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Negotiation Watch:
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1. Japan, Mexico agree to investment rules in new trade pact,
By Luke Eric Peterson

Japan and Mexico have announced the conclusion of a free-trade agreement containing far-reaching rules on foreign investment protection and liberalization.

Following the recent treaty practice of the two countries, the agreement extends national treatment and most-favored nation treatment (MFN) to the pre-establishment phase of an investment (i.e. prior to entry). In contrast with many existing bilateral investment treaties, these pre-establishment commitments afford protection to investors not merely after having established an approved investment, but also with respect to the establishment or acquisition of an investment in the territory of the other party.

Although foreign investors may establish or acquire an investment on terms comparable to those of domestic enterprises, this guarantee is subject to a long list of existing exceptions listed in an annex to the free trade agreement. As well, a second annex

identifies sectors where the parties to the treaty may introduce new measures which would be exempted from treaty rules on non-discrimination.

The treaty contains most of the standard protections found in other investment treaties, including: promises of compensation in the event of expropriation or measures tantamount to expropriation; free transfers; minimum standards of treatment (fair and equitable and full protection & security); and some protection in the event of strife or military conflict.

In addition, the treaty also prohibits a range of so-called performance requirements - these include obligations for foreign investors to achieve a given level of domestic content, to purchase or use local goods and services, or to transfer technologies or production processes. These listed performance requirements may be permitted (or introduced) in designated sectors, provided that the governments have lodged relevant exceptions in the annexes to the treaty. Thus, the full import of the new FTA's rules on performance requirements (and non-discrimination) may be discerned only by careful study of the treaty's voluminous annexes.

In common with virtually all modern international investment treaties, the agreement provides for investor-state arbitration in the event of investment disputes. In contrast with some treaties, however, the reach of this arbitration will pertain only to alleged breaches of the substantive treaty rules - and does not extend to alleged breaches of investment contracts, licenses or other authorizations.

Arbitration may occur under the rules of the International Centre for Settlement of Investment Disputes - a Washington-based facility - or the ad-hoc UNCITRAL rules. In a notable innovation, the treaty proposes the creation of a roster of 20 presiding arbitrators with experience in international law and investment matters.

In terms of transparency, although the treaty specifies that either party to a dispute "may make available to the public" all documents related to the dispute, including the final award, the treaty does not go so far as some recent US free trade agreements (FTAs) which require that all documents be released to the public.

Nor does the Japan-Mexico treaty follow the precedent set by recent US FTAs which hold that all investor-state arbitrations shall be publicly disclosed, the proceedings open to public viewing, and procedures established for amicus-curiae intervention by non-parties to the dispute.

The agreement does provide a process whereby a party may request that similar claims - for example a series of claims by different foreign investors against the same government measure - may be consolidated under the jurisdiction of a single tribunal. Such provisions are increasingly viewed as necessary in light of two related arbitrations against the Czech Republic - CME v. Czech Republic and Lauder v. Czech Republic - which reached broadly different conclusions on the merits of the dispute.

Notably, Article 84 of the treaty also affirms that the two governments may issue statements of interpretation which shall be binding on any tribunal charged with interpreting the treaty provisions. Indeed, the treaty appears to incorporate the gist of an earlier interpretive statement issued by the three parties to the North American Free Trade Agreement (NAFTA) and which clarified the scope of the so-called minimum standard of treatment under international law.

However, the treaty does not incorporate any clarifications as to the reach of the treaty rules on expropriation. Some US FTAs have incorporated language designed to clarify that most legitimate, non-discriminatory regulation, in areas such as health, safety and environment, will not be considered indirect forms of expropriation. The Japan-Mexico does not include such safeguard language in the expropriation rules of the FTA.

Interestingly, the treaty also neglects to include language found in some other recent Japanese treaties, including the Japan-Vietnam BIT, which notes that taxation "does not generally constitute expropriation" and which sets forth further guidelines for which forms of taxation will not fall afoul of expropriation rules.

The investment chapter of the Japan-Mexico FTA does include language which affirms the right of parties to perform functions in sensitive areas such as "income security or insurance, social security or insurance, social welfare, public education, public training, health, and child care". However, this language amounts only to a tautology on account of the fact that such functions need be performed "in a manner that is not inconsistent with this (investment) chapter."

Finally, the treaty does seek to curb the use of so-called "home states of convenience" - incorporation by a foreign investor in an intermediary legal territory in order to avail itself of the use of an investment treaty. Article 70 of the Japan-Mexico FTA stipulates that a party to the treaty may deny the benefits of the treaty to an investor of the other treaty party, "if investors of a non-Party own or control the enterprise and the enterprise has no substantial business activities" in the putative home state. However, this denial of benefits by the host state will be subject to prior notification and consultation.

Sources:

Japan-Mexico FTA, Chapter 7, Annexes 6-9
http://www.mofa.go.jp/region/latin/mexico/agreement/index.html

Japan-Vietnam BIT
http://www.mofa.go.jp/region/asia-paci/vietnam/agree0311.pdf

2. US inks Trade-Investment Framework with Afghanistan,
By Luke Eric Peterson

The US government announced this week that it had concluded a Trade and Investment Framework Agreement (TIFA) with Afghanistan. According to a press release from the Office of the US Trade Representative, the agreement will "provides a forum for Afghanistan and United States to examine ways to expand bilateral trade and investment".

Assistant US Trade Representative Ashley Wills added that "TIFAs have proven to be useful catalysts for promoting the kinds of economic and regulatory reform that have contributed to expanding opportunity, development and hope."

According to the USTR's 2003 Annual Report, the United States has concluded TIFAs with more than a dozen governments. Increasingly, the agreements are viewed as an intermediate step towards a subsequent bilateral investment treaty or broader free trade agreement.

A copy of the new US-Afghanistan TIFA was not available on the USTR's website.

However, a TIFA concluded with Malaysia in May of 2004 may offer some insight into the contents of such agreements. The US-Malaysia TIFA provides for the creation of a Joint Council, and various working groups, to consult on a variety of trade and investment issues including: investment protection, protection of intellectual property rights, biotechnology, liberalization of trade and investment barriers, and regulatory issues affecting trade and investment policies.

Sources:

"United States and Afghanistan Sign Trade and Investment Framework Agreement", USTR Press Release, Sept. 21, 2004

US-Malaysia TIFA, available at:
http://www.ustr.gov/assets/Trade_Agreements/Regional/Enterprise_for_ASEAN_Initiative/asset_upload_file922_3577.pdf

3. UNCTAD releases World Investment Report 2004 on services

The United Nations Conference on Trade and Development (UNCTAD) has released its 2004 World Investment Report: The Shift Towards Services.

For the third consecutive year, the Report highlights a drop in global inflows of Foreign Direct Investment (FDI), however UNCTAD notes that many indicators point to a recovery in 2004.

The Report found that flows to developing countries in 2003 increased by 9% overall, however the specific figures varied from region-to-region, and from country-to-country. Africa saw a marked 26% increase in inflows of FDI, however much of this was driven

by a small number of large natural-resources projects in a handful of countries. Overall, UNCTAD charted an increase in the service sector proportion of FDI. "World FDI flows have seen a dramatic shift towards the services sector - that´s where the action is", said Karl P. Sauvant, Director of UNCTAD´s Investment Division. According to UNCTAD the services sector accounts for "about 60% of the global inward FDI stock (equivalent to an estimated $4.4 trillion), compared to less than 50% a decade earlier." The UNCTAD Report also devotes considerable attention to international treaties which set some of the ground-rules for investment flows, particularly in the services sector.

Recent figures indicate that there were 2265 bilateral investment treaties covering investment in the services (and non-services) sector, as of the end of 2003. In addition, UNCTAD notes that a multitude of broader free trade agreements have been concluded, many of which contain investment and/or services chapters. Although the Report observes that these different types of international agreements may provide an "enabling framework" for new investment, it cautions that, in the absence of other desirable economic determinants , "substantial investment flows are not likely to materialize."

UNCTAD also highlights the increasing complexity which arises thanks to a variety of different international rules governing services at the bilateral, regional and multilateral level. In particular, the Report notes that in relation to the most-favored nation (MFN) treatment found in the WTO's General Agreement on Trade in Services (GATS), very few governments have entered exemptions for their bilateral investment treaties (BITs).

One potential consequence of this could be that all WTO members may be able to enjoy certain rights and protections found in the full range of BITs concluded by those WTO members who have failed to exempt their BITs from the MFN provision of the GATS.

Sources:

UNCTAD World Investment Report 2004: The Shift Towards Services, available at:
http://www.unctad.org/Templates/WebFlyer.asp?intItemID=3235&lang=1

Arbitration Watch:
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4. ICSID tribunal buries NAFTA funeral home claim,
By Luke Eric Peterson

A tribunal operating under the aegis of the International Centre for Settlement of Investment Disputes (ICSID) has rejected a request for a supplementary decision in a high-stakes arbitration between a Canadian funeral home operator and the US Government.

The request had been made by the US Government in an effort to clarify a point in a key 2003 ruling by the tribunal: namely that all claims lodged by the Loewen Group and Mr. Raymon Loewen (TLG) were dismissed on the merits

The US Government noted that the tribunal had not expressly stated that Mr. Loewen's individual claim for damages was dismissed, although the Government was of the view that that dismissal had been implicit in the award.

At the same time, counsel for Mr. Loewen countered that the tribunal had actually "overlooked" Mr's Loewen's individual claim, and contended that it remained to be dealt with by the tribunal.

The Loewen arbitration arose out the Canadian firm's unhappy experience with the US court system. Matters came to a head when a Mississippi court levied a whopping $500 million (US) jury verdict in Loewen's commercial dispute with a Mississippi-based competitor; and imposed a requirement that a bond of $625 million be posted if the firm wished to mount an appeal.

After agreeing to an expensive settlement in the case, the investor turned to the North American Free Trade Agreement, contending that the United States had failed to live up to the NAFTA's investment protection commitments.

As reported in an earlier edition of INVEST-SD News Bulletin, the ICSID arbitral tribunal charged with hearing the Loewen claim issued its ruling in June of 2003. And in that ruling the tribunal found that it no longer had jurisdiction to hear the case, because the Canadian firm had filed for bankruptcy subsequent to the filing of its NAFTA claim, and had restructured its assets into a US corporation.

According to the tribunal this undermined TLG's arbitration claim by running afoul of a legal rule requiring that a "diversity of nationalities" be represented in such arbitrations.

After dismissing TLG's claim the tribunal also went on to note that - had it retained jurisdiction in the dispute - it would have dismissed the claim on its merits, because the investor had neglected to exhaust its domestic legal remedies. In particular, the tribunal ruled that TLG should have appealed to the US Supreme Court in an effort to challenge its treatment in the Mississippi justice system.

It was this contention of the tribunal that Mr. Ray Loewen hoped to challenge. In submissions to the tribunal in September of 2003, counsel for Mr. Loewen contended that the tribunal had jurisdiction to consider Mr. Loewen's claim (on the grounds that he remained a Canadian citizen, even if his former firm now operated as a US enterprise).

Moreover, counsel for Mr. Loewen submitted affidavits to the tribunal which purported to show that The Loewen Group had taken outside legal advice following the unfavorable Mississippi jury verdict, but had been advised that the likelihood of obtaining US Supreme Court review of the ruling was 'extremely remote' and might prove detrimental

to their interests.

However, after more than nine months of deliberating over Mr. Loewen's recent submissions and affadavits, the ICSID tribunal ruled that it was not satisfied by the affidavits, and that they "did not ground an inference that the settlement option was the only available alternative or that certiori petition and the bankruptcy petition we re not available remedies".

Thus, the tribunal rejected Loewen's request.

This may not be the final word in the matter, however, as Mr. Loewen could seek review of the arbitral rulings in domestic court. At press time, Mr. Loewen had not responded (through counsel) to a query from INVEST-SD as to his next legal move.

While arbitrations conducted under the regular ICSID rules of arbitration may be challenged only on limited grounds through an internal ICSID process of review, the Loewen arbitration was mounted under the so-called ICSID Additional Facility rules, which were designed for cases where at least one party - or in the case of the investor, its home state - has not acceded to the ICSID Convention, and is ineligible for arbitration under the regular ICSID rules.

Several earlier NAFTA arbitrations conducted under these ICSID Additional Facility have been challenged in domestic courts, including the Metalclad v. Mexico and Marvin Roy Feldman Karpa v. Mexico disputes.

INVEST-SD will continue to monitor any further developments related to the Loewen dispute.

Sources:

Decision on Respondent's Request for a Supplementary Decision, in the case of The Loewen Group, Inc. and Raymond L. Loewen v. United States of America, ICSID Case No. ARB (AF)/98/3

"Loewen NAFTA arbitration against the United States not fully
Resolved", By Luke Eric Peterson, INVEST-SD News Bulletin, available at:
http://www.iisd.org/pdf/2004/investment_investsd_jan5_2004.pdf

5. UK mining firm loses investment treaty claim against Egypt,
By Luke Eric Peterson

UK-based Joy Mining Machinery Limited has seen its investment treaty claim against Egypt rejected by a tribunal at the Washington-based International Centre for Settlement

of Investment Disputes (ICSID).

Joy had alleged that the Republic of Egypt violated the terms of the 1976 UK-Egypt Investment Promotion and Protection Agreement, including protections against expropriation and guaranteeing free transfer of funds and fair & equitable treatment.

In 1998, the UK firm concluded a contract for the provision of mining equipment and systems to the Industrial and Mining Projects of the Arab Republic of Egypt (IMC). However, the two sides quarreled over performance of the contract, with each side blaming the other for various failures.

Although Joy Mining was paid the full purchase price for its equipment, it was unable to secure the release of Letters of Guarantee and Contract Performance which had been lodged with an Egyptian bank.

The firm turned to ICSID arbitration under the treaty in an effort to recoup these guarantees, and an additional 2.5 million British Pounds in compensation.

However, in a decision on August 6th, the ICSID tribunal charged with arbitrating the dispute dismissed Joy's claim on jurisdictional grounds, noting that Joy's contract could not be characterized as an "investment" under the terms of the UK-Egypt treaty, or the ICSID Convention. In the tribunal's view, the contract was a purely commercial agreement - and that disputes related to the performance of the contract ought to be directed to the dispute resolution avenues provided for in the contract (in this case commercial arbitration under the UNCITRAL rules).

While the tribunal noted that recent ICSID tribunals have "progressively given a broader meaning to the concept of investment", it stressed that a distinction needed to be preserved between ordinary sales contracts and investments (the latter being characterized by such features as: "a certain duration, a regularity of profit and return, an element of risk, a substantial commitment and that it should constitute a significant contribution to the host State's development.")

Additionally, the tribunal rejected the claimant's attempt to shelter its claim under the so-called umbrella clause of the investment treaty, which provides that: "Each Contracting Party shall observe any obligation it may have entered into with regard to investments of nationals or companies of the other Contracting Party."

The tribunal ruled that:

"In this context, it could not be held that an umbrella clause inserted in the Treaty, and not very prominently, could have the effect of transforming all contract disputes into investment disputes under the Treaty, unless of course there would be a clear violation of the Treaty rights and obligations or a violation of contract rights of such magnitude as to trigger the Treaty protection, which is not the case. The connection between the Contract and the Treaty is the missing link that prevents any such effect."

Indeed, the tribunal had no difficulty holding that the non-release of bank guarantees were clearly a commercial element of the contract, and could not constitute an expropriation, or a violation of treaty rules mandating free transfers or fair & equitable treatment.

In the end, the tribunal noted that the parties should turn to contract arbitration in order to resolve their dispute - and that the Egyptian government had clearly signaled in the ICSID proceedings that it would consent to resolution of the dispute under the UNCITRAL rules of arbitration.

One consequence of such a forum shift may be that any further legal developments will not be publicly disclosed, unless the parties to the arbitration wish otherwise. In contrast to ICSID arbitration, which requires that all cases be registered on a public website, UNCITRAL arbitrations generally proceed without public registration or notification.

Sources:

Joy Mining Machinery Ltd v. Arab Republic of Egypt, Award on Jurisdiction, August 6, 2004, available at: http://www.asil.org/ilib/JoyMining_Egypt.pdf

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