason why the SCP opportunity became attractive at the start of 2005 is that the customs duties on sugar doubled at about that time (Exh. C-805; Tr., Day 8, 22 (Lessard); Tr., Day 10, 67 (Osborne); Second ER of D. Lessard, Exhibit A).

b. As explained by Mr. Osborne, the SCP opportunity, being reliant on the Raw Materials Incentive, was not a long-term business proposition but instead was helpful for cash generation. The suggestion seems to be that it was not necessary to pursue it before the Claimants became cash constrained (Tr., Day 10, 67-68 (Osborne)).

c. Mr Osborne also explained that as the financial ratios of the European Food and Drinks Companies were starting to decline by 2005 (though they were not poor), the SCP opportunity and its ability to be highly cash generative became more attractive (Second ER of C. Osborne, ¶ 5.2).

d. Additionally, it was only after the expansion of the Claimants' sugar production facilities was completed in December 2004 that the Claimants had sufficient

capacity to produce and sell SCPs to industrial third parties in addition to selling their private label goods (Second WS of M. Halbac, ¶ 23).

1055. The Tribunal has the following comments:

a. First, if the SCP opportunity only became attractive in 2005 because of an increase in customs duties, it can hardly have been part of the Claimants' original plan. Thus, there was no ongoing investment plan that was frustrated by revocation.

b. Second, by 2005 revocation had already been announced. Thus, the SCP opportunity cannot be said to have properly existed pre-revocation.

c. Third, the expansion of the chocolate cream line (which purports to serve as intention of pursuing this opportunity) was made in December 2004. If the SPC opportunity only became attractive in 2005 because of an increase in customs duties in 2005, the purpose of the chocolate cream line expansion must have been other than pursuing the SCP opportunity. Indeed, Mr. Halbac asserts that this had been planned as early as 2002 (*see* Second WS of M. Halbac, fn. 8 at ¶ 19).

1056. In view of the above, there does not appear to be in the record sufficient evidence of existing and concrete plans rather than, in the most favorable hypothesis for the Claimants, some general speculations that the Claimants might have gone into such sales if certain events would have materialized. In addition, at best, this opportunity appears to have been thought of when the revocation became imminent, as a life saver of sorts to help the Claimants out of financial distress, a mitigating measure to obtain cash flows in times of financial constraint. Indeed, Mr. Osborne's comments cited at paragraph 1050 above seem to suggest this. This is also confirmed by the following statements by Mr. Osborne:

> "1.13 My own view remains that the Claimants had the ***motive, the means and the opportunity*** to generate significant profits from expanding the sales of intermediate sugar products. As I have said, the existence of the opportunity does not appear to me to be contested; and Professor Lessard has dealt with the question of whether the Claimants had the means to take advantage of that opportunity.
>
> 1.14 The fact that the Claimants had not done so, prior to revocation, goes in my view to the question of *motive*. Mr Ellison suggests that it is odd that the "quasi-arbitrage opportunity" was not pursued, prior to revocation, given the high profits apparently available and the low associated risk.
>
> 1.15 I do not find it odd: nothing in the history of the Claimants' operations in Romania suggests to me that the Claimants were motivated to maximise either short-term profitability or personal gain; and all of the interactions that I have had during the course of multiple site visits have suggested the reverse – that they were motivated primarily to build a long term, sustainable business.

1.16 For much of the period up to revocation, ***that motivation would not have been compatible with the exploitation of the opportunity to expand sales of intermediate sugar products***. Once the Claimants started to become financially constrained, however, the motivations would have been precisely aligned, since the survival of the underlying and potentially sustainable business would have been at stake.

1.17 To repeat a point that I have made before, it appears to me that ***the natural assumption is that the Claimants would have taken advantage of the opportunity, as soon as it became expedient or necessary to do so***. As I demonstrate in Section 6 of this report, ***it did indeed become necessary, for reasons connected with the scale of the investments undertaken by the Claimants***."

(Second ER of C. Osborne, ¶¶ 1.13-1.17).

1057. The Tribunal cannot accept Mr. Osborne's conclusions as sufficient evidence of intent to pursue the SCP opportunity. Even if the Claimants had the motive, the means and the opportunity to generate profits from expanding the sales of SCPs to third parties, this does not provide sufficient certainty that, but for the revocation, the Claimants would in fact have engaged in the sale of SCPs to third parties. Absent other convincing evidence in this respect, the Tribunal dismisses this claim.

d. Lost profits incurred as a result of the Claimants' inability to complete the Incremental Investments

i. Overview of the Parties' positions

1058. The Claimants' primary expectation damages case (Method A) is premised on the existence of an alleged ten-year plan to capitalize on the incentives and to complete an expanded manufacturing platform that would have performed profitably after the incentives expired (C-PHB, ¶ 97). This platform allegedly included a malt manufacturing plant, a can manufacturing plant, and a co-generation plant (which the Claimants collectively call the "Incremental Investments"). As part of Method A, the Claimants claim the profits that these Incremental Investments would have generated but for the revocation.

1059. There is no dispute that the Claimants never implemented the Incremental Investments. The Claimants are requesting, in their own words, "damages for lost cash flows that Claimants expected to receive from certain projects that they intended to implement as part of their business plan, and would have implemented, but for the premature revocation of the incentives" (C-Reply, ¶ 595, emphasis in original). Specifically, the Claimants claim:

a. RON 28 million in lost profits from the inability to complete a **malt manufacturing plant**. They base this claim on Prof. Lessard's first and second reports (First ER of D. Lessard, ¶¶ 97-99, Fig. 22, Table 7; Second ER of D. Lessard, ¶¶ 99-103, 113-122, Fig. 16), the evidence cited in those reports, including Mr. Halbac's two witness statements, and the figures contained in Updated Summary of Damages Separating Interest (in RON), Tab 2 of Mr. Schwartz's Opening Presentation;

b. RON 720.4 million in lost profits from inability to complete a **can manufacturing plant**. The Claimants base this claim on Prof. Lessard's first and second reports (First ER of D. Lessard, ¶¶ 105-110, Fig. 23, Table 9 and 10; Second ER of D. Lessard, ¶¶ 104-107, 113-122); Prof. Steenkamp's Expert Report, including Table 15; the evidence cited in those reports, including Mr. Halbac's two witness statements, and the figures contained in Updated Summary of Damages Separating Interest (in RON), Tab 2 of Mr. Schwartz's Opening Presentation.

c. RON 712.6 million from the inability to complete a **co-generation plant**. They base this claim on Prof. Lessard's first and second expert reports (First ER of D. Lessard, ¶¶ 100-104 Table 4; Second ER of D. Lessard, ¶¶ 108-111); the evidence cited in those reports, including Mr. Baciu's witness statement, and figures contained in Updated Summary of Damages Separating Interest (in RON), Tab 2 of Mr. Schwartz's Opening Presentation.

1060. The Claimants assert that they had planned to implement the Incremental Investments, and had in fact taken steps towards their implementation, but the revocation of the incentives deprived them of both the cash and financing leverage necessary to "complete" these Incremental Investments. Relying on the principle of full reparation enshrined in Article 31 of the ILC Articles, as articulated by the PCIJ in the *Factory at Chorzów* case, the Claimants' argument is that, but for the revocation, they would have implemented the Incremental Investments; consequently, to put them back in the position they would have been but for the revocation, the Tribunal should award them the future net cash flows that these plants would have generated.

1061. The Respondent contends that the Claimants have failed to prove with reasonable or sufficient certainty their claims for lost profits related to the Incremental Investments.

1062. First, the Respondent argues that there is no proof that the Incremental Investments would have been undertaken at all. The Respondent notes that Prof. Lessard, despite multiple site visits, meetings with the Claimants' employees, and having relied on much of the information provided by the Claimants, testified that he considered the Incremental Investments to be merely "plausible" (by which he appeared to mean that they would have made "economic sense"), but was unwilling to characterize them as "probable" (Tr., Day 8, 40-2), which the Respondent argues is the minimal standard under international law. Contrary to the Claimants' suggestion, the Respondent denies that all that remained was to "complete" the Incremental Investments. The Respondent argues that to make this assertion the Claimants have mischaracterized the documentary evidence and manipulated witness testimony.

1063. Second, even if there was no doubt that the Incremental Investments would have been undertaken, the Respondent submits that the Claimants cannot meet the sufficient certainty standard to establish that they would have been profitable, or what would have been the level of such projected profits, because the Incremental Investments were not going concerns and had no proven record of profitability. As noted above, the Respondent submits that international law precludes any award of prospective damages for projects that have not commenced, and that the reasonable

certainty standard cannot be satisfied in the absence of a going concern and a proven record of profitability.

1064. In addition, the Respondent argues that the Claimants have failed to prove that the revocation of the incentives was the dominant or proximate cause of their failure to implement the Incremental Investments. The Respondent argues that the financial distress that allegedly prevented the Claimants from implementing the Incremental Investments is attributable to causes other than the revocation of the incentives.

ii. The Tribunal's analysis

1065. For the reasons set out below, the Tribunal rejects the Claimants' claims for lost profits allegedly incurred as a result of their inability to complete the Incremental Investments. It is undisputed that none of the facilities that would have allegedly generated the lost profits claimed (i.e., the malt plant, the canning plant and the co-generation plant) existed in their complete, revenue-generating form at the time of revocation. Instead, the Claimants claim that they intended to build these facilities, and that these facilities were at various stages of completion. The Claimants also argue that the Incremental Investments were consistent with their integrated business model, and submit this as further proof of their intention to complete these facilities. However, after an analysis of the record, the Tribunal finds that the Claimants have failed to prove with sufficient certainty that they would have indeed implemented the Incremental Investments that serve as the basis for this lost profits claim.

1066. In the following sections, the Tribunal addresses the evidence and arguments submitted by the Claimants with respect to each of the Incremental Investments, as well as their general arguments with respect to their integrated business model and advance planning for the Incremental Investments.

(a) The Claimants' integrated business model – Advance planning for the Incremental Investments

1067. In support of their intention to implement the Incremental Investments, the Claimants contend that the Incremental Investments were necessary to the success of the Claimants' overall business model, which they argue was designed to take advantage of the incentives' ten-year duration to build out a manufacturing platform that would be sustainable upon the expiry of the incentives in 2009. The Claimants argue that the Incremental Investments were tied to the brewery, which they claim was also an integral part of their plan for retaining profitability beyond the expiry of the incentives in 2009, because beer was not as dependent on the incentives as their soft drinks or food business. Specifically, they argue that:

a. The malt manufacturing plant would have improved the cost effectiveness of the brewery, improving the Claimants' competitiveness in the beer market;

b. The can manufacturing plant would have permitted the Claimants to competitively expand their beer sales into the private label market; and

c. The co-generation plant would have capitalized on the brewery's waste products to reduce the Claimants' overall energy costs and improve the Claimants' cost and price competitiveness. It would have also provided revenue from the sale of energy and green certificates to third parties.

(C-PHB, ¶ 171; Second ER of D. Lessard, ¶¶ 7-8; First and Second WS of S. Baciu).

1068. The Claimants contend that their model was driven by both the ten-year term of the incentives and the 20-year obligation to continue operations in the disfavored region imposed by EGO 24 (C-PHB, ¶¶ 172-173). This assertion is supported mainly by:

a. Mr. Ioan Micula's oral testimony, where he states that their strategy after 1999 was "to use the temporary facilities for ten years to turn them into permanent advantages. […] By way of these temporary facilities, we tried in fact to turn them into permanent standing facilities by building up those components of the equipment that could be used after termination of the facilities" (Tr., Day 3, 33-35 (I. Micula)).

b. Prof. Lessard's description of the Claimants' business model, which he explains "involved a high degree of commitment […] because the Claimants had to build factories and produce successful products well within the ten-year period that the Incentives were available in order to create a base that would sustain their activities for the ten years they were obligated to remain in business after the Incentives expired" (First ER of D. Lessard, ¶ 39).

1069. The Claimants argue that these facilities made economic sense in the context of their integrated platform and would have been easy to "plug in" to that platform. Through the witness testimony of Mr. Halbac (and to a lesser extent, Mr. Baciu), the Claimants claim that their infrastructure was engineered in such a way that new production facilities could be easily connected to it.

1070. Mr. Halbac explained (and the Respondent did not dispute) that the region in which the Claimants invested did not have the infrastructure in place to support large production facilities. As a result, it was necessary to invest heavily in basic utilities such as reliable electricity, gas, and water supply to support each of the production sites (First WS of M. Halbac, ¶ 45). Mr. Halbac asserted that the basic utilities were built on a larger scale than the companies needed at that time due to the obligation under the EGO 24 to maintain the investment for 20 years, and because the Claimants wanted to make use of the networks for future projects. As a result, the infrastructure was engineered in such a way that it could be easily connected to new production facilities (First WS of M. Halbac, ¶ 46).

1071. In his First Witness Statement, Mr. Halbac included diagrams showing the integration of the different facilities. He stated that the dashed lines in the diagrams "represent investments that EFDG has not completed, but that could have been easily integrated into EFDG's existing utility connections, had early revocation of the EGO 24 incentives not constrained our cash" (First WS of M. Halbac, ¶ 50). He also testified that "[t]he ability of EFDG to engineer and construct utility networks was absolutely

critical, since the State did not provide these utilities for us. We planned ahead and built these networks so that they could support additional production capacities, and as a result, we have been able to expand our facilities fairly easily. This also means that the projects we have been unable to complete could be easily added to our existing network. Thus, EFDG's initial planning for the shared infrastructure has saved considerable amounts of money, because the infrastructure does not have to be duplicated at each site. These cost savings have been invested in the expansion and integration of the business" (First WS of M. Halbac, ¶¶ 60-61).

1072. On the basis of Mr. Halbac's testimony and other evidence in the record, the Tribunal has no reason to doubt that the Claimants built a highly integrated platform that allowed them to save costs if they decided to insert new product lines or plants. However, this does not provide sufficient certainty that the Claimants would have in fact built a malt plant, a can manufacturing plant and/or a co-generation plant. This finding is in line with the general pattern of conduct evinced by the Individual Claimants and the EFDG: they built up and expanded their businesses with foresight, with the intent always to preserve as many options as possible and keep flexible in order to be able to seize those opportunities which would actually materialize at the right time depending on market conditions and financial possibilities, among other considerations. This speaks for the fact that the two Individual Claimants are savvy and experienced business people, which their very success also establishes, but it does not prove that they would actually have embarked on all of the options that they had envisaged at one point or another.

1073. Indeed, there is virtually no contemporaneous evidence of advance planning for any of the Incremental investments. There are no specific feasibility plans for any of the plants, nor is there any record of them in the 2000, 2002 or 2003 PWC business plans (Exh. R-204, R-214 and R-215). Other than a few quotes and invoices, the Claimants have not been able to point to any internal documents, such as budget, memos or correspondence evidencing their intention to build these plants. This is particularly surprising considering that Mr. Halbac testified that EFDG had a "development department" specifically created to reduce costs associated with future investments (First WS of M. Halbac, ¶¶ 20-34). According to Mr. Halbac, this development department consisted of a group of engineers that "cover virtually every aspect of any investment, including mechanical engineers, architectural engineers, electric engineers, civil engineers, structural engineers, and even engineers who focus solely on plumbing" (First WS of M. Halbac, ¶ 21). Mr. Halbac also testified that for each new project, this department organized a team of project managers responsible for the optimum realization of the investments, starting from the initial contracts. Mr. Halbac even included a diagram titled "EFG Plant Building" (First WS of M. Halbac, p. 13) illustrating "EFDG's planning and implementation process for new investments". However, despite the existence of this team of engineers and highly organized and structured process, there is not a single internal plan, memo or email documenting the Claimants' intention to pursue the Incremental Investments.

1074. As discussed in detail in the sections that follow, the documentary evidence in the record refers mainly to correspondence with and quotations from third parties for

equipment necessary to develop these projects. Although it does evidence an interest in these projects as potential investments, it does not prove that the Claimants would have in fact invested in them.

1075. Despite this lack of evidence of advance planning, the Claimants contend that they in fact took steps to materialize the Incremental Investments, which in their view shows that they intended to pursue them (indeed, they argue that only final steps were needed to complete them). The Claimants argue that they were a family-run business that took decisions verbally and did not usually operate on the basis of written plans. They submit that the development of the brewery is evidence of this, because it was built despite the absence of written plans and despite the fact that it was not mentioned in the 2000 or 2003 PWC business plans. Indeed, they point out that according to the 2003 PWC business plan, no major capital investment was planned or needed over the period 2003 to 2007, and despite that statement, the Claimants' heaviest capital investments occurred from 2003 to 2007 (including the expansion of the brewery) (C-PHB, ¶ 179). The Tribunal has duly considered this argument. However, as discussed below, it finds that the steps identified by the Claimants as evidence of their intention to implement the Incremental Investments do not show with sufficient certainty that these investments would in fact have been undertaken.

(b) The malt manufacturing plant

1076. Mr. Halbac testified that, because malt is one of the main ingredients used in beer production, "we had been exploring options for building a malt plant ever since we considered building the brewery. This is because we knew that we could realize significant cost savings if we produced our own malt instead of importing or buying it on the domestic market" (First WS of M. Halbac, ¶ 145).

1077. However, in his Second Witness Statement Mr. Halbac clarified that the plans to construct or complete the malt plan were not immediate. Although he stated that the Claimants always considered the malt plant as a portion of their brewery, he clarified that they "would complete [it] at a critical point in time to increase the brewery's overall efficiency" (Second WS of M. Halbac, ¶ 57). He also stated that at the time that the Claimants constructed the initial stages of the brewery (and later its expansion), it was "unnecessary for [the Claimants] to construct a complete malt plant." This was because they were still benefitting from EGO 24 and could import malt without paying customs duties. However, he added that "we knew that these Incentives would not last forever, and that it would be important for us to make preparations for the malt plant so that we could eventually control our malt production and not rely on outside sources for the main ingredient to one of our most successful products – beer" (Second WS of M. Halbac, ¶ 60). This suggests that the Claimants may have been considering the construction of a malt plant from early on, but they did not specifically plan to build one at any particular time until the expiry of the incentives was near.

1078. The documentary evidence suggests that the possibility of building a malt plant was indeed considered by the Claimants from at least 2002. There is evidence of correspondence with Buhler and Schmidt-Seeger for the construction of a malt plant during 2002,[220] including quotations for malt plants of various capacities (Exh. C-335; C-659; C-628; C-658; C-336[221]). However, the Claimants do not appear to have acted upon these quotations.

1079. Mr. Halbac testified that, at the time of the revocation, the Claimants already had many of the necessary components for a malt plant, including equipment for barley reception, silos for barley, transport, conveying, and cleaning systems for barley, utilities including steam supply, water, water treatment, compressed air, electrical, and cooling systems, malt transport, cleaning, and silos for storing malt (First WS of M. Halbac, ¶¶ 146-151, Second WS of M. Halbac, ¶¶ 57-65; Tr., Day 7, 141-144). According to Mr. Halbac, this accounted for 60% of the malt plant (Second WS of M. Halbac, ¶ 61). Mr. Halbac testified that the only missing elements were the germination equipment, construction of the actual building and final connection of utilities to finish the integration into the brewery (Second WS of M. Halbac, ¶¶ 61-65; Tr., Day 7, 143-144). He also testified that Claimants had taken steps to acquire these missing elements, including the finalization of a contract to purchase the germination machine and negotiations with the EBRD for the necessary financing.

1080. The Respondent denies that the malt manufacturing plant was nearly finished, as the Claimants claim. It notes that the Claimants never bought a germination machine, which was the central component of the malt plant (R-PHB, ¶ 259). The Respondent also argues that the Claimants have sought to pass off infrastructure and equipment used for other manufacturing processes as specifically meant for the malt plant. In particular, the Respondent argues that the empty silo that Mr. Halbac testified was reserved for barley was in fact constructed before EGO 24 (Mr. Halbac testified it was built before 2000) and could have been used for other purposes than storing grains for a malt plant (R-PHB, ¶ 260 and Tr., Day 7, 169 (Halbac)). The Respondent also asserts that Mr. Halbac[222] admitted that the transportation system for malt was in fact used for malt purchased from third parties (R-PHB, ¶ 260 and Tr., Day 7, 148 (Halbac)).

1081. The Tribunal's review of the documentary evidence confirms that, at the time of the revocation of the incentives, the Claimants did indeed have the components identified by Mr. Halbac. However, the Claimants have not established that any of those

[220] Although Mr. Halbac testified that their "first offer for equipment came from Seeger in 1997", that offer was not submitted.

[221] Exh. C-335 is a quotation dated 19 March 2002 from Schmidt-Seeger for a malt plant with a capacity of 23,000 tons; Exh. C-659 is an email from Buhler dated 19 March 2002 with an attached quotation for a malt plant with a capacity of 35,000 tons; Exh. C-628 is an email from Buhler dated 22 April 2002 mentioning the layout (sent by a previous email) for a malt plant with a capacity of 35,000 tons; Exh. C-658 is an email from Buhler dated 2 August 2002 attaching a revised quotation for a capacity of 22,960 tons worth over €3,9 million but with the possibility of extension to 34,440 tons; and Exh. C-336 is a quotation from Schmidt-Seeger dated 4 November 2002 for the establishment components of a malt plant with a capacity of 37,000 – 50,000 tons.

[222] The Respondent refers to Mr. Baciu, but the citation is to Mr. Halbac's testimony.

components were purchased exclusively for a malt plant. Indeed, many of them appear to have been for the brewery's normal operation. In particular:

a. The Claimants appear to have bought malt handling equipment, including silos and conveyor systems in 2004 (Exh. C-970 contains invoices dated November 2002 from Schmidt-Seeger), and invoices dated November 2004 from Privé and Denis (Exh. C-967-968)).[223] However, it is unclear whether this equipment was bought in connection with a malt *manufacturing* plant, rather than malt *handling* related to a brewery. As the Respondent notes, Mr. Halbac testified at the hearing that the silos and conveying systems were also used for other grains, although the silo reserved for barley was empty (Tr., Day 7, 145-148). Mr. Halbac also stated that the transportation system could be used for both malt and barley, but he also testified that the transportation system "was conceived to fit the malt plant", and in the absence of the malt plant to process the barley it was being used to transport malt only (Tr., Day 7, 146-148 (Halbac)).

b. With respect to utilities, Mr. Halbac testified that when the Claimants built the brewery they constructed a steam pipeline with sufficient capacity to supply both the brewery in its expanded form (which would account for 50% of the pipeline's capacity), <u>and</u> the malt and can manufacturing plants (which would account for the remaining 50% of the pipeline's capacity) (Tr., Day 7, 149-153 (Halbac); Exh. C-647, a certificate of completion of the steam pipe).

1082. Even if this equipment had been intended exclusively for the malt plant (which the Tribunal finds has not been established), it is undisputed that the Claimants were missing key elements for a malt plant, in particular the germination machine and the building. Although there is evidence in the record to support the Claimants' assertion that they intended to buy a germination machine and construct the building to house the malt plant, most of this evidence post-dates the revocation of the incentives. In particular:

a. Mr. Halbac testified that the Claimants had purchased land in 2000-2001 with an estimated value of €1 million, which they set aside for the malt plant (Second WS of M. Halbac, ¶ 62), and that the Claimants had "gained approval from the State to construct the building" (Second WS of M. Halbac, ¶ 62). Indeed, the Claimants submitted an Urban Planning Certificate that certifies that the land it refers to may be used to build a malt plant (Exh. C-976), but this certificate was issued on 5 Dec. 2005 (i.e., post-revocation). The certificate also states that it is not in lieu of the relevant building permit.

b. Mr. Halbac referred to a geotechnical study conducted by the Claimants for the malt plant (Second WS of M. Halbac, ¶ 62). This study is indeed in the record (Exh. C-978), but it is dated "2005", which means it was carried out after the announcement of the revocation in November 2004.

---

[223] Exh. C-970 contains invoices dated November 2002 from Schmidt-Seeger), and Exh. C-967-968 contain invoices dated November 2004 from Privé and Denis.

c. Mr. Halbac also testified that the Claimants had ordered the structural building design to the Romanian company IPROLAN (Second WS of M. Halbac, ¶ 63). However, the engineering design contract with IPROLAN (Exh. C-704) is dated 19 June 2006, more than a year after the revocation.

d. Mr. Halbac also testified that the Claimants had a contract in place with Lausmann GmbH for the germination machine (Tr., Day 7, 149 (Halbac); Exh. C-478). At the hearing, the Claimants stated that the document only concerned a germination machine (Tr., Day 7, 172 (Fleuriet)). However, this contract appears to involve more than just a germination machine, as Article 1.1 of the contract mentions a "complete malt producing plant, spare parts, wear parts and accessories as described in the Appendix 1", which in turn includes, among others, steeping, cleaning, kilning and transport equipment. In addition, the contract post-dates the revocation (Exh. C-478).[224]

e. Finally, the record confirms that in the Claimants' negotiations with the EBRD for a potential loan referred to financing for the "potential acquisition, installation and operation of a malt processing plant with a capacity of 30,000 tons" (Exh. C-744, C-745, C-746).[225] However, these documents are from 2006, and therefore post-date the revocation.

1083. The Tribunal's conclusion from the available evidence is that the Claimants contemplated the possibility of building a malt plant from at least 2002, and invested in certain cost efficiencies that they added to the brewery. They also planned ahead with respect to utilities, making sure that the steam pipe could service the brewery as well as future plants. However, they did not plan to build a complete malt manufacturing plant (i.e., a plant that could process barley into malt rather than handle ready-made malt) until close to the expiry of the incentives, presumably because prior to that it was cheaper for them to import duty-free malt. This would explain why their more serious efforts to set up this plant (financing with the EBRD, geotechnical study, contract for germination and other equipment) came in 2005 and 2006, after the early revocation of the incentives.

1084. In the Tribunal's view, this means that, although there is evidence of the Claimants' intention to build a malt manufacturing plant sometime in the future, the Claimants have not proven with sufficient certainty that they planned to build it prior to expiry of the incentives (whether by their early revocation in 2005 or their scheduled expiry in 2009). Nor is it accurate to say that at the date of the revocation the Claimants had built 60% of a malt manufacturing plant. At the date of the revocation, the Claimants could only boast certain minor equipment and cost efficiencies that would have made it relatively easy and less expensive to construct and operate a malt manufacturing plant. What they had was a highly integrated platform to which a malt plant could

---

[224] On its front page, the contract is dated 6 July 2005, but the final price appears to have been negotiated in December 2006 (the date "19.12.2006" is handwritten in Appendix 1 next to the final negotiated price (€ 4.425 million)

[225] Although the Claimants argue that negotiations with EBRD involved financing of a "germination machine", the EBRD documents refer to a full "malt processing plant".

easily have been added. This would prove again that the Claimants are savvy business people. This does not provide sufficient certainty that, but for the revocation of the incentives, they would have built a malt manufacturing plant.

(c) The can manufacturing plant

1085. With respect to their intention to build a can manufacturing plant, the Claimants again rely heavily on Mr. Halbac's testimony.

1086. Mr. Halbac testified that it is very expensive to buy and transport aluminum cans, while it is much cheaper to transport the raw materials needed to produce the cans. He further testified that EFDG had always understood that they would save money by importing raw materials to make their own cans. "Thus, ever since we started considering a brewery, we planned to construct a nearby can making facility." (First WS of M. Halbac, ¶¶ 156-157).

1087. Mr. Halbac also testified that "[t]here is a significant canned beer market in both the Romanian and export markets", and that while the Claimants were building the brewery, they "became even more interested in the prospect of having [their] own can plant" (First WS of M. Halbac, ¶ 162). In addition, Mr. Halbac stated that by reducing the can costs, they could reduce the price for which they sold their canned beer to about the same price as their PET bottled-beer, which would have made them more competitive in both the domestic and export beer markets by increasing their shelf space, which would have in turn increased sales to consumers (First WS of M. Halbac, ¶ 168). Mr. Halbac also testified that canned beer has a better shelf life than PET bottled beer and is cheaper to transport, which is why it was their preferred method of bottling for their export beer (First WS of M. Halbac, ¶ 169).

1088. The evidence in the record suggests that the Claimants did begin to consider building a can plant as early as 1998. Specifically, Mr. Halbac testified that in 1997/1998, the Claimants contacted various American companies to investigate the relevant technologies and visited a trade show in Denver and production facilities (First WS of M. Halbac, ¶ 158). The correspondence submitted as Exh. C-844-846 refers to meetings with Mr. Halbac in 1998 at the vendors' respective booths at "Cannex '98" in Denver, Colorado. Mr. Halbac testified that the Claimants "continued to receive and study vendor proposals" (First WS of M. Halbac, ¶ 162), and indeed, the record includes correspondence and quotations related to, inter alia, a turn-key canning plant and can manufacturing equipment and accessories (Exh. C-337, C-844, C-845, C-856, C-847).[226]

[226] Exh. C-337 contains a proposal from Pac International to Rieni Drinks, dated 20 May 1998. The detailed quotation concerns a turn-key canning plant offered for a price of over $2.6 million. Exh. C-844 is a letter of 18 May 1998 from Cambridge Applied Systems, Inc. (US), to Mr. Halbac concerning requested information on viscometers. Exh. C-845 is a letter 5 June 1998 from Kerry (UK) to Mr. Halbac with an offer for a "Kerry Seam Plus Station". Exh. C-846 is a letter of 30 June 1998 from Chemetall (Sweden) to Mr. Halbac concerning, i.a., can washer treatments. Exh. C-847 is a letter of 9 July 1998 from Omnitech International, Inc. (US), to Mr. Halbac with an offer for can manufacturing equipment and accessories offered at a price of $19.2 million.

1089. Efforts to find suppliers appear to have continued in the following years. Mr. Halbac testified that "[t]o determine whether the can plant was a viable option, our engineers attended a variety of symposiums and expositions. For instance, in 2002, we visited the Metpak exhibition in Essen, Germany to find possible suppliers for the can plant. After this exhibition, we decided we would construct the can plant after the brewery was complete." (First WS of M. Halbac, ¶ 162).

1090. The Claimants also refer to Exh. C-388, C-339 and C-343, which are quotations from 2006-2008 in relation to a can manufacturing plant. In particular, the Claimants appear to have engaged in negotiations with TG Can which included the possibility of financing of supply credit (Exh. C-339; Tr., Day 7, 168 (Halbac)).

1091. In addition to the documents cited above, the Claimants argue that their intention to build a can manufacturing plant is supported by the fact that they took certain steps and made investments in preparation for this plant. At the hearing, Mr. Halbac testified that about 50% of the can manufacturing plant had been either built or purchased (Tr., Day 7, 166). Using as an example an offer from PAC International for a turnkey can manufacturing facility (Exh. C-337), Mr. Halbac testified that the Claimants had already completed the following elements of the plant: support systems equipment area, warehousing, utility and steam supply systems, demineralization system, cooling and hot water systems, compressed air system, waste water treatment, electrical shop and quality control lab equipment, chemical storage, machine shop, and specialized can printing and labeling equipment (Tr., Day 7, 156-159 (Halbac)). According to the Claimants, the only missing elements to complete the can plant were the building (Tr., Day 7, 157 (Halbac)), and the can manufacturing machines for producing the aluminum cans (Tr., Day 7, 165 (Halbac)).

1092. As with the malt plant, the Respondent denies that any of these alleged steps or investments support the Claimants' intention to build a can plant. The Respondent argues that the Claimants have sought to pass equipment used for other manufacturing processes as evidence of a nearly completed can plant, although the most basic components of the plant were missing (R-PHB, ¶¶ 262-264).

1093. In the Tribunal's view, although there is evidence suggesting that the Claimants indeed contemplated the possibility of building a can manufacturing plant, the evidence of concrete plans or specific steps taken to materialize this project is weak. The documentation cited above shows that the Claimants had an interest in purchasing elements for a can manufacturing plant, but it does not prove that they seriously planned to purchase them, in particular considering that this interest did not materialize within an almost 10-year span.

1094. Similarly, while there is evidence to support Mr. Halbac's assertions that the Claimants already had many components necessary for building a can plant, most of these components appear to refer to shared utilities, land or facilities. Specifically:

a. As mentioned above for the malt plant, Mr. Halbac testified that the steam pipe was built with an expanded capacity, so that 50% was reserved for the can and

malt facilities (C-PHB, ¶ 196 and Tr., Day 7, 152-153 (Halbac); Exh. C-649). In other words, it was not built specifically for the can plant.

b. Mr. Halbac also testified that, in late 1999, the Claimants set aside approximately 50,000 square meters of land for a can factory (Second WS of M. Halbac, ¶ 80). There is little evidence in the record of this land other than a photograph that was shown during the 2010 hearing. It is also unclear whether this land was purchased especially for the can plant. In his first witness statement Mr. Halbac had testified that the Claimants had available land located next to the brewery in Drăgăneşti West, which made sense because it would have allowed the canning plant to utilize EDFG's existing infrastructure and become integrated with the rest of the plants, and they would use a significant number of the cans to bottle beer from the brewery (First WS of M. Halbac, ¶ 164). The timing of this step and the absence of purchase documentation suggests that reserve land was indeed available but not that specific investments were made to acquire the land in connection with the can plant.

1095. That being said, some equipment appears to have been bought with the can plant in mind, although again it is unclear if the equipment could also be used in other manufacturing processes. Specifically:

a. Mr. Halbac testified that the grinding machine at the repair shop was purchased in 2002 especially for the can manufacturing plant (Tr., Day 7, 161-163). However, it is unclear why this machine was bought in 2002 if no can plant existed at the time. It is also unclear whether it was also used in other manufacturing processes.

b. Mr. Halbac testified that "one of the most difficult processes in can making is the design and production of the printing plates – which they have been able to do since 2000." (Second WS of M. Halbac, ¶ 90). For this purpose, the Claimants argue that they invested heavily in can printing plates and production equipment as well as film printing machines for the labeling of cans (C-PHB, ¶ 196). The Claimants submitted invoices to support this (Exh. C-951, C-946, C-942). Some of these invoices are from 1998 and pre-date the construction of the brewery, so it seems unlikely that the equipment related to beer cans. The Respondent also argues that machinery used to manufacture and wash printing plates could be used to print on cans, but was acquired and used in the Claimants' business to produce other types of packages (R-PHB, ¶ 262). However, Mr. Halbac testified that "[o]ne of the machines is equipped so as to be able to produce special plates for cans….So we bought that type of machinery instead of the cylindric one in order to be able to manufacture plates for the cans as well" (Tr., Day 7, 171 (Halbac)). Mr. Halbac also testified that no one sold unprinted cans, so they could not have used the plates to print on purchased cans as suggested by the Respondent (Tr. Day 7, 171-172 (Halbac)).

c. Mr. Halbac also testified that in 2003, allegedly anticipating a can making line being constructed in Drăgăneşti, EFDG invested €128,000 in the relocation of its

can filling line to Drăgăneşti. An offer from Krones for new can conveyor equipment offered at a price of €120,000 was apparently accepted in this regard (Exh. C-644).

1096. Despite the purchase of this equipment, the Tribunal is not persuaded that the can plant project was 50% complete, as the Claimants assert, or that it was seriously planned by the Claimants. Even if this equipment was purchased with a possible can plant in mind, the Claimants were also using it for other purposes. In addition, the relocation of the can *filling* line does not necessarily imply that a can *making* line will be subsequently built. More importantly, it is undisputed that the Claimants never purchased the can manufacturing machines for producing the aluminum cans. As a result, the Tribunal finds that the Claimants have not proved with sufficient certainty that but for the revocation they would have built the can manufacturing plant.

(d) The co-generation plant

1097. Mr. Baciu and Mr. Halbac testified that from early on EFDG intended to build a co-generation plant to reduce internal operational costs. The co-generation plant would accomplish this by reducing EFDG's dependence on outside fuel, reducing energy costs, and using waste from the company's production processes (First WS of S. Baciu, ¶ 18; First WS of M. Halbac, ¶¶ 56-59). Mr. Baciu also testified that after Romania passed renewable energy laws in 2004, EFDG's intention was to produce energy to sell electricity to the wholesale market, as well as green certificates (First WS of S. Baciu, ¶¶ 15, 24-29). As a result, the profits that the co-generation plant would have allegedly made rested on both savings on operational costs and the sale of electricity/green certificates to third parties. The Respondent alleges, and Prof. Lessard confirmed at the hearing, that the green certificates accounted for 72% of the value that Prof. Lessard attributed to the project (Tr., Day 7, 109; Tr., Day 8, 95-96).

1098. According to Mr. Baciu, EFDG planned to construct a 20 MW electricity co-generation plant. The estimated cost to build the plant was €20 million (including equipment and connection) (First WS of S. Baciu, ¶¶ 16, 30-32).

1099. After reviewing the evidence, the Tribunal finds that the Claimants have failed to prove with sufficient certainty that they would have built a co-generation plant. Although there is some evidence that the Claimants considered the option of building a co-generation plant in the future, the evidence of advance planning or specific steps in the implementation of such a plant is inconclusive at best.

1100. According to Mr. Baciu, the co-generation plant was part of EFDG's plans from its early days. He testified that the Claimants began contemplating co-generation in the late 1990s, when they considered establishing beverage production lines in Bucharest, and continued with this plan when they established their food business in Bihor after the passage of GD 194/1999.

1101. The record confirms that the Claimants had an interest in building a co-generation plant as early as 1998, and contacted several manufacturers for this purpose. The record includes several offers or quotations for a co-generation plant between 1998

and 1999 (Exh. C-821, C-822, C-823).[227] The Claimants appear to have started to consider co-generation more seriously in 2002:

a. In 2002, the Claimants contracted with ABB to implement switch-gear technology in the substation, which would allow them to reverse the flow of electricity from a future co-generation source into the national distribution network (Exh. C-480).

b. Also in 2002, the Claimants contracted with Biothane International (Biothane) for the construction of their waste water treatment plant. Mr. Baciu explains that they also discussed the possibility of using the by-products of this facility as possible renewable energy sources. These discussions evolved into discussions for the construction of a co-generation plant (First WS of S. Baciu, ¶¶ 19-22).[228] However, there seems to have been no follow-up to this correspondence, and the Biothane co-generation project did not materialize. Indeed, in 2003 the Claimants initiated correspondence with Schmidt for biomass testing (Exh. C-712), and made inquiries with General Electric for turbines (Exh. C-708[229]) (Second WS of S. Baciu, ¶ 44).

1102. The Claimants' interest in a co-generation plant seems to have grown when Romania passed renewable energy laws. Although the laws were not passed until 2004, Mr. Baciu testified that around 2002 they already anticipated that these laws would be passed (First WS of S. Baciu, ¶ 23). According to Mr. Baciu, "[t]his probability of co-generation as a revenue generator gave us another reason to seriously consider construction of our own co-generation facility. Thus, we knew that we could produce energy for our facilities at a lower cost than what we were currently paying in electricity from the State's distribution network, and we knew that any additional energy we produced had the potential to be sold" (*Id.*). When Romania did pass the renewable energy laws in 2004, their attractiveness was enhanced by the possibility of trading green certificates. However, as a result of the revocation of the incentives,

[227] Exh. C-821 is an offer/quotation from ABB dated 4 February 1999; Exh. C-822 is a preliminary proposal from Hyundai dated 3 November 1998, and Exh. C-823 is a quotation from Mannesman dated 19 February 1999.

[228] The record includes:

- Meeting Minutes from 16 April 2002 (Exh. C-483) between European Food and Biothane anticipating potential construction of a co-generation plant, where equipment and next steps were discussed;
- An email from Biothane to European Drinks, 2 May 2002 (Exh, C-484), documenting European Food Group's May 2002 delivery of a sample dried material (DDGS) to determine composition and biodegradability for fuel component testing.
- An email from Christian Flora of EFDG to Biothane dated 27 May 2002 (Exh. C-484, second page), referring to various "problems" related to the "project". Among other matters, Mr. Flora requested the final lay-out drawings, asked about the correct foundation they should build for tanks, requested an offer for tanks and engineering for the boiler, and a time schedule. However, given that the subject line contains the initials "wwtp", this appears to refer to the waste water treatment plant rather than the co-generation plant.
- An email from Biothane to European Drinks, 20 August 2002 (Exh. C-482), referencing a quotation for the construction of a co-generation plant.

[229] Exh. C-708 is an undated presentation from General Electric regarding turbines suitable for co-generation

Mr. Baciu states that "we were unable to continue with our planned expansion and integration (First WS of S. Baciu, ¶ 25). Mr. Baciu explains that this came at a great detriment to their company, because subsequent changes in Romania's renewable energy laws would have enabled them to earn more green certificates than under the original law (specifically, three instead of one per MWh produced), and they would have been entitled to sell these green certificates at a higher value (First WS of S. Baciu, ¶ 26).

1103. The Claimants continued to receive quotations for a co-generation plant after revocation. The Claimants submitted two offers from Siemens dated November 2005 and July 2006 for a turbine and generator and other equipment (Exh. C-687, C-708). Mr. Baciu also testified that in 2009 they received a quotation for a 20 MW co-generation plant from Bio-Energieanlagen, which estimated the project at less than €20 million (First WS of S. Baciu, ¶ 43).

1104. The Claimants' continued interest in a co-generation plant is also evidenced by the EBRD loan negotiation documents. As discussed above, during 2005 and 2006 the Claimants carried out negotiations with the EBRD regarding possible development financing. In addition to the malt plant, the early documents related to those negotiations mentioned the construction of a co-generation plant. Specifically, the co-generation plant was mentioned in the EBRD Environmental Questionnaire dated 12 March 2005 (Exh. C-743) and the first draft Loan Agreement dated 16 June 2006 (Exh. C-745). However, it is not mentioned in either the Term Sheet dated 4 March 2006 (Exh. C-744) or the last draft Loan Agreement dated 2 November 2006 (Exh. C-746). Thus, it would appear that the project either was dropped entirely or at least that by 2 November 2006 (over 20 months after the revocation) it had not yet reached a level of concrete planning.

1105. However, despite the evidence of the Claimants' continuing interest in building a co-generation plant (which spans several years), other than Mr. Baciu's testimony, there is no documentary evidence of concrete internal planning of such a project:

a. Mr. Baciu asserts that when the Claimants developed the lay-out of their factories, they "kept in mind" where an optimal place for the co-generation plant would be, and bought 20 hectares of land for this purpose (Second WS of S. Baciu, ¶¶ 3-5). However, there is no record of this advance planning in internal plans for the factories, nor documentary evidence of the purchase of land.

b. There is no feasibility study or other preliminary study. The Respondent pointed out during the cross-examination of Mr. Baciu that the Claimants had carried out a feasibility study for a corn mill valued at €4.8 million, and found it surprising that the Claimants had not carried out a similar feasibility study for a co-generation plant that would cost approximately €20 million. Mr. Baciu admitted that in the case of the co-generation plant, "no feasibility study was made; only some calculations, engineering calculations" (Tr., Day 7, 120 (Baciu)). However, Mr. Baciu was not able to point to any documentary evidence of these alleged calculations. He stated that they "just calculated internally" for themselves, and

"never kept the figures". He added that these were not financial calculations, only simple calculations involving "the rough cost of the raw materials involved" and "the availability of [these] raw materials", that these calculations were "very easy to do" and that this was "not the kind of document that you save and keep" (Tr., Day 7, 120 (Baciu)).

c. Mr. Baciu submitted for the purposes of this arbitration a diagram showing an overview of the co-generation project at page 5 of his second witness statement showing how the different components fit in, but no such diagram or plan is found among the Claimants' contemporaneous evidence.

1106. Irrespective of the available documentation, the Claimants argue that their intention to build a co-generation plant is evidenced by the steps they took to complete it. Indeed, Mr. Baciu testified that at the date of the revocation of the incentives they had acquired or constructed most of the components of a co-generation plant, as discussed in sub-paragraphs (a) through (g) below. However, although the existence of these components appears to be undisputed, the Tribunal is not persuaded that these components were acquired or constructed specifically with the co-generation plant in mind, or that at the date of the revocation of the incentives the co-generation plant was as near completion as the Claimants suggest. Specifically:

a. Mr. Baciu testified that the Claimants had set aside 20 hectares of land, which would be used for the plant itself and for biomass storage (First WS of S. Baciu, ¶¶ 16, 38, 43; Second WS of S. Baciu, ¶ 5 and related photographs). However, there is insufficient evidence showing when this land was acquired or with what purpose.

b. Mr. Baciu testified that the Claimants had the biomass needed for co-generation, which came from by-products or waste from the products used for food production (Second WS of S. Baciu, ¶¶ 11-12; 18-23). According to Mr. Baciu, this was "the most important component" of a co-generation facility (Tr., Day 7, 95, 99 (Baciu)). However, Mr. Baciu acknowledged that for the size of plant they were considering (20 MW), they would need to purchase additional biomass (Tr., Day 7; 126 (Baciu)). Specifically, a 20 MW electricity co-generation plant would need 160,000 metric tons of biomass, of which 90,000 to 110,000 metric tons would come from internal sources. The remainder would have to be purchased from third parties, but Mr. Baciu testified that the Claimants were well-positioned to buy them at competitive rates and had a transportation system in place (First WS of S. Baciu, ¶¶ 33-38).

c. Mr. Baciu testified that the Claimants had acquired the equipment for the preparation, conditioning, storing and handling of the biomass sources. Mr. Baciu testified that the Claimants had "already built and already mastered the process of collecting, storing, handling, and drying these types of biomass" (Second WS of S. Baciu, ¶¶ 11; 24; Mr. Baciu also included several photographs of existing biomass conditioning installations and storage areas, and explained the process (Second WS of S. Baciu, pp. 6-21). With respect to conditioning, Mr.

Baciu testified that the Claimants had mincers for solid biomass, centrifuges for humid biomass, and dryers (Tr., Day 7, 96-97 (Baciu)). With respect to storage and handling, Mr. Baciu testified that the Claimants had silos, platforms, transportation equipment and loading equipment (Tr., Day 7, 97 (Baciu)). This appears to be undisputed, although it is unclear how much of this equipment was purchased for the cogeneration plant.

d. Mr. Baciu also testified that the Claimants had biogas, produced at the Claimants' wastewater treatment plant. The biogas would serve as catalyst in burning the biomass to produce steam and electricity (Second WS of S. Baciu, ¶ 21-22).

e. Mr. Baciu further testified that the Claimants had built an electrical substation precisely designed with plat space and additional electrical control capacity for constructing and handling co-generation, including step-up transformation capability and an installed switchgear that permits re-direction of co-generated power directly into the State's transmission lines (C-PHB, ¶ 202; Second WS of S. Baciu, ¶¶ 33-45). However, it is undisputed that the substation was not built exclusively for the co-generation plant, but to provide electricity to the group's production facilities (First WS of S. Baciu, ¶ 3). The Tribunal does not doubt that the substation was built with the capacity to eventually "plug in" a co-generation plant: (i) both Mr. Baciu and Mr. Halbac testified that when they built the substation, they also planned for the construction of a co-generation plant (First WS of S. Baciu, ¶¶ 4, 18; First WS of M. Halbac, ¶ 56), and that "[m]any of the features on the substation were placed there only because we had already planned the construction of a co-generation plant" (First WS of M. Halbac, ¶ 56); (ii) as noted above, Mr. Baciu testified that, with the co-generation plant in mind, in 2002 the Claimants contracted with ABB to implement switch-gear technology in the substation, which would allow them to reverse the flow of electricity into the national distribution network;[230] and (iii) the power plant appears to have been found suitable for co-generation.[231] However, this only proves that the Claimants designed their substation in a way that would allow them to easily plug in a co-generation plant; it does not prove that they would have actually built such a plant.

f. Mr. Baciu also testified that the Claimants built an electrical conversion plant to raise the current from 20 kv to 110 kv power (Tr., Day 7, 99 (Baciu)). However, it is unclear whether this was part of the electrical substation or was purchased specifically for the co-generation plant.

[230] The record includes a contract dated 2001-2002 with ABB for electric switchgear (Exh. C-480), but from the English translation it is impossible to determine if the equipment was bought with co-generation as the purpose.

[231] Mr. Baciu testified that a state-owned electric company subordinated to the Ministry of Economy acknowledged in 2010 that the "110/20kV power station European Drinks Sudrigiu has been such designed and made to allow the beneficiary S.C. European Drinks to deliver in SEN its own electricity (BIOMASS COGENERATION), by cell no. 3 and cell no. 20." (Second WS of S. Baciu, ¶ 45; Exh. C-820).

g. Finally, Mr. Baciu testified that the Claimants had a connection to the national power grid, which allowed them to take power from the grid or supply power (Tr., Day 7, 99 (Baciu)). Mr. Baciu also qualified this as one of the most important components for a co-generation plant, together with the biomass source (*Id.*). Once again, for what that connection was specifically built beyond the Claimants' ongoing operations remains unclear.

1107. According to Mr. Baciu, the only missing components to complete a co-generation plant were:

a. The turbine, which the Claimants would have to purchase, and for which they received several quotations from suppliers (Tr., Day 7, 98 (Baciu); Second WS of S. Baciu, ¶ 35). Presumably Mr. Baciu refers to the quotations cited in paragraphs 1101 and 1103 above.

b. A dedicated boiler for steam generation to run the turbine, which would have been designed and largely manufactured in-house.

c. The building to house the plant.

1108. The Respondent emphasizes that the most important (and missing) parts of the co-generation plant were the boiler and turbine and not the biomass and connection to the power grid as claimed by Mr. Baciu (R-PHB, ¶ 256). The Tribunal must agree. Mr. Baciu testified (both in his WS and in cross-examination) that although most of the biomass would come from internal sources, they would need to purchase part of it from third parties (First WS of S. Baciu, ¶ 36; Tr., Day 7, 126 (Rubins/Baciu). As the Respondent points out, this shows that having one's own source of biomass is not essential to the operation of a co-generation plant, although it would of course mean a cost advantage. With respect to the connection to the power grid, Mr. Baciu clarified that by "important", he meant "difficult to obtain." In particular, the connection to the national power grid was a huge advantage for them because it was very difficult for other investors to obtain (Tr., Day 7, 102-104 (President Lévy/Baciu)). However, it cannot be disputed that the boiler and the turbine are crucial elements of a co-generation plant, without which no energy can be produced.

1109. Mr. Baciu also testified that the Claimants had "all the necessary authorizations" to operate a co-generation facility, but in cross-examination he was obliged to retract in part. Mr. Baciu confirmed that they would have needed an authorization from the water management authorities for the boiler, an environmental authorization, an electricity generation license, and an electric supply license, none of which the Claimants had yet obtained. However, with respect to generation he stressed that the company had an authorization as a distributor and eligible consumer, and "most likely would have obtained" the generation license and electric supply license as well. (Tr., Day 7, 123-126 (Rubins/Baciu)). The Respondent argues that Mr. Baciu testified falsely on this point. However, while notable, Mr. Baciu's contradictory statements could have been the result of a misunderstanding during his oral examination: indeed, Mr. Baciu clarified that when he responded to Mr. Fleuriet's question in direct

examination, he "understood that his question referred to the 110 plant and the connection to the national system" (Tr., Day 7, 123-124 (Rubins/Baciu)).[232]

1110. Finally, Mr. Baciu testified that the Claimants had "mastered the technological process for turning prepared biomass and biogas into steam and electricity", as well as considerable engineering expertise and experience designing boilers. In this respect, Mr. Baciu testified that after revocation (around 2010) the Claimants built three biomass boilers which are currently in operation (Second WS of S. Baciu, ¶¶ 25-31). Indeed, from Mr. Baciu's testimony it appears that the Claimants are already using biomass to produce energy. Specifically, Mr. Baciu states that "[i]n these existing boilers, we burn our existing biomass and biogas, capture the steam produced, and use it to run our factories. This reduces our heavy fuel oil costs and the emission of carbon dioxide that results from burning heavy fuel oil" (Second WS of S. Baciu, ¶ 26). Mr. Baciu also testified that the operation of these boilers was similar to that needed for the co-generation process, but they operated at lower capacities and pressures (Tr., Day 7, 97 (Baciu)). Mr. Baciu also clarified that these boilers started operating in May 2010 (Second WS of S. Baciu, ¶ 31). Although this shows the Claimants' capacity to use biomass to produce energy, steam to be precise, for their own consumption, it also shows that, without the turbine, they could not claim to have a co-generation plant. In particular, without the turbine they could not sell energy to third parties through green certificates, which is the main source of the profits they claim.

1111. The Tribunal's conclusion from the evidence discussed above is that the Claimants have not shown with sufficient certainty that they would have implemented a co-generation plant. The record does suggest that, despite the absence of evidence with respect to internal planning, the Claimants considered implementing ways to turn biomass and biogas into steam and electricity. However, that does not show that they would have built an actual co-generation plant. The Claimants requested quotations as early as 1998, and continued to show interest in 2002 and 2003, but it took them seven years from then to go into and to master the process of using their own biomass and biogas for fuel, which they only started doing in 2010 (after the revocation). In addition, the lack of a building, boiler and a turbine, along with the lack of licenses and authorizations, indicates that at the time of the revocation of the incentives the co-generation project was not as close to completion as the Claimants contend.

(e) Conclusions

1112. On the basis of the evidence analyzed above, the Tribunal finds that the Claimants have not proven with sufficient certainty that, but for the revocation, they would have implemented the Incremental Investments.

[232] The Respondent also contends that Mr. Baciu was unable to specify which company (or companies) was/were meant to make the investments required to build the co-generation plant (Tr., Day 7, 105-106 (Baciu)). However, this does not show much. Mr. Baciu was an engineer; it is not likely that he was privy to the Claimants' strategic corporate decisions with respect to the channeling of investments.

1113. With respect to their alleged intention to build these facilities, the Claimants rely heavily on witness testimony. In fact, other than offers and quotes provided by third party suppliers, there is surprisingly little contemporaneous evidence of advance planning predating the revocation. There is not a single business plan, feasibility study, internal memo or budget documenting the Claimants' intention to build these facilities. The construction of these plants thus seems to have been a desirable possibility for the Claimants, which they investigated with third party suppliers, but which never materialized into concrete plans.

1114. The Tribunal does not doubt that the Incremental Investments were consistent with the Claimants' integration model, and would have complemented it very well. Mr. Halbac and Mr. Baciu describe very persuasively the cost-efficiencies that the Claimants could have achieved. As Prof. Lessard testified on cross-examination, the investments were "plausible" (by which he seems to have meant that they made economic sense). However, this does not prove with sufficient certainty that the Claimants would have actually implemented those investments. After the fact, it is always possible to say that one would have engaged into an activity which turns out to have been potentially fruitful: this does not suffice, as it is necessary to prove with sufficient certainty that an intention to do so would have materialized but for the wrongful act. Contemporaneous evidence is not indispensable but, in this instance, its absence does not help the Claimants.

1115. The Tribunal has also given due consideration to the Claimants' argument that, as a family business, they did not make plans on paper, and that the best evidence of their intentions are the steps they took to materialize these investments. However, although there is some evidence of steps taken to further these investments, the record shows that the Claimants had built or acquired almost exclusively equipment that could be used with their existing platform (i.e., utilities, electric connections, transportation, storage and handling systems). Some of this equipment created cost efficiencies that would have made it easy to "plug in" the Incremental Investments, but for each of the Incremental Investments the Claimants still had to purchase the key equipment that would in fact allow them to operate these Incremental Investments as separate profit-making activities. For instance, for the malt plant, they still needed to purchase the germination machine; for the can manufacturing plant, they still needed to purchase the can manufacturing machines, and for the co-generation plant, they still needed to purchase the turbine and manufacture the boiler. As a result, the steps taken by the Claimants do not show with sufficient certainty that the Incremental Investments were projects at an advanced stage of completion, nor that the Claimants clearly intended to carry them out in the near future. They have proved that they had an option to build these Incremental Investments and that they were contemplating them as a possibility, but not more.

1116. The Tribunal does not believe that these conclusions would have been altered by conducting a site visit as proposed by the Claimants. After a full review of the record, the Tribunal confirms the views it expressed in its Procedural Order dated 20 January 2011. In particular, the Tribunal confirms that a site visit was not necessary nor useful for the resolution of the dispute, as it would not have supplied further evidence

of the Claimants' intention to pursue the Incremental Investments than that already in the record. Due to the characteristics of a site visit, it could not have provided further useful, certainly not documentary, evidence of advance planning of these investments; rather, it would have allowed the Tribunal to see the size and characteristics of the Claimants' integrated platform and their ability to easily implement the Incremental Investments, which is sufficiently confirmed by evidence in the record (including the 17-minute video of the site and the Incremental Investments attached as Exhibit C-987, as well as the witness statements of Mr. Halbac and Mr. Baciu, which contain numerous color photographs and diagrams that explain the characteristics and distribution of the site, their oral testimonies and the documentary evidence they cite in their witness statements). However, the fact that the Tribunal has found that Claimants' platform was highly integrated and that they had made certain investments that would have made it easy to add the Incremental Investments does not provide sufficient certainty that, but for the revocation of the incentives, the Claimants would have implemented these projects.

1117. For the reasons stated above, the Tribunal finds that the Claimants have not proven with sufficient certainty that they would have in fact engaged in the activity that they claim would have earned the profits they were allegedly deprived of. In particular, the Claimants have not established that the lost profits that they claim in relation to the Incremental Investments "were *reasonably* anticipated; and that the profits anticipated were probable and not merely possible."[233]

1118. For all these reasons, the Tribunal rejects all lost profits claims related to the Incremental Investments.

4. Financial penalties for failure to pay taxes

a. Overview

1119. It is undisputed that, following the revocation of the incentives, the Claimants have failed to pay certain tax debts to Romania. The Claimants do not question these debts, which they acknowledge are owed.

1120. However, the Claimants argue that their failure to pay these tax debts has caused them to incur substantial financial penalties, which are attributable to the Respondent's conduct and thus require compensation. Indeed, the Claimants contend that the tax penalties that they incurred post-revocation (from 2006 onwards), were "a direct result of the financial constraints caused by Revocation". Specifically, the Claimants argue that if they had been able to benefit from the Raw Materials Incentive until 2009, they would have been able to pay their tax debts to Romania and, as a result, would not have incurred the substantial tax penalties that have accrued since the revocation. Thus, to place them back in the position they would have been but for the revocation, the Tribunal should award them these penalties (C-PHB, ¶¶ 132, 142).

[233] Marjorie M. Whiteman, Damages in International Law, vol. II (1937), p. 1837 (emphasis in original); *AAPL v. Sri Lanka*, ¶ 104.

1121. The Claimants claim damages for two sets of financial penalties (C-PHB, ¶¶ 140, 144):

a. Financial penalties incurred but not yet paid as a result of the Claimants being financially constrained due to the losses incurred as a result of the revocation, in the amount of RON 63.65 million. The Claimants bring this claim unless Romania waives such tax penalties and declares that it shall waive or reimburse all additional financial penalties imposed or assessed until the date of Romania's full and final satisfaction of the award.

b. Financial penalties incurred and paid by the EFDG companies in the period 1 April 2005 to 30 September 2010, in the amount of RON 40 million.

1122. The Claimants argue that, because the Respondent's conduct caused the financial penalties to accrue, the unpaid portion of those penalties should be awarded to the Claimants (if not waived by Romania), and the portion of those penalties that the Claimants have already paid should be awarded back to the Claimants (C-PHB, ¶ 143).

1123. Both claims are cumulatively based on the following evidence (C-PHB, ¶¶ 131 and 141):

a. The calculations contained in paragraphs 85 and 86 and Table 4 of Professor Lessard's first report, dated 22 December 2009;

b. The calculations contained in paragraphs 132 to 135 of Professor Lessard's second report, dated 30 July 2010;

c. The calculations contained in paragraph 3.25 and table 4 of Mr. Osborne's first report and the calculations contained in section 8 of Mr. Osborne's second report;

d. Updated Summary of Damages from Penalties Avoided, Tab 51 from Mr. Schwartz's Opening Presentation;

e. Professor Lessard's corrected tables handed out by counsel at the hearing on 16 November 2010, table 4, page 2;

f. The evidence referred to in the abovementioned sections, paragraphs and tables, including Exh. CO-1.19 ("Workings for December 2009 report") (submitted as an exhibit to Mr. Osborne's second report).

1124. The two claims concern tax penalties incurred not only by the Corporate Claimants, but also by other companies of the group which are not parties to this arbitration (specifically, European Drinks, Edri Trading, Original Products, Rieni Drinks, Scandic Distilleries, TGIE, Tonical Trading, and West Leasing).

1125. The Respondent does not contest the calculations performed by Mr. Osborne or Prof. Lessard. Rather, it contests the existence of a causal link between the revocation and the accrual of the tax penalties, and criticizes the Claimants' experts for simply

assuming that such a causal link existed. The Respondent argues that the Claimants' experts did not conduct their own analysis of the evidence but simply assumed (or "understood" or "believed") it to be true and simply added up the figures. (R-SPHB, ¶ 16). The Respondent points to:

a. Professor Lessard's assertion in his first report that "with revocation of the incentives, EFDG entered a sustained cash crunch";

b. Mr. Osborne's assertion that "since the Companies became financially constrained (2006) significant penalties have accrued on debts to the state";

c. Professor Lessard's "understand[ing] that penalties in earlier periods were in some cases caused by unanticipated changes in Romanian tax or excise regulations" and his "understand[ing]" that the terms of EFDG's credit lines did not permit the Claimants to pay down existing state debts (there being no evidence supporting either "understanding"); and

d. Mr. Osborne's "belief" that penalties "are likely to have arisen only because of the financial constraints the Companies have been under since 2006".

1126. The Respondent argues that these assumptions are in turn based solely on Mr. Ioan Micula's assertion that "we suffered delays in making required tax payments to the State because of the cash constraints caused by the State's termination of the incentives" (Third WS of I. Micula, ¶ 95). The Respondent argues that this is not evidence and stresses that "the Claimants must *prove* that they *could not* pay their taxes *because of* repeal of the Facilities" (R-SPHB, ¶ 17, emphasis in original). The Respondent denies that the Claimants have proved this. To the contrary, it argues that the evidence in the record in fact demonstrates that there is no causal link between the revocation of the incentives and the incurred tax penalties.

1127. In particular, the Respondent contends that the Claimants have not proven that they could not pay their taxes, nor have they proved that this alleged inability to do so was caused by the revocation of the incentives (R-SPHB, ¶ 17). In particular, the Respondent argues that:

a. The Claimants did indeed have access to funds, but chose to spend them elsewhere. The Respondent notes that it is undisputed that the Claimants spent €182 million on other projects and developments after the repeal of the Raw Materials Facility, at the same time that the EFDG companies were not paying their taxes and consequently incurring penalties.

b. The Claimants had access to financing at competitive interest rates after repeal, and thus could have borrowed to cover their tax debts.

c. While the Claimants assert that they could not pay the taxes they owed because of financial difficulties, Mr. Osborne accepted that those financial difficulties would have occurred in any event, even without repeal of the Raw Materials Facility. (Tr., Day 10, 137 (Osborne, acknowledging that "absent sales of SCPs, and

assuming all else equal, they would have been in trouble, if I can put it that way.”)).

d. EFDG’s financial statements show that the Claimants were in arrears on taxes and incurred penalties in every year before the revocation of the incentives.[234] According to the Respondent, there is not a single year, at any time in the Corporate Claimants’ history, in which the Corporate Claimants did not incur fresh penalties for non-payment of taxes. That includes the period in 2004-05 in which the Claimants say they paid down their tax debts. The Respondent argues that there is therefore no basis to infer that the Claimants would have paid their taxes in and after 2006 if they had been able to, and hence no basis to infer that their failure to do so proves that they could not (R-Rejoinder, ¶ 340; First ER of J. Ellison, Section 9; Second ER of J. Ellison, Section 8).

e. EFDG entered into various tax-rescheduling agreements with Romania in 2001, 2002 and 2003, through which Romania forgave millions of Euro in tax penalties due from the Claimants. The Respondent argues that “it thus appears that the Claimants chose not to pay their taxes as part of a long-standing business strategy, hoping to negotiate advantageous restructuring of their tax debts and to use the funds that otherwise would have been paid to the state for other purposes. That this gamble ultimately did not pay off is a far cry from a causal link between the repeal of the facilities and the Claimants’ inability to pay taxes. Indeed, it reveals the entire tax-penalty claim to be an unseemly perpetuation of improper practices against Romania, which the Claimants ask this Tribunal to endorse and continue” (R-Rejoinder, ¶ 341; Second ER of J. Ellison, Section 8). The Respondent further notes (and the Claimants acknowledge) that these rescheduling agreements (and forgiveness of debts granted by Romania) are the main reason why the Claimants reduced their tax debts by 2005 (R-SPHB, fn. 27; *see* ¶ 1132 below).

1128. Finally, the Respondent stresses that the Claimants have failed to produce evidence (other than witness testimony and experts relying on these witnesses) in support of their claim (R-SPHB, ¶ 18). Specifically, according to the Respondent:

a. There is no contemporaneous correspondence with the Romanian tax authorities or internal documents explaining why they were not paying taxes;

b. There is no correspondence with banks refusing to grant loans due to financial constraints;

c. There is no evidence of the “business necessities” on which they spent the €182 million that they acknowledge was spent after the revocation of the incentives to

[234] The Respondent criticizes the Claimants’ experts for failing to mention this state of affairs. In particular, the Respondent notes that the table of penalties paid to the State presented in Mr. Osborne’s First Report (Table 4, p. 22) covers only 2006-2009, while his working papers include payments as far back as 2002 (R-Rejoinder, ¶ 340).

other ends. The only documentary evidence that Mr. Halbac could point out to was for €5 million in relation to the brewery (Exh. C-306). (R-PHB, ¶ 627).

1129. The Respondent also points out that "the vast majority" of the taxes (and resulting penalties) owed to Romania by the EFDG companies relates to VAT payments and employee social security contributions.[235] The Respondent thus argues that the Claimants have improperly retained money that belongs to their customers and employees. In other words, the Claimants have improperly used "other people's money" to finance their operations. The Respondent argues that this seriously undermines their claim, in particular with respect to VAT, because the Claimants had the cash on hand to remit the required amount of VAT, but failed to do so. This failure cannot be attributed to reduced cash flows (R-PHB, ¶ 295; Exh. A to F to the Claimants' Application for Provisional Measures; Respondent's Rejoinder on Provisional Measures, ¶ 18; Respondent's Opposition to Provisional Measures, fn. 9).

1130. With respect to the availability of cash and post-revocation investments, the Claimants acknowledge that they invested approximately €182 million post-revocation, but contend that these investments were for business necessities in order to continue the operation of the companies, comply with legal requirements and meet contractual obligations (Second ER of D. Lessard, ¶ 128; Tr., Day 8, 69 (Lessard); Second WS of M. Halbac, ¶¶ 145-167).

1131. The Claimants deny that the Respondent's additional arguments undermine their claim for damages for tax penalties incurred after the revocation of the incentives (C-PHB, ¶¶ 132-139). First, the Claimants deny that the mere existence of penalties prior to the revocation negates the causal link between the revocation and penalties post-revocation. As Prof. Lessard explains: "If the penalties post Revocation could have been avoided absent Revocation and not otherwise, then the fact of earlier penalties does not change the impact on damages" (Second ER of D. Lessard, ¶ 134).

1132. Second, the Claimants reject the Respondent's contention that they had a "strategy" of not paying taxes:

a. The Claimants contend that the tax arrears and penalties that they incurred in the years prior to the revocation were not due to any such business strategy, but were caused by hyperinflation, regulatory changes and widespread economic difficulties throughout Romania during that period. Romania has suggested that this does not explain the Claimants' situation because they could not have been the only taxpayers affected by this (Second ER of J. Ellison, ¶ 8.2.3). The Claimants agree but contend that Romania misses the point: the fact is that the period of hyperinflation in Romania was widespread and recognized by the government. Indeed, through the enactment of EGO 163/2000 and EGO 40/2002 (Exh. J and K to Claimants' Application for Provisional Measures),

[235] In its Application to Revoke Provisional Measures, the Respondent alleges that VAT comprised approximately 43% of the tax liabilities incurred by EFDG from January 2010 to February 2012 (R-Application to Revoke PM, fn. 85; EFDG tax payment tables, RA-17).

Romania acknowledged "the great number of taxpayers recorded with outstanding budget debts" as "the outcome of the economic environment". These two normative acts offered extensions to taxpayers in arrears and reductions or eliminations of penalties under strict conditions, which the Claimants took advantage of. The Claimants made the additional investments required by Romania for the rescheduling of the debts, and the Claimants paid off outstanding debts in advance of the deadline imposed by Romania under the agreements. The Claimants note that the Respondent has not disputed those facts (C-PHB, ¶ 137).

b. The Claimants argue that they had fully paid off their tax arrears at the time of Revocation, a fact that the Respondent does not dispute (C-PHB, ¶ 138).

c. The Claimants deny that they are tax evaders, as they made partial payments on their outstanding state debts after the revocation when they were financially able to do so. For instance, the outstanding balance on state debts decreased from the third quarter to the fourth quarter of 2007, as well as from the second quarter to the third quarter of 2009. Thus, the Claimants reject any contention that they have deliberately avoided paying taxes or have acted in any way other than in good faith regarding their taxes (C-PHB, ¶ 139).

d. The Claimants argue that their claim for penalties already paid to Romania is further evidence that the Claimants have not altogether avoided paying their outstanding tax debts (C-PHB, ¶ 143).

1133. The Claimants do not deny that the unpaid taxes for which they are being charged penalties include VAT. However, they dispute the Respondent's calculations of EFDG's tax payments submitted as Exh. RA-17, including VAT calculations (Claimants' Response to Romania's Application to Revoke PM, ¶ 68). Specifically, the Claimants argue that:

a. The Respondent has erroneously duplicated European Food's VAT liability and payments and the figures in the section dealing with persons with disabilities, and

b. The Respondent has erroneously included interest and penalties on unpaid VAT for European Food and Rieni Drinks.

1134. At Exh. CA-23 of their Response, the Claimants provide a "full analysis" of the Respondent's Exh. RA-17. However, the Claimants do not explain what is the impact of these recalculations on the amount and percentage of VAT owed.

b. The Tribunal's analysis

1135. It is undisputed that the Claimants did not pay some of their taxes, and that, as a result, they accrued significant financial penalties.

1136. The key question to determine whether this damages claim has merit is whether the Claimants have been able to establish a sufficient causal link between the repeal of

the EGO 24 incentives and their failure to pay their taxes. In essence, the Claimants are arguing that, but for the revocation of the incentives, they would have paid their taxes, but because of the revocation, they suffered financial constraints that prevented them from doing so. Thus, the argument goes, to place them back in the position in which they would have been but for the revocation, the Tribunal must award them the penalties they have already paid and those which they will be forced to pay (unless the Respondent waives the latter).

1137. In the Tribunal's view, to determine whether such a sufficient causal link exists between the Respondent's breach of the BIT and the losses alleged, the Claimants must prove:

   a. First, that after the revocation of the incentives, the Claimants could not pay their taxes. In other words, that they did not, as a matter of fact, have sufficient funds to pay their taxes.

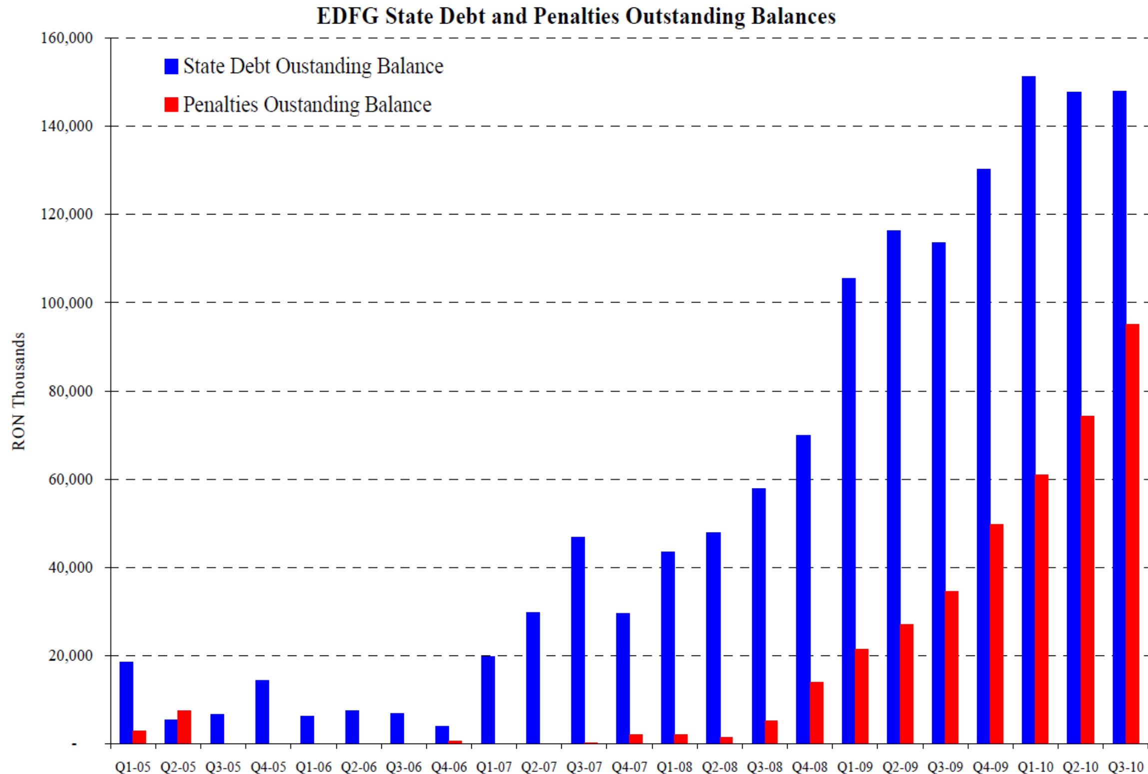
   b. Second, that the dominant cause for this lack of sufficient funds (or the financial constraints that prevented them from borrowing them) was the revocation of the incentives.

   c. Third, that but for that lack of sufficient funds, they would have paid their taxes.

1138. The Tribunal has found it unnecessary to address points (b) and (c) because it has come to the conclusion that the Claimants have not proved that, as a matter of fact, they had insufficient funds to pay their taxes. In the view of the Tribunal, the relevant question is whether the Claimants had sufficient funds to pay their taxes and to meet the needs of their business, giving due deference to the business judgment of the owners and managers of the business.

1139. The Tribunal has first tried to establish from the information in the record what was the amount of the EFDG companies' principal tax debts, which they allegedly could not pay after revocation. This information turned out to be difficult to locate in the Claimants' submissions on the merits, but additional information was provided in the context of the Claimants' various requests for provisional measures on which Romania commented. The Tribunal has found in particular two useful sources: (i) the table provided at paragraph 140 of the Claimants' Post-Hearing Brief, and (ii) footnote 5 of the Claimants' letter of 9 November 2012.

1140. The table provided by the Claimants at paragraph 140 of the Claimants' Post-Hearing Brief shows the outstanding balance of the Claimants' principal tax debt and penalties from 1 January 2005 up to 30 September 2010, as follows:



Source: Data from EFDG Overdue State Debt and Penalties Expense.xls produced as backup to December 22, 2009 Lessard Report, with updated data through September 30, 2010.

1141. The Claimants provide the amounts in RON and on a quarterly basis. It would appear from this table that, at the end of 2005, the outstanding balance of the Claimants' principal tax debt was approximately RON 18 million (today approximately €4 million[236]), and that by the end of 2006 this outstanding balance was less than RON 5 million (today approximately €1.1 million), with minimal penalties. However, by the end of 2007 the outstanding balance for the principal tax debt had risen to approximately RON 30 million (today approximately €6.7 million). Even then, their tax penalties were relatively minor. Since then there has been a steady rise, with its highest point at the end of 2009, where the outstanding principal tax debt appears to have been approximately RON 150 million (today approximately €33.7 million).

1142. These figures are roughly consistent with the Claimants' assertion in footnote 5 of their letter of 9 November 2012, where they stated that "[i]n March 2006, the EFDC companies had virtually no outstanding tax debt […]. By the end of 2006, as a result of the premature revocation of the EGO 24 incentives, the EFDC companies accumulated tax debts in the amount of €4.8 million. By 20 September 2012, as a result of draconian interest and penalties imposed, the EFDC companies' total outstanding tax debt had increased to €104.1 million." Indeed, the first quarter of 2007 shows a principal tax debt of approximately RON 20 million (today approximately €4.5 million) and no accrued penalties.

[236] All Euro amounts in this section reflect the exchange rate of 9 December 2013 of 4.4482 RON/EUR. Source: European Central Bank.

1143. From these numbers, the Tribunal concludes that, in 2007, the Claimants would have needed approximately €5 million to completely pay off their tax debt.

1144. The Tribunal now turns to the Parties' arguments on the availability of cash or financing for the payment of tax debts. The Respondent argues that the Claimants (i) did indeed have cash on hand, but chose to spend it elsewhere, and (ii) had access to financing from the EBRD and other banks, but chose not to use it.

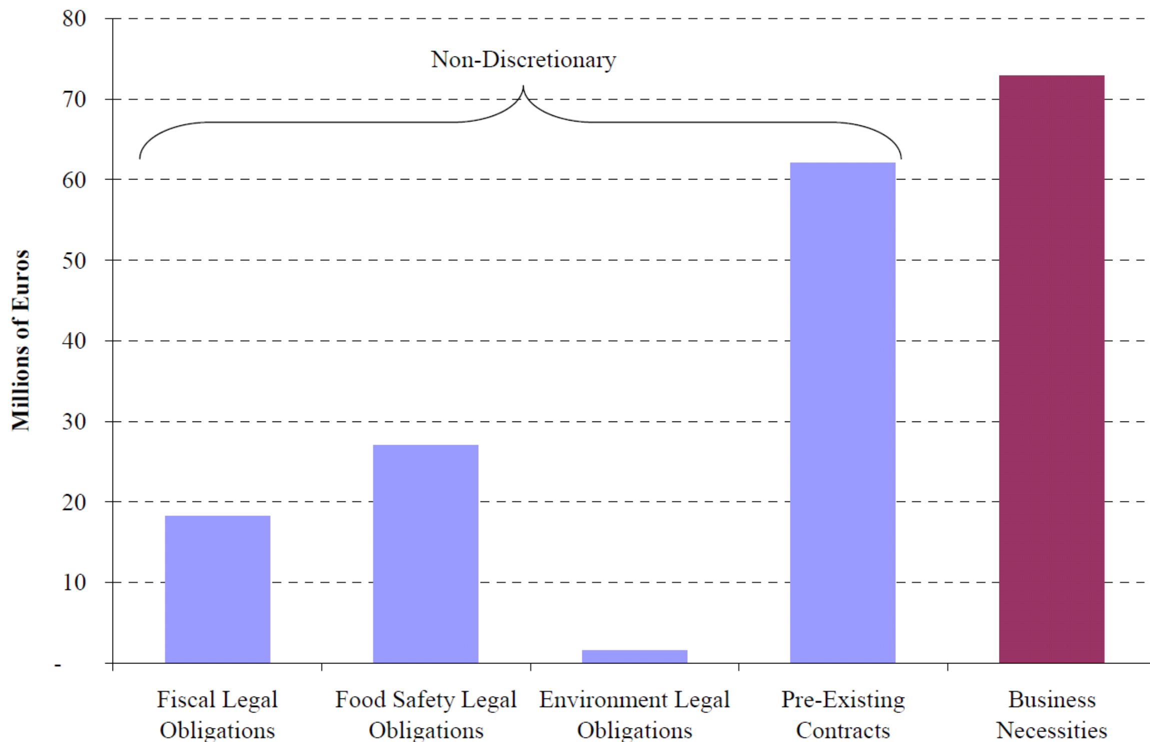
1145. With respect to the first point, it is undisputed that the Claimants spent €182 million on other projects and developments after repeal of the Raw Materials Facility (Tr., Day 8, 69 (Lessard); Second ER of D. Lessard, ¶ 128). The Respondent argues that these funds would have been sufficient to satisfy the Claimants' tax debts (and to fund the Incremental Investments).

1146. The Claimants defend their decision to spend money on other operations and expenditures after the revocation of the incentives. Mr. Halbac testified that "[i]t was determined that we would make investments in our business necessities, as a way of remaining competitive with the business adventures that we did have, and conforming to legal requirements imposed on food and beverage manufacturers" (Second WS of M. Halbac, ¶ 147). In particular, he testified that these expenditures were made to maintain their existing manufacturing platform, preserve their existing market positions, and comply with health and safety laws. According to Mr. Halbac, the Claimants spent approximately €140 million in investments they considered to be business necessities, and an additional €27 million in normal maintenance costs. Although Mr. Halbac described these expenditures in some detail (including a breakdown of the various costs), with one exception[237] he submitted no documentary evidence in support of his assertions (Second WS of M. Halbac, ¶¶ 145-167).

1147. In turn, Prof. Lessard stated that "total investment by EFDG since 2005 has been €182 million", noting that "[t]he majority of these investments were non-discretionary" (Second ER of D. Lessard, ¶¶ 127-128). According to Prof. Lessard, the Claimants had identified five categories of investments: fiscal legal obligations, food safety obligations, environmental legal obligations, investments to fulfill contracts signed before the revocation of the incentives, and "business necessities", as reflected in Figure 17 of his Second Expert Report, copied below:

[237] That exception is a contract with Krones dated 10 May 2004 (Exh. 306) for € 5.2 million related to the expansion of the brewery. [Mr. Halbac mistakenly refers to Exh. 305, and also mistakenly notes the date as 10 May 2003.]

Figure 17— Damages from Revocation



1148. Of these five categories, Prof. Lessard stated that only the first four categories were effectively “non-discretionary investments”, which he defined as “amounts that EFDG was required to spend to comply with legal or contractual obligations.” He stated that these non-discretionary projects accounted for 60% of the investments made since 2005. The remaining 40% was invested in projects that the EFDG considered to be “business necessities” (as shown in the table, these amounted to approximately €70 million). As examples of these “business necessities”, Prof. Lessard referred to capital expenditures required to maintain the EFDG’s existing productive capacity, to the purchase of beer dispensers and new coolers that allowed distribution of beer in draft form, or to the installation of equipment that allowed the EFDG to produce 2.5 liter bottles for mineral water and soft drinks (Second ER of D. Lessard, ¶¶ 129-130).

1149. The Respondent contests the sufficiency of the evidence provided by Mr. Halbac and Prof. Lessard. The Claimants argue that the Respondent had ample opportunity to cross-examine Mr. Halbac about these expenditures and their necessity, but chose not to do so (C-PHB, ¶ 189). The Respondent in turn argues that there was no need to cross-examine him, because (with the aforementioned exception) Mr. Halbac’s assertions were unsupported by documentary evidence (R-PHB, ¶ 627). In addition, the Respondent points out that Prof. Lessard acknowledged that his understanding with respect to the non-discretionary nature of the Claimants’ expenditures post-revocation came from discussions with the Claimants and their personnel (in particular Mr. Halbac), and could cite no documentary evidence in support of his assertion (indeed, in cross-examination Prof. Lessard acknowledged he had not seen

any invoices justifying such "non-discretionary investments" or "business necessities") (Tr., Day 8, 70-71 (Lessard)).

1150. In view of the available evidence, the Tribunal cannot accept the Claimants' assertion that they did not have enough cash to pay their tax debts and, at the same time, meet the needs of their business. The Tribunal reaches that conclusion taking into account the need for the Claimants to be able to continue with their business operations and to exercise managerial discretion in doing so. As noted above, the Claimants could have paid off their outstanding tax debts in full by devoting a mere €5 million in 2007 for that purpose. But instead of paying these tax debts, the Claimants chose to spend over €70 million in "business necessities"[238], despite the fact that the payment of taxes to the State qualifies as a non-discretionary expenditure required to comply with fiscal legal obligations (indeed, Prof. Lessard includes fiscal legal obligations in his description of non-discretionary expenditures). This evidences that the Claimants had made a decision selectively to allocate their available funds among the five categories of "investments" they have identified. Expressed otherwise, they had a policy that they would pay taxes if that payment appeared to be sensible in view of the circumstances. In fact, the Claimants do have an earlier history of not paying their taxes, which corroborates that inference.

1151. The Tribunal does not doubt that the Claimants' investments in these "business necessities" were made with the underlying objective to maintain the competitive nature of their business. However, paying taxes is a legal obligation, and not paying them has legal and financial consequences attached to it. The fact of the matter is that, assuming that Prof. Lessard is correct in saying that 60% of the Claimants' expenditures since 2005 were non-discretionary, the Claimants still had approximately €70 million that they chose to use in other investments or activities. In other words, the Claimants made a conscious choice not to pay €5 million to extinguish their tax debt in 2007, in favor of making other investments.

1152. This may have been a business decision, based on the hope that, by investing in other business activities, the Claimants would have generated more cash than what they would eventually have to pay in taxes and accrued penalties. Prof. Lessard confirmed this at the hearing when, asked why the Claimants had chosen to invest in business necessities instead of in the Incremental Investments, he stated that "the only inference I can make is that the economics of those expenditures [the alleged business necessities] were even better than the economics of these projects [the Incremental Investments]" (Tr., Day 8, 71 (Lessard)). Prof. Lessard also stated that the investments in business necessities "heavily leveraged Claimants' existing assets, and it is reasonable for Claimants to have assumed that they would provide high incremental returns. Thus, Mr. Ellison's suggestion that EFDG could or should have diverted investment from these actual uses to alternative uses is incorrect" (Second ER of D. Lessard, ¶ 130).

---

[238] As shown in Figure 17 of Second ER of D. Lessard, cited above.

1153. What Prof. Lessard seems to be implying is that, economically, it made more sense to spend the available funds on the business necessities because it would have been more profitable than paying taxes (or building the Incremental Investments). In the case of tax payment (which is by definition not a profitable activity), the implication is that the Claimants believed that the profits they would generate from these business necessities would be higher than the penalties they would accrue by failing to pay their tax debts. Indeed, Prof. Lessard accepted as much in cross-examination:

> Q: […] The claimants had €182 million to invest after revocation; correct?
>
> A. They spent that amount on various projects, yes.
>
> Q. They chose not to spend any of that amount to pay down the remaining tax debts; correct?
>
> A. Which tells one that they had at least a 36% internal rate of return on the projects they invested in, because that's the cost of the penalties.
>
> Q. Okay. But they chose not to spend this amount to pay down their tax debts; correct?
>
> A. That's correct.
>
> (Tr., Day 8, 85 (Rubins/Lessard)).

1154. In other words, the Claimants' decision not to pay their tax debts was a strategic choice, which eventually proved to be the wrong one. The Claimants apparently exercised their business judgment, analyzed the pros and cons, and decided to invest in other projects rather than pay their taxes. But this does not mean that they did not have sufficient funds to pay them and still carry on with their business. It is evident from the record that they did have sufficient funds to pay their taxes, at least at a given juncture, namely in 2007. In the Tribunal's view, this fatally severs the chain of causation. Romania cannot be held liable for the Claimants' bad business decisions, especially if such decisions may have implied failure to comply with certain legal obligations, namely the payment of taxes.

1155. As a result, the Tribunal does not need to address the remaining elements of proof identified in paragraph 1137 above. Accordingly, the Tribunal dismisses this claim.

D. THE RESPONDENT'S DEFENSE THAT ACCESSION TO THE EU BENEFITED THE CLAIMANTS

1156. In addition to its specific defenses on each of the Claimants' damages claims, the Respondent argues that, even if the Claimants had to pay more for certain raw materials as a result of the repeal of the incentives, this does not necessarily mean that they were harmed overall. To the contrary, the Respondent contends that the Claimants received economic benefits from EU accession that must be taken into account when assessing what compensation is due (R-Rejoinder, ¶¶ 415-421; R-PHB, ¶¶ 329-331).

1157. Relying on two expert reports by Dr. Bill Robinson of KPMG Forensic, the Respondent contends that the EU accession process brought "price stability, increased trade, FDI, reduced risk premia, strong institutions and a marked acceleration in economic growth" (R-Rejoinder, ¶ 417, First ER of B. Robinson, sections 5.3 and 5.4). Specifically, the Respondent alleges that the Claimants benefited from "increased domestic sales due to increased local expenditure on food and beverages (over 42% between 2001 and 2008), an increase of sales abroad due to an expanded export market (between 13% and 30% higher in each year between 2002 and 2008), and access to duty-free imports through the EU customs union" (R-Rejoinder, ¶ 418; First ER of B. Robinson, sections 6.2 and 6.3).

1158. Using a macroeconomic approach, Dr. Robinson evaluated the tangible benefits of EU accession on 1 January 2007 to the Claimants' business. To quantify these benefits, Dr. Robinson calculated the impact on the Claimants' business of three counterfactual situations (Romania joins the EU in 2009, Romania joins the EU in 2011, or Romania never joins the EU at all), using the following methodology:

> For every percentage point reduction in Romanian GDP growth, the evidence suggests a 0.77 percentage point reduction in growth of expenditure of food and drink and hence (assuming a constant share of Accession-driven growth) in EFDG's sales. By applying actual and counterfactual rates of growth to variable costs and revenues shown in EFDG's financial statements, I calculate the net present value of the effect on EFDG's profits of Romania's Accession in 2007 compared with three counterfactual scenarios [...]. (First ER of B. Robinson, ¶ 8.1.8)

1159. As explained by Dr. Robinson, he tried to assess the effect of a scenario in which the Claimants had access to the incentives but did not have access to the other benefits provided by the EU:

> [...] in that world, where they can still have the import exemptions, I am taking it as instructed that they would not have been in the EU, or that accession would have been delayed for a couple of years, and in that world, although they would have had these nice cheap sugar imports, they wouldn't have sold so much soft drink. And my calculation tries to show, as it were, [...] that net effect (Tr., Day 11, 184 (Robinson)).

1160. Dr. Robinson concluded that:

a. Had EU accession been delayed by two years, the Claimants would have lost €18.9 million in profits;

b. Had EU accession been delayed by an additional two years (*i.e.* four years in total), the Claimants would have lost €34.4 million in profits, and

c. Had EU accession not happened at all, the Claimants would have lost €235 million (First ER of B. Robinson, ¶ 8.1.8).

1161. Dr. Robinson confirmed his conclusions in his second report, which responded to Mr. Boulton's criticisms. In particular, he noted that Mr. Boulton had not disputed

Romania's growth in prosperity over the last decade, which in his opinion was largely due to EU membership (Second ER of B. Robinson, ¶ 3.6.1).

1162. As a result, the Respondent argues that "Romania's EU accession resulted in tangible financial benefits for the Claimants that offset any short-term disadvantages from repeal of the Facilities" (which in the Respondent's view are limited to the Claimants' direct losses claims), and that "[o]nce this adjustment has been made, the Claimants' direct losses are reduced to nil" (R-Rejoinder, ¶ 421).

1163. Relying on *Metalpar v. Argentina*[239] *and GAMI v. Mexico*,[240] the Respondent contends that in situations where state measures both harmed and benefited a claimant's business activities, tribunals have taken the positive impact into account in assessing what compensation is due. In its Rejoinder, the Respondent stated that "[s]ince the advantages of EU membership would have been lost or at least delayed had Romania maintained state aid (including the EGO 24/1998 facilities), these advantages must be considered to be a benefit accruing to the Claimants as a result of the repeal, to be deducted from any compensation assessed as a result of Romania's alleged breaches" (R-Rejoinder, ¶ 416). However, in its Post-Hearing Brief the Respondent clarified that it "is not making a counterclaim or seeking a set-off against an award of damages"; it "simply asks the Tribunal to take into account the important benefits to the Claimants arising out of EU accession in determining the extent to which the Claimants were harmed as a result of Romania's actions" (R-PHB, ¶ 331; see also R-Rejoinder, ¶¶ 415, and Tr., Day 2, 198-200 (Rubins)).

1164. In turn, the Claimants argue that Dr. Robinson's analysis should be disregarded, both with respect to expectation damages as well as reliance damages, as it is "entirely unsupported by authority" (C-PHB, ¶ 230).

1165. More specific comments are provided by the Claimants' expert, Mr. Boulton. Mr. Boulton criticizes Dr. Robinson's report as "deeply flawed" (ER of R. Boulton, ¶ 2.2), because:

   a. "Dr Robinson applies a macroeconomic approach to what is essentially a microeconomic question. In other words, Dr Robinson takes a top down approach to estimating the effect of the EU accession on Romania as a whole, and then simply assumes that the Claimants have benefitted pro rata to the national economy" (*Id.*), and

   b. "Dr Robinson does not consider whether there is any evidence that the Claimants have in fact benefitted from EU accession and ignores those factors that might have had a negative impact" (*Id.*).

1166. In particular, Mr. Boulton criticizes Dr. Robinson for failing to perform an analysis of the Claimants' financial statements to confirm that they have in fact benefitted from EU accession (*Id.*, ¶ 3.10), for failing to take into account the impact of EU accession

[239] *Metalpar v. Argentina*, ¶¶ 218–233.
[240] *GAMI v. Mexico*, ¶¶ 83–87.

on the level of competition faced by the Claimants (*Id.*, ¶¶ 3.17-3.22), and for ignoring the potential effect of EU accession on the Claimants' fixed costs, in particular with respect to EU health and safety legislation (*Id.*, ¶¶ 3.26-3.28). As a result, in Mr. Boulton's opinion, Dr. Robinson fails to establish that the Claimants have in fact benefitted at all from EU accession (*Id.*, ¶ 2.3).

1167. The Tribunal cannot accept the Respondent's defense. As a legal matter, it is unclear whether EU accession, an act of general application in Romania which produced effects on every single person, should be accepted as an act having specific effect with respect to specific persons, such as the mitigation of a specific damage. Even if that were possible (a question that the Tribunal does not need to answer), the Tribunal rejects the Respondent's defense on its merits. The issue is what effect EU accession had on the damages suffered by the Claimants. The Respondent contends that EU accession had a mitigating effect on the Claimants' damages, because accession would have had the effect of increasing their sales and therefore their profits. However, the Respondent has not provided a convincing quantification of this effect: the Tribunal does not find that Dr. Robinson's macroeconomic analysis proves the extent, if any, of the benefits of EU accession to the Claimants in particular.

1168. First, the Tribunal is not persuaded by Dr. Robinson's methodology. It is theoretically possible to attempt to quantify the benefits that accession brought the Claimants by assessing the Claimants' situation in a counterfactual world where accession was delayed or did not happen at all; however, this evaluation must be made with a view to the specific circumstances of the case and a global assessment is relevant only if it is a means to ascertain the effects of accession in the specific case. As Mr. Boulton states, it seems overly simplistic to extrapolate the macroeconomic impact of EU accession on the Romanian economy as a whole to the microeconomic impact on the Claimants (ER of R. Boulton, ¶ 3.15). Although EU accession may have benefitted the Romanian economy as a whole, the extent of the benefits (and the costs) of EU accession will have varied greatly across different industries and companies. Indeed, Dr. Robinson accepted in cross-examination that EU accession could have had varying impacts on existing businesses in Romania (helping some and hurting others, even in the same sector). He also accepted that the costs of EU accession could be widely different for Romanian businesses in the same sector (Tr., Day 11, 184-185 (Fleuriet/Robinson)).

1169. However, Dr. Robinson appears to have focused only on the benefits of EU accession, but ignored the costs. For instance, he did not take into consideration in his calculations that the EFDG's labor costs could rise as a result of accession. Although he stated that his underlying model considered increases in labor costs, he "took the view that they would not change as a result of accession" (*Id.*, 188 (Robinson)). Nor did he consider that the increased sales that he estimated as a result of accession would have required an increase in the Claimants' labor costs: "I did not increase wage costs because I thought that additional volumes could be sold with the same labour force, and my evidence for that is that volumes at the time were lower than they had been, and I don't imagine the factory had shrunk" (Tr., Day 11, 203 (Robinson)).

1170. Similarly, Dr. Robinson did not consider that EU accession could have the effect of decreasing the Claimants' sales as a result of the increased costs and prices due to the revocation of the incentives (a loss of a competitive edge):

> Q. Now, you did not account for any lost sales that the claimants may have experienced as a result of paying increased Customs taxes, or as a result of them paying more domestically to avoid such taxes; correct?
>
> A. Correct.
>
> Q. You have simply assumed -- just so we're clear, you have simply assumed that EU accession only had the positive impact of increased sales?
>
> A. Yes, because Mr Ellison did the negatives.
>
> (Tr., Day 11, 189 (Fleuriet/Robinson).

1171. Further, Dr. Robinson did not take into consideration the fixed costs and regulatory burdens imposed by EU accession (e.g., in matters of health, safety or environment), because in his opinion they had not changed (*Id.*, 196-197). He acknowledged at the hearing that such costs could have affected the Claimants' performance, but decided that they ultimately did not affect his conclusions. Specifically, when counsel for the Claimants represented that the Claimants had incurred significant costs to comply with EU requirements on wooden pallets, Dr. Robinson made the following comments:

> Q. […] this is an example of one of the fixed costs that would have increased as a result of EU accession that you don't consider in your opinion; correct?
>
> A. Yes.
>
> Q. It's a pretty big omission, is it not, in your opinion, not to have considered increases in fixed costs that were required by -- required of our clients by virtue of the fact that Romania was acceding to the European Union?
>
> A. I don't think those are a very large sum in the general scheme of things. I mean, I worried about it, obviously, because I can see there is a case. I didn't worry about it too much, I mean, partly because, as I say, it's a level playing field; the competitors have those increases as well, so it doesn't mean they lose market share.
>
> I sort of comforted myself with the thought that many other judgments I had taken were really quite deliberately cautious. So the EU effect, you know, is 1.5 to 2, and I used 1.5. The food and drink is 1.1.
>
> Now, you might actually argue that the class of food and drink that EFDG are in are rather more towards the luxury end, with the soft drinks and so forth, so actually that would be a bigger number. But I went with the smaller number, which includes the potatoes and all those other very unelastic items.

> So, yes, I haven't specifically allowed for these factors; I admit that. But I don't think it affects my conclusion.
>
> (Tr., Day 11, 198-199 (Fleuriet/Robinson)).

1172. The Tribunal is aware that in re-direct examination Dr. Robinson clarified that, in the two scenarios involving delayed accession, all of those additional fixed costs would have happened to the Claimants anyway, it was just a question of when (Tr., Day 11, 209-210). However, that does not detract from the fact that EU accession brought a "mixed bag of goods" to Romanian companies, which included varying costs and benefits, all of which need to be assessed to understand the total impact of EU accession on the Claimants.

1173. The Tribunal thus finds that the Respondent has failed to prove the extent, if any, of the benefits of EU accession to the Claimants. This does not mean that the Tribunal is oblivious to the fact that EU accession may have had an effect (whether positive or negative) on the Claimants' investments. This raises a procedural question, namely which party must bear the consequences of this uncertainty. It is the Claimants' burden to prove their damage and the Tribunal has found to what extent such damage has been proved. The Respondent has argued that the Claimants' experts have failed to take into consideration the effects of EU accession, and has endeavored to quantify such effects, but – in the Tribunal's view – unsuccessfully. First, the effects of EU accession appear to be mixed, both potentially increasing or decreasing the value of the investment. Second, it is legally difficult to see why an alleged advantage, from which the Claimants should have benefitted in any circumstances and which is available to their competitors, including those who are not located in the distressed zones, should be taken into consideration to their detriment.

1174. For these reasons, the Tribunal dismisses the Respondent's defense to the extent that it requests a diminution of the damages awarded to the Claimants.

E. THE CLAIMANTS' REQUEST THAT DAMAGES BE AWARDED NET OF TAXES

1175. In their Reply, the Claimants had requested that any damages and interest payable be grossed up for taxes, as follows: "Claimants' Permanent Investor Certificates, valid until April 1, 2009, contained profit tax exemption provisions. Therefore, Romania would not have taxed the additional profit arising from lower costs on raw materials from the customs tax exemption. But-for cash flows after April 1, 2009, reflect the 16% profit tax. However, Professor Lessard assumes that an award in this proceeding would be taxable. Therefore, in order for the Claimants to receive the full amount of direct damages from the loss of the customs tax exemption, the damages and interest through April 1, 2009, must be grossed up to reflect the tax payable on the award" (C-Reply, ¶ 652).

1176. The Respondent had contended that there is no merit to the Claimants' gross-up claim (R-Rejoinder, ¶¶ 431-436). Citing Romanian law provisions, it had argued that "[t]he Corporate Claimants might also be able to set off tax losses against any future taxable profits (including a damages award). Moreover, to the extent that an award is

paid to the Micula brothers, Romanian law provides that damages awards are non-taxable" (R-Rejoinder, ¶ 434).[241]

1177. However, in their Revised Request for Relief the Claimants did not include their request for gross-up, and instead requested, presumably for the same reasons, "[t]he total amount of damages payable by the Respondent comprising the amounts set out in paragraphs 2, 3 and 5 to be received net of any tax obligations imposed by Romania on the proceeds" (Revised Request for Relief, ¶ 4).

1178. In their Post-hearing Brief, the Claimants confirmed their primary position that the total amount of damages awarded should be "received by the Claimants net of any tax obligations imposed by the Respondent on the proceeds" (C-PHB, ¶ 268). In their view, the position under Romanian law in relation to both the Individual Claimants and the Corporate Claimants is unclear, but it would be possible for an award to be taxable in both instances. That said, the Claimants asserted that they would maintain their gross-up claim if the Respondent stated that in its view taxes would be payable on an award. Otherwise, the Claimants stated that "[s]hould the Respondent state in sufficiently clear terms that it will not tax any damages award in favour of the Claimants, the Claimants will not seek that that award be grossed-up for taxes" (C-PHB, ¶ 269).

1179. The Respondent opposed the Claimants' request that the award be paid net of any taxes, and requested the Tribunal not to add any language to that effect. Given the EFDG companies' outstanding tax debts, the Respondent argued that such request "could well lead to unknown and unintended consequences". The Respondent urged the Tribunal to "be cautious about phrasing any award in terms that the EFDG Companies might use in other proceedings", adding that the language of the award with respect to taxes that the Claimants request is not commonly used in investment arbitration awards (R-PHB, ¶ 322).

1180. The Tribunal sees no justification for providing that the amounts awarded be received net of taxes. First, part of the damages awarded, for instance the damages for increased cost of raw materials, are not profits at all, but a reimbursement of increased costs, even if they may have effect on the profits.

1181. Second, with respect to the part of the damages that does refer to lost profits, Mr. Boulton (on whose calculations the Tribunal has relied) has used gross profit margins for his calculations (ER of R. Boulton, ¶ 5.63). The Tribunal understands from this that the profits calculated by Mr. Boulton are before tax, and thus absent the Profit Tax Exemption would have been subject to tax. The Respondent does not contest that, under EGO 24, until 1 April 2009 the Corporate Claimants were entitled to the Profit Tax Exemption. However, the Tribunal understands that this exemption would apply only to profits made by the Corporate Claimants, and the Claimants have not shown which company within the EFDG would have made the profits that are being awarded.

[241] Romania relies on the Romanian Fiscal Code (Exh. R-200), Article 42(b), and the KPMG Damages Report, ¶ 13.3.2.

1182. Finally, the Tribunal is indeed aware of the tax dispute between the Claimants and the Respondent. Given this delicate situation which raises many questions of Romanian law and in view of all circumstances, the Tribunal does not consider it appropriate to use in the Award the language requested by the Claimants.

1183. For the foregoing reasons, the Claimants' request that any damages be awarded net of taxes is dismissed.

F. TO WHOM SHOULD THE AWARD BE MADE?

1. The Claimants' request for a different allocation of damages

1184. Up until the hearing on the merits, the Claimants did not specify to whom an award should be made.

1185. In their Reply, the Claimants requested "an award granting them the following relief", *inter alia*, "compensation to Claimants for all damages they have suffered, as set forth herein and as may be further developed and quantified in the course of this proceeding" (C-Reply, ¶ 666, second bullet point).

1186. During the hearing on the merits, however, the Claimants stated that "as a matter of investment treaty law, the Micula brothers are the foreign shareholders while the [C]orporate [C]laimants are the vehicles for some of their investments. For this reason, it's appropriate that any award granted by the Tribunal should be made only to the foreign shareholders protected by the Sweden-Romania BIT, Viorel and Ioan Micula, and […] they are agreed that as between themselves, the damages should be awarded on a 50/50 basis." Citing *Suez v. Argentina* and *PSEG v. Turkey*, the Claimants argued that this approach would be consistent with the approach taken in other treaty cases (Tr., Day 1, 143-145 (Reed)).

1187. The Claimants confirmed this position in their Revised Request for Relief submitted on 20 December 2010, where they requested that "[a]ny damages payable, including interest and costs, should be awarded to the [I]ndividual Claimants, Ioan Micula and Viorel Micula, to be divided between them on a 50:50 basis. In the alternative, any damages payable, including interest and costs, should be awarded to all five Claimants" (Revised Request for Relief, p. 1).

1188. This request was later confirmed in the Claimants' prayer for relief included at the end of their Post-Hearing Brief, in which "the Claimants request an award granting them the relief set out in the Revised Request" (C-PHB, ¶ 279).[242] This was further

[242] The Tribunal is aware that in the body of their Post-Hearing Brief, the Claimants argued that "[s]hould the Tribunal not award damages to the Individual Claimants alone, the Claimants' secondary position is that any 'reliance' damages, or damages calculated on the basis of the fair market value immediately before the alleged breach, awarded should be awarded to the Individual Claimants and any other damages should be awarded to all of the Claimants", and that "[t]heir tertiary position was that "any award be made to each of the five Claimants" (C-PHB, ¶¶ 258-259). However, these arguments were not formulated as formal requests for relief and, as noted in paragraph 876 above, the Tribunal has focused on the Parties' formal requests for relief.

confirmed by the Claimants in their closing arguments during the hearing of June 2011.[243] As a result, the Claimants have formally prayed for two alternatives:

a. That "[a]ny damages payable, including interest and costs, should be awarded to the [I]ndividual Claimants, Ioan Micula and Viorel Micula, to be divided between them on a 50:50 basis" (Revised Request for Relief, p. 1).

b. "In the alternative, any damages payable, including interest and costs, should be awarded to all five Claimants" (*Id.*).

1189. In its Procedural Order of 6 April 2011, which addressed the Respondent's objections to the Claimants' Revised Request for Relief, the Tribunal found that "in requesting that any damages be awarded to Mr. Ioan Micula and Mr. Viorel Micula (the "Individual Claimants") on a 50/50 basis (second sentence of the Revised Request), and in the alternative that any damages be awarded to all five Claimants (third sentence of the Revised Request), the Claimants have reformulated their damages case." The Tribunal also found that "this raises several issues of procedure and of the merits" (P.O. of 6 April 2011, Section 3.3), and issued certain directions in this regard. Specifically, at Section 4.5 of that same Procedural Order, the Tribunal requested the Claimants to confirm that they wished to maintain their request (Section 4.5(a)). The Tribunal then directed the Parties to address the following matters in their post-hearing briefs (Section 4.5(b)):

> (i) Is it possible, as a matter of procedure and of the merits, for the claims of the Individual Claimants to be designated as either sole or principal claimants (as opposed to the Corporate Claimants, who would become subsidiary claimants) at this stage of the proceedings? In particular, would the Corporate Claimants need to waive their claims in favor of the Individual Claimants, and would this waiver be possible under Romanian and international law?
>
> (ii) What are the consequences of this new distribution of damages (if any) on the damages sought by the Claimants as pleaded to this date, both with respect to the factual and legal basis for the sought damages and their quantification?

1190. In addition, by letter of 6 May 2011, the Tribunal formulated certain questions to be addressed by the Parties with respect to the Claimants' damages case. In particular, the Tribunal requested the Claimants to address the following points in relation to their new request for allocation of damages:

> 1.1 […]
>
> a. Please address the Tribunal's questions under Section 4.5 of the P.O. of 6 April 2011. In this context, please clarify what is the exact status of the Corporate Claimants' claims. Are they subsidiary? Are they withdrawn? What are the consequences of either alternative?

[243] In particular, the Claimants did not contradict the President when he stated that he understood that the first two paragraphs at the beginning of page 1 of the Revised Request attached to the Claimants' letter of 20 December 2010 to be a prayer for relief (Tr., Day 12, 134-135 (President Lévy)).

b. Please explain what is the legal basis on which the Tribunal should decline to award damages to the three Claimant Corporations and award damages only to the Individual Claimants? Is there a waiver of some kind by the Corporate Claimants?

c. Please address the exact evidence in the record of the harm allegedly suffered by the Individual Claimants.

(Tribunal's letter of 6 May 2011, Section III.A.1.1).

1191. The Parties' responses to these questions are set out in Section 2 below.

2. The Parties' positions

a. The Individual Claimants' right to claim damages in their capacity as shareholders

1192. Citing a string of cases, the Claimants submit that, as a matter of investment treaty law, the Individual Claimants have the right to claim damages in their capacity as shareholders (C-PHB, ¶¶ 232-238). According to the Claimants, it is well-established that shareholders have standing to bring claims under investment treaties and may submit claims independently from the corporate entities in which they hold shares without the participation of those corporate entities. This is particularly so in this case, where the BIT defines "investment" very broadly as "any kind of asset owned or controlled invested directly or indirectly by an investor". In the Claimants' view, this means that the BIT directly protects all the Individual Claimants' rights in the entire investment, including tangible assets and the PICs, rather than merely the individuals' shares. Given that during the jurisdictional phase the Tribunal found that the Individual Claimants were foreign investors covered by the BIT, it follows that they could have brought the claims independently and without the participation of the Corporate Claimants in relation to the entire investment. In the Claimants' view, the Tribunal's Decision on Jurisdiction and Admissibility did not limit the scope of the Individual Claimants' claims to those of the Corporate Claimants; to the contrary, the Tribunal declined to determine every element of property over which it had jurisdiction.

1193. With respect to the damages that shareholders may claim as a result of an investment treaty violation, the Claimants contend that shareholders do not need to prove that they suffered harm directly and separately or independently from that suffered by the entity in which they hold shares. According to the Claimants, there is nothing in the BIT, the ICSID Convention or investment treaty law that would limit the rights of shareholders in this respect. For example:

a. In *Goetz v Burundi*, the tribunal observed that "[…] prior ICSID case-law does not restrict the capacity to act to only those legal persons that are directly affected by

the alleged breaching measures; it extends that capacity to cover the shareholders in such legal persons, who are the actual investors."[244]

b. In *Bogdanov v. Moldova*, the tribunal stated that "[i]n the practice of investment arbitration it is generally accepted that the shareholders may be awarded indirect damages (SCHREUER. C. "Shareholder Protection in International Investment Law", cit, pp.18f.). The remedy that may be claimed by the Foreign Investor, therefore, is not limited to the damage directly affecting his rights as shareholder in the Local Investment Company, but extends to any losses affecting the assets of the Local Investment Company, including also any reduction in value of the assets due to any alleged breach of contract by the Respondent. The indirect damage suffered by the Foreign Investor, therefore, corresponds to the loss of the Local Investment Company […]."[245]

1194. The Claimants also assert that, in cases where claims have been brought by both shareholders and the companies in which they hold shares, ICSID tribunals have awarded damages directly to the shareholders alone and without the need for those shareholders to quantify their losses separately from those of the companies. The Claimants rely on the following cases, among others:

a. *PSEG v. Turkey*, where the Tribunal, after noting that the project company was wholly owned by PSEG Global, decided to award all compensation to PSEG Global.[246]

b. *Eastern Sugar v. Czech Republic*, where the tribunal awarded full damages to the parent company for losses suffered by its subsidiary following the subsidiary's loss of its quota.[247]

c. *Vivendi v. Argentina II*, where claims were brought by both the parent shareholder (Vivendi) and its subsidiary, and the tribunal, after concluding that Argentina had breached its treaty obligations to both Vivendi and its subsidiary,

---

[244] *Antoine Goetz and others v Republic of Burundi* (ICSID Case No. ARB/95/3), Award Embodying the Parties' Settlement Agreement, 10 February 1999, ¶ 89, as translated in S.A. Alexandrov, "The 'Baby Boom' of Treaty-Based Arbitrations and the Jurisdiction of ICSID Tribunals – Shareholders as 'Investors' under Investment Treaties", Journal of World Investment & Trade, vol. 6, issue 3, June 2005, pages 393-398 (Exh. C-234).

[245] *Bogdanov v. Moldova* (BIT Arbitration under the Rules of the Arbitration Institute of the Stockholm Chamber of Commerce), Award, 22 September 2005, pp. 18-19.

[246] *PSEG v. Turkey*, ¶ 340.

[247] *Eastern Sugar B.V.(Netherlands) v. Czech Republic,* SCC Case No. 088/2004, Partial Award, 27 March 2007 (hereinafter *"Eastern Sugar v. Czech Republic"*), ¶ 367. ("The Arbitral Tribunal is aware that the loss of quota was suffered primarily by Eastern Sugar Ceska Republika a.s. However, this is a practically wholly-owned subsidiary of the Claimant Eastern Sugar B.V and the value of the subsidiary is in the present circumstances in practical terms determined by the value of the quota allocated to it. The Arbitral Tribunal deems it correct to award to the Claimant full damages for Eastern Sugar Ceska Republika a.s.' loss of quota attributable to the Third Sugar Decree.")

stated that "[a]s its 94.4% de facto shareholder, Vivendi is entitled to a 94.4% share of [the subsidiary's] damages".[248]

1195. The Respondent argues that "[t]he Claimants have confounded two issues: the Miculas' standing to bring a claim and the quantum of damages to which they may be entitled" (R-PHB, ¶ 340, R-SPHB, ¶ 53). The Respondent submits that, "[w]hile the Miculas' *jus standi* is a matter of jurisdiction, the amount of damages they can be awarded is a separate substantive legal issue." The Respondent clarifies that it does not contest the Individual Claimants' standing to bring a claim in respect of their identified investment (their shareholdings), and notes that the Tribunal accepted jurisdiction over claims arising from that investment. However, the Respondent emphasizes that that does not mean they are entitled to the same damages as the Corporate Claimants (R-PHB, ¶ 340).

1196. The Respondent contends that the cases cited by the Claimants do not support the proposition that a shareholder can be compensated for the quantum of harm suffered directly from the corporation (R-PHB, ¶¶ 343-345; R-SPHB, ¶¶ 54-55). For instance, in *PSEG v. Turkey*, a parent company was compensated for sunk costs that it had itself invested. In *AAPL v. Sri Lanka*, the tribunal declined to award the claimant damages for harm to the local company's assets, and instead held that "[t]he scope of the international law protection granted to the foreign investor in the present case is limited to a single item: the value of his share-holding in the joint-venture entity […]."[249] In *Eastern Sugar v. Czech Republic*, the Respondent did not contest the payment of damages to the parent company rather than to the subsidiary, and the claimant had presented a report calculating the loss of share value.[250] In *Vivendi v. Argentina II*, the tribunal awarded the investment value of the concession, measured by the sunk costs that Vivendi had put into its local subsidiary.[251] In other cases cited by the Claimants, tribunals have awarded damages to compensate shareholders for the loss of value in their equity participation, measured differently from the damages incurred by their subsidiaries (as was the case in *Enron v. Argentina* and *CMS v. Argentina*), or lost dividends (as was the case in *LG&E v. Argentina*). As a result, the Respondent contends that "[s]hareholder damages are limited to losses suffered by the shareholder himself, such as any losses in the value of his shares or lost dividends" (R-PHB, ¶¶ 343-345).

1197. Citing *Nykomb v. Latvia*[252] and *Gemplus and Talsud v. Mexico*,[253] the Respondent argues that "[u]nder principles of company law common to virtually all jurisdictions, it

---

[248] *Compañía de Aguas del Aconquija S.A. and Vivendi Universal S.A. v Argentine Republic*, (ICSID Case No. ARB/97/3, Award, 20 August 2007 (hereinafter *"Vivendi v. Argentina II"* or *"Vivendi II"*), ¶. 8.3.20).

[249] *AAPL v. Sri Lanka*, ¶ 95.

[250] *Eastern Sugar v. Czech Republic*, ¶ 358.

[251] *Vivendi v. Argentina II*, ¶¶ 8.3.12-8.3.19.

[252] *Nykomb Synergetics Technology Holding AB v. The Republic of Latvia*, SCC Case No 118/2001, Award, 16 December 2003 (hereinafter *"Nykomb v. Latvia" or "Nykomb"*), p 39. ("The Respondent has argued, and the Arbitral Tribunal must agree, that the reduced flow of income into Windau obviously does not cause an identical loss for Nykomb as an investor. […] [I]t is clear that the higher payments for electric power would not have flowed fully and directly through to Nykomb. The money would have

cannot be assumed that the harm suffered by even a 100% shareholder equates to the harm suffered by a corporation" (R-PHB, ¶¶ 343-348; R-SPHB, ¶¶ 57-58). The Respondent submits in this respect that "[t]his approach is clearly correct. As noted by the *Nykomb* tribunal, a number of deductions may be made to a company's income before it can be distributed to shareholders as dividends. To ignore this is to be blind to the legal and economic reality of equity ownership" (R-PHB, ¶ 346).

1198. In response to the Respondent's arguments, the Claimants submit, relying on scholarly writings by Ripinsky and Williams, that "two factors appear to be determinative of whether a shareholder can claim directly the losses of the underlying business or whether a shareholder is restricted to its flow-through damages […] first the provisions of the relevant BIT; and second, whether the shareholders hold a majority or a minority interest" (Tr., Day 12, 95 (Reed)). With respect to the first factor, a BIT's definition of investment will determine whether the protection to a shareholder extends only to its direct investments or also to its indirect investments. The Claimants argue that, if the definition of investment extends to a shareholder's indirect investments (as is the case here), then shareholders would be entitled to claim for harm to the assets of the underlying company. With respect to the second factor, the Claimants contend that it would be all the more appropriate to treat the underlying business unit as the protected investment when the shareholder owns a majority interest in the underlying company. In this regard, citing Ripinsky and Williams, they submit that "[i]f the business unit in its entirety is considered to be the claimant's protected investment, then all of the damages caused to the business must be assumed to flow to the shareholder as the owner of the business, or part thereof, directly without distortion" (Tr., Day 12, 102 (Reed)).[254]

1199. The Claimants argue that both of these factors were present in the cases cited by the Claimants where tribunals awarded the parent company the damages suffered by the subsidiary (*Azurix v. Argentina, Vivendi II, Eastern Sugar v. Czech Republic*). By contrast, in all of the cases cited by the Respondent except one, at least one of the factors was missing. Specifically, in *AAPL v. Sri Lanka*, the relevant BIT did not

---

been subject to Latvian taxes etc., would have been used to cover Windau's costs and down payments on Windau's loans etc., and disbursements to the shareholder would be subject to restrictions in Latvian company law on payment of dividends. An assessment of the Claimant's loss on or damage to its investment based directly on the reduced income flow into Windau is unfounded and must be rejected.")

[253] *Gemplus and Talsud v. Mexico*, ¶ 12-50 ("The Claimants' claims for compensation derive only from their status as investors with investments in the form of their respective minority shareholdings in the Concessionaire, as distinct from any claim by the Concessionaire itself. Perhaps inevitably, the Parties' submissions occasionally elided this important distinction, effectively treating the valuation of the Concessionaire's future profits (if any) as the relevant exercise for the assessment of compensation due to the Claimants. The exercise required of this Tribunal is, in contrast, the valuation of the Claimants' lost investments in the form of their shares in the Concessionaire and not, as such, the lost profits incurred by the Concessionaire under the Concession Agreement. The latter are not, of course, irrelevant; but they are not directly relevant as if the Claimants' claims were made by the Concessionaire itself.")

[254] The Claimants do not provide a citation for this, but the Tribunal notes that the text roughly corresponds to S. Ripinsky & K. Williams, Damages in International Investment Law (2008), pp. 149-150.

protect indirect investments of shareholders and the claimant was a minority shareholder, while in *Gemplus and Talsud* the claimants were minority shareholders (Tr., Day 12, 99-103 (Reed)).

1200. The Claimants concede that *Nykomb v. Latvia*, cited by the Respondent, does not conform to Ripinsky's and Williams' theory. However, they submit that there is a third factor that should be considered, namely "whether the company in which the shareholder holds the shares was specifically set up for the purposes of carrying out the investment, and that is therefore whether the local entity is simply a vehicle for the investment, an investment vehicle" (Tr., Day 12, 105 (Reed)). The Claimants point out that Nykomb had not incorporated the local entity, but had acquired the shares at a subsequent point in time, when the dispute had already arisen, and submit that these circumstances could have been a factor that led the tribunal to limit Nykomb's recovery to the value of its shares.

1201. In view of the foregoing, the Claimants submit that all of the cases cited by the Parties "can be reconciled with the following proposition: that where a foreign investors [sic] incorporates an entity in the host state for the purposes of making an investment in the host state, and where the investor owns 100% interest or at least a majority interest in the entity thus created and controls it, and where the investment treaty protects both the investor's indirect and direct interests, the local entity can properly be viewed as a conduit or investment vehicle and the investor's protected interest is in the underlying business and assets carried out through the investment vehicle, such that the investor is entitled to claim the local entity's losses as its own" (Tr., Day 12, 107-108 (Reed)). The Tribunal understands that the Claimants' position is that this is the case here: (i) Article 1(1) of the BIT does not limit its protection to the Individual Claimants' direct investments (their shares), but extends to their indirect interest in the underlying EFDG companies; (ii) the Individual Claimants own virtually 100% of the shares of the EFDG, and (iii) the Corporate Claimants were created as investment vehicles.

1202. Despite these arguments, the Respondent contends that most of the cases cited by the Claimants do not support the right of shareholders to compensation for the profits lost by the underlying business of their company. For example, in *Siemens* the Tribunal refused to award damages to the shareholder for its subsidiary's lost profits; it only awarded Siemens the book value of the subsidiary itself. Similarly, it argues that claims for lost profits were rejected in *Vivendi II* and *Azurix v. Argentina* (Tr., Day 13, 249 (Rubins))

1203. The Respondent further contends that, "as the present case shows, it would be fundamentally unjust to ignore the fact that shareholders are last in line for corporate assets. Those assets cannot go to shareholders if that means creditors cannot be paid in full" (R-PHB, ¶ 346). More specifically, the Respondent argues:

a. "This is part of the basic bargain investors make when they choose to conduct business through corporations rather than in their own names. […] The Individual Claimants […] chose to run their food and drinks business through a complex

network of corporations because it was advantageous to do so. They cannot now ignore the facts that the Corporate Claimants have separate legal personality; that the Individual Claimants do not own the corporations' assets; or that the corporations' creditors—including the state, through its undisputed entitlement to overdue tax payments—have the first claim on those assets, if (as the Claimants contend) the Corporate Claimants are incapable of paying their debts" (R-PHB, ¶ 347).

b. "[O]ne of the most obvious scenarios in which harm to a corporation causes no compensable harm to shareholders is when the corporation cannot pay its debts, so that the shares have no value in any event. This highlights an important reason for not diverting to the Individual Claimants damages actually suffered by the Corporate Claimants: the risk of a fraudulent conveyance" (R-PHB, ¶ 348). Indeed, the Respondent argues the Claimants "acknowledge that the very reason they have suddenly requested that all damages go to the Individual Claimants is to avoid paying the Corporate Claimants' tax obligations" (*Id.*).[255]

1204. In response to questions from the Tribunal regarding the protection of the Corporate Claimants' creditors (including Romania) in the case of an award to the Individual Claimants,[256] the Claimants stated in their oral closing arguments:

> [T]hose points are kind of answered in allowing shareholders to bring these kind of claims. And the reason for that in investment law is they are the real parties in interest in these matters, and creditors, including state creditors, cannot think that they have a claim to these kinds of losses because they know that shareholders have their own rights in international law. So a creditor or the taxman has no expectation that they can recover these taxes or whatever on the basis of amounts to be awarded in an ICSID arbitration.
>
> […]
>
> With respect to the position of the [C]orporate [C]laimants and their creditors and employees if the Tribunal were to make an award to the shareholders, […] in our view strictly as a legal matter, the answer is that the BIT protects foreign investors and breaches of the foreign investors' rights entitled them to compensation, and the foreign investors are the real parties in interest, as has been decided in a number of cases. The fate of the investment vehicle doesn't come into the balance, strictly legally speaking, in our submission.

---

[255] The Respondent cites a letter from King and Spalding dated 15 April 2011 (Exh. R-242), in which the Corporate Claimants state that they "certainly have no intention of avoiding their liabilities to commercial creditors, in respect of whom they are not in default." The Respondent concludes that "they apparently do intend to avoid their liability for taxes that they admit are overdue" (R-PHB, ¶ 348).

[256] Specifically, Dr. Alexandrov asked counsel for Claimants: "If the Tribunal decides to follow your suggestion and order payment to the two individual claimants, wouldn't the Tribunal expose respondent to a situation where respondent would not be able to collect principal due that is not disputed? […] [A]ssuming we agree with your legal proposition that the two individual claimants are entitled to the damages of the group, and that the damages should be paid to them, if there are any damages of course, the question then is […] if the Tribunal wants to protect Romania and make sure that Romania collects the debt that is owed by the corporate claimants, how do we reconcile that with the legal proposition that you are advancing that the shareholders are entitled to be paid the amount of damages?" (Tr., Day 12, 132-134).

> As a more pragmatic matter it seems to us that if you were to make the award that we urge, then my client -- Johnny Micula would have an award, and an award is not money. There would be a negotiation with the state and with the banks. Probably the banks would have to take a bit of a haircut because these are basically more or less sound businesses but crippled by debt. If the debt were relieved, things might be better. The state might have to do something as well.
>
> We see it more as an issue that arises after an award rather than in arriving at the award, as a strict matter. I suppose if the parties can't agree, it is of course plausible that the companies will go into bankruptcy. That doesn't actually mean that people will lose jobs because the businesses will presumably be sold, new investors will be found, they won't have to carry those debts; they will remain with the bankrupt entities. The banks will presumably lose money if the assets aren't sufficient to cover all the debts. We think that's the proper view.
>
> With that said, it does follow from some of the points that Professor Alexandrov made that you may be in a position to make a distinction between damages owed to the individual shareholders in their own right, and notably in relation to the investments of the companies that are not the corporate claimants, you may be able to take a view on the damages owed to the corporate claimants. So whilst we think that is possible, we don't actually think that is the right approach.
>
> (Tr., Day 12, 133-140 (Reed))

1205. In its closing statement, the Respondent strongly objected to the Claimants' comments in this respect. According to the Respondent, the Claimants' comments suggest that "international law gives equity holders a right to take for themselves what may be their company's largest asset, a claim against the state, and creditors be damned", which is a result that would be "contrary to basic corporate law" and could not be expected either by the Corporate Claimants' creditors or their employees (Tr., Day 13, 253 (Rubins)). Instead, the Respondent reiterates that "the assets of a company, which includes all receivables, do not belong to the shareholders. The [C]orporate [C]laimants have obligations to third parties that rank higher in priority than dividends payments to shareholders: they need to pay corporate creditors, they need to pay their employees' salaries and they need to pay Romania for the undisputed taxes they owe. These are all ahead of them in line." (Tr., Day 13, 252 (Rubins)).

1206. The Respondent further criticized the Claimants' suggestion that an award of damages would be followed by a negotiation with the Romanian State and other creditors, arguing that the Claimants' position appeared to be that "international law gives shareholders a stick with which to beat their creditors" and that it allows them to "empty the company of its assets under the guise of a BIT and then strike a deal the banks and the state can't refuse because they are holding all the cards" (Tr., Day 13, 254 (Rubins)).

b. **Is it possible for the Individual Claimants to be designated as the sole or principal claimants at this stage of the proceedings?**

1207. The Claimants submit that "[i]t is possible as a matter of both procedure and the merits for the Individual Claimants to be designated as the sole or principal claimants at this stage of the proceedings" (C-PHB, ¶¶ 239-243).

1208. The Claimants first argue that, as "the Individual Claimants could have brought their claims independently without the participation of the Corporate Claimants in the first instance […] there is no legal basis why the Individual Claimants cannot become the sole or principal claimants at this stage" (C-PHB, ¶ 241). The Claimants rely on *Suez v. Argentina*, where the tribunal allowed the proceedings brought by the local company to be discontinued at the jurisdictional stage, noting that this discontinuance "[…] does not affect the rights of the Shareholder Claimants to bring a claim in ICSID arbitration under the two BITs in question. The Claimant Shareholders would have had a right to bring such claims independently without the participation of the [local company] in first instance."[257] Although the Claimants acknowledge that in this case no discontinuance is being sought, and the Claimants' request for damages to be awarded to the Individual Claimants was made at the merits stage rather than at the jurisdictional stage, they argue that the tribunal's reasoning in *Suez v. Argentina* is equally applicable to the present case.

1209. In addition, the Claimants assert that "the claims for monetary damages in this case have always related to the financial losses suffered by the individual shareholders. The Corporate Claimants were primarily included as Claimants five years ago as a result of the original alternative claim for restitution of the EGO 24 regime. Unlike monetary damages, which have consistently been awarded to shareholder claimants in BIT practice, restitution of a legal framework – essentially an order for specific performance – could only be awarded to the Corporate Claimants. Regardless, that claim for restitution was dropped at the beginning of the merits phase of this case. There has never been any question that this case involved claims for monetary damages, that the Micula brothers owned nearly 100% of the companies comprising the European Food and Drinks Companies, or that the brothers, as shareholders, were the Claimants who ultimately suffered the losses at issue in this dispute" (C-PHB, ¶ 242).

1210. In light of the case law cited in the preceding section, the Claimants contend that awarding damages to the Individual Claimants is lawful under international law:

    a. The Claimants emphasize that the investment vehicle in *Suez v. Argentina* was entitled to lawfully withdraw its claim, leaving only the shareholders as claimants. Similarly, the Claimants argue that "as a matter of principle, it must be that in every case where both the shareholders and the local investment vehicle could have brought proceedings but only the shareholders did, the local investment

[257] *Suez, Sociedad General de Aguas de Barcelona S.A. and Interagua Servicios Integrales de Agua S.A. v. Argentine Republic* (ICSID Case No. ARB/03/17), Decision on Jurisdiction, 16 May 2006 (hereinafter *"Suez v. Argentina"*), ¶ 51.

vehicle 'waived' its rights to an award." In addition, they contend that "had the Individual Claimants commenced these proceedings alone, this issue would likely never have arisen. Consequently, this is a non-issue about which the Tribunal need not concern itself further" (C-PHB, ¶¶ 244-245).

b. The Claimants further submit that "[t]he approach in international investment law is to award damages to the foreign investor, not to the investment vehicle incorporated in the host state." According to the Claimants, "[t]here are sound policy reasons for this approach", as the contrary "would entirely undermine the protections afforded by investment treaties if states could breach their obligations to foreign investors, impose draconian penalties on the local investment vehicle and then demand that tribunals make payments only to the local investment vehicle on the basis that otherwise the investment vehicle will get away with not paying taxes and penalties (that it should never have incurred)" (C-PHB, ¶ 246).

1211. The Claimants further submit that awarding damages to the Individual Claimants is lawful under Romanian law (although they clarify that, in their view, Romanian law is irrelevant to this issue and the Tribunal should award damages in accordance with international law). Specifically, the Claimants argue that:

a. Pursuant to the "principle of availability", Romanian law recognizes the right of legal persons to exercise their civil rights as they see fit. According to the Claimants, this principle allows legal persons to determine whether or not they wish to commence legal proceedings, what claims or defenses to make in such proceedings, whether to discontinue or settle such proceedings, and whether to appeal or enforce any decision. The Claimants further submit that this principle gives to legal persons the right to agree that any damages award to which they are entitled be granted to other co-claimants with the same entitlement to such an award. Thus, pursuant to this principle the Corporate Claimants would be entitled to "waive" any rights they have to the award (C-PHB, ¶ 249). In support of this contention, the Claimants cite article 129(6) of the Romanian Procedural Civil Code, which provides that "[i]n all cases, the judges shall decide only regarding the request's object in dispute." According to the Claimants, "[a]s it is applied, that provision supports the Claimants' contention that they can decide amongst themselves how the Tribunal is to award their damages. There is no requirement that the Corporate Claimants formally waive their claims in order to apply that principle" (C-PHB, fn. 364).

b. In addition, the Claimants submit that nothing in the Romanian Commercial Code or laws regulating companies, including Law 31/1990, would prevent the Corporate Claimants from assigning their rights to the award to the Individual Claimants (C-PHB, ¶ 250).

1212. By contrast, the Respondent submits that the Individual Claimants cannot be designated as sole or principal claimants at this stage without Romania's consent or without complying with certain legal requirements (R-PHB, ¶¶ 335-338, R-SPHB, ¶¶ 59-64).

1213. The Respondent contends that, if the Individual Claimants were designated as sole Claimants at this late stage with the consent of the Corporate Claimants, that would constitute an abandonment of the Corporate Claimants' claims that would amount to a partial discontinuance of the proceeding. In that case, the Respondent argues that it would be entitled to an award with *res judicata* effect against the Corporate Claimants. The Respondent explains that the Corporate Claimants cannot discontinue the proceeding without Romania's consent under Rule 44 of the ICSID Arbitration Rules, and that Romania will not consent to any resolution that would permit the Corporate Claimants later to revive claims or requested relief that they have pursued (or could have pursued) in this proceeding, or without compensation for wasted costs.

1214. Romania further contends that the Claimants' reliance on *Suez v. Argentina* is inapposite, because in that case the local company's claims were withdrawn without objection by the Respondent. Here Romania has objected expressly: "apart from the substantive unfairness to the Corporate Claimants' creditors, including Romania, of the proposed waiver, a respondent that has been made to defend proceedings for five years has a legitimate interest in both an award with *res judicata* effect and reimbursement of its wasted costs as conditions of a discontinuance" (R-SPHB, ¶ 61).

1215. According to Romania, Romanian substantive and procedural law lead to the same conclusion. Citing Romanian case law, the Respondent submits that "[a] court need not accept a claimant's withdrawal of claims over the respondent's objection; but if the court does accept the withdrawal, it must render a judgment extinguishing the underlying right and determining the costs consequences of the claimant's waiver"[258] (R-SPHB, ¶ 61).

1216. The Respondent adds that, in any event, Romanian civil and company laws prohibit any action, including renunciation of claims, that could violate the rights of third parties, including removing assets from a company's patrimony to the detriment of creditors.[259] Given the value of the Corporate Claimants' damages claims and the Claimants' assertion that the Corporate Claimants have zero equity value and cannot pay their overdue debts, the Respondent argues that relinquishing those claims would prejudice the rights of creditors. The Respondent notes that Romanian law permits an interested party, such as a creditor, to move to nullify the waiver.[260] Romania, which is a substantial creditor, opposes the waiver, but notes that the other creditors of the Corporate Claimants may have no knowledge of a proposed waiver (R-SPHB, ¶ 62).

1217. Even if the Corporate Claimants were to waive their own damages claims, the Respondent argues that that would not be equivalent to assigning those claims to the Individual Claimants (R-PHB, ¶ 336). Only by assignment, and not by waiver, could

[258] The Respondent cites Civil Decision 28/30 January 2008, Constanta Court of Appeal, Civil Section; High Court of Justice and Appeal of Romania Decision 3519/26 November, 2008; Romanian Civil Procedure Code, Article 247(1).

[259] The Respondent cites Law 31/1990, Article 237(3), Article 237(4), and Article 272 (1)(2).

[260] The Respondent cites the Romanian Civil Code, Title III, Chapter III, Section II, Article 975.

the Individual Claimants receive compensation for harm to the Corporate Claimants. However, the Respondent argues that "Romanian law does not permit a debtor to give away an asset, receiving no payment in return, if that may frustrate creditors' ability to recover what they are owed. When the debtor is a corporation or limited liability company, the conditions are stricter, as such entities can only rarely make gratuitous transfers (particularly to their own shareholders). To effect an assignment, the Corporate Claimants and Individual Claimants would need to enter into an assignment agreement, on an arm's length basis – in other words, in which the Individual Claimants paid market value for the assignment. Procedurally, the assignment would have to be validly approved by a general meeting of shareholders, and it would have to be publicised in a manner set out by Romanian law if it were to have any effect against third parties – including, again, the Corporate Claimants' creditors who are not represented here" (R-SPHB, ¶ 63).[261] Here, the Respondent points out that the Corporate Claimants have not assigned their claims to the Individual Claimants, and it is highly unlikely that such an assignment could be made without violating Romanian civil and criminal law (R-SPHB, ¶¶ 63-64).

1218. Without an assignment of the Corporate Claimants' claims, the Respondent contends that the Individual Claimants cannot receive compensation that they have not proven to be their own. As explained in the previous section, the Respondent submits that, if liability is proven, each Claimant would be entitled to compensation for harm to his or its own investment, and damage to the Corporate Claimants' assets cannot be equated with damage to the Individual Claimants' shares in the Corporate Claimants. As a result, the Claimants cannot properly ask the Tribunal to award to the Individual Claimants damages that would have been awarded to the Corporate Claimants had they not stepped aside. Thus, the request for "all damages" to be paid to the Individual Claimants cannot entitle them to anything more than compensation for losses they have suffered (R-PHB, ¶¶ 336-337).

1219. The Respondent contends that, "[f]or the same reason, it is irrelevant that the Individual Claimants could have chosen to bring a case by themselves, without joining the Corporate Claimants. Had they done so, they would have been entitled (assuming liability) only to damages they had suffered. […] Whether the Corporate Claimants withdraw now, had never been in the case, or continue to pursue their own damages claims, the Individual Claimants would not be entitled to receive compensation that they have not proven to be their own" (R-PHB, ¶ 338).

c. The impact of the Claimants' requested allocation on the factual or legal bases for the claimed damages or their quantification

1220. The Claimants contend that "[a]warding damages to the Individual Claimants alone does not have any consequences with respect to the factual or legal basis for the claimed damages or the quantification of those damages" (C-PHB, ¶¶ 251-254). The Claimants assert that the Individual Claimants own (directly or indirectly) virtually all of the shares in each of the companies of the EFDG. As a result, had the Individual

[261] The Respondent cites Law 99/1999, Title VI, Chapter 1, Article 2(a) and Chapter 3, Article 29, as well as Articles 1391 *et seq.* of the Romanian Civil Code.

Claimants commenced these proceedings on their own, as the Claimants argue that they were entitled to do, they could have claimed and been entitled to all of the damages being sought in these proceedings.

1221. By contrast, the Respondent argues that the Individual Claimants are not entitled to any damages, because they have not proven the quantum of any loss. Indeed, the Respondent contends that there is no factual basis for any award of damages to the Individual Claimants, whether or not the Corporate Claimants stay in the case, because the Claimants have not assessed the damages incurred by the Individual Claimants, whether as shareholders of the Corporate Claimants or in any other capacity. The Respondent also argues that the Claimants have not justified their request for a different damages allocation, and that this request at such a late stage constitutes a change of position that should be taken into consideration when determining costs (R-PHB, ¶¶ 332-350, R-SPHB, ¶¶ 53-65).

1222. The Respondent contends that, because they have not proved damages that they themselves have suffered (*i.e.*, the diminution in value of their shares), the Individual Claimants should receive nothing. The Respondent adds that "[t]his is the Individual Claimants' burden of proof, and they have not even attempted to quantify the loss in value of their shareholdings in the Corporate Claimants. The Claimants have consistently declined to instruct one of their many quantum experts to carry out such a valuation. It would be fundamentally improper, and improper to Romania, to excuse this willful failure of proof and guess at a damages figure for the Individual Claimants, which is the only basis on which any damages could be awarded to them" (R-SPHB, ¶ 65).

1223. Contrary to the Respondent's contentions, the Claimants argue that there is significant evidence in the record showing that the Individual Claimants have suffered harm as a result of the Respondent's unlawful actions (C-PHB, ¶¶ 255-257):

   a. According to Mr. Osborne's calculations, in 2001 the EFDG had retained earnings of €152 million. The Claimants argue that this means that the EFDG companies could have paid to their shareholders (the Individual Claimants) €152 million at that time. The Claimants further assert that today the EFDG's retained earnings are gone and as such, the Micula brothers, as shareholders, have lost at least that €152 million (less the €17 million worth of dividends paid in the interim period) (First ER of C. Osborne, ¶¶ 3.27-3.30).

   b. In his reliance damages analysis, Mr. Osborne valued the Claimants' pre-EGO 24 businesses at €400 million.[262] According to the Claimants, had the Individual Claimants sold their businesses at that time for that price, the Individual Claimants, in their capacity as shareholders, would likely have received the vast majority of this sale. Also relying on Mr. Osborne, the Claimants contend that, if

[262] As noted in paragraph 886 above, the Tribunal understands that the Claimants' final prayer on the basis of Mr. Osborne's reliance damages analysis is RON 811 million, not €400 million. That being said, as the Tribunal is not awarding any damages for this head of claim it is unnecessary to determine whether the Claimants could have augmented this claim.

the Miculas were to sell their businesses today, they would likely recover not a single lei. The Claimants argue that Mr. Ellison agreed that the value of the shares prior to the revocation could have been as high as €350 million and that the current value of the shares is likely to be nil or virtually nil (Tr., Day 12, 109-110 (Reed); Tr., Day 10, 36-37 (Osborne)).

c. The Individual Claimants have suffered losses even from an expectation damages perspective. The Claimants argue that, "[h]ad the Claimants been able to make additional sales, due to the advantages of the Raw Materials Incentive (including an ability to sell their products at lower relative prices than their competitors to take advantage of the SCP opportunity) and by being able to complete the Incremental Investments (again by being able to take advantage of the incentives), the Claimants' businesses would have been more profitable, which would likely have led to increased dividends to the shareholders and/or the Individual Claimants being able to sell the businesses for a considerable profit.

1224. With respect to the impact of their requested allocation on the quantum of damages, in their closing statements the Claimants made the following comments (Tr., Day 12, 108-112 (Reed)):

a. "If the Tribunal considers that the Micula brothers' protected investments in Romania include the underlying business assets, then no separate damages calculation is required: all the damages should be awarded to the brothers as 50/50 shareholders. There's no need for the [C]orporate [C]laimants to withdraw from the case or to waive any claim, and the award would be binding upon them." (Tr., Day 12, 108-109 (Reed)).

b. In the Claimants' submission, the question of flow-through damages only arises if the Tribunal takes the view that only the Individual Claimants' shares constitute protected investments. In this case, their damages would be limited to the impact on the shares themselves, in particular to the loss of value of those shares. The Claimants argue that this loss of share value has been calculated by Mr. Osborne in his reliance damages analysis.[263] As explained in the paragraph 1223.b above, the Claimants submit that, based on this analysis, the loss of value of the Individual Claimants' shares is €400 million.

c. If, as in *Nykomb*, the Tribunal were inclined to take a stricter approach, and was inclined to limit the damages to the shareholders to amounts that would have been available to distribute as dividends, the Claimants submit that the Tribunal would still be able to establish quantum in this case. The Claimants argue that the Individual Claimants would have been entitled to take as dividends all of the retained earnings built up in the EFDG companies over the preceding years. The Claimants assert that the retained earnings of the EFDG companies over the years 1999-2004 amount to €173 million, a number that is not controversial as it

[263] The Claimants refute the Respondent's suggestion that they did not instruct any of their experts to carry out an evaluation of the loss of value of the shares of the Individual Claimants in the EFDG: they argue that this evaluation was carried out by Mr. Osborne in his reliance damages analysis.

is taken directly from the accounts and does not require computation. The Claimants argue that, because these amounts were earnings available for distribution as dividends, they take into account all of the creditors (Tr., Day 12, 110-111 (Reed)). The Claimants further contend that, under the *Nykomb* approach, the Individual Claimants would have been entitled to a proportion of the EFDG companies' future income (*i.e.* the Claimants' claims for expectation losses). The *Nykomb* tribunal assessed that the shareholders were entitled to one-third of the underlying company's losses, but the Claimants submit that under normal circumstances a higher proportion would be appropriate (Tr., Day 12, 110-112 (Reed)).

1225. In turn, the Respondent denies that the Individual Claimants' loss of shareholder value can be quantified on the basis of Mr. Osborne's reliance losses analysis:

a. The Respondent acknowledges that Mr. Osborne attempted to quantify the EFDG shareholder equity prior to the revocation by comparing EFDG to other publicly traded companies in the same line of business. However, the Respondent contends that the valuation date chosen by Mr. Osborne (2001) is not a proper valuation date because it is neither the date of the breach nor the date of the award. Rather, the Respondent argues that Mr. Osborne chose 2001 because it is the date of EFDG's financial peak, the "year just before the straight-line drop" in the financials, "so it's helpful to come up with a big number" (Tr., Day 13, 250 (Rubins)).

b. The Respondent also denies that Mr. Ellison confirmed a nil value for the EFDG today. The Respondent asserts that Mr. Ellison said that the value could be nil, but as he had not seen any audited financial statements for the EFDG since 2006, "he could say nothing about the state of EFDG's business today, and [the Tribunal] can't know because of the absence of documentation" (Tr., Day 13, 250 (Rubins)). Indeed, the Respondent asserts that, in their closing statements, the Claimants stated that the EFDG's business had been improving in 2009[264] and that this was also confirmed by a better EBITDA in the financials (Tr., Day 13, 250-251 (Rubins)).

c. The Respondent also notes that, according to Mr. Ellison, there was substantial shareholder equity in the business according to the 2009 draft financial statements, which suggests substantial remaining value for the Micula brothers. Specifically, the Respondent states that "[a]ccording to the draft 2009 accounts, shareholder equity was RON 461.7 million; […] €109 million roughly. So by assuming a zero value today, which is what Mr. Osborne does, he was asking you to ignore that €109 million are there, and the claimants would be likely to access that money on liquidation" (Tr., Day 13, 252 (Rubins)).

[264] The Respondent notes that, in their closing statements, the Claimants admitted that "on operating profits the company has actually performed better in 2009 than in 2008, although not well enough to meet their debt repayment obligations" (Tr., Day 12, 119 (Reed), and that "[t]hese are basically more or less sound businesses but crippled by debt. If the debt were relieved, things might be better" (Tr., Day 12, 139 (Reed)).

1226. Instead, the Respondent argues that the proper way to value the Individual Claimants' losses would have been "to perform a DCF valuation of the claimants' business as it was just before repeal and as it would have been with the €8 million per year in facilities through 2009", because this would have allowed the Tribunal to isolate the effect of the revocation. The Respondent "infer[s] that the result of such conventional modelling would have revealed the limited direct impact on equity value" (Tr., Day 13, 251-252 (Rubins)).

1227. The Respondent concludes that, "[o]n this record, the only damages that have been quantified are damages allegedly incurred by EFDG companies, not all of which are claimants. The Tribunal should ensure that only damages proven to have been incurred by each Corporate Claimant are awarded to the specific Corporate Claimant that incurred them. […] [D]amages allegedly incurred by other entities cannot be recovered by any of the Claimants" (R-PHB, ¶ 350).

1228. In response to questions from the Tribunal, the Claimants clarified that, if the Tribunal were inclined to award damages to all five Claimants, the damages suffered by the Individual Claimants may not be coextensive with those suffered by the Corporate Claimants:

a. With respect to the reliance losses claim, the Corporate Claimants could not make the same claim as the Individual Claimants, because the reliance loss is calculated on the loss of value to all companies of the EFDG (Tr., Day 12, 129 (Reed)), not all of which are claimants here. Possibly somewhat contradictorily, the Claimants have also argued that, should the Tribunal award reliance damages, it would be inappropriate to award these damages to the Corporate Claimants. This is because the reliance damages approach looks at the value lost from the pre-EGO 24 businesses as a result of investing in reliance on the incentives. As the Corporate Claimants were specifically created in order to receive the incentives, had the Individual Claimants not invested in reliance on the incentives, it is likely that the Corporate Claimants would have never been created and thus would have never incurred a reliance loss (C-PHB, ¶ 253).

b. For similar reasons, should the Tribunal award damages by looking at the fair market value of the investment immediately before the breach, the Claimants contend that such an award ought to be made to the Individual Claimants to compensate them for the loss in value of their business (C-PHB, ¶ 254).

c. With respect to expectation losses, counsel for the Claimants first stated that "they would not be coextensive if much of the loss was suffered outside of the three [C]orporate [C]laimants", but then clarified that "they may be more or less the same", depending on which company had suffered most of the damages, adding that in his understanding "most of the expectation damages would have been suffered by European Food" (Tr., Day 12, 129-130 (Reed)).

3. The Tribunal's analysis with respect to the requested allocation of damages

a. The Claimants' request that all damages be awarded to the Individual Claimants

1229. The Tribunal rejects, for procedural reasons, the Claimants' request that all damages be awarded to the Individual Claimants.

1230. Relying on *Suez v. Argentina*, the Claimants contend that, as "the Individual Claimants could have brought their claims independently without the participation of the Corporate Claimants in the first instance […] there is no legal basis why the Individual Claimants cannot become the sole or principal claimants at this stage" (C-PHB, ¶ 241).

1231. That the Individual Claimants could have brought claims on a stand-alone basis is not in dispute. However, the Tribunal disagrees with the consequences that the Claimants purport to derive from that observation. It is true that in *Suez v. Argentina* the tribunal, applying Rule 44 of the ICSID Arbitration Rules,[265] allowed the local company to withdraw its claim leaving only the shareholders as claimants.[266] However, the local company in that case elected to pursue a very different route than that followed by the Corporate Claimants in this case. First, the investment vehicle expressly withdrew its claim and sought a discontinuance of the proceeding. Second, upon Argentina's request, the local company supplied the minutes of their shareholders meeting authorizing that discontinuance. Third, having received those assurances, Argentina consented to the discontinuance.

1232. Here the situation is quite different. The Corporate Claimants have not requested the discontinuance of the proceedings with respect to their claims. Quite to the contrary, the Corporate Claimants are still seeking alternative relief in case the Tribunal decides not to grant all damages to the Individual Claimants. As a result, Rule 44 is simply not applicable to the situation at hand.

1233. Even if the Claimants' request could be interpreted as an implied request for a discontinuance with respect to the Corporate Claimants (*quod non*, because they have expressly stated that they are not seeking a discontinuance), the conditions set out by Rule 44 would not be satisfied because Romania has objected to such a discontinuance. Indeed, Romania has expressly stated that it will not consent to any resolution that would permit the Corporate Claimants to revive at a later date the claims or the relief that they have pursued (or could have pursued) in this proceeding, or without compensation for wasted costs.

---

[265] ICSID Arbitration Rule 44 provides: "If a party requests the discontinuance of the proceeding, the Tribunal, or the Secretary-General if the Tribunal has not yet been constituted, shall in an order fix a time limit within which the other party may state whether it opposes the discontinuance. If no objection is made in writing within the time limit, the other party shall be deemed to have acquiesced in the discontinuance and the Tribunal, or if appropriate the Secretary-General, shall in an order take note of the discontinuance of the proceeding. If objection is made, the proceeding shall continue."

[266] *Suez v. Argentina*, ¶ 51.

1234. Rule 44 provides that if an objection is made, the "proceeding shall continue", regardless of the nature of the objection, or whether it is justified or not. In this case, moreover, Romania's objections are more than reasonable.

1235. As the Corporate Claimants have not discontinued their claims, it follows that they are not waiving their claims against Romania and, in fact, definitely maintain them in the event that the Tribunal should not make the award fully payable to the Individual Claimants. Moreover, there is nothing in the Claimants' submissions that could amount to a conditional waiver (that is, a waiver conditioned upon the Individual Claimants obtaining the requested relief). Even if the Corporate Claimants had indicated that they waived their claims against Romania, there is no evidence in the record establishing that such waiver would be valid, in particular under Romanian law (for instance, there are no shareholders' minutes or board resolutions from the Corporate Claimants or their shareholders authorizing such a waiver). In these circumstances, the Tribunal agrees with Romania that it is entitled to an award with *res judicata* effect against the Corporate Claimants.

1236. In the Tribunal's view, whether the Individual Claimants could have been entitled to bring this case independently, without the participation of the Corporate Claimants, is irrelevant. They did not choose to do so. The fact is that this arbitration was commenced and pursued by five Claimants, all of whom have requested relief to this Tribunal. The Corporate Claimants have sought the same relief as the Individual Claimants and have not withdrawn their claims. The Tribunal must thus decide the claims raised by the five Claimants and not only the claims raised by two of them.

1237. All five Claimants have requested monetary relief. The Tribunal having found liability, the Claimants' request to have all damages awarded to the Individual Claimants would thus deprive the Corporate Claimants of a right (credit or account payable) to the relief requested. This would amount to the Corporate Claimants suffering a loss in the amounts owed in favor of their shareholders, which is particularly serious considering that the Claimants allege that the Corporate Claimants are unable to pay their debts. The Corporate Claimants would have to give their valid consent to such a conveyance, for instance, through an assignment of their claims to the Individual Claimants, an assignment that would have to comply with the relevant provisions of Romanian law. There is no evidence in the record that they have done so. Thus, as things stand, the Tribunal cannot disregard the Corporate Claimants' requests for relief.

1238. For the reasons set out above, the Tribunal rejects the Claimants' request for all damages to be awarded to the Individual Claimants.

b. Allocation of damages to all five Claimants

1239. As previously explained, in calculating the total damages, the Tribunal has decided to follow the Claimants' primary damages methodology, which quantified expectation damages for the entire EFDG. The Tribunal has found that the Claimants have proven two groups of damages: (i) increased costs of raw materials (sugar, other raw materials other than PET, and the sugar stockpile) for a total of RON 120,733,229

(Section VII.C.2), and (ii) lost profits of RON 255,700,000 on the sale of finished goods (Section VII.C.3 above).

1240. The Tribunal still must consider whether, and how, the damages should be allocated among the five Claimants. The Tribunal has carefully considered the arguments of both sides. As discussed above, the Tribunal has concluded that (i) it cannot award the entirety of the damages to the Individual Claimants. For the reasons set out below, the Tribunal has also concluded that it cannot (ii) award the entirety of the damages to the Corporate Claimants; (iii) allocate the damages to each of the five Claimants; or (iv) without double counting, compensate the Corporate Claimants for the direct harm they suffered and compensate the Individual Claimants for the indirect harm they suffered. As a result, the Tribunal shall not allocate the damages but shall award the entirety of the damages to the five Claimants collectively.

1241. First, for the reasons set out in Section (a) above, the Tribunal cannot award the entirety of the damages to the Individual Claimants.

1242. Second, the Tribunal cannot award the entirety of the damages to the Corporate Claimants, for the simple reason that a portion of the damages are associated with *other* companies that the Individual Claimants own. The Corporate Claimants are not entitled to compensation for such damages.

1243. Third, in Method A, the Claimants' principal expectation damages scenario (which the Tribunal has chosen to follow for the reasons set out in Section VII.C.1 above), the Claimants have made no attempt to allocate the damages among the five Claimants other than to request that the total damages be split evenly between the Individual Claimants.[267] In addition, it is evident from the reports prepared by the Claimants' experts and from their oral testimony that, for each head of claim, they have quantified the losses for the entire EFDG, including damages suffered by the non-claimant companies.[268] While counsel for the Claimants asserted at the hearing on

[267] The Tribunal is aware that, at paragraph 258 of their Post-Hearing Brief, the Claimants stated that their secondary position was that "any 'reliance' damages, or damages calculated on the basis of the fair market value immediately before the alleged breach, awarded should be awarded to the Individual Claimants and any other damages should be awarded to all of the Claimants" (C-PHB, ¶ 258). However, the Claimants have not made a formal prayer for this relief. Even if this statement could be construed to be a prayer for relief, the Tribunal rejects it on the merits. First, the Tribunal has not awarded any reliance damages nor damages based on the fair market value of the Claimants' investments immediately before the breach. In addition to favoring the Claimants' expectations damages case (as discussed in Section VII.C.1 above), the Tribunal does not find that the record contains a reliable quantification of the fair market value of the Claimants' investments immediately before the breach. The Tribunal understands that Mr. Osborne's analysis of reliance losses does not attempt to quantify the fair market value of the Claimants' business before the breach, but rather the value of the Claimants' pre-EGO 24 business, that is, money they could have invested elsewhere if they had not invested in reliance on the incentives. Even if Mr. Osborne's quantification could be understood to be a proxy for the fair market value of the business before the breach, the Tribunal cannot accept it, as the valuation date chosen by Mr. Osborne (2001) predates the revocation by over three years. In any event, the Claimants have not demonstrated how these reliance damages would be compatible with other damages, nor provided sufficient support for the allocation requested.

[268] *See, e.g.,* First ER of D. Lessard, ¶¶ 72-73; Tr., Day 8, 118-121 (Lessard); First ER of C. Osborne, fn. 1 and Appendix 2 (definition of "Companies"); ER of R. Boulton, p. i (definition of "Companies"); Second ER of BCG, p. 2; Tr., Day 10, 88-89 (Osborne).

closing arguments that "most of the expectation damages would have been suffered by European Food" (Tr., Day 12, 130 (Reed)) and Prof. Lessard testified along the same lines during the merits hearing (Tr., Day 8, 118-121), neither the Claimants nor their experts have provided a figure for the damages suffered by each Claimant, or stated in what proportion these damages should be distributed. Nor does the record contain clear elements that would allow the Tribunal to carry out such an allocation. There is, therefore, no evidentiary basis for allocating the damages.

1244. The Respondent argues that the Claimants' failure to quantify damages for each Claimant is reason to deny the payment of some or all of the damages. According to the Respondent, "the only damages that have been quantified are damages allegedly incurred by EFDG companies, not all of which are claimants. The Tribunal should ensure that only damages proven to have been incurred by each Corporate Claimant are awarded to the specific Corporate Claimant that incurred them. […] [D]amages allegedly incurred by other entities cannot be recovered by any of the Claimants" (R-PHB, ¶ 350). The Respondent further argues that the Individual Claimants cannot be awarded damages suffered by the EFDG companies, because "damage to the Corporate Claimants' assets cannot be equated with damage to the Individual Claimants' shares in the Corporate Claimants" (R-PHB, ¶ 336). Instead, the Respondent submits that "[s]hareholder damages are limited to losses suffered by the shareholder himself, such as any losses in the value of his shares or lost dividends" (R-PHB, ¶ 344).

1245. The Tribunal has found that the Claimants have quantified the damage suffered by the entire EFDG, of which the Corporate Claimants are a part and of which the Individual Claimants own at least 99.96%. In the circumstances of this case, the Tribunal does not find that the Claimants' failure to specify and prove the exact quantum of damages suffered by each one of the five Claimants is sufficient reason to deny the payment of the damages that have been quantified. The Tribunal is satisfied that some or most of the damage was directly suffered by the Corporate Claimants, and that virtually all of the damage was indirectly suffered by the Individual Claimants. There is nothing inconsistent between those two conclusions. Indeed, while the Tribunal will not enter into the discussion of whether shareholder damages are equivalent to the damages suffered by the underlying company,[269] the Tribunal is satisfied that, given the size of the Individual Claimants' shareholding in the EFDG companies, the Individual Claimants indirectly suffered at least a large part, if not virtually all, of the damage suffered directly by the Corporate Claimants. Furthermore, the Tribunal has already found that, provided that the Individual Claimants can prove their ownership of the other companies in the EFDG and can prove that they have been affected in this regard by the Respondent's breaches of the BIT, they can claim for losses they have suffered indirectly through those companies (see Section VII.B.2 *supra*). The Tribunal has further found that the Individual Claimants have met that burden and are, therefore, entitled to damages suffered by the non-claimant EFDG entities as well. Having established that both the Corporate and Individual Claimants were harmed, the Tribunal is not comfortable with

[269] If the Tribunal had to address this matter, it would not do so unanimously.

declining to award damages to one group or the other simply because it lacks the information needed to allocate the damages among them.

1246. Fourth, on the current record, the Tribunal cannot separately award damages to the Corporate Claimants for their direct damages, and damages to the Individual Claimants for their indirect damages. In Method A, the Claimants have only quantified the direct damages suffered by the entire EFDG. The Tribunal has no basis to distinguish which part of those damages has been suffered directly by the Corporate Claimants, and which part has been suffered indirectly by the Individual Claimants as a result of their shareholdings in non-claimant companies of the EFDG. Nor can the Tribunal award the Corporate Claimants all of the direct damages quantified in Method A, and in addition award the Individual Claimants the reliance damages quantified in Method C.[270] To do so would result in double recovery.

1247. Given these constraints, the Tribunal concludes that the appropriate way forward is, as the Claimants suggest, to award any damages, interest and costs to all five Claimants collectively, without allocating the damages among them. The Tribunal believes that this conclusion is particularly appropriate given that neither party has actually prayed for a particular allocation of damages among the five Claimants. The Claimants have requested that all damages be awarded to the Individual Claimants or, alternatively, to all five Claimants. They have not proffered adequate evidence or legal arguments to support a particular allocation. The Respondent also has not sought any particular allocation, other than to oppose Claimants' request that damages be awarded to the Individual Claimants. This Award thus disposes of the total amount that Romania has to pay fully to discharge its obligations and does not deal with the specific entitlement of each Claimant individually.

1248. A tribunal should not pass judgment on what has not been claimed. In particular, if two or more claimants fail to request a specific allocation of damages and rather claim for common entitlement, there is no reason for a tribunal to determine which claimant is entitled to what, subject of course to counterclaims or defenses made by the respondent in this regard.

[270] In addition, the Tribunal has rejected Method C, for the reasons set out in Section C.1 and fn. 267 above.

VIII. INTEREST

A. INTRODUCTION

1249. Up until their Reply, the Claimants requested "post-award interest (until the date Romania pays in full) at the highest possible lawful rate" (C-Reply, ¶ 657). The Claimants further requested that this interest be compounded, arguing that compound interest is the generally accepted standard in international investment arbitrations (C-Reply, ¶¶ 657-658).

1250. However, in their Revised Request for Relief the Claimants requested "[a]n award of interest on the damages payable pursuant to paragraph 2 above calculated in the following manner:

> 3.1 For losses as described in paragraphs 2.1(a) to (c) above [i.e., increased cost of raw materials], interest compounded on a quarterly basis at a rate of 3 month ROBOR (Romanian Interbank Offer Rate) plus 5% from 1 March 2007 until the date of Romania's full and final satisfaction of the award.
>
> 3.2 For losses as described in paragraph 2.1(d) above [i.e., lost opportunity to stockpile sugar], interest compounded on a quarterly basis at a rate of 3 month ROBOR plus 5% from 1 July 2010 until the date of Romania's full and final satisfaction of the award.
>
> 3.3 For penalties as described in paragraph 2.2A above [i.e., tax penalties already paid by the Claimants], interest compounded on a quarterly basis at a rate of 3 month ROBOR plus 5% from 1 July 2007 until the date of Romania's full and final satisfaction of the award.
>
> 3.4 For losses as described in paragraph 2.3 above [i.e., lost profits on sales of finished goods], interest compounded on a quarterly basis at a rate of 3 month ROBOR plus 5% from 1 May 2008 until the date of Romania's full and final satisfaction of the award.
>
> 3.5 For losses as described in paragraph 2.4 above [i.e., lost sales of SCPs to third parties], interest compounded on a quarterly basis at a rate of 3 month ROBOR plus 5% from 1 March 2007 until the date of Romania's full and final satisfaction of the award.
>
> 3.6 For losses as described in paragraph 2.5 above [i.e., lost profits incurred due to the Claimants' inability to complete the Incremental Investments], interest compounded on a quarterly basis at a rate of 3 month ROBOR plus 5% from 30 September 2009 until the date of Romania's full and final satisfaction of the award.
>
> 3.7 For losses as described in paragraph 2.6 above [i.e., the Claimants' alternative claim for lost sales on finished goods as calculated by BCG], interest compounded on a quarterly basis at a rate of 3 month ROBOR plus 5% from 15 August 2007 until the date of Romania's full and final satisfaction of the award.
>
> 3.8 For the amounts lost by the Claimants as a result of investing in reliance on the Incentives as described in paragraph 2.7 above [i.e., the Claimants' alternative claim for reliance losses], interest to be

applied compounded on a quarterly basis at a rate of 3 month ROBOR plus 5% from 1 January 2002 until the date of Romania's full and final satisfaction of the award.

3.9 The ROBOR rate to be applied in relation to paragraphs 3.1 to 3.8 above is to be the average annual rate for each year or part thereof.

1251. The Respondent objected to the Claimants' specified interest claim, but in its Procedural Order of 6 April 2011, the Tribunal found that there had been "no detrimental reformulation of the Claimants' claim for interest" (P.O. of 6 April 2011, ¶ 3.2). The Tribunal does not see any good cause to change its view and, accordingly, will address the Claimants' request for interest as it was formulated in their Revised Request for Relief, to the extent that it refers to the heads of claim for which the Tribunal has decided to award damages.

B. THE CLAIMANTS' POSITION

1252. The Claimants request pre- and post-award interest at 3-month ROBOR plus 5%, compounded on a quarterly basis (Revised Request for Relief, ¶ 3; R-PHB, ¶ 261). The Claimants submit that this interest should be calculated from different starting dates depending on the head of claim, and run until the date of Romania's full and final satisfaction of the award (Revised Request for Relief, ¶ 3).

1253. With respect to their request that interest be compounded, the Claimants argue that compound interest is the generally accepted standard in international investment arbitrations. In this respect, the Claimants note that since 2000, 16 out of 17 BIT tribunals ruling on BIT cases have awarded compound interest[271] (C-Reply, ¶¶ 657-658).

1254. The Claimants submit that there are three reasons for awarding compound interest. First, the payment of compound interest "furthers the principle of full compensation because it aids in restoring the claimant to the position where it would have been had the respondent not committed the breach" (C-Reply, ¶ 662). They add that "[t]he role of interest is to compensate a claimant fully for the delay between the date of harm suffered and the award of damages. […] [I]nterest awarded on a compound basis more accurately reflects what the claimant would have been able to earn on the sums owed if they had been paid in a timely manner" (C-Reply, ¶ 663). Second, the Claimants argue that an award of compound interest "prevents unjust enrichment of the respondent by requiring it to pay compensation for the benefits received from using the money it wrongfully withheld" (*Id.*) Third, the Claimants argue that awarding

[271] The Claimants cite, inter alia, *Santa Elena v. Costa Rica*, ¶ 104; *Wena Hotels Limited v. Arab Republic of Egypt* (ICSID Case No. ARB/98/4), Award, 8 December 2000 (hereinafter *"Wena Hotels v. Egypt"* or *"Wena"*), *Vivendi v. Argentina II*, ¶ 9.2.6; *LG&E v. Argentina*, Award, 25 July 2007, ¶ 103; *Middle East Cement Shipping and Handling Co. S.A. v. Arab Republic of Egypt* (ICSID Case No. ARB/99/6), Award, 12 April 2002, ¶ 174; *ADC Affiliate Limited and ADC & ADMC Management Limited v. Republic of Hungary* (ICSID Case No. ARB/03/16), Award, 2 October 2006, ¶ 522; *Azurix v. Argentina*, ¶ 440, *PSEG v. Turkey*, ¶ 354; *Enron v. Argentina,* ¶¶ 451-52; *CMS v. Argentina*, ¶ 471; *Waguih Elie George Siag and Clorinda Vecchi v. Arab Republic of Egypt (*ICSID Case No. ARB/05/15), Award, 1 June 2009, ¶ 598.

simple interest generally fails to compensate claimants fully, because the claimant is in essence making interest-free loans to the respondent. This in turn creates an incentive for respondents to delay the proceedings because they are able to profit from the use of the claimant's money during the pendency of the arbitration (or enforcement proceedings) (C-Reply, ¶¶ 663-664).[272]

1255. With respect to the requested rate (ROBOR + 5%), the Claimants argue that this is the approximate rate at which they borrowed money during the relevant period. The Claimants acknowledge that the 5% above ROBOR is higher than that at which interest has been awarded in several other ICSID cases (which has tended to be 2% above LIBOR). However, the Claimants argue that in those cases the claimants were large, multinational companies, with greater access to funding, at lower rates, than the Claimants, who are not international companies and cannot borrow at only 2 points above the interbank offer rate. Thus, the Claimants argue that a higher rate is required in order to reflect the Claimants' higher actual borrowing costs and ensure that they are adequately compensated for the Respondent's breaches (C-PHB, ¶ 262).

1256. In the Claimants' view, the Respondent's objections to an interest rate based on ROBOR are unsustainable. They argue that "ROBOR is the rate at which banks lend to each other, that is set by the market and which accurately reflects Romania's underlying economic conditions. Therefore at times of high inflation, which occurred in Romania in the period relevant to this dispute, it is logical that ROBOR rose accordingly, including to 30% at one point. However, due to the manner in which ROBOR is calculated and applied, it cannot sensibly be contended that it is not an appropriate rate for the calculation of interest when a claimant borrows from Romanian banks and/or borrows in RON" (C-PHB, ¶ 263). The Claimants add that "in the period 2005 to date (which is the period relevant to the Claimants' expectation damages claim), the average (mean) 3 month ROBOR rate was only approximately 8.9%, which is considerably below the 30% rate which the Respondent would have the Tribunal believe was the norm. In fact, for extended periods since 2005 the 3 month ROBOR rate has been below 5%. Tellingly, as at 10 January 2011 (the date of Freshfields' letter objecting to the Detailed Request), the 3 month ROBOR rate was only 5.16%" (C-PHB, ¶ 264). Finally, the Claimants note that Romania has charged the Claimants a penalty interest on unpaid taxes "at a consistent annual rate of 36.5% (with an effective rate in excess of 40%)", arguing that "[i]f anything, the Claimants' use of ROBOR rates as the basis for their calculations is conservative when juxtaposed to the punitive, draconian interest rates imposed on the Claimants by the Respondent" (*Id.*).

1257. With respect to the date from which interest must be calculated on the damages awarded by the Tribunal, the Claimants argue that "each date is the approximate midpoint between the time the relevant loss or damage began to be incurred and the

[272] The Claimants cite Jeffrey Colón and Michael Knoll, Prejudgment Interest In International Arbitration, Vol. 4, Issue 6, TRANSNATIONAL DISPUTE MANAGEMENT 10 (Nov. 2007), and John Y. Gotanda, A Study of Interest, Villanova University School of Law Working Paper Series, Paper 83, at 4 (2007).

time when that loss or damage would have ceased to have been suffered" (C-Reply, ¶ 265). Specifically:

a. With respect to the claims for increased cost of sugar, PET and other raw materials, the Claimants claim interest calculated from 1 March 2007. This date is "approximately the midpoint between the time at which the Incentives were prematurely revoked (22 February 2005) and the time when the Incentives were due to come to an end (31 March 2009)" (C-Reply, ¶ 265(a)).

b. With respect to the claim for the lost opportunity to stockpile sugar in 2009, the Claimants request an award of interest calculated from 1 July 2010. According to the Claimants, this is "the approximate midpoint between the time when the sugar stockpile would have started being used (31 March 2009) and the time, based on Mr Osborne's calculations, when it would have all been used (31 August 2011)" (C-Reply, ¶ 265(b)).

c. With respect to their claim for lost profits on sales of finished goods, the Claimants claim interest from 1 May 2008, which is the approximate midpoint of the period for which Mr Boulton has calculated losses (1 January 2005 to 31 August 2011)" (C-Reply, ¶ 265(d)).

1258. According to the Claimants, "[t]he midpoint provides a sensible and practical date from which the Tribunal may make its calculations" (C-Reply, ¶ 266). It notes that this approach has been adopted by other tribunals, such as the tribunals in *PSEG v. Turkey* (where the tribunal chose the mean date of the seven year period during which the relevant expenses were incurred[273]), and *Nykomb v. Latvia* (where the tribunal awarded interest "from the mid point of the respective periods up to the time of the award"[274]).

C. The Respondent's Position

1259. The Respondent argues that the Claimants' interest claim should be rejected with respect to the interest rate, compounding and date of calculation (R-PHB, ¶¶ 325-328).

1260. With respect to the interest rate, the Respondent contends that the rate requested by the Claimants (ROBOR + 5%) is far higher than that awarded by other investment arbitration tribunals, and could end up yielding a rate as high as 30%. The Respondent argues that this rate is at odds with the rates used by their own experts, noting that Mr. Osborne used EFDG's RON cost of debt for pre-award interest (about 11% according to Mr. Osborne, First Osborne Report, ¶ 4.10), whereas Professor Lessard applied ROBOR without any premium (First ER of D. Lessard, ¶ 111). The Respondent further argues that "the proposed rate is based on speculation as to what the Claimants' borrowing costs could be, rather than on their actual borrowing costs"

[273] *PSEG v. Turkey*, ¶¶ 349-351.
[274] *Nykomb v. Latvia*, p. 43.

(R-PHB, ¶ 326). According to the Respondent, the record on the EFDG's borrowing costs "reveals a rate of 5.88% for foreign currency and 10.75% for borrowings in RON" (EFDG combined financial statements for the year 2006, 31 December 2006, Exh. JMHE–8, p 27), which is consistent with Mr. Gamecho's testimony that the Claimants had access to financing at rates of less than 5.5% (Tr., Day 4, 54 (Gamecho)). The Respondent further contends that there is no justification for the 5% premium.

1261. The Respondent also objects to a rate based on ROBOR. It argues that the fact the Claimants' claims are made in RON does not mean that the Tribunal must use a RON-based interest rate for pre-award interest. The Respondent argues that the Claimants had substantial loans in Euros and purchased many of their imports in Euros. The Respondent contends that "the Claimants are subject to the inherent currency risks of their business", and thus "[i]t is not for Romania to subsidise that risk through payment of a higher interest rate. Therefore, only a pre-award interest rate that takes into account the fact that the Claimants can borrow in Euro would be appropriate" (R-PHB, ¶ 327).

1262. Further, the Respondent argues that any award of interest should be on a simple rather than compound basis. The Respondent relies on the Commentary to ILC Article 38, which states that "[t]he general view of courts and tribunals has been against the award of compound interest, and this is true even of those tribunals which hold claimants to be normally entitled to compensatory interest. […] [G]iven the present state of international law it cannot be said that an injured [party] has any entitlement to compound interest, in the absence of special circumstances which justify some element of compounding as an aspect of full reparation."[275] The Respondent also relies on *ADM v. Mexico*,[276] *Feldman v. Mexico*,[277] *Biloune v. Ghana*,[278] and *Occidental v. Ecuador*[279] (R-Rejoinder, ¶ 351, fn. 560).

1263. In view of the above, the Respondent submits that "the interest rate the Tribunal should apply for pre-award interest (the purpose of which is compensatory) is 3-month EURIBOR without any premium and on a simple basis" (R-PHB, ¶ 327). The Respondent further submits that "any post-award interest should be set a 3-month ROBOR, without any premium, and on a simple basis." The Respondent does not make entirely clear the reasons for the difference in approach between pre- and post-award interest, nor does it explain further or in more detail why it should be awarded on a simple basis.

1264. The Respondent further contends that the Claimants have manipulated the starting dates for the calculation of interest in order to maximize their claim. It argues that "[t]he selection of a mid-point date inflates the claim in this case in circumstances

[275] Commentary to ILC Article 38, ¶¶ 8-9.

[276] *Archer Daniels Midland Company and Tate & Lyle v United Mexican States* (ICSID Case No. ARB(AF)/04/05), Award, 21 November 2007, ¶¶ 294-297.

[277] *Feldman v. Mexico*, ¶¶ 205, 206 and 211.

[278] *Biloune v. Ghana*, pp 230 and 231.

[279] *Occidental v. Ecuador*, ¶ 211.

where the largest of the Claimants' alleged losses occurred after this arbitrary point in time. For example, selecting a mid-point start date in respect of sugar purchases ignores the fact that most sugar purchases were actually made in later years" (R-PHB, ¶ 328). The Respondent adds that "it would not have been difficult for the Claimants to present interest calculations starting from the dates when losses were allegedly suffered", as Prof. Lessard did in his calculations (*Id.*).

D. THE TRIBUNAL'S ANALYSIS

1265. Having found a breach of the BIT, the Tribunal must ensure that the Claimants are restored to the position they would have been had the breach not occurred. This includes awarding interest on the sums that the Claimants would have had if the breach had not occurred in order to compensate for the cost of money until the full payment of the Award. The Respondent does not dispute the principle that interest must be awarded; rather, it objects to the rate, compounding and date of calculation proposed by the Claimants.

1. Simple versus compound interest

1266. The overwhelming trend among investment tribunals is to award compound rather than simple interest. The reason is that an award of damages (including interest) must place the claimant in the position it would have been had it never been injured. As noted by the *Wena* tribunal, "'almost all financing and investment vehicles involve compound interest. […] If the claimant could have received compound interest merely by placing its money in a readily available and commonly used investment vehicle, it is neither logical nor equitable to award the claimant only simple interest.'"[280] The Commentary to ILC Article 38, on which the Respondent relies to object to compound interest, does not reflect the recent tribunal practice, with which the Tribunal agrees.

1267. The Tribunal will thus award compound interest, at the rate determined below.

2. Rate

1268. The Claimants request the same treatment for both pre- and post-award interest (3-month ROBOR plus 5%, compounded on a quarterly basis), starting from different dates depending on the claim. The Respondent requests that (i) pre-award interest be granted at a rate of 3-month EURIBOR without any premium and on a simple basis, while (ii) post-award interest should be set at 3-month ROBOR, without any premium, also on a simple basis.

1269. As a preliminary matter, the Tribunal does not see why the cost of the deprivation of money (which interest compensates) should be different before and after the Award, and neither Party has convinced it otherwise. Both are awarded to compensate a party for the deprivation of the use of its funds. The Tribunal will thus award pre- and post-award interest at the same rate.

---

[280] *Wena Hotels v. Egypt,* ¶ 129 (citing John Y. Gotanda, Awarding Interest in International Arbitration, 90 Amer. J. Int'l L., 40, 61 (1996).

1270. The Tribunal agrees with the Claimants that the appropriate rate is that which would compensate them for their cost of borrowing money during the relevant period. In the Tribunal's view, the Corporate Claimants' cost of debt should be assessed on the basis of operations in RON: the Claimants are Romanian nationals with their principal place of business in Romania, and the fact that they could borrow in Euro does not detract that the currency in the place where they operate was and remains RON.

1271. The Respondent objects to using a ROBOR-based rate, arguing that at times it has risen as high as 30% (R-PHB, ¶ 325). It has not provided any sufficient evidence for this allegation, but the Claimants appear to accept that this in fact occurred at one point in time (C-PHB, ¶ 263). In turn, the Claimants argue that in the period 2005 to the date of their Post-Hearing Brief, the average (mean) 3-month ROBOR rate was approximately 8.9%. This allegation is similarly insufficiently supported. This lack of evidence on the actual ROBOR rates is, however, irrelevant: as the Claimants note, the ROBOR rate is the rate at which Romanian banks lend to each other, and commercial borrowing rates will usually thus be ROBOR plus a premium. It is thus highly likely that any borrowing by the Claimants in Romania between 2005 and the date of payment of the award would have been and will be subject to a ROBOR-based interest rate plus a premium. In any event, the rates reflected in the record (10.75% for RON-based operations for 2006, 13.8% for those operations in 2005, according to the Corporate Claimants' 2006 financials (Exh. JMHE–8, p. 27) and 11% according to Mr. Osborne (First ER of C. Osborne, ¶ 4.10)), are closer to the Claimants' allegation that the mean 3-month ROBOR rate during the relevant period was 8.9%, than to the 30% rate alleged by the Respondent. Accordingly, the Tribunal finds that a 3-month ROBOR plus a reasonable premium, compounded on a quarterly basis, is reasonable, 3-month ROBOR being computed at an average annual rate to be applied for each period of one year or part of a year.

1272. The question that remains is what premium is reasonable. The Claimants request 5% above the ROBOR rate. They argue that, because they are not international companies, they cannot borrow at only 2 points above the interbank offer rate (which is the premium that has been awarded by other investment tribunals). The Tribunal finds this argument persuasive: the Claimants probably would not have obtained better conditions. The Tribunal will thus award interest at 3-month ROBOR plus 5%, compounded on a quarterly basis.

3. Date of calculation

1273. Interest must be calculated from the date on which the loss was suffered. This is usually the day on which the breach occurs. This cannot be the case or, at least, is not easily practicable when the damage is suffered progressively after the date of the breach, as has happened here. After the revocation of the incentives became effective on 22 February 2005, the Claimants incurred their damages progressively: they progressively purchased raw materials at a higher price, thus progressively incurring higher costs, and they progressively lost profits that they could have earned on the sales of their own finished goods. With respect to the lost opportunity to

stockpile sugar in 2009, because they were unable to stockpile sugar at that time, they progressively bought sugar at a higher price.

1274. Under the circumstances, the Tribunal finds that the midpoint approach proposed by the Claimants is appropriate. Despite the Respondent's arguments, it would have been difficult and next to impossible for the Claimants to point out to the exact date on which this damage was suffered, while at the same time, damage has definitely been proved to exist during that period. Indeed, a part of the damage may have been suffered every day since the revocation. The Tribunal also notes that this midpoint approach has been used by other investment tribunals.[281] And it does not seem that there exist circumstances in this arbitration that should detract as a matter of principle from this approach: for instance, the record does not point to a use of the stockpile that should not have been evenly spread over the months concerned (in which case the "midpoint approach" could lead to distortions).

1275. Finally, with respect to lost profits, the Tribunal is aware that, according to the Commentary to ILC Article 38, "[w]here a sum for loss of profits is included as part of the compensation for the injury caused by a wrongful act, an award of interest will be inappropriate if the injured State would thereby obtain double recovery", because "[a] capital sum cannot be earning interest and notionally employed in earning profits at one and the same time" (Commentary to ILC Article 38, ¶ 11). However, the Commentary goes on to say that "interest may be due on the profits which would have been earned but which have been withheld from the original owner." The Tribunal understands that, by awarding interest on lost profits on sales of finished goods as of the midpoint in which the total quantified would have been earned, interest is only applied to amounts that would have been earned but were withheld from the Claimants.

1276. Accordingly, the Tribunal awards interest, at 3-month ROBOR, the ROBOR being computed at an average annual rate to be applied for each period of one year or part of a year, plus 5%, compounded on a quarterly basis, calculated from the following dates until full payment of the award:

   a. With respect to the claims for increased cost of sugar and other raw materials, interest shall be calculated from 1 March 2007, which is the approximate midpoint between the time at which the EGO 24 incentives were revoked (22 February 2005) and the time when the incentives were due to expire (31 March 2009).

   b. With respect to the claim for the lost opportunity to stockpile sugar in 2009, interest shall be calculated from 1 November 2009, which is the approximate midpoint between the time when the sugar stockpile would have started being used (31 March 2009) and the time, when it would have all been used (1 July 2010). The Tribunal is aware that, according to Mr. Osborne's calculations, the Claimants' optimal stockpile of 75,000 tonnes would have been used by 31 August 2011 (First ER of C. Osborne, ¶4.10). However, the Tribunal has

---

[281] *See, e.g., PSEG v Turkey*, ¶¶ 349-351; *Nykomb v. Latvia*, p. 43.

awarded this claim on the basis of Mr. Ellison's calculations, which account for a smaller stockpile of 30,000 tonnes. The Tribunal has thus adjusted Mr. Osborne's timing forecast to this smaller amount.

c. With respect to the claim for lost profits on sales of finished goods, the interest shall be calculated from 1 May 2008, which is the approximate midpoint of the period for which Mr Boulton calculated losses (1 January 2005 to 31 August 2011) (C-Reply, ¶ 265(d)).

IX. THE PARTIES' OTHER REQUESTS FOR RELIEF

1277. In the context of the Respondent's Application to Revoke Provisional Measures, both sides requested other specific relief that was deferred for determination to the final Award *(see* paragraph 111 above). These requests for relief concern (A) set-off of the amounts awarded to the Claimants against the EFDG's tax debts with Romania, and (B) post-award injunctive relief, as explained below. [282]

A. THE PARTIES' REQUESTS CONCERNING SET-OFF OF THE AMOUNTS AWARDED AGAINST THE EFDG'S TAX DEBTS

1. The Respondent's position

1278. The Respondent argues that, because of the EFDG's opaque intra-group finances and the prejudice to Romania's tax enforcement rights resulting from the Claimants' manipulation of provisional measures, if there were to be any monetary award in favor of any Claimant, the amount should be explicitly subject to set-off against all of the EFDG companies' tax debts (Respondent's Revocation Application, ¶ 8(b)).

1279. In support of this request, the Respondent argues that, in its Supplemental Decision on Provisional Measures, the Tribunal made a "straightforward recommendation" that the Individual Claimants should allow any award to them to be set off against the Corporate Claimants' tax debts — a recommendation that has been ignored by the Claimants (Respondent's Revocation Application, ¶ 60(c)).

1280. On this basis, the Respondent requests the Tribunal to "explicitly provide in the Award that any amount awarded to any of the Claimants, whether as damages, arbitration costs, or otherwise, is subject to set-off by Romania against the tax debts of all eleven EFDG companies, including lawful interest and penalties" (Respondent's Revocation Application, ¶ 87(c)).

1281. The Respondent maintained this request in its Reply on its Revocation Application (¶¶ 2 and 41(c)), but did not provide further arguments or respond to the Claimants' comments set out below.

2. The Claimants' position

1282. The Claimants argue that the Tribunal lacks jurisdiction to grant the Respondent's set-off request, for three main reasons (Claimants' Response, ¶¶ 113- 116):

a. First, because it is procedurally improper: The Claimants contend that the Respondent has not established, or even argued beyond a cursory request, that it is entitled to a set-off. Such a new claim would have to be briefed and it is far too late in the arbitral process for that. In any event, the Claimants assert that such a set-off would be unnecessary because the Respondent has retained all of

[282] All briefs cited in this section relate to the Respondent's Application to Revoke Provisional Measures.

its rights to collect outstanding taxes from the EFDG (Claimants' Response, ¶ 114).

b. Second, because the parties against whom the set-off would be ordered (that is, the Claimants) are not identical to the parties who owe the debts: The Claimants argue that the Tribunal would thus lack the necessary jurisdiction. Relying on Article 8.1 of the UNIDROIT Principles of International Commercial Contracts, the Claimants add that "[e]ligibility for set-off requires that the obligations be between the same parties", which is an argument going to the merits (Claimants' Response, ¶ 115 and fn. 113).

c. Third, the Claimants argue that the Tribunal has no jurisdiction *rationae materiae* because the Respondent's set-off request is not "a legal dispute arising directly out of an investment" within the meaning of Article 25(1) of the ICSID Convention, as it was not especially contracted for in an investment agreement and does not arise directly out of an investment (Claimants' Response, ¶ 116).

1283. In addition, the Claimants argue that, apart from any legal defense to the Respondent's set-off request, it would be fundamentally unfair to provide for a set-off, or for the Award (or at least a significant portion thereof, reflecting at least the value of the retained earnings at the time the incentives were withdrawn) to be made out to anyone but the Individual Claimants "on a 50/50 basis" (Claimants' Response, ¶ 117). The Claimants contend that they are entitled to full compensation for their significant losses over the years due to the revocation of the EGO 24 incentives, and that allowing set-off would be unfair in the light of these losses (Claimants' Rejoinder, ¶¶ 67-72).

1284. The Claimants add that a set-off would imply that the Individual Claimants should take personal responsibility for the EFDG companies' tax debts. In their view, this would not only be unfair to the Individual Claimants, but would also imply that the Individual Claimants, by paying further amounts to the ongoing business operations in Romania or paying debts relating to those investments, would be making additional investments, which are not reflected in the current damages claim and for which compensation would be owed (Claimants' Rejoinder, ¶¶ 63-66).

1285. The Claimants acknowledge that if the Award is made out to the Individual Claimants alone, unless the Award is of a certain size, some creditors may not be paid in full, including the Respondent. In that case, they note that the EFDG companies may no longer be viable as going concerns. They argue that these are factors to consider in determining how the Award should be drafted, but they should not be at the forefront of the Tribunal's considerations, as the ICSID Convention was put in place to protect investors, not creditors (Claimants' Response, ¶ 118). The Claimants further note that the Respondent did not respond substantively to their arguments, but merely referenced the Tribunal's recommendation. The Claimants argue that the Tribunal recommended that the Parties were free to agree to a set-off, and the Parties did not agree.

1286. For the reasons set out above, the Claimants request the Tribunal to "issue a declaration that Romania is not entitled to set-off tax debts of the companies against an Award in favor of Claimants" (Claimants' Response, ¶ 127(c)).

3. The Tribunal's analysis

1287. The Tribunal has carefully considered both sides' prayers for relief with respect to set-off, and dismisses them both.

1288. First, both prayers have been made too late in the arbitral proceedings. To the extent that both requests are for declaratory relief to be given in the Award, the requests must be seen as ancillary claims covered by Article 46 of the ICSID Convention[283] and Rule 40 of the ICSID Arbitration Rules. In particular, the Respondent has not raised the issue of set-off as a defense to the Claimants' claims: it has not requested an acknowledgment of set-off, nor for set-off to be ordered; it is seeking a declaration that any amounts awarded to any of the Claimants are subject to set-off by Romania against the tax debts of the EFDG companies. The Claimants request a declaration in the opposite sense. In this context, the Parties do not argue whether the legal conditions for set-off are satisfied, but discuss rather whether set-off should be allowed or not as a "modus" (qualification) added to any amount awarded. Such requests for declaratory relief must be treated as ancillary claims subject to the time limits set out in Rule 40 of the ICSID Arbitration Rules.

1289. Pursuant to Rule 40 of the ICSID Arbitration Rules:

> (1) Except as the parties otherwise agree, a party may present an incidental or additional claim or counter-claim arising directly out of the subject-matter of the dispute, provided that such ancillary claim is within the scope of the consent of the parties and is otherwise within the jurisdiction of the Centre.
>
> (2) An incidental or additional claim shall be presented not later than in the reply and a counter-claim no later than in the counter-memorial, unless the Tribunal, upon justification by the party presenting the ancillary claim and upon considering any objection of the other party, authorizes the presentation of the claim at a later stage in the proceeding.
>
> (3) The Tribunal shall fix a time limit within which the party against which an ancillary claim is presented may file its observations thereon.

1290. Both Parties' requests regarding set-off have been made considerably past the time limits set out in Rule 40. The Respondent's request was made in its Application to Revoke Provisional Measures submitted on 1 August 2012, more than three years after the submission of its Counter-Memorial. Similarly, the Claimants' request was made in their Response to the Respondent's Application to Revoke Provisional

[283] Article 46 of the ICSID Convention provides: "Except as the parties otherwise agree, the Tribunal shall, if requested by a party, determine any incidental or additional claims or counterclaims arising directly out of the subject-matter of the dispute provided that they are within the scope of the consent of the parties and are otherwise within the jurisdiction of the Centre."

Measures, submitted on 28 September 2012, almost two years after the submission of their Reply. The record does not evidence any good causes for such delay.

1291. If the Tribunal had not dismissed these requests on procedural grounds, it would have done so on the merits. Indeed, whether the Respondent has a right to set off the Award against the EFDG's tax debts would be (primarily at least) a matter of Romanian law and of enforcement of this Award. Romanian law establishes the conditions under which a set-off may be carried out and nothing the Tribunal says will affect that. In certain jurisdictions, set-off may even operate as a matter of law (*ipso iure)* when strict conditions are met. Thus, as a matter of principle, the Tribunal is not in a position to declare that Romania has a right to set-off the amounts awarded in this arbitration against the EFDG's tax debts. Whether Romania has a right to set-off the amounts awarded against the Claimants or other companies of the EFDG will depend on whether the conditions set out in Romanian law are fulfilled.

1292. Even if the Tribunal were to state that, in principle, Romania has a right to set-off, it would not be able to decide whether in this particular case such set-off is warranted. The Respondent has not explained why the (Romanian law) conditions for set-off are fulfilled in this case, what are the amounts to be set off, or which are the specific parties involved. The only apposite mention of legal principles applicable to set-off seems to be the Claimants' reference to the UNIDROIT Principles (see paragraph 1282 above) rather than applicable Romanian law. In addition, for the reasons set out in Section VII.F above, the Tribunal has declined to allocate the damages among the Claimants, and is instead awarding the totality of the damages to all five Claimants. Under the circumstances of the case itself, the Tribunal is simply not in a position to declare whether Romania is or is not entitled to set off an award in favor of the Claimants against the EFDG companies' tax debts.

1293. For these reasons, the Tribunal dismisses the Respondent's request that the Award explicitly provide that any amount awarded to any of the Claimants is subject to set-off by Romania against the tax debts of the EFDG companies, without prejudice to the application of Romanian law, especially but not exclusively its dispositions for the satisfaction of tax debts.

1294. For the same reasons, the Tribunal dismisses the Claimants' request for a declaration that Romania is not entitled to set off tax debts of the EFDG companies against the Award, again without prejudice to the application of Romanian law, including for the satisfaction of tax debts.

B. THE CLAIMANTS' REQUEST FOR POST-AWARD INJUNCTIVE RELIEF

1. The Claimants' position

1295. Again in the context of the Respondent's Application to Revoke Provisional Measures, the Claimants request the Tribunal to provide in the Award that the Respondent "is enjoined from any further tax collection measures of any kind in respect of the Claimants and the EFDC until such a time as the damages awarded by the Tribunal have been paid in full, and include a pecuniary alternative in case of non-performance" (Claimants' Rejoinder, ¶ 75(b); *see also* Claimants' Response, ¶ 127(b)).

1296. According to the Claimants, it is obvious that Romania intends to collect on the taxes owed to it as soon as it can, by whatever means it can (Claimants' Response, ¶ 108). The Claimants understand that the provisional measures recommended by the Tribunal will come to an end upon issuance of the Award. They thus argue that for any award in their favor to have any meaning, equivalent relief to that granted under the provisional measures must be put in place in the Award until the Claimants are compensated in full (Claimants' Response, ¶ 119; Claimants' Rejoinder, ¶ 58).

1297. The Claimants argue that the Tribunal has the jurisdiction to order permanent injunctive relief. They rely on *Enron v. Argentina,*[284] where the tribunal allegedly asserted that it had such power (Claimants' Response, ¶ 122). The Claimants also rely on writings by Prof. Schreuer, as well as the Decision on Jurisdiction rendered by this very Tribunal (Claimants' Rejoinder, ¶¶ 54-55).

1298. The Claimants note that already in their First Application for Provisional Measures, they requested

> an Order preserving the status quo ante by instructing Respondent to withdraw or otherwise cease and desist from enforcing the above-described seizure orders, or from implementing any new such orders against any of the EFDC prior to the Tribunal's issuance of its final award (***and that the award itself deal with the matter as appropriate at that time, such as by maintaining the Order in place until Romania has satisfied the terms of the award in full***) […] (Claimants' First Application for Provisional Measures, ¶ 43, emphasis added).

1299. The Claimants recognize however that this relief has not been expressly requested, but submit that the Tribunal is empowered to make such an order under paragraph 6 of Claimants' Revised Request for Relief,[285] which seeks "[a]ny further relief that the Tribunal may deem fit and proper" (Claimants' Response, ¶¶ 120-121; Claimants' Rejoinder, ¶ 59).

1300. In the alternative, if the Tribunal concludes that it cannot order relief on the basis of the Revised Request for Relief as drafted, the Claimants request that the Tribunal

[284] *Enron v. Argentina (Decision on Jurisdiction)*, ¶¶ 77-79.

[285] The Claimants refer to their "Detailed Request for Relief", which the Tribunal refers to throughout this document as their "Revised Request for Relief".

permit the Claimants to add a specific request for injunctive relief to their Request for Relief pursuant to Rule 40 of the ICSID Rules (Claimants' Response, ¶ 123). The Claimants argue that the Respondent has already had notice of the Claimants' intentions and will suffer no prejudice as a result of the requested amendment to the Request for Relief. Specifically, the Claimants assert that the cover letter enclosing their Revised Request for Relief put Romania on notice that Claimants might seek to amend the requested relief "[i]n the event that financial or operational circumstances materially change to Claimants' detriment prior to the Tribunal's issuance of its award" (Claimants' Response, ¶¶ 124-125).

1301. Even if the Tribunal were to conclude that Romania will suffer prejudice as a result of the requested amendment of the Request for Relief, the Claimants contend that such prejudice should be balanced against the greater harm that the Claimants would suffer if the request is not granted. According to the Claimants, "it would be a fundamental denial of justice to Claimants and an absurd result if Romania could bankrupt the companies on the day after the Award was issued, prior to making payment, the timing of which is solely within its control" (Claimants' Response, ¶ 125).

2. The Respondent's position

1302. The Respondent argues that the Claimants' request must fail for the following reasons.

1303. First, the Respondent submits that Provisional Measures are temporary in nature and cannot be upheld beyond the point where the proceedings come to an end. Relying on writings by Prof. Schreuer, the Respondent contends that the Tribunal's authority to grant interim relief pursuant to Article 47 of the ICSID Convention and Rule 39 of the ICSID Arbitration Rules only extends throughout the arbitration and any provisional measure lapses automatically when a final award is rendered. According to the Respondent, this cannot be circumvented by including the provisional measures in the Award (Respondent's Reply, ¶ 36).

1304. Second, the Respondent argues that it is irrelevant whether the Tribunal has the power to grant injunctive relief, because the legitimacy of the collection of taxes has never been subject matter of the proceedings leading to the Award. By contrast, in *Enron v. Argentina* the request for permanent injunctive relief was linked to taxes that were the basis for Enron's expropriation claim (Respondent's Reply, ¶ 37).

1305. Third, the Respondent contends that the Claimants' new attempt to amend their Request for Relief is in fact a new claim submitted out of time. The Respondent notes that, pursuant to Article 46 of the ICSID Convention and Rule 40(2) of the ICSID Arbitration Rules, any incidental or additional claim must be presented no later than in the reply. The Respondent adds that such a new claim would require further written and oral proceedings, and the Claimants have failed to provide a justification for it (Respondent's Reply, ¶ 38).

1306. Fourth, the Respondent argues that the Claimants' request to amend their Request for Relief involves relief in favor of eight EFDG companies that are not parties to the

present arbitration, but Article 46 of the ICSID Convention does not permit extension of the dispute *ratione personae*. The fact that the Claimants purported to reserve their right to amend their Request for Relief is thus irrelevant, as the issues at stake in the provisional measures are not part of the dispute which forms the subject matter of the arbitration proceedings (Respondent's Reply, ¶ 39).

3. The Tribunal's analysis

1307. There is no dispute that the provisional measures recommended by the Tribunal in its five decisions on Provisional Measures will lapse upon the issuance of the Award. The Tribunal concurs with Prof. Schreuer when he states that

> The provisional nature of interim measures implies that they are recommended only for the duration of the proceedings. [...] Provisional measures will lapse automatically upon the rendering of the tribunal's award. They will also lapse upon the discontinuance of the proceedings in accordance with Arbitration Rules 43-45. Although neither Art. 47 nor Arbitration Rule 39 say so explicitly, this is a consequence of their provisional nature.[286]

1308. However, the Claimants are neither requesting the extension of these provisional measures beyond the Award, nor the recommendation of new provisional measures. The Claimants frame their request as one for "permanent injunctive relief". Thus, the threshold question is whether the Tribunal has the authority to issue permanent (or rather, definitive) injunctive relief in the Award, even if it is only temporary.

1309. In its Decision on Jurisdiction and Admissibility the Tribunal recognized its power to grant non-pecuniary relief (Decision on Jurisdiction and Admissibility, ¶ 166).[287] An ICSID tribunal's powers derive from the nature and purpose of its mandate, which in turn is defined by the parties' consent. In this case, such consent is reflected in the ICSID Convention, the BIT and the Claimants' request for arbitration. From these instruments it emerges that the Tribunal's task is to resolve the legal disputes between the Claimants and the Respondent arising directly out of the Claimants' investments in the territory of the Respondent which have their origin in the Respondent's breaches of the BIT. As none of the aforementioned instruments *expressis verbis* defines the powers granted to a tribunal nor limits the remedies available to the Claimants in the event of an internationally wrongful act,[288] this

[286] C. Schreuer, The ICSID Convention: A Commentary, 2nd edition (2009), pp. 774-775.

[287] At paragraph 166 of its Decision on Jurisdiction and Admissibility, the Tribunal stated: "Under the ICSID Convention, a tribunal has the power to order pecuniary or non-pecuniary remedies, including restitution, i.e., re-establishing the situation which existed before a wrongful act was committed. As Respondent itself admits, restitution is, in theory, a remedy that is available under the ICSID Convention (Tr. p. 56). That admission essentially disposes of the objection as an objection to jurisdiction and admissibility. The fact that restitution is a rarely ordered remedy is not relevant at this stage of the proceedings. Similarly, and contrary to Respondent's argument, the fact that such a remedy might not be enforceable pursuant to Article 54 of the ICSID Convention should not preclude a tribunal from ordering it. Remedies and enforcement are two distinct concepts."

[288] The only remedy specified by the BIT is compensation in cases of expropriation (Article 4 of the BIT). However, the BIT does not specify what remedies are available in cases of breaches of other standards of protection.

Tribunal must conclude that its powers include all of those required to provide effective remedy in order to redress the injuries suffered by the Claimants as a result of such internationally wrongful acts, within the limits of the parties' requests for relief and provided that such relief is admissible under international law. In the Tribunal's view, such relief includes pecuniary and non-pecuniary relief.

1310. The Tribunal is aware that, although Article 54(1) of the ICSID Convention provides that a state shall recognize an award as binding, it then proceeds to limit a state's obligation to enforce an award to the pecuniary obligations imposed by that award.[289] However, this should not be interpreted as limiting ICSID tribunals to awarding pecuniary relief. As the Tribunal already stated, awarding remedies and enforcement are two distinct concepts.[290] Moreover, the *travaux préparatoires* of the ICSID Convention confirm that "the restriction in Article 54 to pecuniary obligations was based on doubts concerning the feasibility of an enforcement of non-pecuniary obligations and not on a desire to prohibit tribunals from imposing such obligations."[291] Indeed, the fact that Article 54 found it necessary to specify that only pecuniary obligations could be enforced confirms that a tribunal has the power to order non-pecuniary relief.[292]

1311. In the Tribunal's view, such non-pecuniary relief may take many forms, such as restitution or specific performance.[293] It may also take the form of definitive (i.e., not provisional) injunctive relief, if the Tribunal finds that such relief is necessary to ensure that the breach will be redressed. To quote Prof. Schreuer:

> There is a wide range of possibilities for non-pecuniary obligations that awards might impose. […] Possible obligations imposed upon the host State would include the restitution of seized property […] or desistance from imposing unreasonable taxes. In the cases so far published, ICSID tribunals have framed the obligations imposed by their awards in pecuniary terms. This is not due to a belief that they lack the power to proceed otherwise. Rather, the cases involved situations in which the investment relationship had broken down and the claimants had defined their demands in pecuniary terms. […] It is likely that in the future more cases will arise,

---

289 Article 54(1) of the ICSID Convention provides in relevant part: "Each Contracting State shall recognize an award rendered pursuant to this Convention as binding and enforce the pecuniary obligations imposed by that award within its territories as if it were a final judgment of a court in that State. […]."

290 *See* Decision on Jurisdiction and Admissibility, ¶ 166.

291 C. Schreuer, Non-Pecuniary Remedies in ICSID Arbitration, Arbitration International, Vol. 20, No. 4 (2004), pp. 325-326.

292 Indeed, Article 53(1) of the ICSID Convention, which deals with the binding nature of the award rather than enforcement, provides that "[t]he award shall be binding on the parties" and that "[e]ach party shall abide by and comply with the terms of the award except to the extent that enforcement shall have been stayed pursuant to the relevant provisions of this Convention", without limiting such binding nature to the non-pecuniary obligations imposed by the award.

293 In the state-to-state sphere, the ILC Articles expressly recognize a tribunal's power to grant non-pecuniary relief. Article 31 of the ILC Articles provides that "[t]he responsible State is under an obligation to make full reparation for the injury caused by the internationally wrongful act." In turn, Article 34 provides that "[f]ull reparation for the injury caused by the internationally wrongful act shall take the form of restitution, compensation and satisfaction, either singly or in combination, in accordance with the provisions of this chapter."

> involving disputes stemming from ongoing relationships, in which awards providing for specific performance or injunctions will become relevant.[294]

1312. Finally, the power to award injunctive relief has been affirmed by ICSID tribunals. For instance, in *Enron v. Argentina* the tribunal expressly concluded that "in addition to declaratory powers, it has the power to order measures involving performance or injunction of certain acts."[295]

1313. The Tribunal concludes that it has the power to grant injunctive relief in a final award. This relief, however, must be definitive (i.e., not provisional, not meant to "preserve the respective rights of either party" until final resolution of the dispute, which is the objective of provisional measures pursuant to Article 47 of the ICSID Convention). The Tribunal prefers the term "definitive" to "permanent", as the relief granted may be temporary (i.e., granted only until a certain date or until a certain condition is met). However, as the Tribunal will become *functus officio* upon the rendering of the Award (subject to a party filing a claim for rectification, supplementary decision, interpretation or revision of the Award pursuant to Articles 49, 50 or 51 of the ICSID Convention), the injunctive relief granted cannot be later reconsidered or lifted by the Tribunal, as would be the case with provisional relief: such definitive injunctive relief would have *res judicata* effect.

1314. The Tribunal turns now to the Claimants' specific request for post-award injunctive relief.

1315. The first question that arises is whether this request for relief is timely. As a request for definitive relief in the Award, the request must be treated as an ancillary claim, and thus the conditions set out in Rule 40 of the ICSID Arbitration Rules (cited at paragraph 1289 above) apply.

1316. The Claimants formally articulated their request for post-award injunctive relief in their Response to the Respondent's Application to Revoke Provisional Measures, submitted on 28 September 2012, which is considerably past the submission of their Reply (submitted in December 2009). Although the Claimants had included a similar request in their First Application for Provisional Measures, submitted on 3 November 2010 on the eve of the hearing on the merits (see paragraph 1298 above), that request was also submitted after their Reply. In any event, as the Claimants themselves acknowledge, this request was made in the context of a request for provisional measures and was not formulated as a substantive request for relief in the award.

1317. The Claimants contend that their request is timely because the Tribunal is empowered to award post-award injunctive relief as a result of their request for "[a]ny

---

[294] C. Schreuer, The ICSID Convention: A Commentary, 2nd ed. (2009), pp. 1137-1138. Prof. Schreuer adds that "[t]ribunals imposing such non pecuniary obligations should keep the impossibility to enforce them in mind. Such awards should […] provide for a pecuniary alternative in case of non-performance such as liquidated damages, penalties or another obligation to pay a certain amount of money." (*Id.*)

[295] *Enron v. Argentina (Decision on Jurisdiction)*, ¶ 81.

further relief that the Tribunal may deem fit and proper" (Revised Request for Relief, ¶ 6). A first question is whether, as a result of such a generic request, the Tribunal has the power to order relief that has not been expressly requested. Assuming that the Tribunal has the power and the discretion to make such an order (a matter that the Tribunal does not need to address), in the particular circumstances of this case, the Tribunal would not wish to exercise any such discretion to order definitive injunctive relief such as the relief sought by the Claimants without having been expressly requested to do so. In particular, the Tribunal would be loath to do so because that would defeat one of the *rationes legis* of Article 40, namely afford the Responding State the possibility fully to put its case in defense to a given relief before the evidentiary hearing and take advantage of that hearing to bring forth the correlative necessary evidence. The Respondent was not in a position at the time to predict that Claimants would subsequently come up with the disputed prayers or that the Tribunal would exercise its discretion, if it exists, in the way the Claimants are suggesting now.

1318. The Claimants' request for definitive injunctive relief is thus untimely, and it falls to the Tribunal to determine, upon justification by the Claimants and after considering the Respondent's objections, whether it authorizes the presentation of the claim at a later stage in the proceedings. After considering both Parties' arguments, the Tribunal finds that there is not a sufficient justification to authorize the presentation of this claim at this stage of the proceedings. Nor was there sufficient justification to authorize the presentation of this claim in September 2012, when the Claimants first formulated their request for definitive injunctive relief. The Claimants submitted their first application for provisional measures in November 2010. They thus had ample time since the occurrence of the facts that gave rise to their alleged need for injunctive relief to properly file for an ancillary claim for definitive relief in accordance with Rule 40. The Claimants have not justified why such a claim could not have been brought before September 2012. Accordingly, the Tribunal dismisses the Claimants' request for definitive injunctive relief.

1319. Had it not dismissed the claim on procedural grounds, the Tribunal would have done so on the merits. The Tribunal has dismissed the Claimants' argument that the Respondent's wrongful act (the breach of the BIT) caused them to incur the tax debts and penalties that are the basis for the Respondent's tax enforcement actions (*see* Section VII.C.4 above). Thus, while during the pendency of these proceedings the legitimacy of the tax penalties imposed upon the Claimants could be deemed to be part of the subject matter of the dispute, the Claimants' claims in that respect have been dismissed on the merits. Similarly, now that the proceedings are finalized, the Claimants have no independent right to the maintenance of a status quo or to a non-aggravation of the dispute that could require preservation. There is thus no justification for providing the requested additional and definitive injunctive relief in the Award.

1320. Finally, although the Tribunal has the power to grant additional definitive injunctive relief in the Award, any such relief should be granted with the utmost caution. Once the Award is issued and subject to potential requests for rectification, supplementary

decision, interpretation or revision, the Tribunal will become *functus officio*. It will not be able to reconsider the injunctive relief granted, which would have *res judicata* effect.

1321. Under the circumstances, the Tribunal is not convinced that such additional relief is warranted. In its decisions on provisional measures, the Tribunal repeatedly stated that Romania must be allowed to collect the taxes due to it. While these proceedings were pending and for their duration, the Tribunal afforded protection to the Claimants in order, among other reasons, to maintain the status quo and prevent the aggravation of the dispute. The Tribunal recognized the benefits of preventing the Claimants' bankruptcy and allowing the Claimants' business to survive as a going concern. However, the Tribunal cannot do so indefinitely. It trusts that the Parties will find a way to pay their respective debts in a way that allows the Claimants' investment to continue contributing to the prosperity of Bihor County.

1322. For these reasons, the Claimants' request for post-award injunctive relief is dismissed. Accordingly, all provisional measures recommended by the Tribunal will cease to have effect as of the date of dispatch of this Award.

X. COSTS

1323. Both sides request an award of costs in respect of the legal fees and expenses and the costs of arbitration incurred in connection with this proceeding and have filed submissions quantifying their fees and costs (Claimants' Request for Costs, ¶¶ 58-59; Respondent's Submission on Costs, ¶ 49).

1324. The Claimants' legal fees and expenses amount to EUR 18,409,213 or RON 86,478,476. They have advanced USD 1,510,000 on account of the fees and expenses of the Members of the Tribunal and the ICSID administrative fees and expenses, including the lodging fee of USD 25,000. The Claimants seek an award of the entirety of these costs and compound interest at a rate of 3-month ROBOR plus 5% until the date of payment.

1325. The Respondent's legal fees and expenses amount to EUR 11,499,347.97. It has advanced USD 1,485,000 to ICSID.

1326. The Parties agree that the Tribunal has broad discretion to allocate all costs of the arbitration, including legal fees and expenses, between the Parties as it deems appropriate, pursuant to Article 61 of the ICSID Convention. Both sides argue that a costs award is warranted because they should prevail in the arbitration and because the other party has conducted the arbitration in a manner which has led to delay and increased costs.

1327. The Tribunal has considered all the circumstances of this case: the procedure (including the jurisdictional phase, the Parties' requests for production of documents, the Claimants' requests for provisional measures, the Respondent's request for revocation of provisional measures, the Claimants' request for a site visit, the merits phase of the proceeding, the Claimants' revised request for relief, and multiple hearings) as well as the Parties' substantive arguments on jurisdiction, admissibility and the merits. As evidenced by Section II above, there were numerous procedural issues and difficult legal questions involved in the jurisdictional and merits phases. Many of these issues were far from clear-cut and involved meritorious arguments by both Parties. The Claimants have prevailed on jurisdiction and have established a breach of the fair and equitable standard under the BIT. They have, however, only been partially successful in regard to their claims for damages, which evolved during the proceedings.

1328. In light of these factors, the Tribunal has concluded that it is fair overall that both sides (that is, the five Claimants on one side and the Respondent on the other) bear the costs of the arbitration (the fees and expenses of the Members of the Tribunal and the charges for the use of the facilities of the Centre) in equal shares, and that each side bears its own legal and other costs incurred in connection with this case.[296]

[296] The Parties will receive a statement of the account from the ICSID Secretariat. Any remaining balance will be reimbursed to the Parties.

XI. DECISION

1329. For the reasons stated in the body of this Award, the Tribunal makes the following decision:

a. The Claimants' claim that the Respondent has violated Article 2(4) of the BIT by failing to observe obligations entered into with the Claimants with regard to their investments is dismissed by majority.

b. The Claimants' claim that the Respondent has violated Article 2(3) of the BIT by failing to ensure fair and equitable treatment of the Claimants' investments is upheld by majority. In view of this decision, the Tribunal does not need to determine whether the Respondent has breached the BIT by impairing the Claimants' investments through unreasonable or discriminatory measures (Article 2(3) of the BIT, second part) or by expropriating the Claimants' investments without the payment of prompt, adequate, and effective compensation (Article 4(1) of the BIT).

c. As a result of the Respondent's breach of the BIT, the Claimants are awarded and the Respondent is ordered to pay RON 376,433,229 as damages, broken down as follows:

    i. RON 85,100,000 for increased costs of sugar;

    ii. RON 17,500,000 for increased costs of raw materials other than sugar or PET;

    iii. RON 18,133,229 for the lost opportunity to stockpile sugar; and

    iv. RON 255,700,000 for lost profits on sales of finished goods.

d. The Respondent is ordered to pay interest on the amount specified in sub-paragraph (c) above, at 3-month ROBOR plus 5%, compounded on a quarterly basis, calculated from the following dates until full payment of the Award:

    i. With respect to the claims for increased cost of sugar and other raw materials, interest shall be calculated from 1 March 2007.

    ii. With respect to the claim for the lost opportunity to stockpile sugar, interest shall be calculated from 1 November 2009.

    iii. With respect to the claim for lost profits on sales of finished goods, interest shall be calculated from 1 May 2008.

e. The Claimants on one side and the Respondent on the other shall bear the costs of the arbitration in equal shares, and each Party shall bear its own legal and other costs incurred in connection with this case.

f. All provisional measures recommended by the Tribunal will cease to have effect as of the date of dispatch of this Award.

g. All other claims or prayers for relief are dismissed.

Dr. Stanimir A. Alexandrov
Arbitrator
Date: 9 December 2013

Prof. Georges Abi-Saab
Arbitrator
Date: 5 December 2013

Dr. Laurent Lévy
President of the Tribunal
Date: 5 December 2013

CLA-000070

In the Matter of an Ad Hoc Arbitration under the Treaty between the Federal Republic of Germany and the People's Republic of Poland concerning the Encouragement and Reciprocal Protection of Investments between:

NORDZUCKER AG

Claimant

v

THE REPUBLIC OF POLAND

Represented by the Minister of the State Treasury of the Republic of Poland

Respondent

SECOND PARTIAL AWARD

ARBITRAL TRIBUNAL

Professor Andreas Bucher, Arbitrator

Dr. Maciej Tomaszewski, Arbitrator

Mrs. Vera Van Houtte, Chairman

TABLE OF CONTENTS

0. **ABBREVIATIONS** .... p. 4

1. **INTRODUCTION** .... p. 4

2. **BREACH OF ARTICLE 2 (1) FIRST OR THIRD SENTENCE OF THE TREATY?** .... p. 4

2.1 Promotion .... p. 5

2.2 Admission in accordance with its law .... p. 5

2.3 Fair and equitable treatment .... p. 6

a. Transparency, candour and due process .... p. 7

1. Applicability of the transparency obligation .... p. 7

2. Lack of transparency .... p. 7

(i) Failure to inform about the re-valuation of the shares .... p. 8

(ii) Failure to respond to Nordzucker's requests for information, to inform about reconsidering the privatization process and about the importance of the price increase, and to repeat the second stage .... p. 12

(iii) Failure to inform and consult with Nordzucker about the creation and composition of Polski Cukier .... p. 24

(iv) Failure to communicate about the reason of the refusal of consent .... p. 27

b. Respect of Nordzucker's legitimate expectations .... p. 29

c. Arbitrary decisions based on political and nationalistic reasons .... p. 30

d. Bad faith in the negotiations .... p. 31

2.4 Conclusion .... p. 32

3. COSTS .... p. 32

4. DECISION .... p. 32

0. ABBREVIATIONS

BIT:	Bilateral Investment Treaty between Germany and Poland
CWS:	Witness Statement of Claimant (as numbered by it)
GAM:	General Assembly Meeting
NoA:	Notice of Arbitration of Nordzucker dated 17 February 2006
PHMN:	Post-hearing Memorial of Nordzucker dated 25 January 2008
PHMP:	Post-hearing Memorial of Poland dated 25 January 2008
RWS:	Witness Statement of Respondent (as numbered by it)
SoC:	Statement of Claim of Nordzucker dated 15 December 2006
SoD:	Statement of Defence of Poland dated 30 April 2007
SoRep:	Statement of Reply of Nordzucker dated 30 July 2007
SoReb:	Statement of Rebuttal of Poland dated 17 September 2007
SPA:	Share Purchase Agreement
Transcript I:	Transcript of the hearing on 5 November 2007
Transcript II:	Transcript of the hearing on 6 November 2007
Transcript III:	Transcript of the hearing on 7 November 2007
Transcript IV:	Transcript of the hearing on 8 November 2007

1. INTRODUCTION

1. In its first Partial Award of 10 December 2008, this Arbitral Tribunal has concluded that it has jurisdiction to entertain a claim based on an alleged breach of the obligations in article 2 (1) first and third sentences of the Treaty concerning the encouragement and reciprocal protection of investments signed on 10 November 1989 between Germany and Poland, as amended by the Protocol of 14 May 2003. Article 2 (1) is one of the articles of the BIT on which Nordzucker has based its claim. Hence this Tribunal will hereafter review whether these two sentences of this provision have been breached in respect of the acquisitions by Nordzucker of the Gdańsk and Szczecin Groups.

2. BREACH OF ARTICLE 2 (1) FIRST OR THIRD SENTENCE OF THE TREATY?

2. Article 2 (1) of the BIT states as follows:

"Each Contracting Party shall in its territory promote as far as possible investments by investors of the other Contracting Party and admit such investments in accordance with its respective laws. Investments that have been admitted in accordance with the respective law of one Contracting Party shall enjoy the protection of this Treaty. Each Contracting Party shall in any case accord investments fair and equitable treatment."

3. The first sentence of article 2 (1) of the BIT is identical to article 2 (1) of the German Model BIT (2005), which is cited as a typical clause for "treaties concluded by European countries [that] do not grant a right of admission but limit themselves to standards and guarantees for those investments which the host state has unilaterally decided to admit"[1].

4. The BIT did not create for Nordzucker an absolute right to invest, nor for Poland an absolute obligation to sell to investors. In the admission of foreign investments, Poland was and is still authorized to apply its own legislation which it need not revise after the ratification of the BIT.

5. Whereas the second sentence of article 2 (1) of the BIT grants the protection of the Treaty only to investments that have been admitted, the third sentence, requiring fair and equitable treatment applies in any case to investments, which requirement this Tribunal has interpreted in its first Partial Award dated 10 December 2008 as applying also to near-investments, *i.e.* investments in the process of being admitted in accordance with the first sentence.

6. Thus, as regards investments not yet admitted, a host State has only the obligations of article 2 (1) first and third sentences of the BIT:

   - promote them as far as possible and admit them in accordance with its law;

   - treat them fairly and equitably.

2.1 Promotion

7. There is no allegation in the submissions of Nordzucker that Poland has not promoted the investments as far as possible.

2.2 Admission in accordance with its law

8. The file contains no indication that Poland has failed to admit the investments in the Gdańsk and Szczecin Groups in accordance with its law. Nordzucker has not pointed to an infringement of any statute or rule and the Tribunal has not found one. The Tribunal finds that the refusal of the State Treasury to give its consent in the GAMs of MKSC and PPSC for the sale of the shares in the Sugar Plants of the Szczecin and Gdańsk Groups did not infringe Polish domestic law or the Rules for Selecting the Buyer of the Shares which explicitly required the approval of the SPA by the General Meeting of the Sugar Holding Company and did not limit the possibility to refuse consent to specific reasons [2].

[1] R. DOLZER and C. SCHREUER, Principles of International Investment Law, Oxford University Press, 2008, p. 81

[2] See Exh. C6: §15 of the rules for the Poznań Group; §15.1 of the rules for the Szczecin Group and those for the Gdańsk Group; §25 of the rules for the Toruń Group, of which §26 even states that MKSC has the right to close the proceedings with giving no reasons and without indemnity

2.3 Fair and equitable treatment

9. The Claimant claims that the Respondent failed to give fair and equitable treatment to what the Claimant considers to be its investment but what this Tribunal found in its first Partial Award dated 10 December 2008 to be only an "investment about to be made" (see chapter 6.4.b.3 of that Award), in that the Respondent:

- did not act with transparency and candour nor provide basic due process;

- did not respect Nordzucker's legitimate expectations;

- acted arbitrarily because it based its decisions on political and nationalistic reasons;

- acted in bad faith during the negotiations with Nordzucker.

10. The Respondent argues that the standard of breach of fair and equitable treatment in international investment case law is particularly high.

It relies on the *S.D. Myers, the Waste Management* and *the Thunderbird* cases which require

- treatment "*in such an unjust or arbitrary manner that the treatment rises to the level that is unacceptable from the international perspective*"[3];

- "*(...)conduct [which] is arbitrary, grossly unfair, unjust or idiosyncratic, is discriminatory and exposes the claimant to sectional or racial prejudice, or involves a lack of due process leading to an outcome which offends judicial propriety*"[4]; or

- "*gross denial of justice or manifest arbitrariness falling below acceptable international standards*"[5]

and denies having breached this high standard.

11. The Tribunal will review each of the allegations of the Claimant separately and review whether the facts as retained by the Tribunal breach the standard.

---

[3] *S.D. Myers, Inc. v. Canada*, UNCITRAL (NAFTA), First Partial Award of 13 November 2000 ("*S.D. Meyers v. Canada*"), Para. 263, Exh. RA 30

[4] *Waste Management, Inc. v. Mexico*, ICSID Case No. ARB(AF)/00/3, Award of 30 April 2004 ("*Waste Management*"), Para. 98, Exh. RA 32

[5] *International Thunderbird Gaming v. Mexico*, UNCITRAL (NAFTA), Final Award of 26 January 2006, Para. 194, Exh. RA 20

a. Transparency, candour and due process

1. Applicability of the transparency obligation

12. While the Parties agree that transparency is an element of fair and equitable treatment, the Claimant disagrees with the Respondent about the scope of the transparency obligation. It argues that the transparency standard applies not only to legislative and administrative acts of a State but to all State acts. It relies on the absence of wording in the BIT which would limit the obligation of transparency to the exercise of regulatory powers and on the *PSEG* case where the Tribunal found that there was "evident negligence on the part of the administration in the handling of the negotiations with the Claimant", as well as on the *Mafezzini* case in which the Tribunal found that "the lack of transparency with which this loan transaction was conducted is incompatible with Spain's commitment to ensure the investor a fair and equitable treatment". It also insists on the fact that Poland in this case did use regulatory powers when it interfered as a sovereign in the privatization process.

13. The Respondent denies that the transparency obligation exceeds the sphere of *acta iure imperii* and argues that subjecting a State to this transparency obligation in a merely commercial transaction would give the investor an inequitable advantage. It relies on the *Tecmed, Waste Management v. Mexico* and other cases in which the lack of transparency was linked only to administrative proceedings.

14. This Tribunal holds in this respect that, given its finding in chapter 6.3 of its first Partial Award, the objection of Poland that the transparency obligation is inapplicable in this case, is without ground. It may be argued that the Ministry of the Treasury was acting in a double capacity, as the chief of the State administration responsible for the privatization process in Poland, and as representative of the State Treasury which was the sole shareholder of the selling company. However, the Tribunal finds no basis in the BIT to distinguish between legislative/administrative acts and acts of any other nature committed by a State.

2. Lack of transparency and due process[6]

15. The Claimant argues that, on basis of the following factual circumstances, Poland breached its obligations of transparency, candour and due process:

1. it failed to inform Nordzucker about the new valuations of the shares;

2. it failed to respond to Nordzucker's requests in relation to the privatization process;

[6] The Tribunal considers "candour" to be sufficiently close to the concepts of transparency and due process so as not to have to deal with it separately.

3. it never informed Nordzucker that it was reconsidering the privatization process for the Gdańsk and Szczecin Groups;

4. it never clearly informed Nordzucker that increasing the offered price was a condition for the privatization to continue;

5. it failed to repeat the "second stage" of the privatization procedures;

6. it followed an "informal process" of which Nordzucker was not informed and which was different from the Rules for Selecting the Buyer of the Shares; and

7. it failed to inform and consult with Nordzucker about the creation and composition of Polski Cukier.

16. The Respondent responds that not only the legal framework of the restructuring of the Polish sugar industry was transparent, but that Poland also acted transparently vis-à-vis Nordzucker in the sales process. It considers that it informed Nordzucker in the 18 January 2001 meeting of the fact that the price was too low and that the Ministry, not being allowed to negotiate the price with Nordzucker, could not do more than "suggest unofficially that Nordzucker take the initiative"[7]. It holds that there was ample opportunity for Nordzucker to discuss the price with Ministry representatives and concludes that it was Nordzucker's failure to make use of this opportunity and its unwillingness to increase the price, which led to the failure of the sale, and that Nordzucker's allegations of lack of transparency are therefore unfounded.

(i) Failure to inform about the re-valuation of the shares

17. The Tribunal finds Poland's failure to inform Nordzucker that it had requested at the end of January 2000 an update of the valuation of the shares of the companies comprised in the Poznań and Szczecin Groups does not constitute a lack of transparency. Leaving aside the fact that there is no dispute about the sale of the Poznań Group, the Tribunal is of the opinion that Poland, as sole shareholder of the selling Sugar Holding Company, was free to update its own estimates of the sales prices and that this was probably a normal thing to do when the minimum sales price for each Group had been determined already a while ago and when the Ministry was being challenged by political opponents because the privatization was allegedly realized at prices which were too low[8].

18. There is no evidence on file that Nordzucker was at the beginning of 2000 concerned by the fact that the sales procedures were not proceeding as quickly as the 1995 Regulation and the

[7] PHMP §41 and Transcript II, p. 181: 19 - 183: 21
[8] Transcript II, p. 34: 20 - 35: 14

Rules for Selecting the Buyer of the Shares prescribed[9]. Thus, the timing became, with Nordzucker's implicit consent, "at large" and, as long as the Ministry did not otherwise change the procedure in a way which immediately affected Nordzucker's role or obligations in the procedure, it had no duty to inform Nordzucker of any internal initiatives without direct impact on the sales procedures. That there was no impact on the procedure is confirmed by an internal memorandum of the Ministry dated 9 February 2000: "The Ministry of the State Treasury does not challenge the material elements of Nordzucker AG's bid, *i.e.* the price for the shares and the overall value of the investment outlays"[10].

19. The Tribunal finds that the procedure for the Gdańsk and Szczecin Groups has been followed properly - although slower than prescribed - until May-June 2000 when Nordzucker was designated as winning bidder for both Groups and an SPA for Szczecin was initialled on 28 June 2000, that is the same date as the SPAs for the Toruń and Poznań Groups.

20. On 7 June 2000, the Minister of the State Treasury himself wrote to Nordzucker referring to the latter's designation as "a potential investor for four regional groups of Sugar Plants", confirming that:

> "*In course of talks carried on also in the Ministry of the Treasury, an accord was reached on essential matters with regard to three groups of regional sugar plants. Thus, a prompt finalization of these transactions seems to be possible. Enclosed please find the initialled covenant which the Ministry of the Treasury is ready to enter into upon signing of agreements of disposal of shares in the said groups.*
>
> *However, one issue requires a conclusion. Namely, the guarantee of performance of obligations towards planters of the Toruń Group may not be left aside for separate treatment.*
>
> *In view of the Ministry of the Treasury, your guarantees of performance of the Planter's Package Deals should be consistent for all groups of regional sugar plants which you intend to acquire. The Ministry of the Treasury expresses its conviction that the obligations included in the Planters' Package Deals have been taken with the intention of fair performance thereof, hence the providing of guarantees of performance thereof in the agreement of disposal of shares should not arise any contrariety on your side.*

---

[9] Under the 1995 Regulation, the selection of the potential investors was to be done in two months and the negotiation and the conclusion of the SPA in five months. The Rules for Selecting the Buyer of the Shares for the Poznań and Szczecin Groups contained specific data which made the duration of the procedure even shorter than required under the Regulation (maximum three months for the entire procedure). As the procedure for Toruń, Poznań and Szczecin Groups had started, respectively, on 10 May 1999, 2 June 1999 and 29 June 1999, and Nordzucker had been selected as bidder on, respectively 10 August 1999, 6 August 1999 and 17 September 1999, the SPAs for these three Groups should in accordance with the 1995 Regulation have been concluded at the latest in the beginning of January, respectively mid February 2000.
In November 1999, the 1999 Regulation shortened even the term of five months between the selection of the bidder and the signature of the SPA to three months. Whether or not this change was to apply also to procedures already engaged, the change proves that Poland still wished to proceed diligently with the privatization, notwithstanding (or may be because of) the adoption of the Resolution on 9 September 1999 in the Polish Parliament encouraging the government to create a national sugar company.

[10] Exh. R54

I think that we will soon clarify this obvious issue to facilitate prompt conclusion of this transaction "[11].

21. The initialled covenant attached was in fact a draft shareholders' agreement for Szamotuły (a Sugar Plant of the Poznań Group) and one for Kluczewo[12], a Sugar Plant of the Szczecin Group. Hence, it is not clear which are the "said groups" mentioned by the Minister: only the Poznań and Szczecin Groups, or the three Groups referred to in the first sentence or all four Groups targeted by Nordzucker.

22. One thing seems clear, though: on 7 June 2000 only the Toruń Group still had a problem but the Minister was confident that it would be solved. Thus, the letter certainly gives a positive impression, in particular that the three acquisitions could indeed be concluded soon. The Tribunal has no reason to believe that the letter was not written in good faith and that the Minister did not sincerely believe that the transactions were to be closed in the near future.

23. This impression was confirmed by another letter of only two days later, 9 June 2000, from the Undersecretary of State, Mrs. Litak-Zarebska (who also appeared as a witness before this Tribunal), and which described in some more details the remaining procedural steps to come to a signed SPA with PPSC. The letter deserves quoting in full:

" *In reference to the dates of executing share purchase agreements of Poznań, Szczecin and Toruń Group sugar plants, I would like to remind you that the procedure in accordance with which a share purchase agreement can be signed with Poznańsko-Pomorska Spółka Cukrowa S.A. is as follows:*

1. *initialling draft share purchase agreements;*

2. *approval of the initialled share purchase agreements (by way of a resolution) by the Management Board and the Supervisory Board of Poznańsko-Pomorska Spółka Cukrowa S.A.;*

3. *formal review of the initialled agreements and resolutions of the Management Board and the Supervisory Board by the Ministry of State Treasury;*

4. *approval of the sale of shares by the General Meeting of Shareholders of Poznańsko-Pomorska Spółka Cukrowa S.A.;*

5. *execution of share purchase agreements by Nordzucker AG and Poznańsko-Pomorska Spółka Cukrowa S.A.*

[11] Exh. C51

[12] The Tribunal notes that Szamotuły S.A. is mentioned on the first page, but that the last page, both in the English and the Polish version, refers to Kluczewo S.A. This is probably due to a clerical error when the Kluczewo model, which is identical, was used for the Szamotuły covenant.

I am convinced that with more dynamic efforts of all parties, June 21, 2000 seems to be a realistic date for the execution of those agreements (provided that all previous stages are successfully completed).

As regards the guarantees of performance of the Planter's Package for the Toruń Group sugar plants, let me inform you that the position expressed by the Minister of State Treasury in the letter addressed to Nordzucker AG on June 7, 2000 has not changed. I hope that this issue will be reflected in the agreements initialled by the parties. If within the aforesaid time limit this is not possible, I suggest signing agreements for Poznań and Szczecin Groups (in the agreements for those Groups, all important issues have been agreed upon)."[13].

24. Leaving aside an anomaly in this letter[14], the Tribunal notes that the letter details in five sub-steps the formal steps yet to be accomplished as from 9 June 2000, and that the Undersecretary is optimistic: "*June 21, 2000 seems to be a realistic date for the execution of these agreements (provided that all previous stages are successfully completed)*"[15].

25. The Undersecretary of State testified at the hearing that when she reminded Nordzucker of the subsequent steps, it showed that "in our view, there is very little for us to do"[16] and "at this stage, none of those steps was difficult"[17]. The only step which was required from Nordzucker was the first (initialling of the SPAs). This initialling was delayed because no agreement had been reached yet about the terms and conditions of the Toruń Group, but, as the letter of 9 June 2000 shows, the Ministry was prepared to proceed with the initialling of the SPAs for the Poznań and Szczecin Groups if the Toruń SPA could not be agreed soon. It follows from Nordzucker's reply[18], one week later, to the above mentioned letter that it eventually did agree with the Ministry's proposal for Toruń, on 16 June 2000. Strikingly, Nordzucker writes on that date that it hopes to be able to initial the SPAs for three Groups on 21 June 2000, thus itself extending the procedure beyond the date the Ministry had advanced for the execution. The Tribunal notes, incidentally, that both letters, of 7 and 9 June 2000, insist on the performance guarantees of the Planters' Package for Toruń not yet being agreed. This supports the testimony of Mrs. Litak-Zarebska at the hearing that:

"*We had the biggest problem of lack of understanding on the part of Nordzucker as to some mandatory contractual provisions, contractual provisions like the security for the performance of obligations, the standard provisions in the agreements. And that took the*

[13] Exh. C52
[14] The letter refers to PPSC as signatory of the SPA's for the Toruń, Poznań and Szczecin Groups, whereas the Toruń Group was the property, not of PPSC, but of MKSC.
[15] Tribunal's underlining
[16] Transcript II, p. 57: 12-13
[17] Transcript II, II, p. 61: 19-20
[18] Exh. C53

most of our time. If it were not for that, we would have finished that privatisation much earlier"[19].

26. On 30 June 2000, Nordzucker confirms to the Undersecretary that "*on 28 June 2000 in Poznań Nordzucker AG initialled with MKSC S.A. and PPSC S.A. the agreements related to the purchase of shares in the privatized sugar mills: [of the Toruń, Poznań and Szczecin*[20] *Sugar Groups]*"[21]. The SPAs were thus initialled by Nordzucker one week after the date of 21 June 2000 which the Undersecretary of State had envisaged for their execution. Thereafter, the course of events shows continued progress for at least two of the three Groups:

- 13 July 2000: GAM PPSC approves SPA Poznań

- 12 August 2000: GAM MKSC approves SPA Toruń

- 28 August 2000: signature SPA Poznań

- 4 September 2000: signature SPA Toruń

27. Thus, the Tribunal comes to the conclusion that until the summer of 2000 the sales procedures followed a normal course, even if some delay was incurred, which can be easily explained by the difficulties to come to an agreement on the terms and conditions of the SPAs. Moreover, there is no evidence that Nordzucker was at that time concerned by the slow progress of the procedure.

(ii) Failure to respond to Nordzucker's requests for information, to inform about reconsidering the privatization process and about the importance of the price increase, and to repeat the second stage

28. By letter of 2 August 2000 Nordzucker inquired about the process for the Szczecin and the Toruń Groups and on 30 August 2000 about the Szczecin and Gdańsk Groups. Nordzucker complains that these letters of 2 and 30 August 2000 were not answered. To the extent the letter of 2 August 2000 inquired about the process for the Szczecin and Toruń Groups and the SPA for the Toruń Group was signed on 4 September 2000, the Tribunal considers that there has been reaction to the letter of 2 August 2000. This is not so for the 30 August 2000 letter with which Nordzucker sent to the State Treasury draft SPAs for the Szczecin and Gdańsk Groups, as well as for further letters, of 25 October 2000, expressing to the

[19] Transcript II, p. 146: 7-13
[20] There is no evidence showing why the SPA for the Gdańsk Group was not initialled at the same time as the SPAs for the three other Groups.
[21] Exh. C54

Undersecretary its concern about the lack of privatization of the two Groups, and of 14 November 2000, sent to both the Undersecretary and the Board President of PPSC concerning the Szczecin Group.

29. The PPSC replied on 17 November 2000 that the privatization documentation had been forwarded to the Minister of the State Treasury[22], but the Ministry itself never reacted in writing to any of the letters. Neither the Undersecretary of State nor Mr. Jeznach, who was at the time acting Director of the Privatization and Supervision Department of the Ministry of the State Treasury, could, in the course of their oral testimony, give a valid reason for leaving Nordzucker without an answer, after the encouraging and intense correspondence of the Ministry in June 2000.

30. It is not clear to the Tribunal whether the absence of written reaction from the Ministry to the letters allow to conclude that the Ministry broke all contact with Nordzucker as from October 2000. As the facts mentioned in § 28 suggest, the answer is probably negative. It is not contested that the Parties met on 12 August and 4 September 2000 for the signature of the SPAs for Poznan and Toruń although, no letters posterior to the one of 9 June 2000 have been produced. Moreover, the Tribunal has the testimony of Mrs. Litak-Zarebska which has not been contested, who stated that, although she found it "impolite" to leave the letters unanswered:

"But even if those letters remained unanswered, then I would like to assure you that Mr Galuszynski, the attorney who is present here and who was representing Nordzucker, I think he can confirm that even with myself or other staff members of the department we had something like a hotline with each other. The meetings were frequent, and we discussed various issues about the agreements, et cetera.

(...)Yes, these were phone calls or meetings between the attorney of the investor and myself, or lawyers from the Ministry"[23].

31. Even in the assumption that this statement applies also to the period September – December 2000, and not only to the earlier period, the Tribunal nonetheless finds the failure to respond in writing to the letters more than impolite and wonders whether it may have another cause.

32. The Tribunal has been convinced by the testimony of the two mentioned witnesses and the evidence on file that the mounting political pressure on the Ministry as a result of the protests of the growers in the Szczecin area, caused the Ministry to hesitate to go forward with the sales and to look again at the financial side of the transaction as the Undersecretary of State testified:

[22] Exh. C63
[23] Transcript II, p. 184: 3-6

" *The reason the Ministry of State Treasury postponed the decision on consent to the execution by PPSC of the agreement to sell shares in the Szczecin Group companies was firstly due to the protests focused on the Sugar Plants in this Group of growers*[24] " and

" *But definitely at the Ministry this process [of an audit made after the growers' protests] had an impact on revisiting, or reviewing again the documentation process, which had to prolong the process*"[25].

This delay lasted about six months according to Poland's witnesses[26].

33. In a memorandum of 20 September 2000, Mr. Jeznach stated that the price offered for the Gdańsk Group was too low and recommended that the consent to sell the Gdańsk Group to Nordzucker be denied, that a new valuation be prepared and that the price setting phase of the process (the so-called "second stage") be repeated[27]. It is also proven that the Undersecretary of State followed these recommendations and ordered a new valuation and repetition of the second stage. Mr. Jeznach testified that he did not act upon these orders because of "*simply a coincidence of unfavourable, of bad events developments*"[28].

34. In a second memorandum, dated 3 October 2000, Mr. Jeznach came to the conclusion that also the price offered for the Szczecin Group was too low and advised against its sale – also for reason of the negative impact of the intensification of the sugar beet cultivation on animal breeding, thus causing unemployment in the area – but this time he did not suggest to repeat the second stage[29].

35. A handwritten note of the Undersecretary of State on the Polish version of this second memorandum was deciphered with her assistance at the hearing and translated and then explained by her[30]. It thus was shown that the Undersecretary of State did not agree with Mr. Jeznach's recommendation of 3 October 2000 to stop the sales procedure for the Szczecin Group, but ordered that a report be prepared by an independent advisor on the price, thus leaving open the possibility that the second stage might be repeated also for Szczecin.

36. During the entire period that Mr. Jeznach prepared the above mentioned memoranda and that the Undersecretary of State acted on them by ordering a new valuation, and/or that the so-called audit was performed, Nordzucker was, as far as the Tribunal can judge from the evidence produced, left in uncertainty about the procedure, although the Ministry was aware that the "revisiting"[31] of the price was delaying the sales procedure. The Ministry's

[24] RWS 1 §32
[25] Transcript II, p. 100: 3-11
[26] Transcript II, p. 103 : 1-9, III, p. 38 : 10-17
[27] Exh. R64
[28] Transcript II, p. 203: 17
[29] Exh. R66
[30] Transcript II, p. 175: 15 - p. 180: 3
[31] Transcript II, p. 100 : 8-11

witnesses at the hearing acknowledged at least implicitly that Nordzucker should have been informed because they indicated that they believed the Sugar Holding Companies would inform Nordzucker about the problems which had arisen[32]. Even in the assumption that the Ministry was not personally responsible to inform Nordzucker, and that the Sugar Holding Companies should have done it, the Tribunal finds it difficult to understand that the Ministry left all Nordzucker's letters from August till November 2000 unanswered. Even if there was a misunderstanding between the Ministry and the Sugar Holding Companies as to whom had to inform Nordzucker of the fact that there were doubts about the adequacy of Nordzucker's price and that a new valuation was being made (or at least ordered to be made or considered to be ordered), the absolute silence of the Ministry from the beginning of October 2000 until December 2000 does not seem compatible with the requirements of fair and equitable treatment of the foreign investor in this privatization process. Neither the belief that the Sugar Holding Companies would inform Nordzucker of the delay in the procedure and the possible reopening of the second stage, nor the administrative lack to follow up the instructions of the Undersecretary of State can explain why she and everybody else, whether or not acting upon her instruction, failed to react to any of Nordzucker's letters. This silence contrasts so starkly with the Ministry's letters of June 2000 that it is hard to believe in an unlucky coincidence. It is hard to see what the excuse could be for leaving three successive letters totally unanswered when they come from an investor with whom the Ministry had been in direct and frequent contact since more than a year and to whom the Ministry had written the letters of 7 and 9 June 2000 which clearly envisaged imminent action and no major problems.

37. The Tribunal, having reviewed the evidence, believes to understand why the Ministry remained silent or possibly even chose to remain silent: clearly, the Ministry was caught between its negotiations with Nordzucker (which were drawing to their end to such an extent that the Undersecretary of State had been able to advance a date for the closing of the transactions), on the one hand, and the political developments, in particular driven by the protest of growers' groups, which made the envisaged sale of the Gdańsk and Szczecin Groups more delicate every day, on the other hand. However, it follows from the testimony of the Undersecretary of State that the Ministry felt confident that, provided the price for the Groups was sufficiently high to put it beyond criticism on the political level, the sale could go forward.

38. Further, this Tribunal finds that, if it was so clear for the Ministry that the correctness of the price was crucial in the given circumstances, the Ministry's inertia is difficult to understand. If the price was too low – whether objectively or politically – the Ministry should have proceeded with the new valuation and, depending on its results, could have decided to repeat the second stage after adopting a resolution refusing consent to the sale. Its total inaction towards Nordzucker in transactions which had proceeded very far and were the subject of

[32] RWS 3 §20; Transcript II, p. 117: 15-18 and p. 113: 3-7; Transcript III, p. 23: 7-22

public scrutiny was probably the worst possible course. The Ministry kept Nordzucker "on the line" and made Nordzucker wait at least half a year more.

39. Moreover, as no evidence has been produced that a re-valuation has been made, the Tribunal finds it hard to understand that this (need for a) re-valuation was the reason of the delay. If it is true, as it has been claimed much later by Poland, that consent to the sales was refused because the prices offered by Nordzucker were too low, the Tribunal fails to understand why Poland has not produced the result of these re-valuations.

40. On 7 December 2000, Nordzucker wrote to the new Undersecretary of the State Treasury, Mr Tropilo, and indicated that it wanted to discuss with him the status of the privatization of the Szczecin and Gdańsk Group Sugar plants. This led to a meeting on 18 January 2001 at which not the Undersecretary was present, but Mr. Jeznach. What happened precisely at this meeting has been the subject of long debates between the parties, both before the Polish courts and before this Tribunal.

41. On review of the testimonies about the 18 January 2001 meeting, the Tribunal considers it proven that Mr. Jeznach gave a hint that the price offered by Nordzucker was possibly too low. On both sides, Mr. Jeznach's "hint" was reported as being short. For Mr. Lukas, it was a "20 second remark in two sentences", made when they negotiated another topic and not taken seriously[33]. For Mr. Jeznach, the issue was not discussed "for longer than one minute"; in his opinion, "it was only a signal, like delivering the information that the proposed price was not satisfactory to us"; "it could have been at the end of the meeting"[34]. Mr. Jeznach did not inform Nordzucker that pricing was a crucial issue that may stop the whole process. When this question was put before the witness at the hearing, he answered clearly: "*No*"[35]. He was very explicit on this point: "*I was not able to do so. I couldn't do so. As I said yesterday, I could not negotiate pricing conditions; I could only signal, send out the signal because I was not the party to negotiations; neither was the Ministry.*"[36] In conclusion, it is common ground between the Parties that Mr. Jeznach on 18 January 2001 did not say explicitly that if the price was not increased the sales could not proceed, and, clearly, the Sugar Holding Companies did neither.

42. There is evidence that the Ministry was uncertain which procedure it could legally follow in order to obtain a higher price for the two Groups: its own formal procedure left no room for price "negotiations" and it felt even that it could not inform Nordzucker about the problem "Because the price was not negotiated"[37].[38]

[33] Transcript I, p. 136: 17-21
[34] Transcript III, p. 146: 16-21
[35] Transcript III, p. 27: 16-21
[36] Transcript III, p. 25 : 5-11
[37] Transcript II, p. 112: 18
[38] It is the Tribunal's understanding of the procedure that, had there been several selected bidders, there would have been negotiations with all of them. If Nordzucker was the only bidder, it is not clear whether the Commission could only agree with its price (provided it

43. In the Tribunal's opinion, this explains why - but, again, does not justify that - the Ministry/Mr. Jeznach was not more outspoken, on 18 January 2001 or thereafter, about the fact that the price was too low. As the Undersecretary testified, "*It was a very delicate matter, because of the fact that one had to reach an informal agreement that we will invalidate the second stage of the privatization regarding the price offer and then the investor at the invitation of the sugar company will submit their price offering*"[39]. On the other hand, the Tribunal is also of the opinion that Mr. Jeznach could hardly insist on the need to increase the price if he did not have the result of a new valuation which would have been an indication of the amount by which the price would at least have to be increased in order to be acceptable.

44. When the Tribunal questioned the Parties at the hearing on this point, it appeared that the sole way for Poland to obtain a higher price than what Nordzucker had offered (other than a voluntary offer of Nordzucker to pay a higher price), consisted in the termination of the current sales procedure, obtaining a new valuation of the shares, determining a new minimum sales price and restarting the entire procedure or at least its second stage. The selected bidders were then to make new offers with prices at least as high as the new minimum sales prices so fixed.

45. This procedure was burdensome and lengthy, though, and would largely have been a sham since there would not have been any other "selected bidders" than Nordzucker as it was expected that it would have been the only interested participant in that renewed procedure[40]. Therefore, if Nordzucker was willing to increase its initial bid price voluntarily, the same result (of a "politically acceptable" price) could be reached much quicker and easier[41].

46. However, the Rules provided that price negotiations between the Commission and each of the bidders who fulfilled the requirements for participating in phase II, had to be closed by a certain date[42]. Thereafter, the Management Board had to choose the buyer and present its decision with full documentation to the GAM. Once that step of the procedure concluded, Nordzucker had not to expect further negotiations. The next step was approval or refusal of consent by the GAM[43]. Thus, the Tribunal concludes that, since a draft SPA had been initialled for the Sczcecin Group, the negotiations had indeed been closed at the level of the

---

was at least equal to the minimum price or whether it had also the option to negotiate about an increase (even if the minimum price was respected). Whatever the case, there can be no doubt that, if the Commission concluded the negotiations and the bidder was proposed as the "recommended purchaser", its price bid must have been accepted, at least at that level. Thereafter, the GAM could still reject the sale at that price.

[39] Transcript II, p: 112: 21- 25

[40] Certainly in the Szczecin procedure, where the only other candidate, Danisco, was not qualified for the second stage. For the Gdańsk Group, not only Nordzucker but also Danisco and Pfeifer & Langen qualified for the second stage, but Danisco did not make a price bid and Pfeifer & Langen made a lower bid than Nordzucker (R55).

[41] The Tribunal leaves in the middle whether a new minimum sales price should in any case have been determined or whether the Ministry could have decided without such objective measure, that the price increase was sufficient for it to be "politically safe" in selling at that price.

[42] Exh.C6-A §13.1 and B §13.1

[43] It is not clear whether in case of a refusal, the total procedure or its second phase had to be restarted or whether direct negociations could be started again.

Management Board[44]. As Mr. Jeznach explained at the hearing, the sugar companies had no power to re-open the price negotiations. This explains why the Ministry could not legally request Nordzucker to increase the price, as long as it had not first adopted a decision in the GAM to refuse to sell. It could only give a "signal" to Nordzucker that the price was too low – whether objectively, because the initial minimum sales price had in the meantime become too low, or whether politically, if the Ministry had to fend off the opposition against the privatization by showing that a "juicy" price had been obtained for the latest privatized plants – in the hope that Nordzucker would react to it with a voluntary offer to increase the price to a level where the State Treasury could feel confident that it could not be reproached to squander the state property.

47. This could explain why the "signal" of 18 January 2001 to Nordzucker was not stronger and in particular why the two parties have not been able to discuss openly how Nordzucker could contribute, with a price increase or otherwise, to make the transactions favourable enough for Poland so as to silence the opponents of the privatization. It also explains why the Ministry could not present the issue in writing to Nordzucker. If MKSC in a letter sent to Nordzucker the day after the morning of 18 January 2001[45] asked Nordzucker whether its offer which had been made in response to the invitation to bid of 8 March 2000 was still valid, this is another signal of the hesitation on the seller's side and an invitation to Nordzucker to discuss the offer which, in theory, had lapsed already.

48. Poland has argued that "*If Nordzucker had only been willing to discuss the price with the Ministry of State Treasury, there would have been ample opportunity for Nordzucker to discuss the matter with Mr. Jeznach or other Ministry of the State Treasury representatives*"[46], suggesting that the sale might then have gone through.

49. The Tribunal has no doubt that the signal given by Mr. Jeznach has been well understood by Nordzucker, even if it has claimed that it did not give it much attention[47]. Mr. Einfeld testified that "*We said, "No, Mr. Jeznach, we don't want to increase the - - we do not see any possibility to increase the price"* "[48]. That Nordzucker did not misunderstand the message, is also proven by its strong reaction, in its letters of 6 February 2001 to the Management Board Presidents of PPSC and MKSC which were clearly written in the assumption that Nordzucker was entitled to close the deals for the prices it had offered and that the sales procedure left no room for Poland to start price negotiations. Each of these letters to the Management Board Presidents of PPSC and MKSC states that "*the attempt to challenge the economic rules of the transaction by carrying out new valuations of the Companies raises our strongest objection as it materially violates the privatization procedure and the basic principles of civil law (being bound by an accepted offer)*" and the letter to PPSC even

[44] At least for this Group.
[45] Exh. C91
[46] PHMP, §51
[47] CWS5, §9-12; Transcript I, p. 101: 1
[48] Transcript I, p. 193:6-8

repeats the message for each Group[49]. This letter also proves that Nordzucker had been informed of the government's suspicion that the prices offered were too low, and of its (plans for) new valuations[50]. The letter also makes it clear that Nordzucker did not want to envisage a price increase because it considered that its price offer had already been accepted and, hence, that there was a binding agreement.

50. However, Nordzucker was mistaken in this respect: the acceptance of the price offer of Nordzucker did not, under the applicable rules, imply that an agreement was concluded. It merely meant that the next step in the procedure could be made *i.e.* that an SPA had to be negotiated. Even if that SPA was thereafter initialled, the agreement still required a formal approval by the GAM of the selling Sugar Holding Company before it was validly concluded.

51. This Tribunal considers that Nordzucker, as a commercially diligent party and negotiator which was moreover assisted by Polish advisers, cannot have ignored, following the 18 January 2001 meeting, that a price increase might facilitate the conclusion of the sale in the difficult political circumstances which had in the meantime arisen and of which Nordzucker was fully aware.

52. While this Tribunal accepts that Nordzucker has learned only at the 18 January 2001 meeting that the Ministry had a concern about the price, it also considers as proven that Nordzucker was quite aware of the political evolution within the Parliament and conscious of the risk that this political evolution could present for the sale to it of the Sugar Groups. Indeed, in its second letter of 6 February 2001, to Mr. Chronowski, the new Minister of the State Treasury, with whom it had a meeting on the same date, Nordzucker confirms that:

"We are aware of the problems that are currently hindering the progress of the privatisation.

During our discussion you emphasised the unclear status of Polski Cukier, property restitution claims affecting fifteen sugar plants and the impact of public opinion.

As regards Polski Cukier and the settlement of the property restitution claims, you stated that an opinion regarding Polski Cukier would be presented in the following six weeks. During the same period of time, the resolution of the property restitution claims should also be clarified.

At the same time, the ongoing discussion between investors and the Ministry of State Treasury regarding the current privatisation should continue.

[49] Exh. C65 = R69 and Exh. R70
[50] Mr. Lukas explained at the hearing that the terms used in the letter were designed to pick up the comment on valuations made by Mr. Jeznach at the 18 January 2001 meeting (Transcript I, p. 141: 21-143:8).

We assume that the further course of the Gdańsk and Szczecin group privatisation will be in line with the currently effective regulations, as long as legal security is ensured.

We appreciate your promise to continue discussions concerning the current situation in the above topics.

Should any new problems arise that might inhibit successful completion of the ongoing privatisation, please do not hesitate to contact us as a matter of urgency to reach an understanding."[51].

53. This letter in this Tribunal's opinion contradicts strongly the impression which Nordzucker now attempts to give *i.e.* that, as from February 2001 it was left without information by Poland on the privatization problems. Rather, this letter proves that the consistency of Nordzucker's own behaviour in the privatization process may be questioned: if on 6 February 2001 Nordzucker itself states that there is still "an ongoing discussion between investors and the Ministry of State Treasury regarding the current privatization", how could it, *bona fide*, sue the Sugar Holding Companies two months later on basis of an agreement which had allegedly been concluded on 18 January 2001?

54. On the other hand, it appears fair to draw the conclusion from the 6 February 2001 letter that the issue of the price, not mentioned in the letter, was not mentioned either at the meeting Nordzucker had with Mr. Chronowski at the same day, as this has been confirmed by one of its participants on Nordzucker's side, Mr. Einfeld[52]. Mr. Einfeld also told the Tribunal that Mr. Chronowski mentioned that when the actual political debate was over, "we will continue the process of privatization with Nordzucker[53].

55. As no new valuations for the Szczecin and Gdańsk Groups have been produced, the Arbitral Tribunal has investigated what was the price increase needed. The Ministry of the State Treasury did not expect the price to be lower than PLN 2000 per tonne of quota[54]. To meet this price, Nordzucker should have offered PLN 53,884,560 for the Szczecin Group and PLN 65,982,680 for the Gdańsk Group instead of PLN 47,570,200 for the Szczecin Group and PLN 64,056,509 for the Gdańsk Group[55]. Thus the price increase for the two Groups was PLN 8,240,481 or approximately 7.4% of the prices initially offered. Given the relatively small size of this price difference, this Tribunal has difficulty to grasp why Nordzucker – which no doubt was aware of market prices, and has admitted that Mr. Jeznach mentioned the valuation issue at the 18 January 2001 meeting – has allowed its commercial alertness (which should in the given circumstances have prompted it to inquire whether something could be done to match the valuation concerns of the Ministry) to be overtaken by a legal –

[51] Exh. R88
[52] Transcript I, 198: 13-24
[53] Transcript I, 197: 14-16
[54] RWS 3 §16
[55] SoReb, §50

but erroneous – conviction that the agreement had already been concluded and that it was entitled to the transfer of the shares for the price of the initial bid.

56. In the meantime, a new Prime Minister, Mr. Buzek, had been appointed and on 2 March 2001 Nordzucker wrote to him about its concern and uncertainty concerning the privatization of the Gdańsk and Szczecin Groups[56]. A similar letter was also written on the same date to the new Minister of the State Treasury, Mrs. Aldona Kamela-Sowińska, requesting furthermore that dates be fixed to "sign and execute" the SPAs[57]. Following the adoption, on 21 March 2001, of a motion of the Minister of the State Treasury[58] requesting the Council of Ministers to accept the change in the sugar industry restructuring and privatization strategy and to give its consent to the establishment of the Polish national sugar company, Mr. Jeznach, on 2 April 2001, replied to Nordzucker's letter of 2 March 2001 that "*the decision concerning the privatization [of the Gdańsk and Szczecin Groups] in the sugar industry will be taken after the Council of Ministers takes a standpoint on changes to the privatization strategy in the sugar industry, taking into account the establishment of the company "Polski Cukier"* "[59].

57. It is striking that this sentence is exactly the same as the sentence figuring in a letter of a few days earlier, dated "March 2001", of the Ministry of the State Treasury (signed by Mrs. Dabrowska for the Director of the Department of Supervision and Privatization I) to the Director of the Secretariat of the Prime Minister, but which also said: "*In connection with the Szczecin and Gdańsk Groups, where the investor selection procedure has been completed, I would like to inform you that the analysis of the terms and conditions of the transaction and the sugar plants' economic situation indicate that there is a need to update the valuation and repeat the price tender*"[60]. The Tribunal cannot explain why Mr. Jeznach in his letter of 2 April 2001 to Nordzucker did not mention the need to update the valuation and repeat the price tender, unless the "March 2001" letter of Mrs. Dabrowska was written prior to the 21 March 2001 motion of the Ministry and Mr Jeznach's letter took that motion into account, meaning that he knew all too well that his Ministry proposed that the two Groups would not be sold to Nordzucker but go to Polski Cukier.

58. The fact that, as late as March 2001, the Ministry still wrote that "there is a need to update the valuation and repeat the price tender", although Mr. Jeznach had already reached this conclusion in his memorandum of 20 September 2000 on the Gdańsk Group[61] and Mrs. Litak-Zarebska ordered a re-checking of the price when she received Mr. Jeznach's memorandum of 3 October 2000 on the Szczecin Group proves at least a negligence on the Ministry's behalf. If the re-valuation was indeed necessary, it should not have waited more than half a year to do it.

[56] Exh. R89
[57] Exh. C66
[58] Exh. C92
[59] Exh. R71
[60] Exh. R73
[61] Exh. R64

59. It could be argued that Poland has been dissuaded from making new valuations by Nordzucker's firm refusal to increase the price (first during the meeting of 18 January 2001, then in its letters to the selling companies of 6 February 2001 and finally by bringing the law suits on 24 and 25 April 2001). In this hypothesis, which the Tribunal is prepared to consider as plausible, it fails to understand why the Ministry, knowing how much Nordzucker wished to acquire the two Groups, never told Nordzucker that its refusal to even consider a price increase necessarily would make the sales impossible. Poland never made Nordzucker understand that its refusal not to increase the price was not a mere part of the negotiation, but an actual deal-breaker. If Poland had given this message to Nordzucker, it could have reproached Nordzucker that it was itself the cause for the sales not being made. Absent transparency of Poland in this respect, it has only to blame itself if, until 1 August 2001, Nordzucker never dreamed of giving notice of the expiration of its bid and withdrawing its offer, but continued to await the consent of the GAMs.

60. It also appears from the letter of Nordzucker of 2 March 2001 to Mr Buzek that in the meantime a problem had arisen between Nordzucker and the Ministry of the State Treasury in relation to the issue of new shares for the Toruń Group sugar plants in relation to the capital increase, which may also have contributed to the *de facto* impossibility for the Parties to cooperate on a solution for the price problem of the Gdańsk and Szczecin Groups. This impossibility became probably definitive when, on 24 and 25 April 2001, Nordzucker sued respectively MKSC and PPSC before the Polish courts in order to have these Sugar Holding Companies ordered to execute the SPAs and hand over the shares in Gdańsk and Szczecin Groups.

61. The Arbitral Tribunal draws from the evidence offered to it the conviction that Nordzucker's strong reaction to the hint about the price increase of 18 January 2001 has been understood by Poland as a refusal of Nordzucker to even consider an increase of the price and has estranged the parties (later possibly also enhanced by the discussions around the Toruń capital increase) which made a further concerted action to finalize the sales impossible. This Tribunal is convinced that, if Nordzucker had had a commercial eagerness and reacted less negatively to the hint of Mr. Jeznach, and if the parties had continued to talk to each other instead of going to court, a solution might have been found. Nordzucker still had contact with the new Ministry of the State Treasury and the Prime Minister but if it was too delicate for the officials of the State Treasury to do more than give a signal about the price being too low, it was definitely beyond these Ministers to suggest themselves to Nordzucker that only money could meet the mounting pressure of the political opposition against the sale. The Tribunal's conviction is also based on the finding that notwithstanding the decision of the Council of Ministers of 13 June 2001 to create Polski Cukier, and the adoption of the act creating Polski Cukier on 21 June 2001, the Kalisko-Koninska Group has been sold, on 13 July 2001, because "the investor assumed on itself some additional obligations, like the guarantees that were provided by the companies and some others, and that was agreed

between the sugar company itself and the investor"[62]. However, the Tribunal notes that the Kalisko-Koninska Group had, as from 21 March 2001, been singled out as a group of which the privatization process had to be completed, irrespective of the creation of Polski Cukier[63].

62. Even if the Parties' respective behaviour is understandable (Poland finding it too delicate to simply request Nordzucker to increase the price; and Nordzucker considering that the price was accepted already), the Tribunal considers that the Ministry was negligent because it allowed a delicate situation to drag on and it took no action to get out of it within a reasonable time, one way or another, whether by adopting, much earlier, a decision in the GAM not to sell, or by clearly informing Nordzucker that it had to "improve" its bid.

63. Mr. Jeznach, who was one of the main witnesses of Poland, seems to have played a steering role in the events: he wrote the two memoranda of 20 September and 3 October 2000 stating that the price was too low (although his basis for his findings was never very clear)[64]; he was aware that he had to take action in accordance with the Undersecretary's orders on basis of these memoranda and failed to inform Nordzucker and the Sugar Holding Companies thereof[65] and could not recall whether he had ever taken the action ordered by the Undersecretary[66]; he disagreed with the Undersecretary's decision to do a re-valuation[67]; he only gave a weak signal to Nordzucker in the meeting of 18 January 2001; he did not inform Nordzucker that it was not possible for the Minister to consent to the execution of the agreements particularly in view of the share sale price which was too low, but expected the relevant sugar companies to do so without admittedly checking that that information was correctly given to Nordzucker[68]; and he did not write to Nordzucker on 2 April 2001 what he had known before, i.e. that there was "a need to update the valuation and repeat the price tender". He represented the continuity in the Ministry throughout the sales procedure and was instrumental in letting a year go by in which the Parties were alienated from the common goal they had in the summer of 2000.

64. On basis of the above, this Arbitral Tribunal finds that Poland failed to respond as from October 2000 till December 2000 to Nordzucker's requests for information on the progress of the privatization procedure. The delay in answering (or the failure to answer to) Nordzucker's written requests in the fall of 2000 can be understood by the need the Treasury felt to proceed with a re-valuation of the shares because of the changed economic circumstances since the first valuations had been made and the minimum sales prices had been fixed. The Tribunal has comprehension for the Ministry's hesitance about how to realize its wish to sell the Groups for a correct price in view of the increase of market price, notwithstanding the mounting political pressure. These two evolutions, the increasing

---

62 Transcript III p. 196: 4-7
63 Exh.C92, p.3
64 Transcript II, p. 197: 1 - p. 199: 14
65 Transcript II, p. 201: 22 - p. 204: 7
66 Transcript II, p. 209: 2-18
67 Transcript III, p. 201: 1-2
68 RWS 3 §20

market price and the political opposition, were also known to Nordzucker, as they were known by everybody concerned with the sugar industry. This may also explain why Nordzucker did not send any reminders or actually complain when it did not receive answers to its letters.

65. As from January 2001, the Tribunal's assessment is different. The communications (both oral and written) from the Ministry to Nordzucker, taken as a whole, gave Nordzucker reason to believe that the sales remained possible notwithstanding the turning of the political tide. Nordzucker certainly had enough reason - also without receiving information from the Ministry -- to be concerned, because it knew what happened on the political scene. However, the messages it received (*e.g.* in its meeting with Mr. Chronowski on 6 February 2001) were overall reassuring and hence, it continued to wait. The Ministry, on its side, did not take a decision in the GAMs refusing to sell to Nordzucker, or alternatively, decide to restart the (second phase of the) procedure or request Nordzucker to increase its price "informally" after making it clearly understood that the sale would otherwise not go through.

By taking no action at all, but letting Nordzucker wait further and allowing the turning political tide to grow stronger, Poland failed in its duty to manage the sales procedure diligently and fairly[69] and to finalize it within a reasonable time.

(iii) Failure to inform and consult with Nordzucker about the creation and composition of Polski Cukier

66. As regards the alleged failure to inform and consult with Nordzucker about the creation and composition of Polski Cukier, this Tribunal is of the opinion that Nordzucker has shown that it was closely following political developments in Poland at the time and that, also with the assistance of its Polish counsel, it was or could have been adequately informed of the creation of Polski Cukier.

67. When the Polish government was confronted in March 2000 with the plans for the creation of Polski Cukier, it clearly intended them not to interfere with the ongoing privatizations: "*It is considered to form a new company i.e. Polski Cukier, based on 16 sugar plants ...The said sugar plants would be financed, inter alia, from the funds obtained from sales of shares in other sugar plants in the course of implementing the regional restructuring concept, carried out at present*"[70]. In other words, the privatizations which had been launched already were indispensable to generate the funds which were needed for investments in the Sugar Plants which were not earmarked for privatization.

[69] In particular by adopting itself a motion to the council of Ministers on 21 March 2001 which formalized its decision to contribute the Groups to Polski Cukier, its attitude towards Nordzucker became inconsistent because it left the candidate purchaser simultaneously in the opinion that the sale would still be possible.

[70] Announcement of the Council of Ministers of 2 March 2000 (Exh. C87).

68. Mrs. Litak-Zarebska who was Undersecretary of the State Treasury until December 2000 testified that:

> *"Throughout the time that I was responsible for the sugar industry, we believed that Polski Cukier (if such company were to be set up) should be created from 16 sugar plants owned by the Poznańsko-Pomorska, Mazowiecko-Kujawska and Lubelsko-Malopolska companies, which were not included in the regional restructuring.*
>
> *[...]*
>
> *Thus it was not the government's intention to block the pending privatization process, as the company Polski Cukier was to be set up parallel to these processes.*
>
> *[...]*
>
> *As far as I know, Nordzucker is accusing the Ministry of not informing it of potential political obstacles to the successful closing of the sale processes that were already underway. In view of the fact that throughout this time I took the stance, supported by the Minister, that the creation of the concern could not in any way affect the talks held with potential investors, in our view there was no reasons to inform them.*
>
> *In addition, during the time that I was responsible for the privatization of the sugar sector, the process to sell Nordzucker shares in the Gdańsk and Szczecin Group was never at any time held up by the work underway in the Sejm to adopt the act obliging the government to set up Polski Cukier.* "

69. That this testimony can carry its full weight is confirmed by Mr. Lukas: "*My feeling is that Mrs. Litak-Zarebska was always fighting against this Polski Cukier approach, and she supported us and told us: don't be worried about that, it has no effect on you*"[71].

70. In December 2000, Mrs. Litak-Zarebska was succeeded by Mr. Jacek Tropilo who failed to meet with Nordzucker on 18 January 2001 but sent Mr. Jeznach who gave the price "hint" in line with his memoranda of 20 September and 3 October 2000. There came also a new Minister of the State Treasury and apparently also a new policy in relation to the sugar industry.

71. In his Motion of 21 March 2001 "regarding the adoption of changes in the strategy of the sugar industry privatization", the Minister of the State Treasury proposed to the Council of Ministers to agree that instead of 16 sugar plants and three Sugar Holding Companies, also "all sugar plants for which the privatization process has not been completed yet" be absorbed by Polski Cukier, because "it will be the most advantageous for the newly established entity

[71] Transcript I, p. 139: 10-18

to concentrate as many sugar plants in that entity as possible, especially those whose economic and financial condition is favourable and whose technological potential is high"[72]. In particular the Minister recommended "the option of choosing 28 sugar plants", which 28 plants included, according to Mr. Jeznach's witness statement "the sugar plants making up the Gdańsk and Szczecin Groups"[73].

72. Following this recommendation, the letter of Mr. Jeznach of 2 April 2001 informed Nordzucker that *"the decision concerning the privatization of the [Gdańsk and Szczecin] sugar plants will be taken after the Council of Ministers takes a standpoint on changes to the privatization strategy in the sugar industry, taking into account the establishment of the company "Polski Cukier""*.

73. Therefore, Nordzucker was aware of the risk that the two groups it was waiting to buy might shift to Polski Cukier. Indeed, Mr. Lukas replied at the hearing to a question why he brought the law suits against the two Sugar Holding Companies (on 24 and 25 April 2001):

"The reason was the establishment of Polski Cukier at this time, and we have the feeling that the Szczecin group and the Gdańsk group will be shifted to Polski Cukier and we wanted to protect our interests at this time, so we wanted to put our hands on these shares so that they cannot be contributed to Polski Cukier. That was the reason "[74].

74. Having reviewed all the evidence produced, the Tribunal has the distinct impression that the Ministry of the State Treasury (or at least certain officials) at the latest in the winter of 2000/2001, abandoned its intention to sell the two Groups to Nordzucker, but failed to inform Nordzucker thereof (actually continued to feed its hope) so that the political alternative could be put in place first before dismissing Nordzucker.

75. The statement, in Poland's post hearing memorial, that *"It follows that after [......]18 January 2001 [...]6 February 2001, an internal decision was reached within the Ministry to refuse to approve the sale of the Gdańsk and Szczecin Groups to Nordzucker due to the fact that the price was too low"* [75] no doubt intends to convince the Tribunal that the price was indeed the reason of the ultimate refusal. However, in this Tribunal's opinion, the statement is much more important as evidence that the decision of the GAMs not to consent to the sales could and should have been taken almost 6 months earlier than 1 August 2001 or, at least that the Ministry could have informed Nordzucker earlier of its intention to refuse consent at a later GAM. Hence, the sales procedure could have been closed – albeit without success – much earlier.

---

[72] Exh. C92
[73] RWS3, §24
[74] Transcript I, p. 82: 14-20
[75] PHMP §176

76. Certainly if Poland's statement that *"the adoption of the 2001 Act had no impact on Poland's decision to refuse to sell the Gdańsk and Szczecin Groups to Nordzucker"*[76] is correct, the Tribunal sees no good reason why it waited so long to decide to refuse to sell. In that case, Poland did not deal fairly with its "negotiation partner". And if that statement is accurate, why did the GAM of PPSC, on 1 August 2001, state in its decision that the sale could not go through because the newly created Polski Cukier was to absorb the two Groups targeted by Nordzucker? While this Tribunal acknowledges that the primary reason was the political opposition, it is equally convinced that a higher price would have allowed the parties to agree and that the low price was therefore a closely related reason.

77. This Tribunal therefore finds that Poland did not act equitably and fairly when, knowing since early 2001 what was most likely going to happen with the two Groups (it recommended this course), it left Nordzucker without timely and sufficient information and did not inform it of the crucial importance which, it now claims, the price had. Moreover, Poland did not conclude the sales procedure but left it hanging (presumably as a fall-back option should something go wrong with the creation of Polski Cukier). This was not fair to Nordzucker.

(iv) Failure to communicate about the reason of the refusal of consent

78. The decision of the GAM of PPSC of 1 August 2001 mentions as reason for its refusal to consent to the sale of the Szczecin and the Gdańsk Groups the fact that the newly created Polski Cukier would also encompass these Groups[77]. The letter of the (new) Undersecretary of State, Mr. Laszkiewicz, of the same date, informing Nordzucker of the refusal, gave as additional reason that there were "formal and legal issues related to the procedure and documentation concerning the selection of an investor"[78]. Later, and especially in this arbitration procedure, Nordzucker's refusal to increase its price, has primarily been invoked as reason by Poland.

79. As regards the formal and legal issues related to the procedure and documentation for the sale, this reason must be considered simply inaccurate in view of the assurance given by Mr. Jeznach at the 18 January 2001 meeting, that *"the agreement was approved in formal and legal terms"*[79] and of the total absence of any evidence on further negociation between the Parties about the terms of the SPAs (and even their price) since August 2000. As much as this Tribunal believes that Mr. Jeznach gave a hint at the 18 January 2001 meeting about the price being too low, it also accepts as a fact that Mr. Jeznach also made this statement.

---

[76] PHMP §32
[77] Exh. C70
[78] Exh. C71
[79] Oral testimony of Mr. Jeznach befor the Toruń Court on 10 December 2001 (Exh. C96).

80. In relation to Nordzucker's refusal to increase its price, the Tribunal has indicated above that, while a price increase voluntarily proposed by Nordzucker, in 2000 or early 2001, might indeed have prevented that the sale was postponed so much as to become entirely impossible in the new political context, such price increase has not been clearly requested by the Ministry or the selling companies and therefore cannot serve as a proper reason justifying the refusal.

81. In any case, it is a fact that whatever price Nordzucker would have offered after the taking effect of the Polski Cukier Act of 21 June 2001, the sale could no longer take place because it had been decided that the sugar plants concerned had to be merged with others in Polski Cukier[80]. That presumably also explains why no correct and complete information on the situation was given to Nordzucker until the Privatization Act had actually been changed and Polski Cukier created. This also confirms that this political reason was the primary reason. If the other two reasons were true reasons, the GAMs could have taken a decision to refuse the sale for either of these reasons at the latest after 18 January 2001 but presumably much earlier since between Mr. Jeznach's memoranda of 20 September and 3 October 2000 not much happened either with regard to price or, as far as the file shows, with regard to formal documentation.

82. The Tribunal acknowledges that Nordzucker freely took part in the privatization proceedings governed by the Rules under which the consent of the Ministry of the State Treasure in the sellers' GAMs was a formal requirement for an agreement to exist, and under which the Ministry could give or refuse its consent with discretion and without having to give reasons.

83. Therefore, this Tribunal considers that Poland has not breached its duties under article 2 (1) third sentence of the BIT in relation to giving the reasons for its decision to refuse to sell, once it was taken, but that it lacked transparency in its communications during the negotiations, certainly from 18 January 2001 on, about the reasons which were going to lead to the negative decision.

84. This Arbitral Tribunal finds that the lack of information regarding the actual reasons of its possible refusal of consent, in combination with the lack of open and frank communication by the Ministry in the period October 2000 – March 2001 about what was upholding the sales constitutes a lack of transparency which Poland was under the BIT obliged to show in its dealings with a prospective investor who had completed the entire sales procedure and who was waiting for the other party to agree or at least tell him clearly what he had to do when a "hint" proved insufficient to push him into action.

85. For completeness' and clarity's sake, the Tribunal insists on the fact that the reasons mentioned or not mentioned, true or false, relate only to the transparency of the process, but

[80] In this respect, the sale of Kalisko-Koninska on 13 July 2001 proves that a sale was still possible after the adoption of the Act, provided it took place before the Act took effect. Moreover, an explicit exception had been provided for this Group (Exh. C92)

not to the validity or legality of the decision of the Ministry not to consent in the GAM to the sale. The Ministry was under the applicable rules free not to consent, without even having to give reasons.

b. Respect of Nordzucker's legitimate expectations

86. "Nordzucker believed that if it was selected as the winning bidder, and subsequently complied with the Rules, the process would be completed by the State"[81].

87. The Tribunal, upon review of the evidence available, comes to the conclusion that this expectation of Nordzucker was not reasonable and legitimate. The Rules were clear that being the winning bidder only meant that it could engage in negotiations, also on the price[82], and that upon closing of the price negotiations, the Management Board had to present its decision to the GAM which had to approve it. Mrs. Litak-Zarebska, in her letter of 9 June 2000, insisted explicitly on the five procedural steps still to be accomplished at that time[83]. Consequently, being the winning bidder was no guarantee for becoming the purchaser. The only reasonable expectation was that there would be negotiations, both on the various packages, and possibly even on the price (whether it was equal to or exceeded the minimum price set in the invitation to bid).

88. Furthermore, the reasonableness of Nordzucker's expectations has to be tested in relation to the circumstances and context. Nordzucker was or must have been aware of the threat that a national sugar company might by created and that the groups it targeted might also be interesting for that new entity. In the political context of Poland at the time, Nordzucker should have been aware that political opposition could make the privatization difficult if not impossible and it was or must have been aware that this political situation could be a reason why the consent of the Ministry in the GAM of the Sugar Holding Companies might be withheld. Even if it bad received assurances from Mrs. Litak-Zarebska that the creation of Polski Cukier would not impact on the sales procedure, the last of these dated from 23 October 2000 when she confirmed in an interview that the privatizations started should continue[84]. Thereafter, and in particular after 18 January 2001, Nordzucker had no reason to continue to be confident in the course of the sales procedure. Mr. Jeznach's statement that from a legal and formal point of view the documentation raised no more problems, was counterbalanced by his hint that there was a price problem. If Nordzucker only took hope from that meeting and no concern, it did so at its own risk. Besides, its letters to the Sugar Holding Companies of 6 February 2001 confirm that it came out of that meeting with a concern. If Nordzucker wrote on 6 February 2001 to the Ministry of State Treasury that it

[81] PHMN §95
[82] see *e.g.* Exh. C6-A §12
[83] see § [23] above
[84] Exh C80-H

was "*aware of the problems that are currently hindering the process of the privatization*" and that the Minister had "*emphasised the unclear status of Polski Cukier*", but that Nordzucker nonetheless assumed "*that the further course of the Gdańsk and Szczecin group privatization will be in line with the currently effective regulations, as long as legal security is ensured*"[85], it expressed an expectation which it created at its own risk. Its request that "*Should any new problems arise that might inhibit successful completion of the ongoing privatization, please do not hesitate to contact us as a matter of urgency to reach an understanding*" was largely undercut by its simultaneous letters to the presidents of the Sugar Holding Companies that it would not accept a challenge of the economic basis of the transaction and was *de facto* withdrawn in April when it sued the Sugar Holding Companies on the basis that the sales were concluded at the prices offered.

89. Having followed – through its Polish advisors – the political scene relating to the privatization of the sugar industry, Nordzucker in any case could not reasonably expect that the sugar industry privatization process could not change substantially. Certainly with the changes of Undersecretary in charge and Ministry of the State Treasury, as well as of the Prime Minister, at the end of 2000 and the beginning of 2001, a turnaround could not be excluded. This probably explains why Nordzucker wrote to Mr. Tropilo in December 2000, and to the new State Treasury Minister and to the Prime Minister, in the spring of 2001.

90. The Tribunal understands that Nordzucker has been disappointed by the course of matters, but it does not agree that the expectations which have not been fulfilled were reasonable and legitimate, given the political protests against the privatisation since 1999 which grew stronger thereafter and were well publicized, and given the Rules which made it clear that the sales procedure would be closed only upon the Minister's consent in the GAM.

c. Arbitrary decisions of Poland based on political and nationalistic reasons

91. This Tribunal does not agree that the decisions of Poland have been arbitrary. It is not because the decisions were based on political reasons that they are arbitrary. And the political change has not been abrupt either. There is also no evidence in this case that the decision has been inspired by nationalistic reasons. The protests of the growers who would rather themselves become shareholders of the plants than having the plants sold to private investors, was not as such nationalistic. Even if one of the members in the Parliament has used nationalistic language at one time, the Respondent cannot be held responsible therefore. Nordzucker's conclusion that Mr. Jeznach's proposal in the fall of 2000 to discontinue the privatization process was also based on "the foreign nationality of the buyer" is not justified: Mr. Jeznach referred to a "danger on the part of large companies"[86] which were found to

[85] Exh.R88
[86] Exh. R66

cause an intensification of specialized crop production to the disadvantage of animal breeding. If Mr. Jeznach referred in this context to "foreign company" that was unavoidable as only Nordzucker was in the running for these groups.

d. Bad faith in the negotiations

92. The Tribunal has found no evidence of bad faith of Poland in the negotiations. Poland has been in a very difficult situation and the Ministry has been obliged to manoeuvre between growing political opposition on one side and its own wish to sell the Groups and conviction that this was the better solution for the Polish sugar industry (which existed at least until December 2000). That the balance between these two facts became an imbalance as from 18 January 2001 and if the Ministry, as a result of Nordzucker's refusal to consider a price increase, and its bringing suit against the sellers, started to abandon the idea of selling to Nordzucker, is not a matter of bad faith but a natural - even if avoidable if either party had been a bit more coming forward - phenomenon between negotiating parties.

93. Nordzucker was not a powerless party in the negotiations and was repeatedly in a position to abandon the deal had it wished so. Indeed, after it was selected as winning bidder, the SPAs still had to be negotiated and the file shows that negotiations were fierce and time consuming (cfr. Toruń SPA). The time schedule mentioned in the Regulation and in the Rules for Selecting the Buyer of the Shares, has been exceeded. In reply to a question of 19 January 2001 of one of the selling Sugar Holding Companies, Nordzucker declined to withdraw its offer and confirmed its will to conclude the transaction. The Tribunal thus finds that Nordzucker, fully aware of the protraction of the procedure and of the reasons therefore, not only wanted to make the purchase, but also make it at the price initially offered and in terms and conditions which it negotiated as best as it could. Nordzucker was of the opinion that it had a strong legal case and that Poland was obliged to conclude the transaction with it for the initial price, thereby neglecting the delicate balancing act which negotiations per definition are and running the risk that its counterpart might be overtaken by the events and decide to terminate the negotiations if it believed that they were leading nowhere given the fixed position of Nordzucker.

94. The Tribunal finds that each of the Parties has defended its interests in the sales procedure, which has led each of them to not being fully transparent in their dealings with the other and making statements in this arbitration which were not always consistent with each other or with the documents at the disposal of the Tribunal. The Tribunal found no evidence of bad faith, however.

2.4 Conclusion

95. The Tribunal concludes that, starting from January 2001, Poland has failed to deal fairly and equitably with Nordzucker by not communicating transparently about the reasons of the slow down of the procedure as from October 2000 on, about its alleged internal decision that the price offered by Nordzucker had become too low to make the sale and about its decision to merge the two Groups with Polski Cukier. In this way, it has caused Nordzucker a set-back of at least half a year for alternative investment plans and costs for the useless follow-up of the process and the situation in respect of the Szczecin and Gdańsk Groups.

3. COSTS

96. The Tribunal reserves its decision on costs until its final award and until it will have received, upon its instruction, details of the Parties' claims for costs.

4. DECISION

For the above stated reasons,

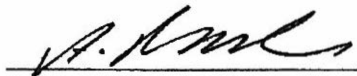
The Tribunal decides:

1. That Poland breached its duty under article 2 (1) third sentence of the Treaty concerning the encouragement and reciprocal protection of investments signed on 10 November 1989 between Germany and Poland, as amended by the Protocol of 14 May 2003, by failing to finalize the sales procedure within a reasonable time and uselessly protracting it, also by its lack to communicate transparently with the candidate investor during the last period of the pre-contractual phase of a sales procedure of the Gdańsk and Szczecin Sugar Groups.

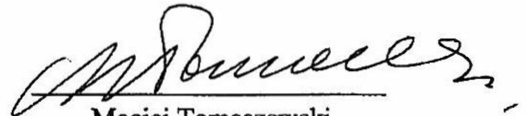
2. That the damages caused by this failure will be dealt with in a separate future award after the Parties have been given an opportunity to express themselves on this issue.

Signed in seven originals, one for each Party, one for each member of the Arbitral Tribunal, one for deposit with the clerk of the Court of First Instance and one as a reserve copy.

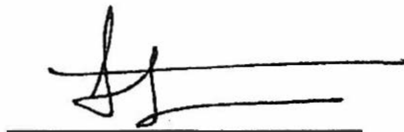
Brussels, 28 January 2009



Andreas Bucher
Co-arbitrator



Maciej Tomaszewski
Co-arbitrator



Vera Van Houtte
Chairman

Arbitration CAS 2004/A/725 United States Olympic Committee (USOC) v. International Olympic Committee (IOC) & International Association of Athletics Federation (IAAF), award of 20 July 2005

Panel: Mr. Kaj Hobér (Sweden), President; Mr. L. Yves Fortier QC (Canada); Mr. David A.R. Williams QC (New Zealand)

Athletics
Disqualification of a relay team further to the suspension of an individual member of the team
Interpretation of the IAAF Rules

1. **Rule 59.4 of the IAAF Rules in force at the time of the Sydney Games concerns the disqualification, ineligibility and annulment of performance results of *individual* athletes, in cases where an athlete has been found guilty of a doping offence; it does not concern teams or team results. One should not take a rule that plainly concerns individual ineligibility and the annulment of individual results, and then stretch and complement and construe it in order that it may be said to govern the results achieved by teams.**

2. **Clarity and predictability of the rules are required so that the entire sport community are informed of the normative system in which they live, work and compete, which requires at the very least that they be able to understand the meaning of rules and the circumstances in which those rules apply.**

This case, in its essence, concerns the interpretation of relevant IAAF Rules and their application to five members of the gold medal-winning U.S.A. team (the "U.S.A. team") in the men's 4 x 400m relay event at the 2000 Sydney Olympic Games (the "relay event"). It is a most peculiar case, arising in most unusual circumstances.

As explained more fully in this Award, the results of the relay event and the fate of the medals awarded to the U.S.A. team at the 2000 Sydney Games have, five years later, been called into question as a result of two occurrences.

First, on 28 June 2004, a Panel of the Court of Arbitration for Sport (CAS) found that a Doping Appeals Board of USA Track & Field (USATF), the national federation that governs the sport of athletics in the United States of America, had misdirected itself and reached an erroneous conclusion when, on 10 July 2000, it exonerated Mr. Jerome Young (a sixth member of the U.S.A. team, who is not one of the Appellants in this arbitration) of having committed a doping offence on 26 June 1999, just prior to the Sydney Games. The CAS Panel found that Mr. Young had

committed a doping offence, that the resulting period of ineligibility extended through the Sydney Games, and that Mr. Young should therefore not have participated in those Games (CAS 2004/A/628, award of 28 June 2004).

Second, on 18 July 2004, the IAAF Council determined that "as a consequence of Jerome Young's ineligibility to have competed at the Sydney Olympic Games in 2000 [by virtue of having committed a doping offence on 26 June 1999], the result of the USA Men's 4 x 400m relay event is annulled and the final placings are revised accordingly".

It is the subject matter of the second of these decisions – that is, whether under IAAF Rules in force at the time of the Sydney Games, the results of the relay event should be annulled and the final placings revised accordingly – that is the primary issue in the present appeal.

First Appellant, USOC, is the body to which all US Olympic sports federations are affiliated and is responsible, among other duties, for the selection and registration of athletes in the Olympic Games. USOC has its seat in Colorado Springs, Colorado, U.S.A.

Second, third, fourth, fifth and sixth Appellants, Messrs. Michael Johnson, Antonio Pettigrew, Angelo Taylor, Alvin Harrison and Calvin Harrison (the "Athletes") are five of the six athletes who were members of the U.S.A. team awarded gold medals in the 4 x 400 men's relay event at the 2000 Sydney Olympic Games. The sixth member of that team, Mr. Jerome Young, is not a party in these proceedings.

First Respondent, the International Olympic Committee (IOC) is the governing body of the Olympic Movement. One of its missions is to ensure the regular celebration of the Olympic Games. The IOC has its seat in Lausanne, Switzerland.

Second Respondent, the International Association of Athletics Federations (IAAF) is the international federation that governs the sport of athletics throughout the world. The IAAF has its seat in the Principality of Monaco. On 18 July 2004, the IAAF Council made the decision (the "IAAF decision") that is the subject of the present appeal.

IAAF Rule 59.4 is in the following terms:

> If <u>an athlete</u> is found to have committed a doping offence and this is confirmed after a hearing or the athlete waives his right to a hearing, <u>he</u> shall be declared ineligible. In addition, where testing was conducted in a competition, <u>the athlete</u> shall be disqualified from that competition and the result amended accordingly. <u>His</u> ineligibility shall begin from the date of suspension. Performances achieved from the date on which the sample was provided shall be annulled.

(emphasis added)

Bye-law 1.2 to Rule 57 of the Olympic Charter provides:

1. Technical provisions relating to IFs at the Olympic Games:

   The IFs have the following rights and responsibilities:

[…]
1.2 To establish the final results and ranking of Olympic competitions.

In addition, it is relevant to note articles 6.11 (d) and (e) of the IAAF Constitution in force as from 1 November 2003 (the version of the IAAF Constitution that is relevant here), which provide:

> The Council's powers shall include the following:
> […]
> (d) to make decisions in urgent matters relating to all Rules. Any such decisions may be notified to the members by the IAAF Office and shall be reported to the next Congress.
> (e) to make decisions regarding the interpretation of the Rules. Any such decisions may be notified to the members by the IAAF Office and shall be reported to the next Congress.
>
> (emphasis added)

Although this case concerns essentially a pure question of law, an appreciation of its lengthy and complicated history is relevant to an understanding both of the context in which the present appeal arises and of the issues addressed in this Award. That history has been thoroughly traversed by the parties in their written and oral submissions, and is summarized here.

On 26 June 1999, Mr. Young provided a urine sample while competing at the United States National Outdoor Championships in Eugene, Oregon. The IOC-accredited laboratory in Indianapolis, Indiana reported that the sample was positive for nandrolone metabolites.

On 11 March 2000, a USATF Doping Hearing Panel found Mr. Young guilty of a doping offence. That decision was reversed on 10 July 2000 by a USATF Doping Appeals Board, thus exonerating Mr. Young and rendering him eligible to enter and compete in the Sydney Games. The USATF, IAAF and IOC accordingly allowed Mr. Young to compete in the Sydney Games as a member of the U.S.A. team, which eventually won the gold medal.

During the Sydney Games, Mr. Young competed in the semi-final heat for the relay event, on 29 September 2000. He did not compete in the final race on 30 September 2000, which four members of the U.S.A. team (Michael Johnson, Antonio Pettigrew, Alvin Harrison and Calvin Harrison) won.

There is no evidence and there has been no suggestion that any member of the U.S.A. team (including Mr. Young) used or ingested any prohibited substance or committed any doping offence during the Sydney Games. Nor is there any evidence, and there has been no suggestion, that any member of the U.S.A. team even knew of Mr. Young's case at the time.

The reason for this lay in USATF's rules (since amended) concerning athletes' privacy and the confidentiality of information pertaining to doping cases in which athletes were ultimately exonerated. In July 2002, the IAAF submitted its concerns about the USATF's confidentiality policy to arbitration before a CAS Panel. On 10 January 2003, that Panel held that although IAAF Rules

did obligate the USATF to disclose information regarding its drug tests to the IAAF, and that information should have been disclosed, given the passage of time and the equities, including the IAAF's familiarity with the USATF rules in question, the USATF should not in the circumstances be required to disclose the identity, or any information about the drug tests, of athletes who had been exonerated[1].

In August 2003 – three years after the Sydney Games – the United States media (*Los Angeles Times*) reported Mr. Young's June 1999 doping offense and subsequent exoneration by the USATF Doping Appeals Board.

On 30 September 2003, the IOC Executive Board formed a Disciplinary Commission to investigate the circumstances surrounding Mr. Young's entry and participation in the Sydney Games.

In early February 2004, USATF released the unredacted decision of its Appeals Board that had exonerated Mr. Young and sent it to the USOC. The USOC forwarded the decision to the IOC and IAAF.

On 18 February 2004, the IAAF referred the matter to arbitration before the CAS, requesting that the decision exonerating Mr. Young be overturned.

On 29 June 2004, a CAS Panel ruled, *inter alia*, that (1) the USATF Doping Appeals Board had acted erroneously in overturning the 11 March 2000 decision finding Mr. Young guilty of a doping offence; (2) Mr. Young should have been ineligible to compete in international competition for the 2-year period from 26 June 1999 (the date of his urine sample) to 25 June 2001; and (3) Mr. Young therefore should not have been allowed to compete in the Sydney Games.

On 5 July 2004, the IAAF convened an Extraordinary Council Meeting for 18 July 2004, to consider the action which it should take in the light of the decision in the Jerome Young case and further to the correspondence received from the IOC Disciplinary Commission.

By letter dated 17 July 2004, USATF sent the IAAF a written submission in the matter, stating, *inter alia*, that fairness demanded that Jerome Young alone, and not his innocent teammates, should forfeit the gold medal won by the U.S.A. team.

Two days prior to the Extraordinary Council Meeting, a "Briefing Note to Council" was prepared for the assistance and use of the Council members at their 18 July 2004 meeting (the "IAAF briefing note"). The IAAF briefing note set out the history of the Jerome Young case, the action required of the IAAF Council, the relevant IAAF Rules, and how relevant previous cases had been dealt with.

On 18 July 2004, the Extraordinary Council Meeting was held in Grosseto, Italy.

> The IAAF Legal Counsel stated:
>
> […]

---

1 See CAS 2002/O/401, in: REEB M. (ed.), Digest of CAS Awards III 2001-2003, The Hague 2004, p. 36 ff.

> (x) (…) all the IAAF Council was required to do was to interpret the relevant IAAF Rules in 1999 as regards the consequences of Jerome Young's ineligibility on the USA Relay Team. The IAAF Council was not being asked to reach a decision on the withdrawal of the gold medals of the USA Relay Team Members. This was a matter exclusively for the IOC.

There then ensued a general discussion among Council members. As stated at paragraph 9 of the General Secretary's note:

> The broad views of the council were:
>
> (i) That the spirit and intent of the relevant IAAF Rules was to annul all Jerome Young's results in the 2-year period of his ineligibility, including the USA 4x400m Relay Team result at the Sydney Olympic Games.
>
> (ii) That the natural consequence under the relevant IAAF Rules of the annulment of an individual's results was the annulment of any relay result in which the athlete had competed. Every member of a winning relay team is awarded a gold medal whether they participate only in the preliminary rounds or in the final. This shows that a relay is one event composed of the preliminary rounds and a final. If an athlete is ineligible to compete as part of the team in a preliminary round, the team's performance in the overall event must be affected.
>
> […]
>
> (v) Jerome Young's appearance in the Sydney Games was caused by the fault of USATF; USATF had, [despite reminders from the IAAF Council,] failed to comply with IAAF Rules in notifying the IAAF of its doping decisions; had they done so, Jerome Young would never had been allowed by the IAAF to compete in Sydney.

The IAAF President then summed up the discussion and called for a vote to be taken as to whether the results of the USA team should be modified. In a secret ballot, the meeting voted 16 - 1 in favour of annulling the result (with one abstention). The motion was therefore passed.

On 18 July 2004, the IAAF President wrote to the Secretary of the IOC Disciplinary Commission. His letter reads:

> […]
>
> Further to the request of the IOC Disciplinary Commission by letter dated 2 July 2004, the IAAF Council has interpreted the relevant IAAF Rules that were in force at the time that Mr. Young committed a doping offence on 26 June 1999. Its interpretation is that, as a consequence of Jerome Young's ineligibility to have competed at the Sydney Olympic Games in 2000, the result of the USA Men's 4x400m Relay Team is annulled and the final placings are revised accordingly.
>
> […]

The present arbitration was commenced by the filing of Appellants' Statement of Appeal with the CAS on 27 September 2004.

The hearing of the appeal took place in London, on 10 May 2005.

LAW

1. As stated by Appellants in their Statement of Appeal, this appeal is brought pursuant to both IAAF Rule 21 (IAAF Handbook 2002-2003) and more particularly, because the matter concerns the Olympic Games, Article 61 of the Olympic Charter, which provides:

   Any dispute arising on the occasion of, or in connection with, the Olympic Games, shall be submitted exclusively to the Court of Arbitration for Sport, in accordance with the Code of Sports-Related Arbitration.

2. For its part, the IAAF acknowledges that the Athletes, who are the subject of the IAAF decision, have standing to appeal that decision to the CAS in virtue of IAAF Rule 60.13 (IAAF Handbook 2004-2005)[2]. However, the IAAF contends that USOC enjoys no such standing and should be removed as a party to these proceedings. For the reasons set forth below, and in view of the Panel's findings in respect of the substantive issues in this appeal, the IAAF's request that USOC be struck as a party to these proceedings need not be determined; and the Panel thus refrains from doing so.

3. The question to be answered is whether, under IAAF Rules in force at the time of the 2000 Sydney Olympic Games, the results obtained by the U.S.A. team in the relay event should be annulled. It is the unanimous opinion of the Panel that they should not be annulled.

4. IAAF Rule 59.4, which the IAAF puts before the Panel as the principal governing rule in the circumstances, is set out in full above. For ease of reference, it is reproduced here:

   If an athlete is found to have committed a doping offence and this is confirmed after a hearing or the athlete waives his right to a hearing, he shall be declared ineligible. In addition, where testing was conducted in a competition, the athlete shall be disqualified from that competition and the result amended accordingly. His ineligibility shall begin from the date of suspension. Performances achieved from the date on which the sample was provided shall be annulled.

---

[2] IAAF Rule 60.13 (IAAF Handbook 2004-2005) reads as follows:

Parties entitled to appeal decisions

In any case involving International-Level athletes (or their athlete support personnel) or arising from an International Competition , the following parties shall have the right to appeal a decision to CAS:

a. the athlete or other person who is the subject of the decision being appealed;

b. the other party to the case in which the decision was rendered;

c. the IAAF;

d. the IOC (where the decision may have an effect on eligibility in relation to the Olympic Games; and

e. WADA (in doping-related matters only).

5. It was urged upon the Panel with great conviction and eloquence by the IAAF's counsel that IAAF Rule 59.4 provides a clear statement of a rule providing for the annulment of the results of the U.S.A. team in the circumstances of this case – that is, a rule to the effect that *where an athlete tests positive in an earlier competition and is subsequently declared ineligible, and his results from the date of the provision of his sample through to the imposition of his ineligibility are annulled* (as in the case of Mr. Young)*, the result of any relay team in which he has competed during such period* (e.g., the results of the U.S.A. team at the Sydney Olympic Games) *shall also be annulled.*

6. The IAAF argues that the express provisions of IAAF Rule 59.4 must be "complemented" by anything which is necessarily to be implied in them, and that they must be construed "purposively". It maintains that Rule 59.4 is to be complemented, for example, by provisions such as those contained in IAAF Rules 170 (17) and (18), which govern the composition of a relay team and the nature and timing of permitted substitutions to a team. It contends that the annulment of the U.S.A. team's winning results "follows inexorably" from the last sentence of Rule 59.4, which states that "[p]erformances achieved from date the sample was provided shall be annulled," in that:

   There is no distinction drawn between performance in individual or in relay results. Young's performance in the first round and semi-final stage of the 4 x 400 men's relay (which occurred … during his period of ineligibility) are annulled. It follows inexorably that (i) the other results of the squad in which he [Mr. Young] ran (the qualification round squads) are annulled, since the squad had to compete 4 not 3 legs (in qualification) (ii) the results of the squad in which he did <u>not</u> run (the final squad) are also annulled, since <u>that</u> squad's right to participate and participation in other final depended upon the results of the earlier squad being valid.

   Alternatively since the word "performances" is not limited to the athlete's own performances it should be construed as applying to the performances of a team in which the athlete participated.

7. More broadly, the IAAF contends that the applicability of the relevant rules in the circumstances of the present case, and the consequent annulment of the results obtained by the U.S.A. team in the relay event is implicit in order to give efficiency to the Olympic Movement Anti-doping Code and related rules. In the submission of the IAAF, "it would be perverse and undermine the force of the Anti-doping Code if results achieved through reliance on an ineligible athlete, whether [results] of the athlete or of his team, should stand".

8. In sum, the IAAF takes the position that both a purposive and even a literal interpretation of IAAF Rules require that the results of the gold medal-winning U.S.A. team be annulled. The proposition, it says, is straightforward: Jerome Young was ineligible to compete at the Sydney Olympic Games; his results are annulled; therefore the results of the four-some in which he ran must also be annulled; and the results achieved by the four U.S.A. team members who ran in the final race of the relay event must similarly be annulled, since they only made it to the finals due to the results achieved by the U.S.A. team in earlier heats, in which Mr. Young ran. "In team sports," the IAAF submits (with reference to the CAS award OG 1998/004-005, published in the Digest of CAS Awards I 1986-1998, p. 435ss.), "the chain is no stronger than its weakest link".

9. As stated above, the argument is not without force or logic. However, in the view of the Panel, even when articulated in its most simple and compelling fashion, its shortcomings are apparent.

10. On its face, Rule 59.4 concerns the disqualification, ineligibility and annulment of performance results of *individual* athletes, in cases where that athlete has been found guilty of a doping offence; it does not concern teams or team results (in fact, as explained below, the IAAF Rules did not contain any express provisions covering the sort of situation at issue in this case until they were amended in 2004-2005.)

11. IAAF Rule 59.4 plainly deals with, and is plainly intended to deal *only* with, the situation of "an athlete" who is found to have committed a doping offence. It speaks to "the athlete" being disqualified and to the period of "his" ineligibility as well as to the annulment of his performances achieved as from the date on which his positive sample was provided.

12. To take a rule that plainly concerns individual ineligibility and the annulment of individual results, and then to stretch and complement and construe it in order that it may be said to govern the results achieved by teams, is the sort of legal abracadabra that lawyers and partisans in the fight against doping in sport can love, but in which athletes should not be required to engage in order to understand the meaning of the rules to which they are subject.

13. In seeking a proper interpretation of relevant IAAF Rules and their application in the circumstances of this case, one returns inevitably to the observations contained in the IAAF briefing note prepared for IAAF Council members in advance of their 18 July 2004 deliberations and decision. Whereas the alleged clarity of the relevant IAAF Rules is much to be doubted, this much *is* crystal clear and is stated, correctly, in the IAAF briefing note: "In the 2000 Rules, there was … no specific provision for what should happen when a competitor who had been a member of a team (either of a relay team or otherwise) was found guilty of doping".

14. As explained in the IAAF briefing note, it is not until their amendment in 2004-2005 that IAAF Rules provide expressly for what happens when an athlete who is a member of a relay team is found guilty of doping. According to the briefing note, Rule 39.4 of the 2004-2005 IAAF Rules makes it clear *"for the first time"* that:

    [I]f an athlete tests positive in an earlier competition or admits doping (and is subsequently declared ineligible) and his results from the date of the provision of his sample through to the imposition of his suspension or ineligibility are annulled, the result of any relay team in which he has competed during such period shall also be annulled.

15. It is immediately apparent that this is in essence the very rule which the IAAF contends existed, whether literally or by implication, at the time of the 2000 Sydney Olympic Games. This is the rule which it attempts to tease out of IAAF Rule 59.4.

16. In fact, IAAF Rule 39.4 says more than even the IAAF briefing note suggests. While it is true that the 2004-2005 IAAF Rules are the "the first time" that the implication for teams whose members may have committed doping offences is spelled out, Rule 39.4 also introduces the concept of *fairness* as a consideration. It reads as follows:

    [W]here an athlete has been declared ineligible under R40 below, all competitive results obtained from the date the positive sample was provided (whether in competition or out of competition) or other anti-doping rule violation occurred, through to the commencement of the period of provisional suspension shall, unless fairness dictates otherwise, be annulled, with all resulting consequences for the athlete (and, where applicable, any team in which the athlete has competed) including the forfeiture of all titles, awards, medals, points and prize and appearance money.

    (emphasis added)

17. The relevant IAAF Rules in force at the time of the Sydney Games contained no such "fairness consideration". And of course, to construe those Rules, in particular Rule 59.4, in the manner contended for by the IAAF in this arbitration would entail an automatic disqualification or annulment of the results of the entire USA team, without any consideration of fairness to the members of that team. In the view of the Panel, the absence of a "fairness consideration" in Rule 59.4 makes it even less likely that it was intended to apply, by implication, to teams as well as to individuals.

18. The IAAF contends that "this is not a Q.[3] case". In a sense, however, this is very much "a Q. case". Firstly, the clarity of the relevant anti-doping rules related to team results in force at the time of the Sydney Olympic Games is manifestly in doubt. This explains why the main issue before this Panel is, as the IAAF recognises, the merits of the IAAF decision interpreting those rules.

19. Secondly, the principles underlying the approach adopted by the CAS in CAS 94/129 and similar cases cannot be ignored, as the IAAF suggests they should be, on the basis that, because the Athletes were entirely ignorant of their teammate's doping offence (given that he had been exonerated at the time, and that exoneration was not overturned until many years later), their behaviour was in no way affected by those rules or their understanding of them.

20. The rationale for requiring clarity of rules extends beyond enabling athletes in given cases to determine their conduct in such cases by reference to understandable rules. As argued by the Appellants at the hearing, clarity and predictability are required so that the entire sport community are informed of the normative system in which they live, work and compete, which requires at the very least that they be able to understand the meaning of rules and the circumstances in which those rules apply.

21. There was simply no express rule in force at the time of the Sydney Games which provided for the annulment of results obtained by a team, one of whose members later was found to have been ineligible to compete at the time. As became apparent in these proceedings, such a

---

[3] CAS 94/129, published in the Digest of CAS Awards I 1986-1998, p. 187ss.

rule could only be said to have been produced by what the Panel in the CAS 94/129 case referred to as "an obscure process of accretion" – here, as the IAAF would have it, a process of complementation and inference. The Panel consider that the following oft-cited passage from the CAS 94/129 decision is apposite:

> The fight against doping is arduous, and it may require strict rule. But the rule-makers and the rule-appliers must begin by being strict with themselves. Regulations that may affect the careers of dedicated athletes must be predictable. They must emanate from duly authorised bodies. They must be adopted in constitutionally proper ways. They should not be the product of an obscure process of accretion. Athletes and officials should not be confronted with a thicket of mutually qualifying or even contradictory rules that can be understood only on the basis of the de facto practice over the course of many years of a small group of insiders.

(emphasis added)

22. In *A.C.* v. *FINA*,[4] in which, as in this case, the International Federation in question argued for a "purposive construction" of the relevant rules, the CAS nonetheless granted the Appellant's appeal in part (as to the sanction). In doing so it cited with approval the approach taken in CAS 94/129 and further stated that the federation in question bore the responsibility:

> [T]o take every step to ensure that competitors under their jurisdiction were familiar with all rules, regulations, guidelines and requirements in such a sensitive area as doping control.
>
> […]
>
> It is important that the fight against doping in sport, national and international, be waged unremittingly. The reasons are well known … It is equally important that athletes in any sport … know clearly where they stand. It is unfair if they are to be found guilty of offences in circumstances where they neither knew nor reasonably could have known that what they were doing was wrong (to avoid any doubt we are not to be taken as saying that doping offences should not be offences as a strict liability, but rather that the nature of the offence [as one of strict liability] should be known and understood).
>
> For this purpose, it is incumbent both upon the international and the national federation to keep those within their jurisdiction aware of the precepts of the relevant codes.

(emphasis added)

23. IAAF Rule 59.4 applies plainly to Mr. Young. The same simply cannot be said with respect to the Athletes who are Appellants in this case.

24. For these reasons, the Panel is unanimously of the opinion that the decision taken by the IAAF Council on 18 July 2004 interpreting its rules is incorrect, and should be overturned.

4 CAS 96/149, published in the Digest of CAS Awards I 1986-1998, p. 251 at 261-262.

The Panel reaches this conclusion with all due respect to the IAAF Council and its role under the IAAF Constitution as the primary decision-maker regarding the interpretation of its Rules.

25. On the basis of IAAF rules applicable at the time of the 2000 Sydney Olympic Games, the results obtained by the Athletes in the men's 4 x 400m relay event at the Sydney Games shall not be amended. Those results therefore stand. Furthermore, it is the understanding of the Panel that only Jerome Young in the US relay team should be stripped of his gold medal pursuant to the CAS award 2004/A/628 of 28 June 2004.

26. Having so found, the Panel considers it unnecessary for it to consider the other issues raised by the parties in these proceedings. In particular, the Panel considers that there is no need for it to determine, and it refrains from determining:

    - Whether the IAAF has the jurisdiction, power or authority to annul the results of the relay event (the Panel having determined that, even assuming (without deciding) that the IAAF has such jurisdiction, its decision in this case was incorrect);
    - Whether the IAAF decision should be overturned on grounds unrelated to the merits of that decision (for example, whether modification of the results of the relay event is time-barred, or whether the IAAF decision is vitiated by a lack of due process);
    - Whether or not USOC, as distinct from the Athletes, has standing to appeal the IAAF decision.

27. The Panel also refrains from determining, because it need not in the circumstances determine, the IOC's Request for a Stay of the proceedings as against it.

The Court of Arbitration for Sport rules:

1. The appeal filed by Michael Johnson, Antonio Pettigrew, Angelo Taylor, Alvin Harrison and Calvin Harrison on 27 September 2004 is upheld.

2. The IAAF Council decision of 18 July 2004 is hereby overturned.

3. On the basis of IAAF Rules in force and applicable at the time of the 2000 Sydney Olympic Games, the results of the men's 4 x 400m relay event at those Games shall not be amended; those results stand.

(…)

Journal of International Economic Law 11(4), 705–715
doi:10.1093/jiel/jgn031. Advance Access publication 14 October 2008

CLA-000072

INTRODUCTION TO THE MINI-SYMPOSIUM ON TRANSPARENCY IN THE WTO

*Debra P. Steger**

I. ORIGINS OF THIS MINI-SYMPOSIUM

This mini-symposium on transparency emanates from an international, collaborative project on institutional reform of the World Trade Organization (WTO), organized by the Emerging Dynamic Global Economies (EDGE) Network, and funded by the International Development Research Centre (IDRC). This project, which commenced in 2007, includes major research institutions and leading researchers in Africa, Asia, Europe, North America, and South America. Inspired by the Report of the Consultative Board to Director-General Supachai Panitchpakdi (the 'Sutherland Report'),[1] it has three major research themes: decision making and internal management of the WTO; relationship between the WTO and regional trade agreements (RTAs); and transparency. The articles in this collection grew out of a workshop held on Institutional Reform of the WTO at the Centre for International Governance Innovation (CIGI) in Canada in March 2008.

The Sutherland Report was published in 2004, but has met with little response from the Members of the WTO. The Report was both comprehensive and pragmatic; it addressed serious questions relating to the governance and legitimacy of the WTO as an international organization within the rapidly transforming global economy. The Doha Round has stalled, with little prospect of real progress being made on the negotiating front in the foreseeable future. This is an appropriate moment to reflect on the WTO as an institution and to do some serious thinking about reform of the institutional structures of the WTO. The Sutherland Report provided an excellent start—it asked the right questions about very serious and important issues and made pragmatic, practical recommendations. If anything, it did not go far enough.

* Professor, Faculty of Law, University of Ottawa and leader, EDGE Network Global Economic Governance Project; former Director, WTO Appellate Body Secretariat. E-mail: dsteger@uottawa.ca. I would like to thank David Quayat for his able assistance in editing the papers in this mini-symposium, and, of course, the authors themselves who have been very cooperative in producing their papers under short timeframes over the course of the summer.

[1] 'The Future of the WTO: Addressing Institutional Challenges in the New Millennium' (WTO, 2004).

 © Oxford University Press 2008, all rights reserved

II. WHY INSTITUTIONAL REFORM OF THE WTO IS NECESSARY

There are a number of reasons why institutional reform of the WTO is important at this time in the history of the multilateral trading system. Many insiders and observers, including WTO Director-General Pascal Lamy, believe that the first priority is to conclude the Doha Development Round (DDR), and then Members can turn their minds to reform of WTO institutions. Lamy has long been a strong proponent of institutional reform of the WTO, however, as Director-General the past few years, his primary concern has been shepherding the DDR to a successful conclusion.

We are at a transformational moment in the history of the world. The rapid rise of the emerging economies—China, India, and Brazil—has shifted the global power balance, and the influence of the United States as a hegemonic power is declining. Current international organizations, such as the United Nations, the International Monetary Fund (IMF), and the International Bank for Reconstruction and Development (World Bank) were designed for a very different time, created primarily by developed countries to serve their interests at the end of the Second World War. However, the world economy is rapidly changing and the interests of the large developing countries, in particular, must be taken into account in the international organizations if they are to remain relevant and effective. This is a particularly difficult time for international negotiations—witness the problems with the DDR—because the new clubs and alliances have not yet been formed. China and India, in particular, are recognized by the United States and the European Union as major economic powers, but they are criticized for not yet using their influence and fulfilling their responsibilities on the world stage. In the DDR, for example, China and India are playing a watching, waiting, and learning game, rather than showing leadership in pressing for a conclusion. The real threat to the international community would come if these major developing country powers were to develop their own alliances and institutions, and not participate in the established international economic institutions.

International organizations, including the United Nations, the IMF, and the World Bank, have recognized that their governance structures are outdated, and are engaged in major reform processes in order to respond to the criticisms about legitimacy, accountability, and decision making. However, these concerns are not even on the radar screen of Members of the WTO. Why is this so?

In part, it may be because there was a major institutional negotiation in the Uruguay Round that led to the establishment of the WTO as an international organization with its own charter[2] and quasi-judicial,

[2] Agreement Establishing the World Trade Organization (the WTO Agreement), *The Results of the Uruguay Round of Multilateral Trade Negotiations: The Legal Texts* (Geneva 1994).

dispute-settlement system.[3] In the transformation from the GATT to the WTO, important new institutions were established, including the WTO itself and the Appellate Body.[4] While the dispute-settlement system has functioned effectively and efficiently since 1995, the decision-making processes in the WTO are in need of improvement. When it comes to negotiations and rule making, the WTO, in many respects, functions much like the old GATT. The new rules for decision making and amendments, set out in Articles IX and X of the WTO Agreement, are rarely used, and instead, Members resort to the familiar GATT practice of decision making by consensus. The new rule-making procedures in the WTO Agreement have been characterized by commentators as 'cumbersome' and even 'impossible' to use.[5]

The efficiency of the dispute-settlement system contrasted with the inefficacy of the decision-making and rule-making system has created an imbalance in the institutional structures of the WTO. The Uruguay Round reforms, including the establishment of the Appellate Body, propelled the dispute-settlement system into a judicial model, with compulsory jurisdiction, binding decisions, and arbitral procedures for compliance, setting an example for other international legal systems. The result is a strong, effective dispute-settlement mechanism coupled with weak, ineffective, political decision-making procedures. Unlike domestic legal systems, it is almost impossible for decisions of the Appellate Body to be corrected by the legislative bodies—the Ministerial Conference or the General Council. This situation cannot persist indefinitely without damage to the WTO as an institution, especially as pressures increase on the dispute-settlement bodies as a result of the inability of Members to negotiate and clarify the rules in the DDR.

Because the rule-making procedures of the WTO are so cumbersome and difficult, countries are turning increasingly toward negotiating RTAs. While RTAs have not been shown to provide the same economic benefits as multilateral agreements, there is growing business pressure, especially in the rapidly growing economies of the world, to negotiate new regional arrangements. New alliances are being forged among developing countries, particularly in Asia and Africa, which have not had a history of RTAs in the past. The United States and the European Union have also embarked on

[3] Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU), *The Results of the Uruguay Round of Multilateral Trade Negotiations: The Legal Texts* (Geneva 1994).

[4] For the history of that negotiation, see Debra P. Steger, 'The World Trade Organization: A New Constitution for the World Trading System', in Marco Bronckers and Reinhard Quick (eds), *New Directions in International Economic Law: Essays in Honour of John H. Jackson* (The Hague: Kluwer International 2000) 135–54.

[5] See Marco C. E. J. Bronckers, 'Better Rules for a New Millennium: A Warning Against Undemocratic Developments in the WTO', 2 Journal of International Economic Law 547 (1999), at 551–52.

aggressive strategies to negotiate bilateral arrangements with many countries and RTAs around the globe. The explosion of RTAs is causing growing fragmentation of the multilateral trading system and serious erosion of the Most Favoured Nation principle.

With the exception of the European Union, the dispute-settlement mechanisms of the RTAs are relatively weak, particularly when compared with the WTO. Thus, while the RTAs are easier to negotiate and conclude that the WTO is to amend, there is an imbalance between the rule-making and dispute-settlement mechanisms of RTAs. And, it is the opposite imbalance from that of the WTO. Although the relationship between the WTO and the RTAs is not clear, we can expect to see more interaction between them in the future. In particular, the strong WTO dispute-settlement system will likely be pressed to hear more cases involving possible conflicts or differences between the rules of the WTO and the RTAs.

Looking into the future, a vibrant, relevant WTO would have a mandate to deal with international economic regulation generally, not just trade. The DDR is focused on market access: in agriculture, in goods, and in services. Many new issues: competition, investment, technology, environment—are not on the agenda in the current Round. As a result, these issues are being negotiated in RTAs and other bilateral agreements. The issues of interest to multinational business, such as rule of law/good governance behind the border, corruption, corporate social responsibility, exchange rates, and immigration, are not even a glimmer in the eye of multilateral trade negotiators. Why not? Partly because the WTO decision-making and rule-making procedures are so cumbersome, if not impossible, to use that governments and private parties have moved to other forums.

The WTO is not *sui generis*, it is one among international organizations. This is a transformative moment in history for international organizations generally, and the WTO faces similar legitimacy and accountability challenges as the others. The WTO lacks many of the management structures and rule-making processes that are taken for granted in other international organizations. For example, it does not have an executive body or a management board, a Director General or a Secretariat with real powers to set legislative priorities and propose new rules, a functioning legislative body, formal mechanisms to interact with stakeholders and civil society, or formal structures to approve new rules (other than the consensus of WTO Members acting collectively, as the CONTRACTING PARTIES did under the GATT 1947). In many ways, it is the 'least-developed' of the international organizations. Coherence in the international trading system, among other things, demands that the WTO develop more formalized governance structures to put it on a par with other international organizations, make it more functional and efficient, and render it more accountable to all of its Members (including developing countries), stakeholders, and the public at large.

III. TRANSPARENCY

Like a diamond, transparency has many facets. The object, however, is the same—to let light shine in on rule-making and decision-making processes both within the WTO and within Member governments.

The WTO as an institution has important transparency challenges. The first is to make its internal negotiation, decision-making, and rule-making processes more open, transparent, and inclusive in order to give a real voice to the developing and least developed country Members, which now constitute an overwhelming majority of the Organization. This is the challenge of 'internal' transparency. The second is to respond to external critics—mainly non-governmental organizations (NGOs) and non-state actors—which maintain that the WTO is a closed, non-democratic, unaccountable, supranational entity. This is the issue of 'external' transparency.

There are two other aspects to transparency as it relates to the WTO. The first is 'access to information'—the WTO has made great strides in derestricting documents and making information available online on its website. In fact, there is now so much information available on the WTO website that it is often difficult to find pertinent information, much less keep up to date with the most recent developments. There remain some important documents that are not made public, such as the full pleadings of parties in Appellate Body and some panel proceedings as well as some documents relating to negotiations, however, these deficiencies could be resolved easily if WTO Members had the will to do so.

Today, NGOs and non-state actors are more concerned with 'participation' in WTO dispute settlement, negotiations, and meetings, than with access to information. In the dispute-settlement system, the Appellate Body has confirmed that it and the panels can accept *amicus curiae* submissions from non-state actors, if they decide that it would be useful in the cases at hand. While a majority of WTO Members strongly oppose this practice, the filing of *amicus curiae* briefs has become a commonplace occurrence in WTO dispute-settlement proceedings. In addition, parties in a few recent cases have taken the major step of opening up the hearings of panels and the Appellate Body to the public. As Peter Van den Bossche demonstrates in his contribution to this symposium, the WTO lags far behind most other UN organizations in granting non-state actors observer or participant status and in providing formal mechanisms for input, interaction, and debate in meetings and negotiations.[6]

With respect to the domestic administrations of WTO Members, transparency has a different meaning. Sylvia Ostry has observed: 'However imprecise the GATT/WTO definition of transparency, the core of the definition goes to

[6] Peter Van den Bossche, 'NGO Involvement in the WTO: A Comparative Perspective', 11 Journal of International Economic Law (2008), doi:10.1093/jiel/jgn032.

the heart of a country's legal infrastructure, and more precisely to the nature and enforcement of its administrative law regime.'[7] Padideh Ala'i and Ljiljana Biukovic, in this symposium, emphasize that the principle of transparency is essential to the rule of law and 'good governance' in domestic administrations. Although Article X of the GATT has existed since 1947, the principle of transparency has only recently begun to be taken seriously in WTO dispute settlement. During the GATT 1947 years, it was viewed by panels as a subsidiary obligation that was not as important as the substantive obligations. With the accession of non-democratic, non-market economies, such as China and Vietnam, other WTO Members insisted upon stringent transparency obligations (including notification and comment requirements for new legislative proposals) in order to promote the rule of law and good governance in the domestic administrations of those countries. Without transparent legal systems, it was felt that it would be difficult to implement and enforce WTO obligations. Thus, transparency has taken on a whole new meaning and significance in the WTO in recent years.

IV. OVERVIEW OF THE CONTRIBUTIONS

The contributions in this mini-symposium address the different facets of transparency. The first is the external relations dimension, which represents how the WTO as an international organization relates to the outside world, including its relationships and interaction with NGOs, other international organizations (IGOs), private and public interest groups, parliaments, and civil society. The second is internal or domestic transparency, which relates to the administrative procedures and judicial processes within national governments.

There has been much scholarly discourse on the external relations dimension of transparency, with attention focused mainly on NGOs and civil society.[8] Much less has been written about domestic transparency within national governments and yet, this is a vitally important in ensuring good governance and compliance with WTO obligations by Members. The interaction between domestic interest groups and trade policy making within

[7] Sylvia Ostry, 'China and the WTO: The Transparency Issue', 3 UCLA Journal of International Law and Foreign Affairs 1(1998), at 2.

[8] Some examples are: Steve Charnovitz, 'Participation of Non-Governmental Organizations in the World Trade Organization', 1 University of Pennsylvania Journal of International Economic Law. (1996) 331–57; Phillip M. Nichols, 'Participation of Non-Governmental Parties of the World Trade Organization: Extension of Standing in World Trade Organization Disputes to Non-government Parties', 1 University of Pennsylvania Journal of International Economic Law (1996), 295–329; G. R. Shell, 'Trade Stakeholders Model and Participation by Non-State Parties in the World Trade Organization, 1 University of Pennsylvania Journal of International Economic Law (1996), 359–81; Chios Carmody, 'Beyond the Proposals: Public Participation in International Economic Law', 15 American University International Law Review (2000), 1321.

countries and the resulting impact on WTO negotiations and dispute settlement is only beginning to be explored by academics.[9]

Following on his recent book comparing participation of NGOs in various international organizations,[10] Peter Van den Bossche describes the experience to date with NGO involvement in the WTO. He begins by examining the arguments for and against NGO participation in WTO decision making and dispute settlement, and outlines the legal and administrative arrangements currently in place in the WTO for engagement with NGOs and civil society. He compares the legal arrangements and practical experience of certain United Nations organizations as well as the IMF and the World Bank with the rules and experience of the WTO.

He concludes that the WTO would benefit from more open, formal mechanisms for dialogue with civil society, making it a more responsive and transparent organization and allowing its policies and practices to be better understood and supported. While great strides have been made, largely due to efforts of the WTO Secretariat, involvement of NGOs in rule making, implementation, compliance monitoring, and dispute settlement remains modest, especially when compared with other international organizations, which have more well-established mechanisms for engagement with civil society. The Sutherland Report, he laments, showed a surprising lack of ambition with respect to relationship between the WTO and NGOs. He argues that the WTO can, and should, engage more effectively with NGOs, for example, by granting observer or consultative status to selected NGOs, as is the practice with United Nations organizations. By looking at the experience of other international organizations, it is clear that the WTO has not yet reached its limits in involving NGOs in its activities.

Yves Bonzon explores the possibility of developing more formal, institutionalized mechanisms of public participation in the WTO.[11] He commences with a conceptual framework that establishes four implementation parameters for public participation: the goal, the object, the mechanisms, and the actors. He questions the relevance of the NGO argument that more formalized public participation in the WTO would remedy its perceived democratic legitimacy deficit. The article describes the current arrangements in the WTO for public participation and the political debates from which they emerged. A short comparative analysis of public participation provisions in other international regimes, focusing on RTA regimes such as the European Union, ASEAN, and MERCOSUR, is provided.

[9] Gregory Shaffer is a leading scholar in this area. See Gregory C. Shaffer, *Defending Interests: Public-Private Partnerships in WTO Litigation* (Washington: Brookings 2003).

[10] Sergey Ripinsky and Peter Van den Bossche, *NGO Involvement in International Organisations: A Legal Analysis*, (London: British Institute of International and Comparative Law 2007).

[11] Yves Bonzon, 'Institutionalizing Public Participation in WTO Decision-Making: Some Conceptual Hurdles and Avenues', 11 Journal of International Economic Law (2008), doi:10.1093/jiel/jgn029.

He emphasizes some of the challenges for the WTO in defining the second parameter: the object of participation. In his analysis, Bonzon draws on the emerging literature from the school of global administrative law, in particular, its conceptualization of 'institutional differentiation'. Analysing the WTO's institutional structure, he concludes that the decisions that would benefit most from public participation are almost exclusively those reached by the dispute-settlement bodies, the panels, and the Appellate Body. He also suggests that panels and the Appellate Body could perform judicial review of other international organizations (e.g. International Standards Organization), whose standards the WTO Agreement requires them to apply, as one way to achieve public participation in its processes. Ultimately, he believes that any steps toward greater public participation in the WTO would need to be preceded by comprehensive reforms in the institutional structure of the WTO. In this respect, the dispute-settlement system could lead the way.

In her article, Padideh Ala'i equates domestic transparency with good governance within the domestic administrations of states.[12] The rise of the regulatory state, she argues, in the last half of the twentieth century resulted in the transparency obligations in, first, Article X of the GATT, and later, in several of the WTO agreements as well as the recent Protocols of Accession of China, Vietnam, and Ukraine. She traces the history of the jurisprudence relating to Article X of the GATT, which until very recently was viewed as subsidiary to the substantive obligations of the GATT and the other covered agreements. Originally proposed by the United States in 1947, reflecting the provisions of the United States' Administrative Procedures Act, its provisions were viewed by developed country contracting parties to the GATT as merely containing administrative procedures. As a result, panels for many years under the GATT and the WTO ignored claims brought under that provision in favour of more substantive provisions of the GATT and the other goods agreements. This has remained true especially in cases involving claims under the Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade (the Antidumping Agreement), the Subsidies and Countervailing Duties Agreement (SCM Agreement), and the Agreement on Safeguards (the Safeguards Agreement).

Since the establishment of the WTO, she notes, there has been a renewed interest in Article X, with the Appellate Body considering it a separate, substantive, important obligation. With the advent of the Appellate Body, she observes, Article X has emerged from obscurity and has recently been interpreted as containing obligations of fundamental importance, such as transparency and due process. In the cases interpreting Article X,

[12] Padideh Ala'i, 'From the Periphery to the Center? The Evolving WTO Jurisprudence on Transparency and Good Governance', 11 Journal of International Economic Law (2008), doi:10.1093/jiel/jgn027.

she argues, for the first time, panels and the Appellate Body emphasize the importance of transparency and due process from the perspective of traders, taking into account their expectations, rather than on the expectations of WTO Members. She cautions, however, that the relationship between Article X of the GATT 1994 and provisions of other WTO agreements is unclear. Panels and the Appellate Body have been reluctant to find a violation of Article X of the GATT 1994 where there is a more specific transparency or procedural provision in another agreement under consideration.

The WTO, she asserts, is fundamentally a system based on rules that reflect the realities of the administrative state. As a result, the good governance provisions of the WTO, with their genesis in Article X of the GATT 1994, are becoming increasingly important in WTO disputes. A study of the history of the jurisprudence of Article X, she offers, contributes significantly to our understanding of the emerging role of the WTO as a supra-national regulatory body and final arbiter of appropriate administrative and regulatory structures. She concludes that it is important that the WTO expressly acknowledge its role in promoting good governance in domestic administrations, and she recommends that the WTO promote these values through the work of the Trade Policy Review Mechanism and other Councils and Committees, as well as through the dispute-settlement system.

Ljiljana Biukovic focuses on compliance with the transparency obligations of the WTO Agreement on Sanitary and Phytosanitary Measures (SPS Agreement) by non-Western countries, in particular, China and Japan.[13] Transparency, she asserts, is often recognized as a core principle underlying the rule of law and good governance in states. Businesses embrace the principle, hoping it will lead to open markets and fairness in business dealings with governments. WTO Members adopt transparency obligations in furtherance of the objective of increasing competitiveness in the global economy. There are two facets to the concept of transparency, as promoted by the international organizations: regulatory transparency, which relates to the capacity of regulated entities to identify and understand their obligations under the rule of law; and, information transparency, which includes consultation with interested parties, dissemination of regulatory instruments, use of plain language in drafting laws and regulations, exercise of controls on regulatory discretion through administrative procedures, and establishment of judicial review procedures.

The concepts inherent in Article X of the GATT 1994, she argues, are Western concepts that are at the core of liberal democracies and open market economies. However, traditional Asian societies have different values evolving from their historical, cultural, and political traditions. Developing countries, such as China, have limited capabilities to comply with their extensive

[13] Ljiljana Biukovic, 'Selective Adaptation of WTO Transparency Norms and Local Practices in China and Japan', 11 Journal of International Economic Law (2008), doi:10.1093/jiel/jgn028.

transparency obligations, owing to their lack of institutional capacities and the complexities of their constitutional, administrative, and legal systems. Indeed, China's historical and cultural traditions may even conflict with WTO transparency norms, making implementation very difficult. Nevertheless, Asian countries, including China, have undertaken major administrative reforms in order to comply with their WTO obligations, with varied success.

The selective adaptation discourse, she maintains, helps to explain the process of implementation of WTO norms in China and Japan. This paradigm can demonstrate how non-compliance, or less than complete compliance, can be attributed to cultural or historical traditions and values or, alternatively, to lack of political will or institutional incapacities. She recommends that WTO dispute-settlement bodies should look more favourably on non-compliance resulting from cultural differences and allow for more flexible implementation by allowing states discretion in the selective localization of international norms. Shifts in perception and normative consensus relating to regulatory norms can and do occur. In China and Japan, in particular, significant legal and regulatory reforms have been made as a result of WTO transparency obligations. Better understanding of local cultures and traditions is also needed, she emphasizes, in order to reach normative consensus and accommodate more flexible approaches to compliance.

V. CONCLUSION

This mini-symposium on transparency in the WTO is the first scholarly contribution of the EDGE Network Project on Global Economic Governance on the subject of institutional reform of the WTO. By shining more light on transparency, both from the perspective of the negotiation, decision-making and rule-making processes of the WTO and the internal consultation and rule-making processes of its Members, it is hoped that specific ideas for policy reforms can be developed. While the WTO has taken key steps to enhance transparency, especially in improving access to information, it still has a long way to go when compared with other international organizations. The WTO is not so unique from other international organizations that it can keep its operations in the dark indefinitely. Allowing stakeholders, interest groups, and NGOs to have observer status in WTO negotiations and meetings would be an important first step in making the WTO more open, accountable, and comprehensible to the outside world.

Transparency of domestic legal and administrative systems is critically important, especially with respect to recently acceded Members (RAMs) and developing countries, which do not have rule of law or good governance regimes in place. There is a debate about whether developing countries should have to adopt and implement the same concepts of transparency, fairness, and due process, which have been in place in Western developed

countries for decades. Should there be a 'one size fits all' approach to transparency, or is there room for discretion or selective adaptation in implementing WTO transparency obligations into domestic norms? In any case, there needs to be a greater emphasis on capacity building in developing countries to help them develop open, effective consultation and trade policy mechanisms with their own stakeholders and interest groups. By doing so, developing country Members of the WTO will be better able to identify their trade policy interests and participate more effectively in negotiations. This will ultimately give voice to developing countries, lead to more informed and effective negotiations, and benefit the multilateral trading system as a whole.

Tribunal Arbitral du Sport

Court of Arbitration for Sport

Arbitration CAS 2002/O/410 The Gibraltar Football Association (GFA)/Union des Associations Européennes de Football (UEFA), award of 7 October 2003

Panel : Mr. Bruno Simma (Germany), President; Professor Pierre Lalive (Switzerland); Mr. Dirk-Reiner Martens (Germany)

Football
Application for UEFA membership
Rules on membership applicable at the time when the application was made
Legality of a change of rule with a retrospective effect
Principles of fairness and good faith
Freedom of association

1. **According to the new version of Article 5 of the UEFA Statutes, UEFA membership is restricted to associations in countries which are recognised as independent States by the United Nations. This new rule should not be regarded as a rule dealing only with procedural aspects justifying immediate application regardless of when the facts at issue occurred. The immediate application in this matter would entail a violation of general principles of law which are widely recognised, particularly the principles of fairness and of good faith.**

2. **According to the old version of Article 5 of the UEFA Statutes "Membership of UEFA is open to national football associations situated in the continent of Europe which are responsible for the organisation and implementation of football-related matters in their particular territory". GFA indisputably exercises sole responsibility for the organisation and structure of football in its territory. The concept of "nation" or "country" in the sports environment must not necessarily be "understood within its common political meaning. More importantly, UEFA already has – and had at the time when the application was made – a number of member associations from countries which do not enjoy independent statehood, such as Scotland, Wales or the Faroe Islands.**

3. **Generally, freedom of association includes the freedom of an association to accept or to refuse any applicant for membership, even if the applicant fulfils all statutory conditions. However, the exclusion of athletes, or of a sports association to which athletes are affiliated, from an international sports organisation which occupies a dominant or monopolistic position in the organisation of sports competitions may have the effect of a boycott. Such an exclusion should therefore be held invalid, at least to the extent that it is not grounded on objective and justified reasons.**

The Claimant, the Gibraltar Football Association ("GFA"), is an unincorporated body that is responsible for the organisation of all football in the territory of Gibraltar. The GFA was established in 1895, and today it has between 2000 and 2500 members.

The GFA has a Men's senior league composed of three divisions, a Junior league, and Ladies and "Futsal" competitions. All football currently organised by the GFA is non-professional.

Despite proposals made in the past that the Claimant may become affiliated to the Spanish Football Association, the GFA has always been independent from any other football association, whether within Gibraltar or elsewhere.

The territory of Gibraltar is a dependent territory of the United Kingdom. It forms part of Her Majesty the Queen's Dominions, but it is not part of the United Kingdom, and it is not an independent State either although it enjoys a certain level of autonomy.

The Respondent, the Union des Associations Européennes De Football ("UEFA"), is an association incorporated under the laws of Switzerland with its headquarters in Nyon, Switzerland. UEFA is the governing body of European football, dealing with all questions relating to European football and exercising regulatory, supervisory and disciplinary functions over national associations, clubs, officials and players of the European continent.

The Respondent is one of the continental football confederations. All national associations located in Europe and which wish to be affiliated to the Fédération Internationale de Football Association ("FIFA") must previously become a member of UEFA.

In January 1997, the GFA applied to FIFA for membership.

On 27 November 1997, the English Football Association ("FA") confirmed to FIFA its thorough support of the GFA's application for membership.

On 3 March 1999, FIFA wrote to the GFA confirming that the "*preliminary procedure*" was completed, and that "consequently, FIFA may submit the file to the confederation concerned for the second phase of the procedure (evaluation of the organisation for a period of at least two years)".

In that same letter, FIFA further stated that "according to article 4.7 of the FIFA Statutes the confederation concerned shall decide whether to grant provisional membership or associate membership to the applicant association".

In parallel to this letter, FIFA forwarded to UEFA the GFA's file for membership, as confirmed by UEFA to the Claimant on 23 March 1999. The GFA was consequently invited to make an oral presentation of its application to UEFA representatives in April 1999 in Nyon, Switzerland.

On 20 April 1999, following the presentation made by the GFA's representatives in Nyon, UEFA informed the Claimant that they would examine the file with FIFA, possibly proceed with a visit on site in Gibraltar, and then make a recommendation to the UEFA Executive Committee, outlining that "no final decision will be taken until the year 2000".

On 7 January 2000, UEFA informed the GFA that FIFA was in the process of reviewing its affiliation procedure rules, that a meeting was scheduled to take place within FIFA's organisation in March 2000 and, therefore, that UEFA would not be able to give the GFA more information on the process of its own affiliation request until that time.

By letter dated 19 January 2000, the GFA responded to UEFA that it failed to understand why a "present ongoing review of affiliation procedure rules" within FIFA should affect the application by the GFA which had been made before such review was commenced. The Claimant further expressed its concern because the UEFA inspection of the GFA's facilities should have occurred already by the end of the year 1999, and it insisted that it be given "the necessary assurances that our application is being processed as per the present applicable procedures".

By e-mail dated 25 March 2000, UEFA informed the GFA that "FIFA and UEFA administrations have discussed the application procedure for your association. After having received also the green light by the FIFA Committee for national associations we inform you that a joint FIFA/UEFA delegation will visit your association".

On 25 April 2000, UEFA provided the GFA with details of the visit to the GFA's facilities and infrastructures by representatives of FIFA and of UEFA. Such visit was scheduled to take place between 8 and 10 May 2000.

A joint delegation from the FIFA and UEFA administrations eventually conducted the inspection visit in Gibraltar between 8 and 10 May 2000.

On 11 July 2000, the UEFA delegation issued a report of the visit conducted in Gibraltar two months earlier. In this report, the UEFA delegation proposed *inter alia* that "the FA of Gibraltar be admitted to UEFA on a provisional basis" under three cumulative conditions, namely that (i) Gibraltar teams could not enter club competitions or senior and Under-21 national-team competitions immediately, but only UEFA's youth, women's and amateur competitions; (ii) the football infrastructure in Gibraltar must correspond to the UEFA requirements at the time of entering the relevant competitions; and (iii) the GFA's statutes had to be adapted to UEFA's requirements.

The UEFA administration justified this position, which in principle favoured the affiliation of the GFA, by stating that "the FA of Gibraltar fulfils all requisite statutory conditions for admission to UEFA (Article 2 of the Regulations governing the implementation of the UEFA Statutes)".

The report on the FIFA/UEFA joint visit to Gibraltar and the proposals contained therein were supposed to be submitted to the UEFA Executive Committee at its next meeting which was scheduled to be held on 25-26 August 2000.

On 3 August 2000, the FIFA Executive Committee apparently decided to freeze all applications from associations to FIFA, pending the approval of new FIFA Statutes in the year 2004. FIFA informed UEFA of this decision in September 2001.

On 26 August 2000, the UEFA Executive Committee decided to postpone its decision concerning the GFA's provisional membership until its next meeting which was scheduled to take place in October 2000, and to call a meeting between UEFA, the English FA and the Spanish FA on 22 September 2000 in order to discuss this matter.

The meeting between UEFA, the English FA and the Spanish FA did not take place until 30 November 2000. During its meeting on 4-5 October 2000, the UEFA Executive Committee had decided to postpone its decision on the matter again as it was waiting for the results of the aforementioned meeting with the English FA and the Spanish FA.

On 14-15 December 2000, the UEFA Executive Committee met again. In respect of the GFA's application for membership, it considered that independent legal advice was necessary for it to be able to evaluate the application. Therefore, the UEFA Executive Committee decided to set up a legal panel with three members from UEFA's External Legal Experts Panel which was entrusted with the preparation of a substantiated report to the UEFA Executive Committee based on the FIFA and UEFA Statutes (the "Expert Panel").

The Claimant was informed of these decisions by UEFA on 15 December 2000. At that time, UEFA also provided the GFA with a copy of a written report that had been filed by the Spanish FA (in which the latter opposed the GFA's application), asking the GFA to comment thereon in writing by the end of January 2001. The same request was made by UEFA to the English FA.

By the end of the year 2000, the Expert Panel set up by UEFA had received all of the written submissions by the Spanish FA, the English FA and the GFA. The Claimant also filed a supplementary report in March 2001.

The aforementioned three parties made oral submissions before the Expert Panel on 19 April 2001. According to the order of procedure decided by its members, the Expert Panel was then to submit a written legal report to the UEFA Executive Committee, for it to take a final decision on the GFA's application.

As from June 2001, the Claimant repeatedly asked the UEFA what the conclusions of the Expert Panel were. The UEFA Executive Committee was to meet in July 2001 and the GFA assumed that the report of the Expert Panel would be available before such meeting, where the GFA's application for membership would be on the agenda.

The UEFA Executive Committee met on 11-12 July 2001. It did not take any decision on the GFA's application. However, what the UEFA Executive Committee did decide was to put an amendment of the UEFA Statutes before the UEFA Congress to be held in October 2001.

According to this proposed amendment, UEFA membership would be restricted to associations in countries which are recognised as independent States by the United Nations.

On 30 July 2001 and 20 August 2001, the GFA again asked the UEFA what the conclusions of the Expert Panel were.

On 27 August 2001, the Expert Panel appointed by the UEFA rendered its written legal opinion to the UEFA Executive Committee.

The members of the Expert Panel unanimously considered that according to Art. 5 paragraph 1 of the UEFA Statutes (NB: the version that came into force on 24 December 1997 and was amended on 30 June and 1 July 2000) and to Art. 1 and 2, sentence 1 of the Regulations governing the implementation of the UEFA Statutes, "the GFA was entitled to provisional admission as a member of UEFA".

In the same Expert Report of 27 August 2001, the members of the Expert Panel suggested to the UEFA Executive Committee "to amend the UEFA Statutes (...) to avoid similar problems in the future*"*. The Expert Panel thus proposed *"an amendment to the effect that only UN-recognised States may apply for admission to and membership of UEFA"*.

On 30 August 2001, the UEFA confirmed to the GFA that the Expert Panel had rendered its decision. However, as per the order of procedure decided from the outset, the UEFA refused to communicate a copy of the Expert Report to the GFA. The UEFA indicated to the Claimant that the report would be discussed by the members of the UEFA Executive Committee on 6-8 September 2001 and that a decision on the GFA's application would then be taken.

In addition, the UEFA also communicated to the GFA on 30 August 2001 that "as regards the extraordinary Congress in October in Prague, we confirm that there is a request for a change of the UEFA Statutes, and especially the provision of UEFA membership. However we cannot provide you with a copy of these amendments until you are part of the UEFA family*"*.

On 5 September 2001, FIFA's Secretary General wrote to UEFA stating that in FIFA's view it would be premature to proceed with the affiliation of the GFA in the forthcoming months, and that FIFA was planning to change its rules on membership.

On 7 September 2001, UEFA wrote to the GFA and informed it that, at its most recent meeting on the same day, "the Executive Committee did not enter into the request of the Football Association of Gibraltar to be provisionally affiliated to UEFA. The UEFA Executive Committee has already discussed and decided at its July 2001 meeting to change the membership conditions in the UEFA Statutes. These proposals will be dealt with by the UEFA member associations at the next extraordinary Congress in Prague in October 2001. (...) The decision concerning the affiliation request of the Football Association of Gibraltar is therefore postponed until further notice.*"*

During the same meeting of the UEFA Executive Committee, a request for admission to UEFA filed by the Football Association of Kazakhstan was considered, and the Executive Committee agreed that such request should proceed.

The Football Association of Kazakhstan, which requested admission to UEFA after leaving the Asian confederation in 2001, was eventually admitted as a UEFA member by the UEFA Congress upon the recommendation of the UEFA Executive Committee in April 2002. Kazakhstan is an independent State and accepted as a member by the United Nations.

As from September 2001, the GFA repeatedly requested UEFA to render a decision on its request for provisional membership without delay, and to do so on the basis of the UEFA rules that existed at the time when the application was made.

On 5 October 2001, a meeting took place between senior officers of UEFA and of the GFA during which no solution could be found.

On 11 October 2001, the UEFA Congress approved the change of the UEFA Statutes, whereby UEFA membership would from then on be open only to associations in a country "recognised by the United Nations as an independent State ".

On 13 November 2001, UEFA wrote to the Claimant rejecting the latter's repeated demands for immediate consideration of its affiliation request and stating that "the Executive Committee has so far not taken a *negative* decision on your application request but has only postponed its decision upon FIFA's request".

The GFA replied to UEFA on 20 November 2001 that it considered that UEFA had acted illegally in this matter.

It must be noted that in November 2001, a number of national Football bodies of UK Dependencies which are not independent States and not members of the United Nations were already FIFA members, such as the FA of Anguilla or the FA of the Turks and Caicos Islands. Similarly, the FA of the Faroe Islands, which is not an independent State but a dependency of Denmark, is a FIFA member since 1988 and was admitted as a UEFA member in the mid-nineties.

On 26 April 2002, the GFA, acting through one of its counsel, wrote to UEFA stating that "the GFA (...) understands UEFA's position to be that the GFA is not eligible for membership of UEFA under (new) Article 5.1 and that therefore the GFA's application cannot succeed". The GFA further stated that "(a) UEFA's failure to assess the GFA's application to become a member of UEFA by reference to the rules applicable when the application was made in 1999, under which the application would have been successful, and (b) UEFA's decision instead to change the rules with purportedly retrospective effect in such a way as to make the GFA's application incapable of success, are illegal."

In that same letter, the GFA requested UEFA to accept CAS arbitration in this matter. The same request was submitted again by the Claimant to UEFA on 6 June 2002.

On 12 July 2002, UEFA confirmed to the GFA that its Executive Committee had accepted CAS jurisdiction in respect of the GFA's claims against UEFA in this matter.

On 16 August 2002, the GFA filed a Request for Arbitration accompanied by 38 Exhibits with the CAS, asking principally (i) that the UEFA Executive Committee be ordered to consider the GFA's application for membership by reference to the rules applicable when the application was made in 1999, (ii) to declare that under those rules the GFA is entitled to provisional membership of UEFA with immediate effect, and (iii) to order payment by the Respondent UEFA of all costs of the arbitration as well as legal costs suffered by the Claimant.

The Respondent filed its Answer, accompanied by 8 Exhibits, on 27 September 2002, requesting the CAS to "dismiss all Principal Orders of the Request for Arbitration", with all costs and compensations to be charged to the Claimant.

The hearing was held on 27 May 2003 in Lausanne.

The Claimant presented in its Request for Arbitration and specified in its Statement of Claim the following principal requests for relief:

- That UEFA be ordered to decide the GFA's application for membership by reference to the rules applicable when the application was made or was or ought to have been considered prior to 11 October 2001.
- That it be declared that under those rules the GFA is entitled to provisional membership of UEFA with immediate effect;
- That the Respondent UEFA be ordered to pay of all the costs of the arbitration as well as the legal costs incurred by the Claimant.

The Claimant principally submits that:

a) Under the rules on membership contained in the UEFA Statutes before the modification approved by the UEFA Congress on 11 October 2001, the GFA's application for provisional membership fulfilled all requisite conditions.

b) Under those rules, the GFA was therefore entitled to membership, as evidenced by the behaviour of the UEFA competent bodies in their processing of the Claimant's application.

c) The change of the UEFA rules on membership was inspired by the simple wish to prevent the GFA's application from succeeding, and the reason for that wish was to be seen in the political pressure exercised by the powerful Spanish FA.

d) In July 2001, when the UEFA Executive Committee proposed that the UEFA Statutes be amended to the effect that only associations in countries which are recognised by the United Nations as independent States are eligible for membership, the UEFA Executive Committee must have been aware of the Expert Panel's conclusions.

e) It would be unfair under the circumstances to permit the dismissal of the GFA's application for affiliation by reference to the amended version of the UEFA rules on membership.

The Respondent submitted in both its Answer and its Response the following principal requests for relief:

- That all of the principal orders requested in the Request for arbitration be dismissed.
- That the Claimant be ordered to pay all of the costs of the arbitration as well as the legal costs incurred by UEFA.

The Respondent is principally of the opinion that:

a) Under Swiss law, any association, such as UEFA, has a discretionary right to refuse a person or entity as a member, even if such person or entity fulfils all of the conditions stipulated in the association's statutes.

b) While there are limits to this discretionary right of the association under Swiss law, namely the protection of the personality (art. 28 Swiss Civil Code) and the rules of Swiss Cartel law, those limits were not violated in the present case since UEFA's attitude was neither arbitrary nor based on unjustified reasons.

c) UEFA's attitude in this matter was not dictated by political pressure exercised by the Spanish FA, which however openly opposed the application made by the GFA.

LAW

1. The CAS has jurisdiction over this dispute on the basis of the correspondence exchanged by the parties on 6 June and 12 July 2002.

   Furthermore, during the hearing in Lausanne on 27 May 2003, it was explicitly acknowledged between the parties that the competence of the CAS is not in dispute.

2. Pursuant to Article R45 of the Code, the dispute must be decided "according to the rules of law chosen by the parties or, in the absence of such a choice, according to Swiss law".

3. The issue of the Claimant's right to membership of UEFA is to be examined in the light of the applicable UEFA Statutes. The Panel considers that Swiss civil law is applicable to all aspects of the dispute relating to the construction of the FIFA and UEFA Statutes and Regulations, in accordance with Article R45 of the Code, Article 4, par. 3 a) of the FIFA Statutes and Article 59, par. 1 of the UEFA Statutes.

4. In addition, to the extent that it deems it appropriate, the Panel may apply general principles of law, which are applicable as a type of *lex mercatoria* for sports regardless of their explicit presence in the applicable UEFA or FIFA Statutes. Such general principles of law include for example the principle of fairness, which implies *inter alia* the obligation to respect fair procedures (see, in particular, AEK Athens and SK Slavia Prague vs. UEFA, CAS 98/200,

sections 60/61 and 155 and seq., in Digest of CAS Awards II, 1998-2000, edited by Matthieu Reeb, pp. 65-66 and 102-103).

5. At the time when the GFA applied for membership to FIFA, and when FIFA subsequently forwarded the GFA's application file to UEFA, the criteria for eligibility as a member of UEFA provided for under Article 5 paragraph 1 of the UEFA Statutes were set out as follows:

   "Membership of UEFA is open to national football associations situated in the continent of Europe which are responsible for the organisation and implementation of football-related matters in their particular territory*"* (the prevailing German text read "Mitglieder der UEFA können europäische Verbände werden, die in ihrem Gebiet für die Organisation und Durchführung des Fussballsports verantwortlich sind*";* hereinafter the "Old Rule").

6. Article 5 paragraph 1 of the UEFA Statutes was amended by the UEFA Congress on 11 October 2001. According to the new version of this provision, UEFA membership is restricted to associations in countries which are recognised as independent States by the United Nations (hereinafter the "New Rule"). The Panel interprets this text to mean that the respective country must have been admitted as a member of the United Nations. The United Nations do not "*recognise*" countries in the strict sense of the word. However, what is clear is that under the New Rule, the GFA would not be eligible as a member of UEFA, since Gibraltar is not an independent State admitted to membership in the United Nations.

7. The first question which the Panel must address is therefore to establish whether today, taking into account the circumstances of this particular case, UEFA may validly rely on the New Rule to appraise (and hypothetically dismiss) the GFA's application, although such application was filed and dealt with for a period of several years on the basis of the Old Rule.

8. The CAS has already considered in the past that in the absence of an express provision to the contrary, laws and rules relating to procedural matters apply immediately upon entering into force and regardless of when the facts occurred. On the other hand, it is a general principle that laws, regulations and rules of a substantive nature that were in force at the time when the facts occurred must be applied. Such principles were set out in particular in the CAS award S. vs. FINA, CAS 2000/A/274, sections 72-73 (see, in Digest of CAS Awards II, op. cit., p. 405):

   "Under Swiss law, the prohibition against the retroactive application of law is well-established. In general, it is necessary to apply those laws, regulations or rules that were in force at the time that the facts at issue occurred (…).

   This general principle is, however, subject to several exceptions, including an exception for laws or rules that are procedural in nature. In the absence of an express provision to the contrary, laws and rules relating to procedural matters apply immediately upon entering into force and regardless of when the facts at issue occurred (…)."

9. In the present instance, while the third sentence of Article 2 of the Regulations governing the implementation of the UEFA Statutes sets out the formal conditions which an application for

UEFA membership has to meet, it is quite another question whether Article 5 paragraph 1 of the UEFA Statutes is to be seen as merely procedural.

10. This provision sets out the substantive conditions that any applicant will need to fulfil in order to become a member. For this first reason, in accordance with the general principle of non-retroactivity of laws and rules, the Panel may have to consider that the New Rule may not apply to the GFA's application.

11. Even if the New Rule was to be regarded as a rule dealing only with procedural aspects, the Panel is of the opinion that its application in this matter would entail a violation of general principles of law which are widely recognised, particularly the principles of fairness and of good faith. In particular, the Panel refers to the principle of *venire contra factum proprium*. This principle provides that when the conduct of one party has led to raise legitimate expectations on the part of the second party, the first party is barred from changing its course of action to the detriment of the second party (see, AEK Athens and SK Slavia Prague vs. UEFA, CAS 98/200, in Digest of CAS Awards II, op. cit., pp. 38 and seq.; S. vs. FINA, CAS 2000/A/274, section 37, in Digest of CAS Awards II, op. cit., p. 400; Art. 2 of the Swiss Civil Code).

12. *In casu*, upon receipt of the GFA's application in 1997, the UEFA administration processed it at first without any reservations. The visit on site in Gibraltar by a delegation of UEFA and FIFA representatives in May 2000 was carried out in knowledge of the fact that FIFA was already considering changing its rules on membership in the future (see above).

13. In July 2000, a favourable report was rendered by the UEFA representatives who had inspected Gibraltar' s facilities, outlining that all requisite conditions set out in the applicable UEFA Statutes and Regulations were fulfilled (see above). Subsequently, the UEFA Executive Committee decided to ask for advice of an Expert Panel before rendering a decision on the GFA's application. It was therefore legitimate for the GFA to understand that UEFA would decide on its application on the basis of the conclusions of the Expert Panel, bearing in mind that the GFA, the English FA and the Spanish FA had all been requested to make written and oral submissions in this context.

14. The Expert Panel came to the main conclusion that the GFA was entitled to UEFA provisional membership. In the Expert Report which was submitted in writing to the UEFA Executive Committee on 27 August 2001, the members of the Expert Panel suggested to the UEFA Executive Committee "to amend the UEFA Statutes (...) to avoid similar problems *in the future"* (emphasized added). The Expert Panel thus proposed *"*an amendment to the effect that only UN-recognised States may apply for admission to and membership of UEFA*"*.

15. However, before any decision on the merits was taken by UEFA on the GFA's application on the basis of the Expert Panel's main conclusion, as one would have reasonably expected, the relevant Old Rule on membership was changed in October 2001 upon a recommendation made in July of that same year by the UEFA Executive Committee. The New Rule actually implemented the recommendation that the Expert Panel had made, but only for *future* cases.

16. The present Panel is of the opinion that such a recommendation to replace the Old Rule by the New Rule was made in the light of the conclusions of the Expert Panel. The fact that the UEFA Executive Committee had already made such an amendment proposal at its meeting of 11-12 July 2001 (i.e. prior to receiving the Expert Panel's written report in August) tends to suggest that the UEFA Executive Committee was aware of the Expert Panel's conclusions at that time. The panel is thus satisfied that one of the main purposes for the amendment proposal made by the UEFA Executive Committee was to prevent the GFA's application from succeeding.

17. To apply the New Rule to the Claimant's case under these circumstances would be unfair and contrary to the above mentioned general principles of law. It were the actions of UEFA itself which created legitimate expectations that the GFA's application would be processed under the Old Rule, with adequate speed or at least upon receipt of and in compliance with the advice of the Expert Panel that UEFA had appointed specifically for that purpose.

18. The GFA's application to be admitted as a provisional UEFA member shall therefore be examined on the basis of the Old Rule, namely the rule applicable when the application was made and on the basis of which the Expert Panel appointed by the UEFA rendered its opinion.

19. As mentioned above, according to the Old Rule "Membership of UEFA is open to national football associations situated in the continent of Europe which are responsible for the organisation and implementation of football-related matters in their particular territory*"*.

20. When reviewing whether the GFA's application fulfilled the conditions set out in this provision, the Expert Panel considered that "given that Gibraltar is a European association which is no longer dependent on the [British] FA and which has become autonomous in a sporting respect, and given that the GFA indisputably exercises sole responsibility for the organisation and structure of football in its territory, Article 5 paragraph 1 can only be interpreted as to mean that the GFA from a legal perspective fulfils the criteria of the UEFA statutes for becoming a UEFA member*"*.

21. The same opinion was given by the UEFA administration itself in its inspection report and recommendations issued on 11 July 2000 (see, sections 18 and 19 above).

22. The Panel considers that these opinions are accurate and that there is no reason for considering, as submitted by the Respondent on the basis of the words used in Article 5 paragraph 2 of the UEFA Statutes, that the Old Rule on UEFA membership should in fact – as the New Rule eventually expressed in an explicit way - be construed as restricting eligibility to associations of countries which are recognized politically as independent States.

23. Such a point of view is in fact not supported by the letter of the Old Rule. Neither is it consistent with the opinion of CAS, as expressed in previous cases, that the concept of "nation" or "country" in the sports environment must not necessarily be "understood within its common political meaning" (see, Celtic Plc vs. UEFA, CAS 98/2001, paragraphs 25 seq.,

in Digest of CAS Awards II, op. cit., pp. 118-120). More importantly, the Respondent's argument is contradicted by the fact that UEFA already has – and had at the time when the application was made – a number of member associations from countries which do not enjoy independent statehood, such as Scotland, Wales or the Faroe Islands.

24. As a consequence of the above considerations the Panel is of the opinion that the GFA's application for UEFA membership meets the requirements set out in Article 5 paragraph 1 of the Old Rule.

25. Upon receipt of an application file from FIFA, as in the present case, UEFA must *"decide whether to grant provisional membership or associate membership to the applicant association"* (Article 4 paragraph 7 of the FIFA Statutes).

26. Article 6 paragraph 3 of the UEFA Statutes provides that the UEFA Executive Committee is competent to admit an applicant association as a provisional UEFA member, while the decision on full admission must be taken by the UEFA Congress.

27. The Respondent submits that even though the GFA's application might meet all requisite conditions for UEFA membership, an association like UEFA remains free to admit or to refuse the applicant as a new member by virtue of the principle of autonomy of the association under Swiss law.

28. The Panel must therefore examine whether the fact that the GFA's application meets the requirements of Article 5 paragraph 1 of the Old Rule entitles the GFA to provisional membership or whether UEFA has discretion to invoke the principle of freedom of association and has the right to deny membership on that basis.

29. Generally, freedom of association includes the freedom of an association to accept or to refuse any applicant for membership, even if the applicant fulfils all statutory conditions (see, inter alia HEINI A., Das Schweizerische Vereinsrecht, Bâle 1988, p. 48).

30. However, this principle is now generally considered to be limited, such limits being derived in particular from:

    (i) the contractual nature of the membership to an association and the related obligation to act in good faith in the context of contractual or pre-contractual discussions (Article 2 Swiss Civil Code; see, *inter alia* ZEN-RUFFINEN P., Droit du sport, Zurich 2002, n° 279 and references; BADDELEY M., L'association sportive face au droit, Genève 1994, p. 75; HEINI A., op.cit., p.48);

    (ii) the general prohibition of arbitrary decisions and the need of a control of the association's decision to refuse a new member (Article 2 paragraph 2 Swiss Civil Code);

    (iii) in professional matters, the provisions of competition law and the related need to protect personality rights (see, JdT 1957 I 202-212; Article 7 of the Swiss Federal Law on Cartels).

31. Furthermore, in the context of sports associations, it is now often considered that associations in a monopolistic position – which is undoubtedly the case for the Respondent in Europe – have in fact a duty to accept new members if they fulfil all statutory conditions to that effect. This opinion is derived both from the legislation on cartels and from the provisions on the protection of the personality (see, HEINI A., op.cit., p. 49; BADDELEY M., op. cit., p. 82).

32. The Panel holds, in that respect, that the exclusion of athletes, or of a sports association to which athletes are affiliated, from an international sports organisation which occupies a dominant or monopolistic position in the organisation of the sports competitions at issue may have the effect of a boycott. It is the Panel's opinion that such an exclusion should therefore be held invalid, at least to the extent that it is not grounded on objective and justified reasons.

33. The Respondent itself admitted that a refusal by UEFA to grant the GFA provisional membership could be considered as illegal if it were arbitrary or based on "unjustified reasons".

34. The above legal considerations lead to the general conclusion that, under Swiss law, an association does not remain entitled, under any circumstances, to accept or refuse a new member at its sole discretion. However, in order to rule on the present case, there is no need for the Panel to develop a position of principle on this question. The Panel thus leaves open the question of the right of UEFA to accept or refuse new members at its sole discretion. The Panel is of the opinion that it may rely on the particular circumstances surrounding the GFA's application and the way it was processed by UEFA to decide upon the present case.

35. As pointed out above, UEFA acted from the outset as if the applicant would be granted provisional membership if all applicable conditions were met. The GFA invested a considerable amount of time and resources in obtaining its admission as a UEFA member, relying on the legitimate expectation that UEFA would not refuse its application without any justified reason.

36. The Panel holds that it is therefore the behaviour of the UEFA itself which created such legitimate expectations on the part of the Claimant (visits on site, favourable visit report and recommendation, appointment of an Expert Panel to assist the Executive Committee to decide on the case, favourable conclusions of the Expert Panel following a comprehensive and adversary procedure, etc.).

37. UEFA chose to process thoroughly the GFA's application and by doing so, it led the Claimant to believe that it would be admitted as a provisional member if the Statutes' conditions were met. By doing so, UEFA waived the right that it may have had under Swiss law to reject the Claimant's request for membership without justified reasons.

38. In that respect, it is the Panel's opinion that neither the change of membership rules by UEFA, the purpose of which may have been to enable UEFA to dismiss the GFA's application, nor the clearly negative position allegedly taken by the Spanish FA, which may

have influenced the UEFA's change of attitude and progressive reluctance to decide in a timely manner upon the GFA's application, constitute any such justified reasons.

39. The 11 July 2000 report by the UEFA delegation (see, section 18 above) lists certain conditions which have to be met in order for the GFA application for UEFA membership to succeed. It is for UEFA to decide whether these conditions are in fact met. Given the length of time which has elapsed since the application was first made, such a decision will have to be taken forthwith and will have to conform with the views expressed in this award.

40. The Panel further stresses that the possible change of FIFA rules on membership, which has been put forward by the Respondent as a reason for postponing any decision on the GFA's application, should not be an impediment to the UEFA granting provisional UEFA membership to the GFA.

41. Under Art. 4 paragraph 7 of the FIFA Statutes, the confederation "shall notify FIFA as soon as it considers a provisional member national association to be qualified to become a member of FIFA". This wording suggests that in two years' time, the UEFA shall remain entitled to assess whether the GFA fulfils the criteria for FIFA membership on the basis of the FIFA Statutes then in force.

The Court of Arbitration for Sport rules that:

1. UEFA is ordered to decide on the GFA's application for membership on the basis of the UEFA rules applicable at the time when the application was made. The decision has to be made by the UEFA no later than 31 March 2004.

2. GFA's other motions are rejected.

3. (…)

CLA-000074

Tribunal Arbitral du Sport

Court of Arbitration for Sport

Arbitration CAS 2001/A/317 A. / Fédération Internationale de Luttes Associées (FILA), award of 9 July 2001

Panel: Mr. Dirk-Reiner Martens (Germany), President; Mr. Odd Seim Haugen (Norway); Mr. Jean-Philippe Rochat (Switzerland)

Wrestling
Doping (nandrolone)
Use of nutritional supplements
Strict Liability Rule
Mitigating circumstances

1. **The legal relations between an athlete and a federation are of a civil nature and do not leave room for the application of principles of criminal law. This is particularly true for the principles of *in dubio pro reo* and *nulla poena sine culpa* and the presumption of innocence as enshrined in Art. 6 ECHR.**

2. **It is perfectly proper for the rules of a sporting federation to establish that the results achieved by an athlete at a competition during which he was under the influence of a prohibited substance must be cancelled irrespective of any guilt on the part of the athlete. This conclusion is the natural consequence of sporting fairness against the other competitors. The interests of the athlete concerned in not being punished without being guilty must give way to the fundamental principle of sport that all competitors must have equal chances.**

3. **If the federation is able to establish the objective elements of a doping offence, there is a presumption of guilt against the athlete. The principle of presumed fault on the part of the athlete does not, however, leave him without protection because he/she has the right to rebut the presumption, i.e. to establish that the presence of the prohibited substance in his/her body was not due to any intent or negligence on his/her part.**

4. **An athlete cannot exculpate himself/herself by simply stating that the container of the particular product taken by him/her did not specify that it contained a prohibited substance. It is obvious that the sale of nutritional supplements, many of which are available over the internet and thus sold without an effective governmental control, would go down dramatically if they properly declared that they contain (or could contain) substances prohibited under the rules governing certain sports. Therefore, to allow athletes the excuse that a nutritional supplement was mislabelled would provide an additional incentive for the producers to continue that practice. In summary, therefore, it is no excuse for an athlete found with a prohibited substance in his/her body that he/she checked the label on the product he took and that the label did not specify that the product contained a prohibited substance.**

A. participated in the XXVII Olympic Games in Sydney as a wrestler in the 85 kg weight category, Greco Roman Style. He finished fourth in his competition which took place on September 27, 2000.

After the end of his competition he underwent a doping control. The A sample (No. A403123) showed the presence of "metabolites of nandrolone, norandrostenedione or norandrostendediol (19-norandrosterone and 19-noretiocholanolone). The concentration of norandrosterone in the sample was more than twice the IOC threshold" (4 ng/ml). In his subsequent request for arbitration A. specified the concentration as having been 8 ng/ml.

By decision of the IOC Executive Board of October 1, 2000, A. was disqualified and excluded from the Games of the XXVII Olympiad for the use of prohibited substances (Chapter II, Article 2.2 of the Olympic Movement Anti-Doping Code). He did not challenge this disqualification.

Upon the request of the athlete's national delegation, the test of the B-sample (No. B403123) was carried on October 3, 2000 in the presence of Mr. J. Segura and Mr. S. Nolan. No member of the national delegation was present at the opening of the B-sample since the Chef de Mission and all physicians had already left. The test result of the B-sample confirmed the result of the A-sample.

The FILA Sport Judge suspended A. from all national and international wrestling competitions for a period of two years. On November 3, 2000 this decision was notified to the national Wrestling Federation and subsequently communicated by it to A. The athlete and his national Wrestling Federation unsuccessfully challenged this decision before internal FILA instances.

Over a period of several months prior to the Olympic Games in Sydney A. had taken 8 to 10 different vitamins/nutritional supplements in accordance with a schedule developed by his sponsor, the witness L. who is a wholesaler of health products in Sweden. During this period A. underwent several doping control tests which were always negative. Approximately 5 to 6 weeks before the Sydney Olympic Games A. began taking six tablets a day of Pyrovate 500, a nutritional supplement produced by the US-company Pinnacle and recommended and supplied to A. by L.. A. did not undergo a doping test after he began taking Pyrovate 500 until the positive test at the Olympic Games. When already in Australia in a training camp, the athlete's trainers heard that a weight-lifter had tested positive for nandrolone and that food supplements were suspected to be responsible for this result. As a consequence, the labels of every product taken by A., in particular the Pyrovate 500 label, were checked as to whether the products contained any prohibited substances. The label did not show any such substance and A. continued to take – inter alia – Pyrovate 500. Following the athlete's positive doping test in Sydney Pyrovate 500 was tested by the IOC accredited laboratory in Cologne. The test revealed the presence of anabolic androgenic steroids (nandrolone precursors) which were not declared on the label.

On January 4, 2001 Appellant filed a request for arbitration with the Court of Arbitration for Sport against the decision of FILA's Sport Judge of October 24, 2000.

By letter dated February 19, 2001 the Respondent filed its response to the request for arbitration.

The Appellant claims that his rights were infringed during the internal FILA-proceedings since he was not given the benefit of a fair hearing before the decision of the FILA Sport Judge. With respect to the merits of the case, the Appellant contends that the Respondent cannot rely on "strict liability". Athletes who have broken the rules without intent or negligence should not be punished. Moreover, since the FILA doping regulations required "use" of a forbidden substance, they themselves showed that an intentional element was required for a doping offence. Since Appellant took the forbidden substance neither intentionally nor negligently, the FILA decision should be annulled. Even if the FILA doping rules were considered to contain a strict liability regime the Panel should take into account that there was a case of exceptional circumstances which did not warrant a suspension in addition to disqualification from the Olympic Games. Regarding the product Pyrovate 500 the Appellant observes that neither he nor his trainer were aware of the fact that this supplement could contain a forbidden substance. Finally, A. adds that all his previous doping tests had been negative and that his clean record should also be considered. In conclusion, the Appellant requests that the FILA decision be declared invalid.

The Respondent requests the CAS to reject the appeal and to confirm the decision to suspend the Appellant for a duration of two years. Since in the case in hand it was not contested that a forbidden substance was found in the Appellant's body, in the Respondent's view the suspension was correct since the Appellant was unable to show that he had fulfilled all his duties of care. The Respondent submits that high level athletes have known for several years that nutritional supplements available from US-American producers may sometimes contain forbidden substances. In this respect Respondent cites press releases by the IOC issued in 1999 and at the beginning of 2000 as evidence of the level of awareness in the sports world. The fact that the Appellant tested positive after ingestion of a product which contained a prohibited substance not marked on the label could not in itself provide a valid excuse because this would open a wide door to any kind of abuse. However, the Respondent conceded that the special circumstances of the case might allow the sanction to be reduced.

A first hearing was held on April 3, 2001 and a second one on May 15, 2001, both in Lausanne.

LAW

1. The Appellant alleges a violation of his right to be heard since he was not given the opportunity to present his case before the FILA Sport Judge rendered his decision on the suspension.

2. The CAS jurisdiction is based on the arbitration agreement reached by the parties at the hearing of 3 April 2001 but also results from FILA's rules and regulations (Article 37(c) of the FILA Constitution and Article 6 of the FILA Disciplinary Regulations).

3. Pursuant to Article R58 of the Code, the Panel is required to decide the dispute according to the applicable regulations of FILA and Swiss law since Respondent has its seat in Switzerland and the parties did not choose a different governing law.

4. Since the doping control and the analysis of the samples took place after the FILA Congress held on September 22, 2000 in Sydney the Panel will apply the FILA Constitution as amended at that Congress (FILA Official Bulletin No. 166-167/2001) and the FILA Doping Regulations as well as the Disciplinary Regulation in force at that time. For the interpretation of the FILA rules the Panel will have special regard to Swiss law in accordance with Article R58 of the Code.

5. Indeed, there is no evidence that the FILA Sport Judge heard the Appellant either personally or by written submissions. It seems that he rendered his decision without further inquiries, only on the basis of the documentation on the disqualification by the IOC, provided to him by FILA.

6. However, the Panel will not deal with this argument in detail. It observes that the CAS has always considered the right to be heard as a general legal principle which has to be respected also during internal proceedings of the federations (CAS 91/53 G. v/ FEI, award of January 15, 1992, Digest, p. 79, 86 f). Federations have the obligation to respect the right to be heard as one of the fundamental principles of due process.

7. However, according to Article R57 of the Code, the Panel will hear the case *de novo*. This means that, even if a violation of the principle of due process occurred in the first instance, any such violation may be cured by a full hearing following appeal to the CAS (CAS 94/129 USA Shooting & Q. v/ UIT, Digest, p. 187, 203).

8. The Panel is satisfied that the Appellant committed a doping offence under the relevant FILA Rules as interpreted pursuant to Swiss law.

9. Provisions on doping can be found in several places in FILA's regulations (the following quotes are based on the version of the regulations as applicable after the 22 September 2000 FILA Congress).

10. FILA Constitution

    "Article 9. – Doping
    The absorption of any substance intended to artificially improve the performance of the athlete is strictly prohibited. The IOC's official list is authoritative."

    [The French text reads: "L'absorption de toutes substances destinées à accroître artificiellement la performance..."].

11. The FILA Doping Regulations state the following:

    "Art. 1 – Definition of doping in sport

Doping is defined as the use, intake or administration of any substance that may affect the mental state or the physical performance of the competitor in a positive or negative way.

...

Doping consists of

a) the administration, intake and use of substances belonging to the classes of forbidden pharmacological agents and the use of forbidden methods by athletes...,

b) resorting to substances or methods which are potentially dangerous for the athlete's health, or are capable of increasing his performance artificially,

c) the presence in the athlete's organisation of forbidden substances or the certification of the use of methods which are not allowed, by referring to the list provided by the IOC and to its successive updates".

12. Art. 27 of the FILA Doping Regulations then makes reference to the IOC Anti-Doping Code by stating:

"Art. 27 Particular and Final Provisions

...

2. Concerning anything which is not indicated in these Regulations, the standards and provisions laid down by the IOC's anti-doping code are applicable.

...

6. Bearing in mind that the anti-doping code of the Olympic Movement has been drawn up in close cooperation with the International Federations, it must apply to ... the various Championships ..., to all other competitions organised by the FILA...
Therefore, any problems of interpretation of any article in these Regulations or for any question not dealt with here, must be referred to the IOC's Anti-Doping Code Lausanne 2000."

13. Finally, the IOC Anti-Doping Code to which the FILA Doping Regulations refer states that (Chapter II Art. 2 and Art. 3):

"Article 2
Doping is:

...

2. the presence in the athlete's body of a Prohibited Substance or evidence of the use thereof or evidence of the use of a Prohibited Method.

Article 3

1. In a case of doping, the penalties for a first offence are as follows:

...

b) If the prohibited substance is one other than those referred to in a) above:

...

III) Suspension from any competition for a minimum period of two years. However, based on specific, exceptional circumstances to be evaluated in the first instance by the competent IF bodies, there may be a provision for a possible modification of the two-year sanction.

2. In case of

a) intentional doping:

...

The sanctions are as follows: [sanctions of up to a life ban]"

The notion of "intentional doping" is further defined in the IOC's Explanatory Memorandum (p. 9):

"With regard to intentional doping, this is a new notion which is added to that of doping as a breach of these rules. The latter exists as soon as the presence of a banned substance has been detected in an athlete's body, independent of any element of intention. Therefore, the athlete has to be punished. Nothing has changed as far as this is concerned. However, in the rare cases where it can be proved that doping was intentional, the Code allows for the imposition of much stricter sanctions..."

14. As to sanctions, Annex D of the FILA Anti-Doping Regulations provides:

"Sanctions

1. *In the event of proving responsibility, the sanctions laid down by the IOC and quoted in annexe 1 which is an integral part of the FILA anti doping regulations. Any updates by the Olympic Movements will be introduced following deliberation by the Executive Committee and defined as follows:*

   Constitutes a violation of the anti doping standards:
   A. *Administering or use of substances which are part of the following classes of forbidden medication: ... anabolising agents ...*
   B. *The use of doping practices ...*
   C. *The absorption of substances belonging to the following classes of pharmaceutical classes whose use is subject to restriction: alcohol ...*
   D. *The administration or absorption of the following substances: ephedrine ...*
2. *For violations mentioned in point 1, letters A, B, C, the following sanctions are applicable:*
   - *two years for the first offence;*
   - *life ban for the second offence."*

15. Finally, with regard to sanctions, Art. 26 of the FILA Doping Regulations provides the following:

"Art. 26 Violations of the anti-doping standards and the relative sanctions

...

4. *The FILA, depending on the case, for positive doping results, can apply heavier sanctions than those laid down in the Regulations.*
5. *The FILA, through its own justice bodies, can find specific and exceptional attenuating circumstances which will enable the sanctions to be reduced."*

16. The Panel finds the provisions on doping in the various FILA regulations rather confusing.

According to the Constitution, doping is the "absorption" of a "substance intended to artificially improve the performance". In turn Art. 1 of the FILA Anti Doping Regulations states that it is sufficient for the substance to "affect" the performance and the same Article declares that "the presence in the athlete's organism of forbidden substances" constitutes a doping offence.

The FILA Doping Regulations then confirm that the IOC Anti Doping Code "must apply" to all FILA competitions and this very IOC Anti-Doping Code states that "Doping is ... the

presence in the athlete's body of a Prohibited Substance" and the IOC's Explanatory Memorandum further explains that doping "exists as soon as the presence of a banned substance has been detected in an athlete's body, independent of any element of intention".

17. Finally, according to Annex D of the FILA Anti Doping Regulations there seems to be a requirement of "proving responsibility" in order for sanctions to be imposed. The same can be concluded from Art. 17.21 of the same regulations which provides for sanctions of a "wrestler at fault".

18. The Panel observes that this "cocktail" of definitions and legal principles in connection with the fight against doping certainly falls short of the clarity and certainty desirable in an area as sensitive as doping and as demanded by CAS (CAS 94/129, USA Shooting & Q. v/ UIT, Digest, p. 187, 203). However, in the opinion of the Panel, the lack of clarity in the FILA Regulations does not go quite far enough to justify rejecting them as a whole as being so unclear that they cannot be applied at all. The Panel will therefore apply these rules as they are but will, if necessary, interpret any uncertainties *contra stipulatorem*, i.e. against FILA.

19. The facts of the case in hand are more straight forward than in most other doping cases:

    It is uncontested that a substance prohibited under Art. 6 of the FILA Doping Regulations (metabolites of nandrolone, norandrostenedione or norandrostenediol (19-norandrosterone and 19-noretiocholanolone)) in quantities in excess of that allowed under the FILA rules (2ng/ml according to Article 27.2 of the FILA Doping Regulations; indeed, the Appellant himself states "a level of 8ng/ml of nandrolone") were found in the Appellant's urine sample taken on 27 September 2000. The Appellant admits that he took Pyrovate 500 during the time preceding his doping test and that – according to the findings of the IOC accredited laboratory in Cologne – this product contained anabolic-androgenic-steroids although this was not declared on the label. No challenge has been brought forward with respect to the conduct of the doping test, the chain of custody of the sample or the laboratory analysis.

20. The parties differ in their interpretation of the FILA rules and the consequences to be drawn from them.

    According to the Appellant

    "(I)t is clear that athletes, who have not broke the rules of doping with intent or negligently, cannot be punished" (Statement of Appeal dated 5 December 2000),

    while the Respondent is of the opinion that:

    "(T)he doping definition resulting from the applicable FILA Regulations is a strict liability definition. If the presence of a doping agent is established, then the sanction applies. No intention has to be shown" (Answer dated 19 February 2000).

21. If, indeed, under the FILA rules no subjective element, i.e. no intent or negligence on the part of the athlete were required for a doping offence to have been committed the Panel would in principle have to apply the two-year sanction provided for in Annex D, Section 2 of the FILA Doping Regulations and would be limited to evaluating whether there are "specific and

exceptional attenuating circumstances which will enable the sanctions to be reduced" (Art. 26, Section 5 of the FILA Doping Regulations).

22. However, the Panel is of the opinion that as a matter of principle and irrespective of "specific and exceptional circumstances" an athlete cannot be banned from competition for having committed a doping offence unless he is guilty, i.e. he has acted with intent or negligence. Even if the rules and regulations of a sports federation do not expressly provide that the guilt of the athlete has to be taken into account the foregoing principle will have to be read into these rules to make them legally acceptable.

23. CAS panels have to interpret the rules in question in a way "which seeks to discern the intention of the rule maker, and not to frustrate it" (CAS 96/149 A.C. v/ FINA, award of March 13, 1997, Digest, p. 251, 259). In interpreting the FILA rules the Panel does not find any indication that they intended to ignore the subjective elements as such. Since the Panel is of the opinion that under Swiss law an athlete cannot validly be banned in the absence of any fault (see *infra)*, an interpretation to the contrary would lead to the rules being void which would frustrate the objective of the fight against doping pursued by the entire sporting world.

24. Before explaining the reasons for the principle of guilt the Panel wishes to clarify that this principle does not apply to the disqualification of a "doped athlete" from the event at which the doping test was conducted. It is therefore perfectly proper for the rules of a sporting federation to establish that the results achieved by a "doped athlete" at a competition during which he was under the influence of a prohibited substance must be cancelled irrespective of any guilt on the part of the athlete. This conclusion is the natural consequence of sporting fairness against the other competitors. The interests of the athlete concerned in not being punished without being guilty must give way to the fundamental principle of sport that all competitors must have equal chances (CAS 94/129 USA Shooting & Q. v/ UIT, Digest, p. 187, 193 et seq.; CAS 95/141 C. v/ FINA, Digest, p. 215, 220; CAS 98/214 B. v/ FIJ, p. 17; CAS 94/126 N. v/ FEI, p. 8).

25. The Panel comes to a different conclusion with regard to the suspension of an athlete from future competition. The so-called "strict liability" rule, i.e. a rule as advocated by the Respondent according to which the mere presence of a prohibited substance in an athlete's body justifies his suspension, does not, in the Panel's opinion, sufficiently respect the athlete's right of personality ("*Persönlichkeitsrecht*") as established in Articles 20 and 27 et seq. of the Swiss Civil Code which CAS panels are required to apply (Art. 58 of the Code of Sports-related Arbitration). In fact, under Swiss law also sporting federations are under a duty to respect the framework established by Articles 20 and 27 et seq. Swiss Civil Code (BADDELEY M., L'association sportive face au droit, Basel et al. 1994, p. 227).

26. As a preliminary remark the Panel wishes to clarify that the legal relations between an athlete and a federation are of a civil nature and do not leave room for the application of principles of criminal law. This is particularly true for the principles of *in dubio pro reo* and *nulla poena sine culpa* and the presumption of innocence as enshrined in Art. 6 ECHR (Swiss Federal Tribunal, ASA Bull. 1993, p. 398, 409 *et seq*. [G. *v*/ FEI] and Swiss Federal Tribunal judgment of March

31, 1999 [5P. 83/1999], unreported, p. 12; see also BADDELEY M., op. cit., p. 220; SCHERRER U., in: FRITZWEILER J. (ed), Doping-Sanktionen, Beweise, Ansprüche, Bern et al. 2000, p. 119, 127).

27. When deciding whether a "strict liability" rule is proper under Swiss law, the Panel has to weigh the interests of the federation against those of the athlete, in particular his right of personality (see BADDELEY M., op. cit., p. 239).

28. In recent times the fight against doping has become sport's most burning problem. At times, public attention and, in particular, that of the media is focused more on whether the athletes are under the influence of doping substances than on the sporting event itself and its results. This development is a very serious threat to the entire sporting movement and, indirectly, to an industry which accounts for an important percentage of the world economy.

29. It is obvious that it would be an important weapon in the fight against doping if the federations were able to impose sanctions on athletes who have tested positive, without having to establish any element of guilt on the part of the athlete. However, this argument, which is one of prevention and deterrence, loses sight of the general objective of doping sanctions, namely the punishment of the athlete for having violated the rules (BADDELEY M., op. cit., p. 219).

30. On the other hand, it has to be recognised that in professional sport doping sanctions have the effect of restraining the athlete from carrying out his chosen trade and thus from earning a living for a certain period of time. In addition, doping sanctions clearly affect the honour and social standing of the athlete concerned and are a stigma on his future.

31. When weighing up the interests of both sides the Panel is of the view that the interests of the athlete take precedence over those of the federation to enforce a rule of "strict liability". The contrary view would only be acceptable if a strict liability rule were the only meaningful weapon in the fight against doping. (see BADDELEY M., in: FRITZWEILER J. (ed), op. cit., p. 9, 22; SCHERRER U., op. cit., p. 119, 127; see also CAS 95/142 L. v/ FINA, Digest, p. 225, 231). As will be shown below, there are other means, in particular when allocating the burden of proof, to ensure an effective fight against doping without accepting the risk of sanctioning an athlete who is not guilty of an offence or whose level of guilt does not justify the full extent of the sanction.

32. The Panel further notes that in a recent decision the Court of Appeals of Frankfurt/Main, Germany also held that liability without fault was incompatible with the rights of the athlete and German law (OLG Frankfurt/Main, judgment of May 18, 2000, 13W29/00 [B. v/ DLV] p. 15).

33. Having established the principle that the suspension of an athlete for a doping offence requires fault on his/her part, this does not, in the Panel's view, mean that it is for the federation to provide full proof of every element of the offence, as is necessary in respect of a criminal act for which a presumption of innocence operates in favour of the accused. There is

no doubt that the federation has to establish and – if contested – to prove the objective elements of the offence, in particular, for example, that the sample was taken properly, that there was a complete chain of custody of the sample on its way to the laboratory and that the analysis of the sample was state-of-the-art. This follows from the general rule that a person who alleges a fact has the burden of proof (CAS 98/208 N., J., Y., W. v/ FINA, Digest II, p. 247; CAS 99/A/234 & CAS 99/A/235 M.M. & M. v/ FINA, award of February 29, 2000, p. 14).

34. However, it would put a definite end to any meaningful fight against doping if the federations were required to prove the necessary subjective elements of the offence, i.e. intent or negligence on the part of the athlete (CAS 95/141 C. v/ FINA, Digest, p. 215, 220; CAS 98/214 B. v/ FIJ, Digest II, p. 318 et seq.). In fact, since neither the federation nor the CAS has the means of conducting its own investigation or of compelling witnesses to give evidence, means which are available to the public prosecutor in criminal proceedings, it would be all too simple for an athlete to deny any intent or negligence and to simply state that he/she has no idea how the prohibited substance arrived in his/her system (see CAS 96/156 F. v/ FINA).

35. For this reason the Panel believes that, with regard to the subjective elements of a doping offence, when weighing the interests of the federation to combat doping and those of the athlete not to be punished without fault, the scales tip in favour of the fight against doping. In fact, doping only happens in the sphere of the athlete: he/she is in control of his/her body, of what he/she eats and drinks, of who has access to his/her nutrition, of what medication he/she takes, etc. In these circumstances it is appropriate to presume that the athlete has knowingly or at least negligently consumed the substance which has lead to the positive doping test (see also: BADDELEY M., op. cit., p. 243; BELOFF M., Drugs, Laws and Versapaks, in O'LEARY J. (ed.), Drugs and Doping in Sport, London 2000, p. 39, 49; STEINER U., Doping aus verfassungsrechtlicher Sicht, in RÖHRICHT/VIEWEG (eds.), Doping Forum, Stuttgart et al. 2000, p. 125, 134; BADDELEY M., in: FRITZWEILER (ed.), op. cit., p. 9, 22).

36. Therefore, if the federation is able to establish the objective elements of a doping offence, there is a presumption of guilt against the athlete.

37. The principle of presumed fault on the part of the athlete does not, however, leave him without protection because he/she has the right to rebut the presumption, i.e. to establish that the presence of the prohibited substance in his/her body was not due to any intent or negligence on his/her part (CAS 95/141 C. v/ FINA, Digest, p. 215, 220 et seq.; CAS 98/214 B. v/ FIJ, Digest II, p. 319). The athlete may for example provide evidence that the presence of the forbidden substance is the result of an act of malicious intent by a third party (CAS 91/56 S. v/ FEI, Digest, p. 93, 97; CAS 92/63 G. v/ FEI, Digest, p. 115, 121; CAS 92/73 N. v/FEI, Digest, p. 153, 157).

38. It is noteworthy that the Swiss Federal Tribunal has accepted an interpretation of doping rules to the effect that it is admissible to presume an athlete's guilt if he/she has been tested positive for a prohibited substance. The athlete is then accorded the opportunity to rebut the

presumption (Swiss Federal Tribunal, Digest, p. 561, 575 [G. v/ FEI]; Swiss Federal Tribunal, 5P.83/1999 [W., C., Z., W. v/ FINA], p. 12).

39. The principle of presumption of guilt and rebuttal thereof by the athlete has also been applied by several CAS decisions, not only with respect of the rules of the FEI which expressly provide for a presumption of guilt, but also in connection with regulations which appear to follow a system of liability without fault (see CAS 91/56 S. v/ FEI, Digest, p. 93, 95; CAS 92/63 G. v/ FEI, p. 115, 120; CAS 92/73 N. v/ FEI, Digest, p. 153, 157; CAS 92/86 W. v/ FEI, Digest, p. 161, 163; CAS 98/204 R. v/ FEI, p. 8; CAS 91/53 G. v/ FEI, Digest, p. 79, 87; see especially: CAS 95/141 C. v/ FINA, Digest, p. 215, 220; CAS 96/156 F. v/ FINA, p. 40 et seq.; CAS 98/214 B. v/ FIJ, Digest II, p. 319; CAS 99/A/252 FCLP v/ IWF, p. 22 et seq.; CAS 2000/A/309 R. v/ RLVB, p. 5). On the other hand, the Panel is conscious of the fact that there have been CAS decisions where the Panel was prepared to apply a strict liability standard with respect to suspensions and was not willing to take into account the subjective elements of the case in questions (see: CAS 98/208 N., J., Y., W.. v/ FINA, Digest II, p. 25; CAS 98/222 B. v/ ITU, Digest II, p. 336-337; see also: CAS 95/150 V. v/ FINA, Digest, p. 265, 272). However, it should be noted that all these decisions took account of the level of "guilt" on the part of the athlete when establishing the duration of the suspension. It can also be taken from these awards that their reasoning was often based on arguments invoked to justify a simple disqualification. They did not consider the very purpose of suspensions as opposed to a mere disqualification and the differences between them. For these reasons the Panel is not prepared to follow these decisions.

40. The Panel recognises that the opinions of the courts and legal authorities differ as to whether the reversal of the burden of proof puts too much burden on the athlete. As an example the OLG Frankfurt in its decision of 18 May 2000 (see above) is in favour of a rule pursuant to which the presence of a prohibited substance in an athlete's body provides prima facie evidence of guilt on the part of the athlete; this leaves the athlete with the burden of proving that, in his/her particular case, the facts were different from the normal sequence of events. In many cases the practical results of both scenarios – a reversal of the burden of proof or the rebuttal of prima facie evidence – will be the same, but the Panel does recognise that the burden on the athlete is slightly less in the latter case. The Panel does, however, believe that, as a matter of principle, the reversal of the burden of proof and thus the burden being on the athlete to provide full proof of the absence of intent or negligence, is adequate and appropriate when weighing the interests of both sides.

In the case in hand, in which none of the objective elements of the offence is in dispute, the Appellant is thus presumed do have intentionally or negligently committed the offence.

41. As has been shown above, the burden is on the Appellant to prove that he is not guilty of a doping offence. To this end, the Panel took the testimony of several witnesses proffered by the Appellant.

42. It is the opinion of the Panel that the Appellant has not succeeded in proving that he was without fault.

43. The Appellant contends that he was not aware that Pyrovate 500 contained a substance which was the source of his positive doping test in Sydney.

44. In fact, the Panel accepts, in the Appellant's favour, that he did not intentionally take a prohibited substance, in other words, that he did not know that Pyrovate 500 contained precursors of nandrolone. The Panel further assumes, in the Appellant's favour, that his use of Pyrovate 500 was in fact the cause for his positive doping test in Sydney.

45. However, the Panel is of the opinion that under the circumstances the Appellant acted negligently when he took Pyrovate 500 without making certain that it did not contain a prohibited substance.

46. As a general remark, the Panel observes that the sporting world has, for quite some time even before the 2000 Sydney Games, been well aware of the risks in connection with using so called nutritional supplements, i.e. the risk that they may be contaminated or, in fact, "spiked" with anabolic steroids without this being declared on the labels of the containers. There have been several cases of positive tests for nandrolone which have been attributed to nutritional supplements and which have been widely publicised in the sports press. This fact was the likely motive for the IOC press releases in October 1999 and February 2000 which give an unequivocal warning about the use of imported and unlicensed nutritional supplements and their possible mislabelling.

47. Under these circumstances it is certainly not a valid excuse for an athlete to contend that he/she – personally – was not aware of these warnings. In fact, athletes are presumed to have knowledge of information which is in the public domain. In this context, the Panel notes that there is CAS case law to the effect that athletes are themselves soley responsible for, inter alia, the medication they take and that even a medical prescription from a doctor is no excuse for the athlete (CAS 92/73, N. v/ FEI, Digest, p. 153, 158). Furthermore an athlete cannot exculpate himself/herself by simply stating that the container of the particular product taken by him/her did not specify that it contained a prohibited substance. It is obvious that the sale of nutritional supplements, many of which are available over the internet and thus sold without an effective governmental control, would go down dramatically if they properly declared that they contain (or could contain) substances prohibited under the rules governing certain sports. Therefore, to allow athletes the excuse that a nutritional supplement was mislabelled would provide an additional incentive for the producers to continue that practice. In summary, therefore, it is no excuse for an athlete found with a prohibited substance in his/her body that he/she checked the label on the product he took and that the label did not specify that the product contained a prohibited substance.

48. The Panel can leave open the question whether a "doped athlete" can be sanctioned on the basis alone that he/she knew (or is presumed to have known) the risk involved in taking nutritional supplements which may contain a prohibited substance not declared on the label. In the case in hand there are additional elements which establish negligence on the Appellant's part:

49. In his statement before this Panel the Appellant admitted that during his training camp before the Olympic Games he had been informed that a weightlifter had tested positive for nandrolone and that nutritional supplements were suspected to be the cause of his positive test. At that point in time at the very latest the Appellant should have ceased taking a nutritional supplement which, it should be noted, was not prescribed to him by a medical doctor but was supplied by his "sponsor", a wholesaler of health products with a direct economic interest in marketing (and testing) these products in the sports world.

50. The rules and regulations of the Respondent (and of the IOC) provide for a two-year sanction in the case of a positive doping test for nandrolone. Even though it is well established that a two-year suspension for a first time doping offence is legally acceptable, there are several CAS decisions according to which a sanction may not be disproportionate and must always reflect the extent of the athlete's guilt (CAS 95/141 C. v/ FINA, Digest, p 215, 222; CAS 92/73 N. v/ FEI, Digest, p. 153, 159; CAS 96/156 F. v/ FINA, p. 48). Therefore, this Panel in its capacity as an appeals body enjoys the same discretion in fixing the extent of the sanction as the Respondent's internal instances (Art. 26.5 of the FILA Doping Regulations, see above). In fact, the Panel would enjoy this discretion even if there were no "exceptional attenuating circumstances".

51. When taking into consideration all the elements of this case, in particular the fact that the Appellant acted negligently but without intent to indulge in doping, the Panel is of the view that, based on the evidence produced, there are mitigating circumstances which warrant a reduction of the maximum penalty allowed under the rules and regulations of the Respondent. As a result, the Panel is of the opinion that it is adequate and appropriate to suspend the Appellant for 15 months. As regards the date upon which the suspension should begin, the Panel takes note of the fact that the sanction imposed by the Respondent started to run on the date the test was carried out (27 September 2000). The Panel sees no reason why it should change this date. Therefore, the Appellant's suspension will last until 26 December 2001.

The Court of Arbitration for Sport rules:

1. The appeal filed by A. on 3 January 2001 is partially upheld.

2. The decision of the FILA Sport Judge of 24 October 2000 shall be modified as follows:

   A. is suspended for a period of 15 months from 27 September 2000 to 26 December 2001.

3. (…).

KluwerArbitration Wolters Kluwer | Kluwer Law International

G. v Fédération Equestre Internationale (FEI), Award, CAS Case No. 1991/A/53, 15 January 1992

G. is a member of the Italian national equestrian team. At the end of September, G. and her mother left their residence, in Lecce, in order to participate with two horses, including the mare F., in a national show jumping event in Grosseto. The horses covered the journey of approximately 700 km by road, in a horse-box.

During the week preceding the national showjumping event, Grosseto hosted the national foal breeders' show. There had been 400 or 500 foals in this competition up to Wednesday 26th September 1990, housed in the stables created for the occasion and for the national showjumping event which was to follow.

G. and her mother arrived in Grosseto late on Thursday evening, and went in search of loose-boxes for their two horses. It should be noted that, while these boxes were numbered, the organization, described as lacking by the appellant and her mother, had not arranged for any allocation of boxes by name, leaving each competitor to sort things out for themselves. Normally, it was the job of the organizer to disinfect and clean out the boxes. However, when G. arrived, the few boxes that were page "79" free had not been cleaned out nor, more importantly, disinfected. She had to take the boxes which she could find, since the large majority of the foals had not yet left Grosseto.

The litter of the box in which G. put her mare F. was dirty, and still contained remains of fodder and feedstuffs. Not having any means of disinfection with her, she did what she could, that is to say gave the box a brief clean out. She was not able to change all the litter owing to the lack of straw, since this was delivered for the needs of the competitors only once a day, in the morning. When she arrived, there was almost none left. She did not, however, take the precaution of emptying her horse's manger.

During her stay in Grosseto, G. competed with two horses, F. being left alone when she was looking after the other horse. During the day, there was no guard provided for the stables; during the night, there was one guard who went from stable to stable.

The event in Grosseto, which was won by G. with the mare F., ended at around 13.00 hours on Sunday 30th September 1990. There was no veterinary control after the competition. G. and her mother stayed in Grosseto until around 09.00 hours on Monday 1st October 1990.

Upon leaving Grosseto, the two horses were once again placed in a horse-box for the journey to Catane (Sicily) where G. and the mare F. were entered to take part in the CSI cat. A competitions taking place during the weekend of 6/7th October 1990. This involved a distance of some 700 km, covered in around 15 hours. Such a journey is relatively long for a horse and creates a degree of stress, particularly as it involves a thirty-minute crossing of the Straits of Messina by ferry, a means of transport which horses do not enjoy.

When asked about the length of the journey and the risk of stress and anxiety, increased by a ferry crossing, the appellant and her mother provided the following information which the Court of Arbitration for Sport regards as constant:

– The mare F. has been used to making long journeys for several years. Indeed, living in Lecce, G. is often obliged to make journeys of 500 or 600 km, or even longer, in order to take part in events with her mare.
– F. is an eight-year old mare. She is described as being very sensitive, but not highly strung.
– For approximately the last five-and-a-half years, she has been treated by a single veterinarian, Dr. C., who has attested in writing that he has never had to prescribe any tranquilizing therapy, and that no substance has ever been given to the horse by G. without his opinion having been sought beforehand.

page "80"

Organization
- Court of Arbitration for Sport

Arbitrators/Judges
- Denis Oswald, President
- Hans Ulrich Sutter
- Benigno Alvarez

Case date
- 15 January 1992

Case number
- CAS Case No. 1991/A/53

Parties
- Claimant, G.
- Respondent, Fédération Equestre Internationale (FEI)

Key words
- Horse doping (promazine)
- Right to be heard
- Negligence by the rider

Source
- **G. v Fédération Equestre Internationale (FEI), Award, CAS Case No. 1991/A/53, 15 January 1992** in Matthieu Reeb (ed), Digest of CAS Awards I 1986-1998, Digest of CAS Awards Series Set, Volume 1 (© Kluwer Law International; Kluwer Law International 1998) pp. 79 - 91

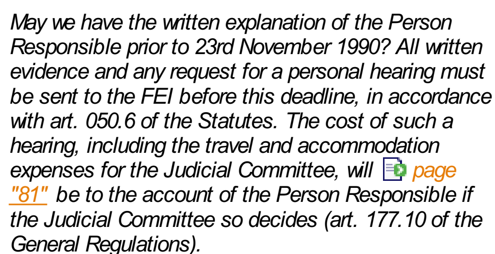
– G. travels with a first aid kit for her horses which was given to her by Dr. C. and which contains a few medicaments including "combelen", which is in all likelihood a sedative, but which G. declares she has never used on her horse. At best, she knows that, if she uses it, she has to inform the veterinarian at the following event, in accordance with the Veterinary Regulations.

Both G. and her mother rule out the possibility that, during the journey from Grosseto to Catane someone could have had access to the horse-box, which remained locked at all times when they were not present. The horses did not leave the horse-box, even during the stopover made on the evening of the first day, that is to say from 19.00 hours until around 08.00 hours the following morning. The horses were fed by nobody other than G. with fodder brought with them from Lecce at the start of the trip.

G. arrived in Catane two days before the start of the CSI. In this town the stables are permanent, and when she arrived the loose-boxes were clean. G. and her mother were accommodated some 500 metres away from the stables. Only the horse F. took part in the event.

On Sunday 7th October 1990, G. and her mare F. took part in the "Premio no. 7" of the Catane CSI, where they placed thirty-fourth. After the event, the horse was chosen by the drawing of lots for a medication control which was performed immediately after the event. The analysis by the Horseracing Forensic Laboratory Ltd, Newmarket (England), dated 31st October 1990, established the presence of Hydroxypromazine in the urine (sample A) of the mare F. "as a result of the administration of promazine".

By fax of 1st November 1990, the FEI informed the Italian Equestrian Sports Federation of the positive result of the analysis, stating the following:

> *Please refer to Veterinary Regulations arts. 1023, 1024 and 1025 and indicate:*
>
> 1. *If you accept the result or if you require a confirmatory analysis (art.1023.3). Please advise prior to 12th November 1990.*
> 2. *If you require a witnessing analyst and, if so, whom (art.1023.4).*
>
> 
>
> *May we have the written explanation of the Person Responsible prior to 23rd November 1990? All written evidence and any request for a personal hearing must be sent to the FEI before this deadline, in accordance with art. 050.6 of the Statutes. The cost of such a hearing, including the travel and accommodation expenses for the Judicial Committee, will* page "81" *be to the account of the Person Responsible if the Judicial Committee so decides (art. 177.10 of the General Regulations).*
>
> *Please note that you are responsible for communicating the content of this letter/fax to the Person Responsible. The Judicial Committee will consider this case based on the written evidence filed unless you request a hearing as indicated above.*

Before the deadline of 12th November 1990, the appellant requested a confirmatory analysis and designated Dr. Z. from the Brughiera Veterinary Clinic near Varese as her expert witness.

The confirmatory analysis was performed in England by the same laboratory on 20th November 1990, in the presence of Dr. Z. who knew on the same day that the result of the first analysis was confirmed, in that the urine of F. contained in the B sample showed exactly the same presence of Hydroxypromazine.

The result of the confirmatory analysis was communicated to the FEI by letter on 23rd November 1990, and received on 26th November 1990.

At almost exactly the same time, that is to say by fax of 23rd November 1990, the Italian Equestrian Sports Federation wrote the following to the FEI:

> *With regard to the defence of G., please could you give us the following information:*
>
> *1) What is the deadline laid down for presenting the account of the defence?*

2) *In the event of a positive response from the confirmatory analysis, may the owner of the horse take part in the meeting of the Judicial Committee?*

In a fax dated 29th November 1990, the FEI gave, *inter alia*, the following answer:

In response to your fax of 23rd November 1990, may we inform you of the following:

1) *In accordance with the legal procedure of the FEI, positive cases are submitted to the Judicial Committee for examination of all the information as soon as this is received (explanation by the Person Responsible, by the national federation, laboratory report, report on the confirmatory analysis, etc.).*
2) *In accordance with article 052.3 of the Statutes, G. has the option to appear, alone or accompanied by witnesses, before the Judicial Committee in order to defend her case. She may also ask to be represented by a lawyer.*

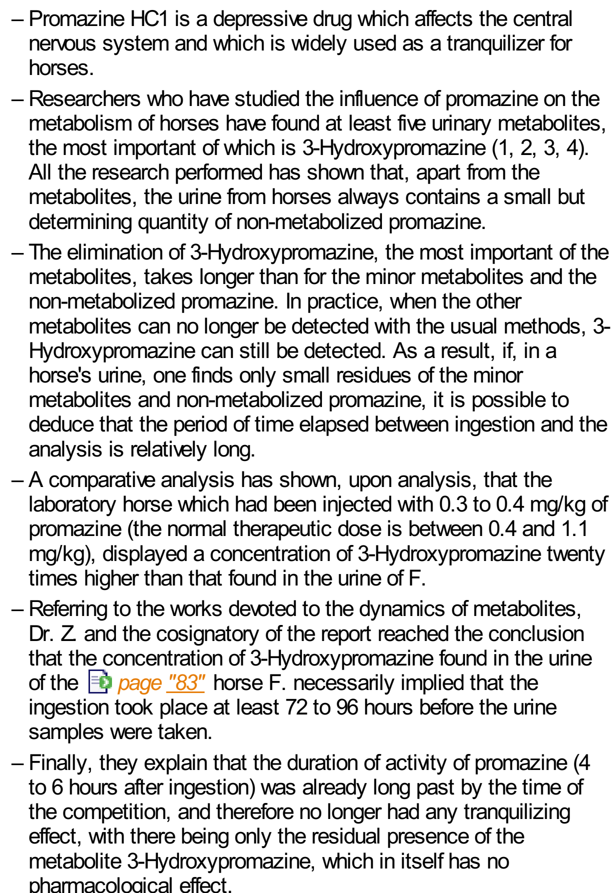
page "82"

The confirmatory analysis of the samples taken from the horse F. took place on 20th November 1990 in the presence of Dr. Z. The result from the HFL laboratory confirmed the presence of the prohibited substance Hydroxy-Promazine. We should be grateful if you could send us the report by Dr. Z. so that we can submit the file to the Judicial Committee.

The FEI did not include the letter from the laboratory with its fax, nor did it ask the Italian Equestrian Sports Federation to inform G., nor did it inform the latter directly. It considered that the presence of the analyst, a witness at the confirmatory analysis, constituted sufficient communication.

Complying with the request of the FEI, confirmed by telephone on 21st January 1991, the Brughiera veterinary clinic, under the signature of Dr. Z., sent an expert appraisal on 3-Hydroxypromazine on 21st January 1991.

The aforementioned report contained, *inter alia*, the following information (summarized translation):

– Promazine HC1 is a depressive drug which affects the central nervous system and which is widely used as a tranquilizer for horses.
– Researchers who have studied the influence of promazine on the metabolism of horses have found at least five urinary metabolites, the most important of which is 3-Hydroxypromazine (1, 2, 3, 4). All the research performed has shown that, apart from the metabolites, the urine from horses always contains a small but determining quantity of non-metabolized promazine.
– The elimination of 3-Hydroxypromazine, the most important of the metabolites, takes longer than for the minor metabolites and the non-metabolized promazine. In practice, when the other metabolites can no longer be detected with the usual methods, 3-Hydroxypromazine can still be detected. As a result, if, in a horse's urine, one finds only small residues of the minor metabolites and non-metabolized promazine, it is possible to deduce that the period of time elapsed between ingestion and the analysis is relatively long.
– A comparative analysis has shown, upon analysis, that the laboratory horse which had been injected with 0.3 to 0.4 mg/kg of promazine (the normal therapeutic dose is between 0.4 and 1.1 mg/kg), displayed a concentration of 3-Hydroxypromazine twenty times higher than that found in the urine of F.
– Referring to the works devoted to the dynamics of metabolites, Dr. Z. and the cosignatory of the report reached the conclusion that the concentration of 3-Hydroxypromazine found in the urine of the  *page "83"* horse F. necessarily implied that the ingestion took place at least 72 to 96 hours before the urine samples were taken.
– Finally, they explain that the duration of activity of promazine (4 to 6 hours after ingestion) was already long past by the time of the competition, and therefore no longer had any tranquilizing effect, with there being only the residual presence of the metabolite 3-Hydroxypromazine, which in itself has no pharmacological effect.

On 7th May 1991, the FEI Judicial Committee, basing its action on the analysis and confirmatory analysis and mentioning the written declaration by G. according to which she had not administered any prohibited substance to her horse F., made the following decision:

1. *Disqualification of the horse F. from all CSI, cat. A events in Catane.*
2. *Suspension of G. from all national and international competitions for three months.*
3. *Publication of the sanction inter alia in the FEI bulletin after expiry of the appeal deadline.*

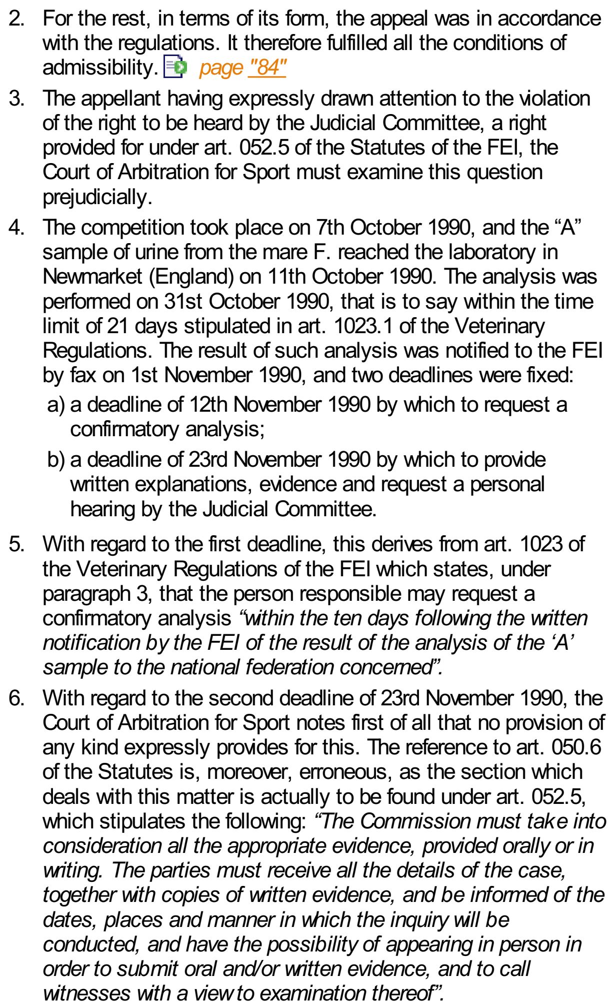
G. appealed against the decision by the FEI Judicial Committee in a document which was not dated, but which reached the FEI by 24th June at the latest.

Through the intermediary of her counsel, the appellant admitted that Hydroxypromazine, a metabolite of promazine, was a prohibited substance in the sense of art. 1013 of the Veterinary Regulations and that such a metabolite had been found in the urine of the horse F. by two uncontested analyses.

In Law

1. The competence of the Court of Arbitration for Sport to review an appeal against the decisions of the Judicial Committee derives from articles 051.6.2 and 053.1 of the Statutes of the FEI under the new terms thereof in accordance with the modifications decided by the General Assembly of March 1991.

   Where the limit of competence with regard to sanctions is concerned, this derives from art. 169 of the FEI General Regulations which refers to art. 168.



2. For the rest, in terms of its form, the appeal was in accordance with the regulations. It therefore fulfilled all the conditions of admissibility. *page "84"*
3. The appellant having expressly drawn attention to the violation of the right to be heard by the Judicial Committee, a right provided for under art. 052.5 of the Statutes of the FEI, the Court of Arbitration for Sport must examine this question prejudicially.
4. The competition took place on 7th October 1990, and the “A” sample of urine from the mare F. reached the laboratory in Newmarket (England) on 11th October 1990. The analysis was performed on 31st October 1990, that is to say within the time limit of 21 days stipulated in art. 1023.1 of the Veterinary Regulations. The result of such analysis was notified to the FEI by fax on 1st November 1990, and two deadlines were fixed:
   a) a deadline of 12th November 1990 by which to request a confirmatory analysis;
   b) a deadline of 23rd November 1990 by which to provide written explanations, evidence and request a personal hearing by the Judicial Committee.
5. With regard to the first deadline, this derives from art. 1023 of the Veterinary Regulations of the FEI which states, under paragraph 3, that the person responsible may request a confirmatory analysis *“within the ten days following the written notification by the FEI of the result of the analysis of the ‘A’ sample to the national federation concerned”.*
6. With regard to the second deadline of 23rd November 1990, the Court of Arbitration for Sport notes first of all that no provision of any kind expressly provides for this. The reference to art. 050.6 of the Statutes is, moreover, erroneous, as the section which deals with this matter is actually to be found under art. 052.5, which stipulates the following: *“The Commission must take into consideration all the appropriate evidence, provided orally or in writing. The parties must receive all the details of the case, together with copies of written evidence, and be informed of the dates, places and manner in which the inquiry will be conducted, and have the possibility of appearing in person in order to submit oral and/or written evidence, and to call witnesses with a view to examination thereof”.*

7. The text of the fax of 1st November 1990 from the FEI is unclear, and leads one to wonder whether the two deadlines are of an alternative or cumulative nature. In accordance with the general principle of law whereby a declaration must be interpreted *contra stipulatorem*, the Court of Arbitration for Sport deems that the indication of a double page "85" deadline was of an alternative nature, in the sense that, from the moment that the appellant had asked for a confirmatory analysis before the deadline of 12th November 1990 – which was the case –, she had respected the requirement of the rules as formulated by the FEI. In the logic of the double analysis system, the simultaneous fixing of two deadlines seems totally inadequate, as it was manifestly inappropriate to demand written explanations and evidence together with a personal hearing before knowing the definitive objective result of the analyses, that is to say the result of the confirmatory analysis as well.
8. Moreover, it is implicit in the fax of 23rd November that the Italian Equestrian Sports Federation interpreted the double deadline in the alternative sense, since it asked the general secretariat of the FEI by what deadline the person responsible could present her defence and how such person could take part in the meeting of the Judicial Committee in the event that the second analysis were to confirm the results of the first.
9. The FEI did not give a clear answer to this double request in its fax of 29th November 1990 and, what is more, did not draw attention to the fact that the deadline of 23rd November 1990 had already passed six days previously.
10. In art. 1024 of the Veterinary Regulations of the FEI, the Court of Arbitration for Sport sees an implicit confirmation of the alternative nature of the deadlines fixed in the fax of 1st November 1990. Indeed, it stipulates in this article that *"if the analysis of the 'B' sample cannot legally be performed, the case must be abandoned and no subsequent action may be undertaken".* In the light of this perfectly clear provision, it would be pointless, even specious, to require written explanations or evidence before knowing the result of the confirmatory analysis which might prove negative and therefore result in the whole procedure's being abandoned. It would be equally premature to seek a personal hearing in such conditions.
11. In the case in point, upon reception of the positive result of the confirmatory analysis, the FEI should have notified this formally to the Italian Equestrian Sports Federation, fixing a new deadline by which to provide written explanations and evidence and to request a personal hearing by the FEI Judicial Committee. By not fixing a new deadline – on the erroneous assumption that the deadline had not been respected – and by making a decision without further investiga page "86" tion, the FEI violated the general legal principle, expressly provided for by the statutes, of the right to be heard.
12. On the basis of the foregoing, the Court of Arbitration for Sport considers that the decision by the Judicial Committee of 7th May 1991 must be annulled, and a new decision made by the Panel.
13. Taking up the case again, the Court of Arbitration for Sport considers as follows:

    > The appellant, rightly, did not call into question the two analyses which she does not contest and which revealed the presence of Hydroxypromazine, the metabolite of promazine, in the two urine samples from the horse F. taken after the CSI "Premio no. 7" in Catane on 7th October 1990. Again with just cause, she admitted that Hydroxypromazine is a Prohibited Substance in the sense of art. 1013 of the Veterinary Regulations, since this stipulates that *"a prohibited substance includes the metabolites of such substance".*

14. In accordance with art. 149.2 of the FEI General Regulations, the presence of the prohibited substance results in a pure strict liability which is expressed in the automatic disqualification of the horse and the rider *"from all competitions at that event"* which implies loss of all rankings obtained. This consequence is confirmed by art. 177.5.1 of the FEI General Regulations.
15. Still to be examined is the problem of the additional penalty which may or must be imposed on the person responsible in application of art. 177.5.2 or 177.5.3 of the FEI General Regulations.

16. The Court of Arbitration for Sport wishes first of all to recall that, where doping or the taking of prohibited substances is concerned, there is normally and generally in the sporting regulations of Federations an inversion of the burden of proof in the sense that, as soon as the presence of prohibited substances is detected, there is the presumption of a voluntary act. It is then up to the athlete to produce evidence to the contrary.
17. The system provided for by the General Regulations of the FEI is different, since the result of the analyses – it rests with the FEI to produce such evidence – must tend to *"be construed as a deliberate attempt to affect the performance of the horse … "* (art. 177.5.2) or *"may not be construed as a deliberate attempt to affect the performance of the horse"* (art. 177.5.3). In other words, it rests with the FEI to establish page "87" the burden of proof of a presumption of intent or a presumption of negligence, principally by means of the analyses performed.
18. It is not for the Court of Arbitration for Sport to judge the system instituted by the General Regulations, but it does wish to note that it is almost impossible to offer proof of the presumption of intent or the presumption of negligence on the basis of simple objective analyses like those performed on the A and B samples by the Horseracing Forensic Laboratory Ltd, such analyses being satisfied with establishing the presence or absence of a prohibited substance, to the exclusion of any other consideration or any other more exhaustive analysis. Already at this stage, the Court of Arbitration for Sport finds that the FEI has not offered proof of a presumption of intent.
19. Consequently, for this first reason, art. 177.5.2 is inapplicable. On the other hand, the presence of a prohibited substance in the urine of a horse presumes negligence on the part of the person responsible and automatically results in the application of art. 177.5.3, unless the person responsible clears himself from such presumption by proving that he had taken all the necessary precautions.
20. The Court of Arbitration for Sport does not know how the FEI learned that Dr. Z. of the Brughiera Veterinary Clinic had produced a report interpreting the results of the analysis. This question may remain undecided. The Panel notes, however, that the FEI asked for such report to be produced in its fax of 29th November 1990 through the intermediary of the Italian Equestrian Sports Federation. Not having received anything, the FEI secretariat asked Dr. Z. directly for it by telephone on 21st January 1991, before taking a decision. One must therefore infer from the above, and especially from the postponement of the decision until such time as the contents of the report from the Brughiera Veterinary Clinic were known, that the Judicial Committee would regard this report as an important piece of evidence. It is therefore surprising to see that the Judicial Committee, which *inter alia* waited for this report before taking the decision which is the subject of this appeal on 7th May 1991, makes no mention of it, in particular under paragraph 2.1, not even to distance itself from it.
21. As this report was not contested either by the decision which is the subject of this appeal or by the FEI during the proceedings of the present case, the Court of Arbitration for Sport regards it as a piece of evidence in the same way as the other documents produced. page "88"
22. The report concludes that the ingestion of promazine took place at least 72 to 96 hours before the urine samples were taken, based on the concentration of the metabolite 3-Hydroxypromazine revealed by the analysis. It explains that the duration of activity of promazine is limited to 4 to 6 hours after ingestion, and that the metabolite 3-Hydroxypromazine as found in the samples – which is just a "residue" of promazine – has no pharmacological effect.
23. Admittedly, this report does not explain in what circumstances this substance found its way into the body of the horse F., but its pharmacological inefficacy at the time of the event constitutes an element which should be taken into account in order to determine whether there is an indication of negligence or intent.
24. This report does not in any case prove that G. deliberately and intentionally sought to improve the performance of her horse. It therefore remains to determine whether she could clear herself of the presumption of negligence indicated by the presence of a prohibited substance in the urine of the mare F.

25. The appellant displayed culpable negligence when she took possession of the loose-boxes for her horses on the occasion of the event held in Grosseto a few days before, by not sufficiently cleaning out the litter and by not removing the fodder and feedstuffs left in the manger. Investigation of the case on this point did not enable her to overturn the presumption of negligence and, on the contrary, established the existence of such negligence.
26. For this second reason, art. 177.5.3 must apply, whereas the application of art 177.5.2 must be ruled out, the proof of intent not having been offered.
27. In short, not only has the FEI not produced proof of a deliberate attempt in the sense of art. 177.5.2, but also, thanks to the report from the Brughiera Veterinary Clinic, and thanks to testimony and her personal hearing, G. has provided evidence which tends to prove that there was no deliberate attempt to alter the performance of the mare F. in the sense of this same provision which, as a result, cannot apply. On the other hand, G. has not shown herself to have taken all the precautions which would have enabled her to clear herself of the presumption of negligence which results from the presence, in the urine of her horse, of a Prohibited Substance. In accordance with the system chosen by the FEI, the Court of Arbitration for Sport must therefore apply art. 177.5.3 of the General Regulations. page "89"
28. The Court of Arbitration for Sport notes finally that, in addition, apart from referring to the automatic disqualification, the decision of 7th May 1991 makes no mention of the legal basis of the additional penalty, that is to say whether it is in application of art. 177.5.2 or art. 177.5.3.
29. Consequently, only art. 177.5.3 is applicable, which provides for an obligatory fine of CHF 1,000.– to CHF 15,000.– and a possible suspension of one to three months. Taking into account the personal details of the rider and the unintentional nature of the infraction, but also of the need to fight against doping in general, the Court of Arbitration for Sport, basing its decision *inter alia* on the guidelines contained in the International Olympic Charter against Doping in Sport, considers that a fine of CHF 1,000.– and a suspension from international equestrian competitions for the period of one month are sufficient penalty for the present case.
30. With regard to publication of the award, the Court of Arbitration for Sport considers that this must be authorized, not only for technical reasons relating to the organization of the FEI, but also in the interest of G. whose case has become known among equestrian circles. To take this double interest into account, the Court of Arbitration for Sport orders the publication of the award by the FEI, but only in a summarized form established by the Court of Arbitration for Sport which indicates expressly the unintentional nature of the infraction in the sense of art. 177.5.3.

The Court of Arbitration for Sport pronounces:

1. The appeal is partially upheld.
2. The decision of 7th May 1991 by the FEI is annulled.

   In a new ruling, the Court of Arbitration for Sport pronounces:

3. The mare F. and the rider G. are disqualified from all the CSI cat. A competitions in Catane on 7th October 1990.
4. In application of art. 177.5.3 GR, the rider G. is punished:
   - with a suspension from international equestrian competitions for the period of one month;
   - with a fine of 1,000.– Swiss francs to be paid to the FEI.
5. (…)
6. (…) page "90"
7. The award shall be published in the next bulletin of the FEI. The award shall appear in a summarized form to be established by the Court of Arbitration for Sport. page "91"

© 2015 Kluwer Law International BV (All rights reserved).
Kluwer Arbitration is made available for personal use only. All content is protected by copyright and other intellectual property laws. No part of this service or the information contained herein may be reproduced or transmitted in any form or by any means, or used for advertising or promotional purposes, general distribution, creating new collective works, or for resale, without prior written

permission of the publisher.
If you would like to know more about this service, visit www.kluwerarbitration.com or contact our Sales staff at sales@kluwerlaw.com or call +31 (0)172 64 1562.