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Beware the "Non-Exclusive" Arbitration Clause

By Daniel Harrison

Privy Council clarifies the nature of arbitration clauses, but uncertainties about the clauses' effect still remain.

"Non-exclusive" arbitration clauses provide that disputes "may" be referred to arbitration (rather than "shall" or "should" be so referred). The Privy Council clarified the nature of these clauses in a recent case, but uncertainties about the clauses' effect still remain.

Ultimately, parties would be well-advised to avoid "non-exclusive" arbitration clauses and opt for exclusive arbitration clauses, if what they really want is for their disputes to be resolved by arbitration. If the parties choose a "non-exclusive" arbitration clause, then they should make sure that they avoid issues by making express provision for the litigation costs in the event of a stay and expressly naming a litigation forum.

Facts of the case

Anzen and Hermes One were parties to a shareholders' agreement relating to a BVI company, which contained a "non-exclusive" arbitration clause.

Hermes One claimed that it had suffered unfair prejudice due to Anzen's management of the affairs of the company and started proceedings in the BVI High Court.[1] Anzen applied to stay the proceedings, relying on the arbitration clause, but the court dismissed the application. It found that the "non-exclusive" arbitration clause meant that Anzen could only stay the court proceedings by starting arbitration proceedings, which it had not done.

On appeal, the Privy Council considered whether the BVI court had erred as to the meaning of the arbitration clause.

The Privy Council decision

The Privy Council considered three possible interpretations of an arbitration clause providing that "any Party *may* submit the dispute to binding arbitration":

1. The parties are prohibited from starting litigation, meaning that this is no different from an "exclusive" arbitration clause where the parties agree that they "shall" or "should" arbitrate their disputes.

2. Any party is allowed to start litigation, but another party could start arbitration proceedings, at which point the court proceedings are to be stayed.

3. Any party is allowed to start litigation, but another party can force a stay of those court proceedings by either "making an unequivocal request to that effect" or applying to the court for a stay.

The Privy Council dismissed Option 1 on the basis that depriving a party of the right to bring court proceedings required clear language, and the use of the word "*may*" was not clear. Option 2 was unworkable; expecting a party to start arbitration proceedings in order to stop the court proceedings is too onerous, when the party would simply be seeking a declaration of no liability.

The council considered Option 3 to be the most preferable; Anzen only needed to "insist on arbitration," by starting arbitration proceedings, applying to the court to stay proceedings or "making an unequivocal request to that effect." Notice to the other side would be sufficient for such a request.

What are the implications for this decision?

Although a "non-exclusive" arbitration clause may be valid in the manner the Privy Council described in this case, the clause poses significant uncertainties for parties:

1. Liability for costs. On one hand, the party that started litigation may argue that it should not be liable for costs because the party was entitled to start litigation at the time. On the other hand, the party that stays the litigation may argue that the other party should be liable for costs because the litigation was unnecessary.

2. Proper litigation forum. If the parties do not identify an agreed forum for litigation (in addition to the forum for arbitration), then either party could find itself brought into proceedings in an unfavourable jurisdiction, and this may have complicated and costly consequences.

As noted above, parties should opt for exclusive arbitration clauses, if what they really want is for their disputes to be resolved by arbitration.

(Privy Council judgments do not bind English courts, but are highly persuasive. Indeed, an English court may be particularly persuaded by this judgment since the Privy Council in this case comprised five UK Supreme Court judges).

Case: *Anzen Limited and others (Appellants) v Hermes One Limited (Respondent) (British Virgin Islands) [2016] UKPC 1*

This article was prepared with the assistance of Mihail Krepchev in the London office of Latham & Watkins.

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Arbitral Awards Based on Penalty Clauses: Enforceable?

By Philip Clifford, Oliver Browne and Jonathan Hew

A recent English High Court decision suggests that some such awards may be enforceable notwithstanding the rule against penalties.

In *Pencil Hill Limited v US Citta di Palermo S.p.A.*, the English High Court enforced an arbitral award that was based on a penalty clause in an agreement. The award was issued by the Court of Arbitration for Sport (the CAS) in Switzerland. The High Court's decision is of interest because penalties are not normally enforceable under English law. We consider the ramifications of the decision on penalties in the context of international arbitration.

The English aversion to penalties

Under English law, penalties are not enforceable. This rule, which is typically justified on public policy grounds, is an exception to the general principle that a contract should be enforced in accordance with its terms.

The Supreme Court considered the issue of penalty clauses last year in *Cavendish Square Holding BV v El Makdessi; ParkingEye Limited v Beavis* [2015] UKSC 67. In their joint speech, Lord Neuberger and Lord Sumption characterised a penalty as *"a secondary obligation which imposes a detriment on the contract-breaker out of all proportion to any legitimate interest of the innocent party in the enforcement of the primary obligation."*

Footballers and penalties – a controversial topic

Palermo and Pencil Hill entered into written contracts relating to the sale of financial rights deriving from certain registration rights of a footballer, Paulo Dybala. Under one of the contracts, which was governed by Swiss law, Palermo agreed to pay Pencil Hill a sum of €6.72 million in two equal instalments. The contract further provided that should Palermo fail to pay, all remaining amounts would become due and, as a penalty, Palermo would be required to pay double the amount outstanding. Palermo failed to pay any of the agreed sum.

In arbitration proceedings before the CAS in Switzerland, Pencil Hill claimed €6.72 million on the basis of the penalty provision. In its award, the CAS directed Palermo to pay Pencil Hill €1.68 million representing 25% of the penalty claimed. Following Palermo's unsuccessful challenge to the supervising court in Switzerland, Pencil Hill sought to enforce the CAS' award in the UK.

Section 103 of the Arbitration Act 1996 obligates English courts to enforce an arbitral award pursuant to the New York Convention, subject to certain exceptions. One such exception is that *"it would be contrary to public policy to recognise or enforce the award."*

In the High Court, Judge Bird ruled in favour of enforcement for two reasons:

- First, the circumstances in which English courts may refuse enforcement under the New York Convention of a foreign arbitral award are narrow, for example, where a universal principle of morality needs to be protected or where there is a risk of injury to the public good. The judge was satisfied that the *"the important public policy against enforcement of penalty clauses [was] not sufficient to permit [him] to refuse enforcement"* in the instant case. The judge also noted the importance of the parties' choice of Swiss law to govern the contract, which empowered courts to interfere with a penalty by reducing it. Accordingly, *"the public policy of upholding international arbitral awards … outweigh[ed] the public policy of refusing to enforce penalty clauses. The scales are tipped heavily in favour of enforcement."*
- Second, the effect of the CAS' reduction under Swiss law of the amount claimed changed the nature of the obligation from penal to non-penal. According to the judge, *"[t]he position then is not that Swiss law upheld a penalty, rather it is that Swiss law removed a penalty and replaced it with an obligation to pay a sum it regarded … as neither exorbitant nor unconscionable."* He added that *"[a]s this Court is … not adjudicating upon the underlying contract, it is easy to see that the decision of the curial court – the court chosen by the parties applying the law chosen by the parties – should be respected."*

Post-match analysis

At first glance, the decision suggests that English courts might enforce an arbitral award based on a penalty clause where such clause is permitted by the governing law of the agreement in which it is contained. This makes sense given the courts' historically robust approach towards enforcing arbitral awards and, more generally, party autonomy and the preservation of the sanctity of bargains struck between parties.

However, a few words of caution are necessary:

- First, the High Court considered the enforceability of penalties in the context of an award pursuant to the New York Convention where the penalty clause was governed by foreign law. The decision does not purport to alter the application of the rule against penalties where, for example, English law governs the contract.
- Second, the permissibility of penalties varies from jurisdiction to jurisdiction.
- Third, one may question whether the High Court really upheld a "*penalty*" at all. As Judge Bird pointed out, the CAS' award reduced the amount payable so as to remove the penal effect of the clause. Viewed in this light, the High Court's decision appears to be in line with the rule against penalties.

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Top 10 Things to Know About the Implementation of the Iran Nuclear Agreement

By Les P. Carnegie, Charles Claypoole, William M. McGlone, Robert E. Sims, Eric S. Volkman, Andrew P. Galdes and Robert Price

The EU and UN terminate most of their sanctions on Iran, while the US implements more limited changes to its longstanding embargo.

On January 16, 2016, the International Atomic Energy Agency (IAEA) verified that Iran had satisfied its nuclear-related commitments under the Joint Comprehensive Plan of Action (JCPOA). The report from the IAEA was the last step needed to reach "Implementation Day" under the JCPOA, and it cleared the way for an immediate easing of nuclear-related sanctions on Iran by the United Nations, the European Union, and the United States.

As forecast in our previous *Client Alerts* on July 16, 2015 and October 29, 2015, Implementation Day triggered the lifting of most EU and UN sanctions against Iran, but the core of US sanctions against Iran remain in place and will continue to pose significant legal restrictions and compliance challenges for US persons and firms and, in some cases, even non-US businesses. This client alert summarizes 10 key points concerning the impact of this historic development on global business and finance.

1. What is the difference between the "*primary*" US sanctions that largely remain in place and the "*secondary*" US sanctions that have been suspended or eliminated?

The distinction between so-called "primary" and "secondary" US sanctions is critical to understanding the impact of the US sanctions relief.

• Primary US sanctions are administered and enforced by the US Treasury Department's Office of Foreign Assets Control (OFAC). These broad and longstanding prohibitions apply to (1) the activities of US persons, (2) non-US persons who cause US persons to violate the sanctions, and (3) transfers of US-regulated goods and technology to Iran. The term "US person" includes (a) entities organized under US law and their foreign branches, (b) US nationals and US lawful permanent residents (wherever located) and (c) any person (regardless of nationality) present in the US. The primary sanctions also apply to entities outside the US that are "owned or controlled" by a US person (*e.g.*, foreign subsidiaries of US companies), but, as discussed below, OFAC has released a general license authorizing overseas subsidiaries of US entities to engage in a range of business activities with Iran.

• Secondary sanctions apply to non-US firms and individuals, even those that have no connection to the US. Over the past few years, the US expanded secondary sanctions targeting Iran, in an effort to deter non-US persons and companies from engaging in activities involving certain sectors of the Iranian economy, including the energy, automotive, financial services, mining, shipbuilding and shipping sectors.

With the limited exceptions outlined below, the US did not ease primary sanctions on Implementation Day. Because the primary sanctions have been imposed primarily for anti-terrorism and human rights reasons, not due to concerns over Iran's nuclear program, these sanctions remain largely outside the scope of the JCPOA.

2. Which US secondary sanctions have been suspended?

As explained in the guidance document OFAC released on Implementation Day, the US suspended or eliminated some — but not all — secondary sanctions targeting Iran, including restrictions on:

- Certain financial and banking services
- The provision of underwriting services, insurance, or re-insurance and associated services
- Transactions with Iran's energy and petrochemical sectors and associated services
- Transactions with Iran's shipping and shipbuilding sectors as well as port operators and associated services
- Iran's trade in gold and other precious metals and associated services
- Trade with Iran in graphite, raw or semi-finished metals such as aluminum and steel, coal, and software for integrating industrial processes and associated services
- The sale, supply, or transfer of goods and services used in connection with Iran's automotive sector and associated services

In its FAQs, OFAC clarified that US persons cannot perform "associated services," unless specifically licensed by OFAC. OFAC has defined the term to covers any service — including technical assistance, training, insurance, re-insurance, brokering, transportation or financial service — necessary and ordinarily incident to the underlying activity for which sanctions have been lifted.

3. Which US secondary sanctions remain?

US secondary sanctions continue to apply to non-US persons who knowingly facilitate significant financial transactions with, or provide material or certain other support to: (1) Iranian parties on OFAC's list of Specially Designated Nationals (SDN List); (2) Iran's Islamic Revolutionary Guard Corps (IRGC) and its designated agents or affiliates; or (3) any other person on the SDN List designated under US executive orders relating to Iran's proliferation of weapons of mass destruction or Iran's support for international terrorism.

On Implementation Day, OFAC removed over 400 parties from the SDN List, the Foreign Sanctions Evaders List (FSE List), and the Non-SDN Iran Sanctions Act List. Nonetheless, over 200 Iranian parties remain on the SDN List and are identified with the following designators: "Subject to Secondary Sanctions," IRGC or IFSR. SDNs that remain targets of US secondary sanctions include, for example, the IRGC, Quds Force, Ansar Bank, Bank Saderat, Mehr Bank and Mahan Air.

Notably, the US announced on Implementation Day that the US Treasury Department determined the National Iranian Oil Company (NIOC) is no longer an agent or affiliate of the IRGC. This determination permits non-US persons to engage in energy-trading activities with NIOC, as well as with Naftiran Intertrade Company (NICO) and the National Iranian Tanker Company (NITC), without facing risks under US secondary sanctions.

4. Which sanctions has the European Union lifted?

On Implementation Day, Council Regulations (EU) 2015/1861 and 1862 amended Council Regulation (EU) 267/2012 to revoke most EU sanctions against Iran. However, as emphasized in the EU Information Note published on January 16, 2016, some activities either remain prohibited or require prior authorization by the competent authority of the relevant EU Member State.

The EU has removed most sanctions, including restrictions targeting the Iranian oil, gas and petrochemical industries, the Iranian shipping, shipbuilding and transport sectors, and the provision of financial, banking and insurance services to Iran, along with restrictions related to the supply of gold, precious metals, banknotes and coinage, and certain enterprise resource-planning software. The EU has also lifted restrictions — including the prior notification and authorization requirements — on the transfers of funds between EU and Iranian persons or entities.

Some EU restrictions remain, including those relating to the export of sensitive goods and technology listed in Annexes I and II of Council Regulation (EU) 267/2012 (related to nuclear proliferation activities), Annex VIIA (enterprise planning software designed for nuclear or military use), Annex VIIB (graphite and raw or semi-finished metals) and the provision of associated services. These activities are not permitted without prior authorization from the relevant EU Member State. The EU arms embargo also remains in place, and other exports, including the export of goods contained in Annex III (the Missile Technology Control Regime list) and goods that could contribute to the development of nuclear weapon delivery systems, remain prohibited. The Iran human rights sanctions regime, which prohibits the export of equipment that might be used for internal repression or for monitoring telecommunications, also remains in place.

EU persons seeking to do business in Iran also need to recognize that dealings with certain counterparties remain prohibited. Various Iranian persons and entities, including certain Iranian banks, such as Ansar Bank, Bank Saderat Iran and Bank Saderat plc, Mehr Bank, Bank Sepah and Bank Sepah International, continue to be designated under the EU asset freeze sanctions. The EU prohibits making funds or economic resources available, directly or indirectly, to such designated persons.

5. What sanctions relief does JCPOA implementation bring for US persons under the primary US sanctions?

With limited exceptions, the core of US primary sanctions remains in place. This means that US persons are generally precluded — absent OFAC authorization — from engaging in most transactions involving Iran or Iranian-origin products.

That said, implementation of the JCPOA introduces several changes to primary sanctions that will allow US persons to pursue certain authorized categories of transactions with Iran:

• **Commercial Passenger Aircraft and Related Parts and Services.** As expected, OFAC issued a Statement of Licensing Policy, which paves the way for US persons and non-US persons (where there is a nexus to US jurisdiction, such as a foreign commercial aircraft with 10% or more US-controlled content) to apply for and receive OFAC licensing to export, reexport, sell, lease, or transfer commercial passenger aircraft and related parts and services to Iran. Any of the items licensed by OFAC must be used exclusively for commercial passenger aviation.

OFAC clarifies in its FAQs that “wide-body, narrow-body, regional, and commuter aircraft used for commercial passenger aviation” are eligible for specific licensing, while the following aircraft are not: “cargo aircraft, state aircraft, unmanned aerial vehicles, military aircraft, and aircraft used for general aviation or aerial work.” OFAC also confirms that parties that secure OFAC authorization under this new licensing program generally do not require a separate license from the Department of Commerce for the export or reexport of the US-regulated commercial aircraft or aircraft parts or components. OFAC will also consider applications by US financial institutions to finance a specific sale of commercial passenger aircraft to Iran.

How quickly OFAC will process license applications under this new licensing program remains unclear, but history suggests that the approval process may not be speedy. Recently, the Iranian Transport Minister announced that Iran intends to purchase 114 civilian aircraft from Airbus.

• **Imports of Carpets and Foodstuffs.** Pursuant to a new general license that will become effective once published in the Federal Register in the coming days, US persons will be permitted to deal in Iranian-origin carpets and foodstuffs, including pistachios and caviar, and to import such Iranian-origin products into the US from Iran or third countries. The general license imposes restrictions on payment arrangements relating to purchases of such goods from Iran or third countries.

Implementation Day does not eliminate or otherwise expand existing OFAC authorizations that permit US parties to export or reexport agricultural commodities (including food), medicine, and medical supplies to Iran under general licenses or to apply for specific OFAC licensing to export or reexport medical devices to Iran.

6. Does OFAC now allow foreign subsidiaries of US companies to engage in non-sensitive trade with Iran?

Under certain circumstances, yes. For US-regulated parties, one of the most significant developments from Implementation Day is new OFAC General License H, which allows non-US entities that are "owned or controlled" by a US person to engage in certain transactions with Iran, provided US persons are not involved in and do not approve or facilitate such transactions. Broadly speaking, this new general license effectively turns back the clock to pre-fall 2012, when the Iran Threat Reduction and Syria Human Rights Act of 2012 (ITRA) effectively extended the primary sanctions to reach the activities of overseas subsidiaries of US companies.

While General License H is effective immediately, it includes several important limitations, and US companies and their foreign affiliates should carefully evaluate if and how foreign affiliates can proceed under the new authorization. Among other activities, General License H does *not* permit the following:

• Exports or reexports of goods, technology, or services from the US or by US persons to Iran that are prohibited under by Section 560.204 of the Iranian Transactions and Sanctions Regulations (ITSR)

• Transfer of funds to, from, or through the US financial system (which would usually include US dollar-denominated trade involving non-US banks)

• Dealings with parties on the SDN List or other US blacklists, such as the FSE List

• Activities involving an item subject to the Export Administration Regulations (EAR) that are prohibited by or otherwise require a license under the EAR

• Transactions involving any military, paramilitary, intelligence or law enforcement entity of the Government of Iran, or any official, agent or affiliate thereof

In its FAQs, OFAC notes that General License H does not allow US-owned or -controlled entities operating outside the US to: (1) ship any items from the US to Iran "if the items are destined for Iran or the Government of Iran at the time they leave the United States"; (2) ship from a third country to Iran items that have been exported from the US with knowledge or reason to know that the items are intended specifically for Iran, where the items are controlled for export from the US to Iran; or (3) ship from a third country to Iran items containing 10% or more US-controlled content with knowledge or reason to know that the items are intended specifically for Iran. OFAC confirms, however, that US-origin items classified "EAR99" (*i.e.,* not identified on the Commerce Control List) can be shipped by an overseas subsidiary to Iran, provided there was no knowledge or reason to know at the time of export from the US that the goods were intended specifically for Iran. This essentially turns back the clock to the "general inventory" principles that certain foreign subsidiaries of US companies observed pre-ITRA.

7. Can US persons engage in activities that allow overseas affiliates to proceed under General License H?

Yes, in limited circumstances. General License H permits activities of US persons "related to the establishment or alteration of operating policies and procedures of a United States entity or a U.S.-owned or -controlled foreign entity" to give effect to the general license. This permission is largely in response to concerns voiced to OFAC that any alteration by a US company of its previously-established worldwide policy not to engage in transactions or dealings with Iran might be viewed as a form of impermissible facilitation under ITSR Section 560.208 and Section 560.417.

In its FAQs, OFAC explains that this authorization "is intended to cover the involvement of U.S. person board members, senior management, and employees" as well as US persons "who may be hired as outside legal counsel or consultants to draft, alter, advise, or consult on such operating policies and procedures." OFAC also states that General License H allows US persons to provide training, advice, and counselling on new or revised operating policies and procedures. Consistent with the ITSR, OFAC states in its FAQs that General License H does not authorize US persons to get involved "in the ongoing Iran-related operations or decision making of its owned or controlled foreign entity engaging in activities with Iran authorized by [General License] H after these actions are taken." This includes "approving, financing, facilitating, or guaranteeing any Iran-related transaction by the foreign entity."

General License H provides an important authorization for US companies to “make available” to their foreign-owned or -controlled subsidiaries “any automated and globally integrated computer, accounting, email, telecommunications, or other business support system, platform, database, application, or server” necessary to process information related to authorized Iran transactions. The general license defines the terms “automated” as systems that operate “passively and without human intervention” (except for routine or emergency maintenance) and “globally integrated” as “available to, and in general use by” the US person and its foreign affiliates. As an example, the OFAC FAQs provide that it would be lawful for the Dubai-based subsidiary of a US company to use the company’s US-based enterprise resource planning (ERP) system to generate, in an automated fashion, a purchase order relating to activities with Iran consistent with General License H, but it would be impermissible for a US person to perform “data entry or internal processing for the creation of a customer record.”

8. What other Iran-related restrictions are important to keep in mind under US law? In addition to the continuation of most US primary sanctions, there are other provisions of US law that could pose challenges for non-US persons that seek to engage in business in or with Iran. For instance, the US recently amended its Visa Waiver Program (VWP) — which allows nationals of 38 countries (including most of Western Europe, Japan, Australia, New Zealand, Singapore and South Korea) to enter the US visa-free for up to 90 days as a business visitor or tourist — to require a travel visa issued by a US embassy or consulate abroad, if the VWP-eligible foreign traveler has visited Iraq, Iran, Syria or Sudan since March 2011, or if the traveler has dual-nationality with such countries. Although how this new requirement will be implemented and whether it can be waived remain unclear, VWP-eligible foreign travelers should be mindful that visits to Iran could impact their ability to travel quickly to the US in the future.

There is also a continuing risk of new sanctions on Iran for reasons unrelated to its nuclear program. For instance, one day after Implementation Day, on January 17, OFAC designated 11 parties in Iran, Dubai and Hong Kong for their involvement in procurement activities in support of Iran’s ballistic missile program. Those parties are off-limits to US persons, and dealings with such parties by non-US persons can subject them to penalties under US secondary sanctions.

9. What are some important aspects of Implementation Day for financial institutions?

For US financial institutions, Implementation Day provides virtually no relief or new opportunities, except for the ability to seek licensing from OFAC to finance a specific sale of commercial passenger aircraft to Iran. OFAC stresses in its Implementation Day FAQs that US financial institutions cannot participate in or support transactions by non-US parties that are no longer subject to US secondary sanctions, and that the once-available OFAC general license for so-called “U-turn” transactions that allowed US dollar clearing activities involving Iran is not being reinstated. OFAC has advised that “U.S. financial institutions continue to be prohibited from clearing transactions involving Iran, with the exception of transactions that are exempt or authorized by a general or specific license issued pursuant to the ITSR.”

In light of past aggressive US enforcement of sanctions violations, the extent to which non-US financial institutions are prepared to support transactions with Iran that are no longer targeted by US secondary sanctions remains to be seen. Indeed, in its guidance, OFAC has warned that “[a]fter Implementation Day, foreign financial institutions need to continue to ensure they do not clear US dollar-denominated transactions involving Iran through U.S. financial institutions, given that U.S. persons continue to be prohibited from exporting goods, services, or technology directly or indirectly to Iran, including financial services.”

The Society for Worldwide Interbank Financial Telecommunication (SWIFT), the Belgium-incorporated providers of secure financial messaging services, announced in a press release on January 17 that Iranian banks which are no longer the target of EU sanctions will be automatically reconnected to SWIFT, following the completion of SWIFT’s normal connection process. The US confirmed that it would not impose secondary sanctions on non-US persons that provide specialized financial messaging services to, or enable or facilitate direct or indirect access to such services for, the Central Bank of Iran or other banks in Iran, with the exception of those presently on the SDN List (*i.e.,* Ansar Bank, Bank Saderat, Bank Saderat PLC and Mehr Bank).

10. Can US or EU sanctions “snap back” into place?

The US can re-impose or “snap back” part or all of the sanctions relief brought about by the JCPOA if Iran fails to fulfil its obligations under the JCPOA. The JCPOA provides for a dispute resolution process that must be followed before re-imposing previously suspended sanctions, and this process could take up to 30 days (or longer if the parties agreed to an extension).

In its FAQs, OFAC explains that the US would "make every effort to resolve any concerns" through this dispute resolution process, but OFAC is "unable to predict how far in advance notice will be given in the event that sanctions snap back." OFAC further explained that the JCPOA "does not grandfather contracts signed prior to snapback," and, therefore, transactions conducted after a snapback "could be sanctionable to the extent they implicate activity for which sanctions have been re-imposed."

Council Regulation (EU) 2015/1861 does not contain specific provisions that enable the EU to "snap back" previous sanctions in the event that Iran fails to comply with its obligations under the JCPOA. However, recital 6 to Council Regulation (EU) 2015/1861 notes that the EU's commitment to lifting its nuclear-related sanctions in accordance with the JCPOA is without prejudice to its right to reintroduce sanctions in the event of Iran's "significant non-performance" of its commitments under the JCPOA. The EU Information Note clarifies that, before sanctions can be re-introduced, all avenues under the dispute resolution mechanism that the JCPOA provides must have been exhausted. In the event that EU sanctions are re-introduced, recital 7 to Council Regulation (EU) 2015/1861 states that the EU would provide "adequate protection for the execution of contracts concluded in accordance with the JCPOA while sanctions relief was in force." This point is echoed in the Information Note.

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FIRM NEWS

Leading International Arbitration Practitioner to Join Latham & Watkins in London

Arrival of Sophie Lamb significantly enhances Latham's International Arbitration Practice in London and globally.

May 31, 2016

Latham & Watkins is pleased to announce that Sophie J. Lamb joined the firm's London office as a partner where she will head the growth and development of the London arbitration practice and contribute to the leadership of the Litigation & Trial Department. Lamb is recognized as one of the market's leading international arbitration practitioners advising both private and sovereign clients in a wide range of commercial arbitration, investment treaty arbitration and public international law matters.

Over the years, Lamb has led numerous investment disputes around the world and acted as adviser and advocate in more than 100 international commercial arbitrations across a range of industries. She has also led complex litigation in the English and overseas courts, including in business and human rights cases, and has full rights of audience in the superior English courts, having appeared as advocate at every level, including the UK Supreme Court. She acts as counsel for investors and for states in arbitrations under the ICSID Convention and in UNCITRAL arbitrations administered by the Permanent Court of Arbitration. She has also been counsel and sat as arbitrator in inter-state arbitrations, including those concerning access to essential resources or energy supply or transit issues.

Jay Sadanandan, London Office Managing Partner, said: "We are delighted to welcome Sophie to the firm. An accomplished team builder, Sophie is recognized as one of the market's leading lights in international arbitration and she will play a major role in the continued growth of our London disputes practice."

"Sophie has rightfully earned a reputation as one of the leading international arbitration lawyers in the world. She is a brilliant strategist renowned for her outstanding advocacy skills and with an impressive track record. We are thrilled to have her join the practice," added Paris-based Fernando Mantilla-Serrano, Global Co-Chair of the International Arbitration Practice.

Jamie Wine, Global Chair of Latham & Watkins' Litigation & Trial Department, said: "We have been steadily growing our capability in the world's key arbitration venues as we look to establish a truly global market-leading disputes practice. Sophie brings a formidable track-record in representing clients in high stakes, market shaping disputes."

Lamb joins the firm from the London office of Debevoise & Plimpton. She began her career as a barrister at One Essex Court, Chambers of Lord Grabiner QC. She graduated from the University of Manchester and the Université de

Bourgogne and earned a Masters in Banking and International Finance Law from the London School of Economics.

“Given the ever-increasing globalization of business as well as the ability to enforce arbitral awards worldwide, companies across sectors are increasingly turning to international arbitration to resolve cross-border disputes. Latham has all the key attributes necessary for a leading international arbitration practice,” said Lamb.

Latham has been strengthening its international arbitration capability over the last few years with the arrival of a number of highly experienced partners, including Claudia Salomon in New York, Ing Loong Yang in Hong Kong, Markus Rieder in Munich and Fernando Mantilla-Serrano in Paris.

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NEWS IN BRIEF

Romania’s EU Catch-22

By Tom Lane

An ICSID Annulment Committee rejected Romania’s application to annul a 2013 Award in Micula v Romania, leaving the State in an EU Catch-22.

(Ioan Micula, Viorel Micula and others v. Romania, ICSID Case No. ARB/05/20, Decision on Annulment) (26 February 2016).

In the *Micula* dispute, Romanian companies owned by the Micula brothers brought a claim under the Sweden-Romania bilateral investment treaty (BIT). The companies complained that Romania had prematurely terminated attractive tax incentives — designed to encourage investment in underdeveloped regions — on which the companies had relied when making their investment. The incentives had been introduced in 1999 and were intended to last for 10 years. However, Romania terminated the incentives in early 2005 — more than four years before they were due to expire — as part of Romania’s discussions to accede to the European Union, on the basis the incentives were seen to violate EU rules against State Aid.

In 2013, an International Centre for Settlement of Investment Disputes (ICSID) tribunal agreed with the claimants that Romania’s actions had given the claimants a “legitimate expectation” that the incentives would be regarded as legal under EU law and would continue for the full term. The tribunal consequently held that Romania’s subsequent cancelations violated the State’s obligation under the Sweden-Romania BIT to provide investors fair and equitable treatment.

Notably, the European Commission (EC) was involved in the original proceedings as a “non-disputing party,” in effect supporting Romania’s position. The EC, which regards intra-EU BITs as incompatible with EU law, subsequently warned Romania that even simply paying the award would count as illegal state aid. (Please see Latham’s previous article on intra-EU BITs here.)

Romania consequently tumbled into a Catch-22 scenario: if it pays the ICSID award, the country will violate a direct EC order; if Romania fails to pay, then it will be ignoring its obligations under public international law arising under the BIT and the ICSID Convention, which requires State parties to treat an award as if it were a judgment by their own courts.

Romania launched annulment proceedings against the original award, alleging that the tribunal had failed to apply the applicable law (by refusing to consider the full extent of Romania’s continuing EU treaty obligations), and had failed to decide whether the award would actually be enforceable, given the EC’s position.

The EC again filed an amicus curiae submission. The claimants noted that such an intervention by a “non-disputing party” was unprecedented in annulment proceedings. Moreover, the EC’s submission not only backed Romania’s grounds for annulment, but even added one of its own: that the *Micula* tribunal had lacked jurisdiction to hear the dispute since Romania’s accession to the EU in 2007 made this an intra-EU matter. This, the EC argued, rendered the BIT ineffective. The Annulment Committee dismissed this latter point without elaboration.

The Annulment Committee focused on the two key underlying issues: the award's enforceability and the supposed lack of application of the critical EU laws. The decision, however, does little to resolve this conflict.

Regarding enforceability, the committee argued that the tribunal had considered the issue, and — since the tribunal had determined that enforceability was not relevant to the merits of the case — the tribunal was consequently free to render its award without regard to the practical feasibility of payment.

The committee also refused to take issue with the tribunal's findings that the full extent of Romania's EU obligations should only be part of the "factual matrix." The committee concluded that the tribunal had not been asked to rule on whether Romania's incentive programs actually were lawful under EU treaties; rather, the tribunal had simply been asked whether the parties "could reasonably have thought that [those incentives] were lawful." Moreover, the lawfulness was "irrelevant" to the ultimate finding of a breach, since Romania's actions in representing these incentives to the claimants had created the "legitimate expectation" that Romania subsequently trounced. These actions violated the BIT's fair and equitable treatment provisions.

Like the tribunal before it, when presented with a case apparently epitomizing a clash of EU law and BITs, the committee decided that there arguably was no conflict of treaties.

In the decision's aftermath, not only do Romania and the claimants face uncertainty, but so does anyone involved with this sphere. Several days after the decision, Advocate-General Juliane Kokott gave a Cambridge University lecture in which she reflected on this state of uneasy limbo. She suggested that if future arbitrators explicitly consider EU law in their decision-making, then conflicts might conceivably be avoided. A recent decision of the German Supreme Court of 3 March 2016 (case no. I ZB 2/15) to submit these issues to the European Court of Justice (ECJ) may, however, now award the ECJ an opportunity to give Member States and their courts clearer guidance as a matter of EU law.

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Compliance with Host State Laws: an Investor's Burden

By Esperanza Barron Baratech

When an investment's existence is conditioned upon compliance with the host State's law, the investor must be aware of the law's requirements.

(*Grupo Francisco Hernando Contreras v. the Republic of Equatorial Guinea*, ICSID Case No. ARB(AF)/12/2, Award on Jurisdiction dated 4 December 2015)

In an award dated 4 December 2015, an arbitral tribunal declined jurisdiction over claims the Spanish corporation Grupo Francisco Hernando Contreras (Claimant) brought against the Republic of Equatorial Guinea (Respondent). The majority of the arbitral tribunal rendered the award, while co-arbitrator Francisco Orrego Vicuña issued a dissenting opinion.

In 2008, the Claimant incorporated a subsidiary in Equatorial Guinea and a joint venture company that it co-owned with the Respondent. The purpose of both companies was to build, promote and exploit an "intelligent industrial polygon" and a self-sustaining city in the territory of Equatorial Guinea. The Claimant and Respondent had also entered into a series of contracts in order to develop the project. In 2012, the Claimant commenced proceedings under Additional Facility Rules of the ICSID, alleging that the State had breached its obligations under the Spanish-Equatoguinean BIT by failing to make payments to the claimant when due.

The tribunal's analysis turned on the definition of "investment" under the BIT, which mandated that investments be made in accordance with the host State's law. The pivotal criteria were whether the Claimant had made an "investment" in Equatorial Guinea, and whether it had done so in accordance with Equatoguinean domestic law.

In its submissions to the tribunal on the definition of "investment," the Claimant did not rely exclusively on the definition of investment under the BIT, but also invoked the so-called *Salini* test. This "test" assumes that there are criteria inherent to the meaning of "investment" as that term is used in the ICSID Convention, namely that: (i) there be a contribution of money or assets; (ii) the investment be of a certain duration; (iii) the investor assumes an element of risk; and (iv) there is a contribution to the economic development of the host State. According to the claimant, its investment in Equatorial Guinea — namely the contracts the Claimant entered into with the Respondent — fulfilled the aforementioned criteria.

In its analysis, the majority of the tribunal affirmed that the *Salini* test sets out the "predominant interpretative approach" to the notion of investment, but discarded the last criterion that the investment should contribute to the economic development of the State. However, because the Claimant had defined its investment as contracts entered into with the State, the debate was confined to whether the contracts between the parties were valid under Equatoguinean law. The majority concluded that in the present case the contracts were not valid, as the claimant had failed to complete certain administrative steps needed to validate a contract with the State. Further, the majority view was that the Claimant bore the onus of having knowledge of, and ensuring compliance with, the respondent's domestic law. Failing to do so was tantamount to negligence.

Arbitrator Orrego Vicuña disagreed with the majority on two grounds. First, in his view, in civil law traditions, a contract is created when there is a meeting of the minds, not when certain formal requirements are met. Second, he opined that when an investor enters into a contractual relationship with a State, the State, rather than the investor, is responsible for ensuring compliance with all domestic State laws. In other words, Equatorial Guinea, not the Claimant, should have ensured that all the steps required by local legislation were met.

Two points are notable in the majority decision. First, the tribunal adopted a strict interpretation of the requirement that the investment should comply with the laws of the host State. However, this may be explained in part by the fact that the Claimant claimed only that its contracts with the State constituted protected "investments" under the BIT, notwithstanding that the BIT allowed the Claimant to define its investment more broadly.

Second, that the majority of the arbitral tribunal — led by the claimant's own arguments — resorted to the *Salini* test as an "objective" definition of investment under the BIT, is surprising. This test was developed in the context of — and is traditionally understood to be directly relevant to — the meaning of "investment" as that term is used in the ICSID Convention. This is because the ICSID Convention does not define an "investment," even though it conditions the Centre's jurisdiction to instances where the dispute arises directly out of an "investment". In the present case, however, the ICSID Convention was not applicable because the case was brought under ICSID's Additional Facility Rules.

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ICC Court Issues Guidance on Arbitrator Conflicts of Interest and Time Limits for Awards

By Hanna Roos

ICC's new disclosure regime aims to increase arbitrator transparency and incentivise expeditious award submissions.

Introduction

The Court of Arbitration of the International Chamber of Commerce (ICC) has issued a "Note to Parties and Arbitral Tribunals on the Conduct of the Arbitration under the ICC Rules of Arbitration" which:

- Pulls together previous guidance in relation to the ICC, conduct of arbitrations, rendering of awards and submission of expenses
- Sets out new guidance on arbitrators' disclosure of conflicts, which aims to ensure that arbitrators are forthcoming and transparent in their disclosure of potential conflicts
- Underlines time limits for the issue of awards and financial penalties for delays

The last two elements are discussed below.

Disclosure regime

The new regime stems from the "fundamental principle" that parties to arbitration have a legitimate interest in being fully informed of all facts or circumstances that may be relevant to their assessment of whether a chosen arbitrator, or prospective arbitrator, is and remains independent and impartial.

The arbitrator must complete the Statement of Acceptance, Availability, Impartiality and Independence (the Statement) required under Article 11(2) of the ICC Rules. The Statement must include any circumstance that might call into question his or her independence in the eyes of any of the parties, or give rise to reasonable doubts as to his or her impartiality.

In performing such assessment, the arbitrator must consider whether he/she or his/her law firm:

1. Represents or advises, or has represented or advised, one of the parties or one of its affiliates
2. Acts or has acted against one of the parties or one of its affiliates
3. Has a business relationship with one of the parties or one of its affiliates, or a personal interest of any nature in the outcome of the dispute
4. Acts or has acted on behalf of one of the parties or one of its affiliates as director, board member, officer or otherwise
5. Is or has been involved in the dispute, or has expressed a view on the dispute in a manner that might affect his or her impartiality

The arbitrator must also consider whether he/she personally:

6. Has a professional or close personal relationship with counsel for one of the parties or its law firm
7. Acts or has acted as arbitrator in a case involving one of the parties or one of its affiliates
8. Acts or has acted as arbitrator in a related case
9. Has in the past been appointed as arbitrator by one of the parties or one of its affiliates, or by counsel for one of the parties or its law firm

The duty to disclose is an ongoing one: it arises at the time of appointment and continues throughout the duration of the arbitration.

The note seeks to paint disclosure as a positive act and standard feature of the ICC's process. Disclosure does not imply the existence of a conflict: "On the contrary, arbitrators who make disclosures consider themselves to be impartial and independent, notwithstanding the disclosed facts, or else they would decline to serve."

Comment

The note imposes an ongoing duty to conduct thorough checks. For example, the arbitrator must have implemented a system for assessing and monitoring, on an ongoing basis, whether his/her firm becomes associated with one of the parties or its affiliates at any point.

The threshold for disclosure is low and any doubt must be resolved in favor of disclosure. The arbitrator should pay "particular" attention to the nine circumstances identified, but the duty to consider relevant circumstances is "not limited" to them.

The new circumstances are more specific than under the London Court of International Arbitration (LCIA) Rules, which require a written declaration but do not set out particular circumstances. The LCIA's guidance provides that arbitrators are to consider "amongst other things, the existence and nature of any past or present relationships, direct or indirect, with any of the parties or their counsel."

The ICC disclosure regime generally tracks the widely applied International Bar Association (IBA) Guidelines on Conflicts of Interest in International Arbitration (IBA Guidelines). Both the ICC regime and the IBA Guidelines highlight the ongoing duty to disclose, stress that doubt must be resolved in favor of disclosure, and clarify that disclosure does not equate to the existence of a conflict. The IBA Guidelines, too, identify concrete situations, which are arranged into a "traffic-light" system of red, orange and green application lists.

The key differences appear to be that the IBA Guidelines set out situations and guidance in more detail, and differentiate on the basis of how recently the situations have occurred (currently, three years ago, etc.). The IBA Guidelines are also widely used, and arbitrators considering making a disclosure on an ICC matter are therefore likely to cross-check their assessment by using the IBA Guidelines' application lists.

Time limits for awards

The ICC note also reiterates that the ICC Court expects arbitral tribunals to render awards within **six months** from the drawing up of the Terms of Reference, or within the time limit the ICC Court fixes for this purpose (Article 30(1)). The note specifies that sole arbitrators are expected to submit draft awards within **two months**, and three-member arbitral tribunals within **three months**, after the last substantive hearing on matters to be decided in the award or the filing of the last written submissions concerning such matters (excluding cost submissions), whichever is later.

The note specifies that if the draft award is submitted after the two/three-month period, the ICC Court may lower the fees as set out below, unless the court is satisfied that the delay is attributable to factors beyond the arbitrators' control or to exceptional circumstances:

If the draft award is submitted for scrutiny x months after the last substantive hearing/ written submission (excluding cost submissions), whichever is later …	… then the fees that the court would otherwise consider fixing are reduced by …
Up to 7 months	5-10%
Up to 10 months	10-20%
More than 10 months	20% or more

The corresponding 'carrot' is that, whenever a tribunal has conducted the arbitration expeditiously, the ICC Court may increase the arbitrators' fees above the amount that it would otherwise consider fixing.

Comment

Quantifying the consequences of delay is in principle welcome, in order to share the baseline expectation and to increase certainty around how long parties should expect to wait to receive their award.

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Venezuela Not Immune Against Enforcement in *Gold Reserve* Dispute

By Hanna Roos

The English High Court has rejected Venezuela's claim to State immunity from enforcement of a BIT award in Gold Reserve Inc. v Venezuela.

Introduction

The English High Court has rejected the Republic of Venezuela's application to set aside an order that granted leave to Gold Reserve Inc. (Gold Reserve) to enforce an arbitration award, in *Gold Reserve Inc. v The Bolivarian Republic of Venezuela* [2016] EWHC 153. The judgment offers valuable guidance to foreign investors seeking to enforce an arbitration award against a State, and highlights the importance of providing full and frank disclosure when seeking to enforce an arbitration award against a State on an ex parte basis.

Background

The original arbitration concerned gold mining concessions and mining rights in Venezuela, known as the Brisas Project, that the Gold Reserve group of companies had acquired. Venezuela terminated the concessions in 2009. Gold Reserve referred the dispute to arbitration pursuant to the dispute resolution clause in the BIT to the Additional Facility Rules of the ICSID. In an award issued on 22 September 2014, the tribunal found that the State had breached its obligation under the BIT to accord the investment of investors fair and equitable treatment, and awarded Gold Reserve approximately US$713 million in damages, plus interest and costs. In May 2015, Gold Reserve submitted — and was granted — an ex parte application to the English courts for permission to enforce the award.

State Immunity

Venezuela applied to set aside the court's order giving leave to enforce the award on the basis that Venezuela is immune from the English courts' jurisdiction. The English State Immunity Act 1978 (the Act) provides that a State is immune from English courts' jurisdiction unless the Act provides otherwise. It was agreed by the parties that Venezuela was entitled to immunity, unless it had "[…] agreed in writing to submit a dispute which has arisen, or may arise, to arbitration […]," as provided in Section 9(1) of the Act.

However, Venezuela argued that it had not agreed to arbitrate with Gold Reserve because Gold Reserve was not an "investor" as defined in the BIT, namely as any Canadian citizen or enterprise "[…] who makes the investment in the territory of Venezuela and who does not possess the citizenship of Venezuela […]." This mirrored an objection to jurisdiction the State raised during the course of the Additional Facility proceedings. The factual basis for Venezuela's challenge was that Venezuela had initially granted the concessions to a Venezuelan company, which was subsequently purchased by Gold Reserve's US-incorporated parent. Gold Reserve acquired the concessions following an internal corporate restructuring. Venezuela argued that, in these circumstances, Gold Reserve was not an investor inter alia because:

1. The investment (*i.e.*, the concessions) existed before Gold Reserve's acquired the investment
2. "Mak[ing] the investment" required an active commitment, whereas Gold Reserve had acquired the investment passively from its parent without committing money or resources to Venezuela's economy in connection with that acquisition

The court held that the issue was one of construing the ordinary meaning of the definition of "investor" in its context, and having regard to the object and purpose of the BIT. The court was not persuaded by Venezuela's arguments, and found that following the acquisition, Gold Reserve expended nearly US$300 million in developing the Brisas Project. The money clearly went into "the territory of Venezuela." Gold Reserve had raised financing for the purpose of developing the Brisas Project and provided those funds for that purpose. Gold Reserve had also controlled the project in its own name by retaining consultants, experts and financial advisers, by interacting with lenders in connection with due diligence and by concluding contracts for the project. Gold Reserve was therefore an "investor" under the BIT. The Court differentiated between these facts and *Standard Chartered Bank v United Republic of Tanzania* ICSID Case No. ARB/10/12 (November 2012) where the purported investor did nothing concerning the investment, and disavowed any control over it.

The court concluded that Gold Reserve was an "investor" under the BIT; that Gold Reserve was a party to an agreement in writing with Venezuela as set out in the BIT. The State accordingly was not entitled to immunity under the Act.

Full and frank disclosure

Gold Reserve's initial application to enforce the arbitration award was submitted without notice, as is customary under the English rules. An ex parte applicant has a duty to provide full and frank disclosure to the court of all relevant matters. The court found that Gold Reserve had failed in that duty because it (i) did not draw sufficiently to the court's attention the nature of the arguments Venezuela had advanced before the tribunal, and (ii) omitted to state that there were ongoing proceedings in Paris and Luxembourg where Venezuela was relying on the State immunity argument.

The court concluded that had these facts been known, it would not have granted the ex parte application. There was therefore a "powerful case" for setting aside the order and holding an inter partes hearing on the immunity question. However, the court concluded that this was "one of those rare cases" where the court did not need to set aside the order because such a hearing had now occurred pursuant to this application, and the court had ruled against Venezuela on the immunity question. The court instead ordered Gold Reserve to pay Venezuela's costs of the full and frank disclosure issue.

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SCC Calls for Discussion of its Draft 2017 Arbitration Rules

By Jan Erik Spangenberg

The English High Court has rejected Venezuela's claim to State immunity from enforcement of a BIT award in Gold Reserve Inc. v Venezuela.

Introduction

The Arbitration Institute of the Stockholm Chamber of Commerce (SCC) has invited the arbitration community to comment on the draft proposals for revised Arbitration Rules and Rules for Expedited Arbitrations.

The draft Arbitration Rules contain various new provisions:

- Article 13 provides for the joinder of additional parties
- Article 14 allows claims arising out of or in connection with more than one contract in a single arbitration
- Article 24 provides rules for appointing administrative secretaries for the arbitral tribunal
- Article 39 provides rules for a decision of issues of fact by summary procedure, *i.e.*, without undertaking every procedural step that might otherwise be adopted for the arbitration

A new Appendix III contains additional new provisions, which apply to investment treaty disputes only, and which provide a procedure for third-party submissions.

A hearing on the new draft rules took place on 9 June 2016 at the SCC. The SCC has also invited all interested users and practitioners to submit comments on the drafts.

Following SCC Board approval, the new rules are scheduled to become effective on 1 January 2017. Whether the draft rules will be adopted in their present form remains to be seen. The draft rules demonstrate that the SCC remains committed to providing an up-to-date framework for arbitral proceedings, and to remaining at the forefront of the evolving discussion of various new mechanisms.

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Swiss Federal Tribunal Distinguishes Between Treaty and Contract Claims

By Jan Erik Spangenberg

Fundamental distinction between foreign investors' claims affirmed.

In a 6 October 2015 judgment (case no. 4A_34/2015), the Swiss Federal Tribunal addressed the fundamental distinction between a foreign investor's treaty claims and contract claims. This distinction between claims raised on the basis of a contract between a foreign investor and the host State, and claims raised on the basis of a treaty between the investor's home State and the host State, can be decisive for the scope of the investment's protection.

The underlying case concerned a foreign investment in the energy sector of an EU Member State. The foreign investor had acquired a domestic electricity producer. A State company purchased the electricity produced under a long-term power purchasing agreement and at favorable prices in order to attract foreign investors. In 2008, the European Commission held that that the power purchasing agreements constituted state aid incompatible with European competition law, and ordered the EU Member State to terminate the agreements. In addition, the State was to seek reimbursement of the state aid the electricity producers received, while allowing certain "stranded costs" of the electricity producers in turn. The EU Member State accordingly terminated the power purchasing agreements and issued a decree not to award any financial compensation to the electricity producers beyond the amount payable to the State for reimbursement of the state aid received.

Subsequently, a dispute between the foreign investor and the EU Member State arose. The investor claimed stranded costs of more than twice the reimbursable state aid, which were not recoverable under the State's decree, and initiated arbitration proceedings under Article 26 of the Energy Charter Treaty (ECT). In a final award of 3 December 2014, an arbitral tribunal constituted under the UNCITRAL Rules under the aegis of the Permanent Court of Arbitration (PCA) and seated in Zurich, Switzerland, held that the EU Member State had breached its obligation to grant fair and equitable treatment to the foreign investor under Article 10(1) ECT. The tribunal awarded the investor damages amounting to €107 million.

The EU Member State filed an appeal with the Swiss Federal Tribunal, requesting that the Swiss Federal Tribunal annul the arbitral award and find that the arbitral tribunal had no jurisdiction. The EU Member State argued that it had made a reservation under Article 26(3)(c) ECT excluding disputes arising under the "umbrella clause" in the last sentence of Article 10(1) ECT from its consent to arbitration under Article 26 ECT. Under such clause, contracting States are required to "observe any obligation" they have "entered into with an Investor or Investment of an Investor" of any other contracting State.

The foreign investor argued that its claim was not based on the "umbrella clause" but rather on the the fair and equitable treatment obligation under the earlier sentences of Article 10(1) ECT. The tribunal sided with the investor and held that in its consideration of the respondent's behavior under the fair and equitable treatment standard, it could also consider the EU Member State's termination of the power purchasing agreement.

Before the Swiss Federal Tribunal, the respondent EU Member State further argued that the arbitral tribunal should not have relied on the legal qualification of the claim the foreign investor submitted. The Swiss Federal Tribunal rejected this argument, recalling the general principle of procedure that one must first rely on the content and legal ground of the claim as raised by the claimant (*i.e.*, the investor) in order to decide jurisdiction. Moreover, the Swiss Federal Tribunal found that the arbitral tribunal had not based its award on finding a breach of the power purchasing agreement, but on the adoption of the government decree, which failed to set up a mechanism to compensate for the stranded costs. The Swiss Federal Tribunal held that this grievance was within the framework for the EU Member State's duties under the first sentences of Article 10(1) ECT to grant fair and equitable treatment. Furthermore, the tribunal held that a connection between the investor's legitimate expectations as to the protection of its investment and the existence of the power purchasing agreement, was not sufficient to turn into contract claims the alleged failure to respect the undertakings on which these expectations were based. Such interpretation would deprive Article 10(1) ECT of any effectiveness.

The Swiss Federal Tribunal's decision is a reminder that investors must carefully investigate and differentiate between the various legal bases on which they may base treaty and or contractual claims. The decision also reaffirms the Swiss Federal Tribunal's careful and considerate approach to the judicial review of arbitral awards and commitment to Switzerland's tradition as an arbitration-friendly seat of arbitration.

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The Revised Draft CETA – A New Approach to Investor-State Dispute Resolution?

By Jonathan Hew and Yasmina Borhani

Revised proposed EU-Canada free trade agreement contains significant amendments to investment chapter, including provisions for new permanent investment court.

A consolidated version of the much-discussed Comprehensive Economic and Trade Agreement (CETA) between the EU and Canada was first published on 26 September 2014. Following a legal review of the text, the EU and Canada published a revised version on 29 February 2016. The legal review has resulted in a number of significant additions to CETA's investment chapter:

- Right to regulate (art. 8.9) – The EU and Canada have sought to preserve the right to regulate within their respective territories to achieve legitimate policy objectives. The fact that regulation negatively affects an investment or interferes with an investor's expectations, including as to profits, will not by itself amount to a breach under CETA's investment chapter.

- Fair and equitable treatment (art. 8.10(7)) – This sub-article clarifies that a measure passed by the EU or Canada that breaches domestic law will not by itself establish a violation of the fair and equitable treatment standard owed to investors.
- Disclosure of third-party funding (art. 8.26) – A claimant must disclose any third-party funding at the time the claim is submitted (or upon conclusion of the financing agreement if funding is secured afterwards).
- Establishment of tribunal (art. 8.27) – A permanent tribunal will be established to hear claims for violation of the provisions relating to non-discriminatory treatment and investment protection. The tribunal will initially comprise 15 members nominated by the EU and Canada (five each from the EU, Canada and various third states). As a general rule, each case will be heard by three members (one each from the EU, Canada and a third state). Each member must be highly qualified in public international law, and beyond ethical reproach. Once appointed, they must refrain from acting as counsel or party-appointed expert or witness in any pending or new investment dispute.
- Appellate tribunal (art. 8.28) – An appellate tribunal will be established that may uphold, modify or reverse a tribunal's award based on an error of law, a manifest error of fact or the grounds set out in art. 52(1) of the ICSID Convention. An appeal must be made within 90 days, and the initiation of other similar procedures is prohibited. The CETA Joint Committee is to determine certain matters regarding the functioning of the appellate tribunal, including appointment of members. As a general rule three randomly selected members will hear each case.
- Multilateral investment court (art. 8.29) – The EU and Canada shall pursue with other trading partners the establishment of a multilateral investment tribunal and appellate mechanism for the resolution of investment disputes. Disputes under CETA will eventually be decided pursuant to the new multilateral mechanism.
- Applicable law (art. 8.31) – A CETA tribunal shall apply international law only. It cannot determine the legality of a party's measure under domestic law. A matter of domestic law shall be a matter of fact only, and any meaning a CETA tribunal gives to domestic law shall not be binding upon the relevant domestic courts or authorities.

The revised CETA text reflects the EU's new approach to investment protection and investor-State dispute resolution. Similar investment provisions can be found in the EU's proposal for the Transatlantic Trade and Investment Partnership (TTIP) and, to a lesser extent, the EU's Free Trade Agreements with Vietnam and Singapore.

The most eye-catching aspect of the EU's new approach is its commitment to establishing a two-tiered, permanent investment court of bilateral (and, eventually, multilateral) competence. Indeed, the EU intends to propose a permanent investment court in its negotiations with all of its trading partners. This move is ostensibly driven by the EU's desire to "meet the expectations of stakeholders for a fairer, more transparent and institutionalised system for the settlement of investment disputes."

However, a permanent investment court is by no means a quick-fix or panacea for the issues traditional investor-State dispute resolution faces. Questions remain as to how the court would be set up and how it would work in practice including, in particular, the process for finding and selecting the 15 members of the court. Whether the EU can convince its other trading partners to accept a permanent investment court and, if so, how the court would be implemented between them, also remain to be seen.

The EU and Canada aim for CETA to be signed in October 2016 and for it to come into force in 2017.

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ICSID Tribunal Orders Restitution and Awards Moral Damages

By Irina Sivachenko

Recently published lengthy award discusses rarely discussed issues of investment protection.

Bernhard von Pezold and others v Republic of Zimbabwe (ICSID Case No ARB/10/15)

The now-published award, as well as a second parallel ICSID arbitration, concern a land dispute between a family of Swiss-German investors (von Pezolds), two Zimbabwean companies they control and the Republic of Zimbabwe (Zimbabwe).[2] The dispute, steeped in Zimbabwe's colonial history, arose from Zimbabwe's post-independence land reforms that led to expropriation of properties belonging to the "white minority population," including the von Pezolds. The von Pezolds owned several large estates in Zimbabwe, including the country's largest tobacco operation. They claimed that by unlawfully expropriating their property without any compensation, Zimbabwe breached its bilateral

investment treaties (BITs) with Germany and Switzerland and violated international and Zimbabwean laws. Zimbabwe denied that the taking was unlawful and, at a late stage of the proceedings, raised several jurisdictional objections, arguing inter alia that the von Pezold's holdings do not qualify as protected "investments" under the BITs.

Having found that "special circumstances" within the meaning of Rule 26(3) of the ICSID Arbitration Rules existed, among them Zimbabwe's instruction of external counsel, the tribunal admitted the late jurisdictional challenges. The tribunal rejected those challenges and, in reaching its decision, offered several important observations on what constitutes protected investments under the ICSID convention and what is sufficient to establish foreign control over an investment. The tribunal ultimately ordered restitution of the expropriated property to the von Pezolds and, in addition, awarded them compensation, including moral damages and costs, both of which are rarely discussed or even awarded in investment arbitration.

Zimbabwe raised the issue of foreign control because the family owned the legal title in the expropriated property indirectly, through shares in a number of Zimbabwean companies, which in turn owned the land. Zimbabwe submitted that the von Pezold's alleged control of these companies did not qualify as foreign control as required under Article 25(2)(b) ICS Convention, because the "chain of control" was broken because of the presence of intermediary companies, and the holdings were "willfully untraceable" and a "nebulous maze ... ultimately owned or controlled by nobody knows whom." The tribunal rejected this argument and found that the chain of control has been properly established because the evidence clearly demonstrated that the von Pezolds exercised overall control over the companies.

The tribunal also rejected Zimbabwe's challenge of its jurisdiction ratione materiae that the von Pezolds' mere ownership of land cannot be considered protected investment.

Zimbabwe claimed that the von Pezolds' properties were not active investments but rather a mere "holding" of a "portfolio." The properties, therefore, did not qualify for protection under the ICSID convention or the BITs because the von Pezolds did not contribute to the economic development of the country. Rather, the family "drained ... land of resources." Zimbabwe also argued that BITs incentivize new investments and offer no protection for investments lingering from the country's colonial past. The tribunal rejected these arguments and held that even if there were a requirement for an active role in the investment, it was satisfied in this case because the von Pezolds actively controlled the properties and were not simply passive offshore shareholders, with no role in the business.

The tribunal similarly dismissed Zimbabwe's claim that there was no protected "foreign" investment because the investment was conducted through local Zimbabwean companies and the funding "came from Zimbabwe and remained in Zimbabwe," with no foreign investments at stake. The tribunal found that there was no "origin of capital" requirement under the ICSID convention or the relevant BITs, and held that the fact that locally incorporated companies were used as part of the investment structure does not undermine the investment's foreign nature.

On the merits, the tribunal found inter alia that Zimbabwe had unlawfully expropriated the von Pezolds property, because it failed to pay compensation. In response to the von Pezolds further claim of a breach of the full protection and security standard, Zimbabwe asserted "force majeure" and customary international law necessity defenses, saying that "the massive popular spontaneous ineluctable uprisings all across Zimbabwe" were an irresistible and spontaneous force, "part of the overwhelming ... March of History." The tribunal rejected Zimbabwe's arguments, finding that Zimbabwe contributed to the unrest and supported the invaders who took the von Pezolds' land by passing land reforms and failing to protect the von Pezolds' property.

The tribunal ordered restitution of the expropriated estates, and awarded US$57 million in shortfall compensation for the losses the von Pezolds incurred due to land damage and losses to farms' productivity, as well as a pre-award and post-award compound interest. If Zimbabwe fails to provide restitution of full legal title, it was ordered to pay US$187 million compensation.

The tribunal also ordered Zimbabwe to pay US$1 million in moral damages to a member of the von Pezolds' family who resided in Zimbabwe, as well as to the local companies that brought their claims in parallel proceedings. The tribunal found that it may award moral damages in exceptional circumstances. In awarding moral damages, the tribunal held that Zimbabwe is liable for threats and actual violence against several claimants, even if Zimbabwe did not directly perpetrate the actions but only failed to protect the von Pezolds from the invaders. The tribunal also ordered that Zimbabwe carry full costs of arbitration and reimburse the von Pezolds for their legal expenses. Zimbabwe applied to ICSID to annul the award. The annulment proceedings are still ongoing.

Endnotes

[1] *http://www.lcia.org/adr-services/guidance-notes.aspx - see "LCIA Notes for Arbitrators", and "The New LCIA Guidance Notes: Useful Reading for Parties" in* https://www.lw.com/admin/UserControls/SiteAttachmentHandler.ashx?attachmentid=d9189365-1996-4ec6-bded-b7ce5f80fbf5

[2] The parallel arbitration Border Timbers Limited, *Border Timbers International (Private) Limited, and Hangani Development Co. (Private) Limited v. Republic of Zimbabwe* (ICSID Case No ARB/10/25) was filed by Zimbabwean companies the von Pezolds control, and concerns similar claims against Zimbabwe. The same tribunal heard both arbitrations, and the parties submitted joint pleadings and evidence, but the proceedings were not formally consolidated and the tribunal rendered two separate awards.

INTERNATIONAL ARBITRATION NEWSLETTER

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About the Publication
Latham & Watkins International Arbitration Newsletter is a regular publication produced by the firm's global International Arbitration team designed to highlight important news, legal issues and developments in a practical and informative way.

If you have any questions about this publication please contact a lawyer on the editorial team, Sebastian Seelmann-Eggebert, Philip Clifford, Catriona E. Paterson and Jan Erik Spangenberg.

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