

THE ARBITRATION REVIEW OF THE AMERICAS 2010



Published by Global Arbitration Review
in association with
Sidley Austin LLP



www.GlobalArbitrationReview.com

CAFTA-DR Provides Strong Investor Protections But No Flurry of Cases

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The free trade agreement among the United States, the Dominican Republic, and Central American countries (Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua) (known as CAFTA-DR) was signed on 5 August 2004, and has now entered into force in all of the signatory countries. It includes a chapter (chapter 10) setting out minimum standards of protection for member country investors in each other's territories – including, importantly, an option for the investor itself to enforce those treaty protections directly in binding international arbitration against a host state. This is a powerful tool for CAFTA-DR investors in protecting their investments, and it means that host states must take the promised investor protections seriously.

When the CAFTA-DR was submitted for ratification in the United States and other countries, concerns were raised that these protections opened the door to wide-ranging legal challenges to national laws and regulations. Critics warned that dozens, if not hundreds, of cases would surely be filed upon ratification, and that all of the signatory countries were at risk. At least to date, however, in the five years since CAFTA-DR was signed and the four years since it was ratified in a majority of countries, those concerns have not been borne out.¹ Only four cases have been publicly disclosed as filed. At the same time, cross-border investment has continued to expand and grow within the region.

As noted, the CAFTA-DR provides important legal protections to investors in the region. These are described in the first section below. The second section surveys the cases filed to date under CAFTA-DR's investor-state dispute resolution provisions.

Investment protections in CAFTA-DR

The investment chapter of CAFTA-DR (chapter 10) offers to protect investors from one CAFTA-DR country, and their investments, in the territory of any other CAFTA-DR country. Like many other modern international investment agreements, CAFTA-DR includes substantive requirements that govern the treatment of foreign investors, including prohibitions against expropriation without compensation, as well as guarantees of national treatment and most-favoured-nation treatment, fair and equitable treatment, and the free transfer of funds. Most importantly, CAFTA-DR allows investors to protect these rights by seeking recourse through neutral, binding international arbitration for alleged violations by the host government.

First, CAFTA-DR prohibits a host state from expropriating a foreign investment without compensation. While CAFTA-DR does not prohibit expropriation outright, it requires 'prompt, adequate and effective compensation' for the investor in the event of an expropriation.² This requirement applies equally to direct

expropriations (eg, the host government confiscates the investment) and indirect expropriations (eg, the government destroys the value of the investor's investment, even if it does not actually confiscate the investment). In addition, CAFTA-DR protects against 'creeping' expropriation, where the government, over time, implements a number of smaller measures that, taken together, substantially deprive the investor of the value of its investment.

Second, CAFTA-DR requires that a host government provide 'national treatment' to foreign investors (eg, treatment no less favourable than that provided to similarly situated domestic investors) and 'most-favoured-nation treatment' (eg, treatment no less favourable than that provided to similarly situated foreign investors).³ These two requirements mandate equality in the conditions of competition, subject to certain limitations and carve-outs that are annexed to the agreement.

Third, unlike many other international investment agreements, CAFTA-DR includes 'pre-establishment rights'.⁴ Most international investment agreements only provide protection to investors after an investment has been made in the host country. Thus, in those cases, the host government is allowed to impose discriminatory provisions on a potential investment, such as prohibiting foreign investors from investing in certain sectors of the economy, or participating in a privatisation bid. CAFTA-DR, on the other hand, requires that the host government provide national treatment and most-favoured-nation treatment even with respect to the establishment of an investment.

Fourth, CAFTA-DR requires that a host government provide 'fair and equitable treatment' to investors in accordance with customary international law.⁵ This requirement incorporates a minimum standard of treatment under customary international law that sets a floor of protection. That is, it guarantees investors a certain minimum level of treatment, regardless of how the host country may choose to treat its own nationals.

Fifth, CAFTA-DR guarantees investors the right to transfer funds into and out of a host country without delay. A wide variety of transfers are protected, including not only the investment itself, but also profits, capital gains, interest, and even payments arising out of a dispute, among others.⁶

Sixth, CAFTA-DR prohibits performance requirements, such as requirements to export a certain percentage of production, engage in technology transfer, or use a certain level of domestic content.⁷ Similarly, CAFTA-DR prohibits any requirement that the investor appoint senior management or members of the board of directors that are nationals of the host state.⁸ These protections allow investors to freely operate and control their investments without undue interference from local officials.

1 El Salvador ratified CAFTA in December 2004; Honduras and Guatemala both ratified in March 2005; the United States ratified in August 2005; the Dominican Republic ratified in September 2005; Nicaragua ratified in October 2005, and Costa Rica ratified in October 2007.

2 CAFTA-DR at article 10.7.

3 CAFTA-DR at articles 10.3 and 10.4.

4 CAFTA-DR at articles 10.3 and 10.4.

5 CAFTA-DR at article 10.5.

6 CAFTA-DR at article 10.8.

7 CAFTA-DR at article 10.9.

8 CAFTA-DR at article 10.10.

Finally, CAFTA-DR provides a strong enforcement mechanism, which allows foreign investors to have their claims heard and redressed through neutral, international arbitration.⁹ The CAFTA-DR governments consent in advance to resolve such disputes through international arbitration, allowing investors to bypass local courts with respect to covered claims against the government. And if an investor prevails, the government is obliged, as a matter of its international legal obligations, to recognise any award and to comply with it promptly. Although investment arbitration awards are usually paid by states without need for enforcement measures, investors are also able to enforce CAFTA-DR awards in courts around the world under various international treaties.

Cases brought under CAFTA-DR's investor-state dispute resolution provision

At the time of CAFTA-DR's signature and in various national debates over ratification, concerns were expressed that these strong CAFTA-DR investment protections would beget a flurry of new cases that would challenge a wide range of national laws and regulations. For example, one critic argued that by ratifying CAFTA-DR, governments would 'actually hand foreign businesses powerful rights that trump the interests or desires of local citizens'.¹⁰ Even very recently, another critic testified before the US Congress that:

*[CAFTA-DR] subjects US environmental, consumer and other public-interest laws to challenge by foreign investors empowered to demand US government compensation directly in foreign tribunals for domestic laws they deem to undermine their expected future profits. The investment chapter of the Central America Free Trade Agreement (CAFTA) expanded on the definition of foreign investments that were provided special protections and rights.*¹¹

CAFTA-DR faced similar vocal opposition in other signatory countries, and in particular, in Costa Rica.

These concerns simply have not been borne out. Public information indicates that only four disputes have been filed under the CAFTA to date. Each of these disputes is discussed below.

*Railroad Development Corporation v Republic of Guatemala*¹²

On 14 June 2007, Railroad Development Corporation (RDC) filed for arbitration on behalf of itself and its majority owned Guatemalan subsidiary, which does business as Ferrovías Guatemala (FVG).¹³ ICSID registered the RDC's arbitration request on 20 August 2007. RDC has alleged violations of CAFTA-DR article 10.3 (national treatment), article 10.5 (minimum standard of treatment), and article 10.7 (expropriation).

In 1997, RDC saw its bid approved to provide railway services in Guatemala. RDC agreed to invest US\$10 million and, in turn, was awarded a 50-year right to rebuild and operate the Guatemalan rail system (which had closed in March 1996). The contract was signed in November 1997, and ratified by the Congress in April 1998. According to the tribunal's decision on jurisdiction, RDC

resumed commercial service between various cities, and cargo traffic increased through 2005.¹⁴

In June 2005, RDC, through its local subsidiary FVG, began a domestic commercial arbitration in Guatemala, alleging that Guatemala had failed to clear squatters from properties in the rail system.¹⁵ In August 2006, the government adopted a resolution declaring that the RDC contract was injurious to the interests of the state.¹⁶ In the CAFTA-DR arbitration, RDC alleges that the resolution resulted in Guatemala's failure to make payments under the contract or to remove squatters from the railway, and encouraged additional encroachments of railway property.¹⁷ Finally, RDC alleges that Guatemala has blocked its attempts to have its concerns addressed in domestic courts.¹⁸ In total, RDC is seeking US\$65 million in damages.

On 29 May 2008, Guatemala challenged the international tribunal's jurisdiction by asserting that the tribunal did not have the power to issue an award because RDC's consent to arbitration was faulty. Guatemala argued that this objection must be considered on an expedited basis under article 10.20.5, which provides for an expedited review of certain objections to jurisdiction.

Guatemala argued that RDC's consent to arbitration was invalid because RDC/FVG were not permitted to seek CAFTA-DR arbitration while continuing to pursue local remedies in Guatemala, including through commercial arbitration and the local courts.¹⁹ Guatemala argued that it had only consented to arbitrate CAFTA-DR disputes that were not being adjudicated through other fora.²⁰ Guatemala argued further that CAFTA-DR requires a request for arbitration to explicitly waive 'any right to initiate or continue before any administrative tribunal or court under the law of any Party, or other settlement procedures, any proceeding with respect to any measure alleged to constitute a breach referred to in article 10.16.'²¹

On 17 November 2008, the CAFTA-DR tribunal considered Guatemala's objections and determined that it has jurisdiction to hear RDC and FVG's claims under the Treaty. With respect to Guatemala's objection that RDC has continued to pursue domestic arbitration seeking redress for certain government actions, the tribunal focused on whether the domestic arbitration claims concern the same measures as the international arbitration claims.²² Ultimately, the tribunal determined that there was no overlap, and thus, that RDC's claims could proceed to the merits.

The parties are currently briefing the merits of the case. On 26 June 2009, RDC filed its memorial on the merits. On 24 July 2009, Guatemala requested that the tribunal address additional jurisdictional objections as a preliminary question (eg, in a separate, preliminary stage). On 24 August 2009, the tribunal issued a procedural order suspending the proceeding on the merits and granting Guatemala's request that the tribunal first address additional jurisdictional objections.

⁹ CAFTA-DR at articles 10.15-10.27 (section B).

¹⁰ Daphne Eviatar, 'A Toxic Trade-off', *Washington Post*, 14 August 2005.

¹¹ Written Testimony of Todd Tucker, Research Director of Public Citizen's Global Trade Watch Division Before the Ways & Means Committee Subcommittee on Trade Hearing on Investment Protections in US Trade and Investment Agreements (14 May 2009).

¹² ICSID Case No. ARB/07/23 (registered 20 August 2007).

¹³ RDC owns 82 per cent of FVG; the other 18 per cent is divided among 65 Guatemalan investors.

¹⁴ Decision on jurisdiction at paragraph 9.

¹⁵ Decision on jurisdiction at paragraph 10.

¹⁶ Decision on jurisdiction at paragraphs 12 to 13.

¹⁷ Decision on jurisdiction at paragraph 15 (quoting arbitration request at paragraph 48).

¹⁸ Decision on jurisdiction at paragraph 16.

¹⁹ Decision on jurisdiction at paragraph 18.

²⁰ Decision on jurisdiction at paragraph 28.

²¹ Decision on jurisdiction at paragraph 28 (quoting reply at paragraph 18).

²² Decision on jurisdiction at paragraph 48.

*Pac Rim Cayman LLC v Republic of El Salvador*²³

On 9 December 2008, Pac Rim Cayman LLC (Pac Rim), a Nevada corporation and wholly owned subsidiary of a Canadian company, filed a notice of intent with El Salvador to commence arbitration under the ICSID rules. Subsequently, on 30 April 2009 Pac Rim filed its request for arbitration, and the case was registered on 15 June 2009. The parties are still in the process of selecting the arbitral tribunal that will hear the case.

Pac Rim is claiming damages of US\$77 million – the amount it asserts it has invested since 2002 in approved natural resource exploration activities in El Salvador. Those exploration activities resulted in the discovery of significant gold ore deposits in 2002 and 2003. Pac Rim filed for an exploitation permit and the necessary environmental permits for mining in 2004. However, Pac Rim alleges that, starting in 2006, the government simply shut down communications with the firm. In March 2008, President Saca announced that no new mining permits would be granted. Pac Rim has alleged that this measure violates El Salvador's domestic law, and constitutes both discriminatory treatment and a violation of the fair and equitable treatment guaranteed by article 10.5 of CAFTA-DR.

*Commerce Group Corporation and San Sebastian Gold Mines, Inc v Republic of El Salvador*²⁴

In a second case relating to El Salvador's mining policies, a joint venture of Commerce Group Corporation and San Sebastian Gold Mines, both US companies, filed a notice of intent to bring claims against El Salvador under the CAFTA-DR on 16 March 2009. The companies subsequently filed a request for arbitration, and their dispute was registered with ICSID on 21 August 2009. The parties are in the process of establishing a tribunal to hear the case.

The two companies had entered into a joint venture to develop mining interests in gold and silver at the San Sebastian Gold Mine. The companies have been active in El Salvador since at least 1968. The companies allege that in 2006 the government revoked their environmental permits, which effectively prevented them from continuing to mine, and refused to issue new permits when the companies applied for them. The companies filed complaints in local courts in 2006, but the matter has not been resolved. The companies have claimed damages exceeding US\$100 million.

In both this dispute and in Pac Rim, press reports indicate that the current government of El Salvador is seeking to reach negotiated settlements with the affected companies.²⁵ At the same time, however, recently proposed legislation would apparently ban precious metal mining in the country and give the companies six months to wind down their operations. The outcome of these discussions, and the pending arbitrations, are being watched closely by other foreign companies invested in mining operations in El Salvador.

*TCW Group Inc and Dominican Energy Holdings, LP v The Dominican Republic*²⁶

On 15 March 2007, the TCW Group (TCW), a US company owned by Société Générale, a French company, filed a notice under the CAFTA-DR citing potential violations of the Treaty. On 21 December 2007, TCW filed its notice of arbitration and statement of claim. In it, TCW alleged violations of the CAFTA-

DR's national treatment, most-favoured nation treatment, fair and equitable treatment, and expropriation protections. TCW is claiming at least US\$680 million in damages. Société Générale has filed a parallel claim under the France-Dominican Republic bilateral investment treaty.²⁷

TCW is the controlling shareholder and 50 per cent owner of Empresa Distribuidora de Electricidad del Este, SA (EDE Este), a Dominican electricity distribution company. TCW purchased its interest in November 2004.

TCW alleges that since March 2007, the Dominican Republic has refused to establish the necessary legal and payment structures for the collection of electricity tariffs, has refused to make payments owed to TCW, has enacted discriminatory and arbitrary regulations that contravene TCW's legitimate, investment-backed expectations, has violated a concession agreement, has failed to treat TCW as well as other foreign investors, has failed to enforce its laws to prevent, and at times has even encouraged, the theft of electricity from EDE Este, and has engaged in retaliatory practices in response to TCW's notice of its intent to invoke the CAFTA-DR arbitration mechanism.

On 21 November 2008, the Dominican Republic filed objections to the CAFTA-DR tribunal's jurisdiction over the dispute with TCW. On 13 February 2009, TCW filed its counter-memorial defending the tribunal's jurisdiction. The Dominican Republic raised four objections to jurisdiction.

First, the Dominican Republic contends that TCW has not waived its right to pursue domestic legal proceedings related to the same measures, as the Dominican Republic claims is required under article 10.18 of CAFTA-DR.

Second, the Dominican Republic argues that TCW's alleged investment does not have the characteristics of an investment for purposes of CAFTA-DR, because TCW has not committed any capital, has no reasonable expectation of gain or profit, and has not assumed any risk associated with EDE Este. TCW contends that it owns an 'enterprise' – EDE Este – (and its stock) and thus has an investment as defined by CAFTA-DR article 10.28. TCW also asserts that the concession agreement constitutes an investment.

Third, the Dominican Republic argues that neither a direct nor indirect expropriation has occurred, and thus the tribunal does not have jurisdiction over such claims. TCW reasserts its expropriation claims, and argues that (for purposes of jurisdiction) it need only show the possibility that the tribunal could rule in its favour on the issue.

Fourth, the Dominican Republic argues that the events giving rise to the arbitration occurred before CAFTA-DR came into force, and thus are outside of the jurisdiction of the tribunal. TCW counters that, at a minimum, the tribunal has claims over all actions that occurred after March 2007. But more fundamentally, TCW argues that the conduct constitutes 'continuing and composite acts' and thus is within the tribunal's jurisdiction.

The tribunal has declared its intention to rule on the jurisdictional objections by January 2010.²⁸ In the parallel arbitration under the France-Dominican Republic BIT, the tribunal issued a decision on jurisdiction in October 2008 in which it allowed the arbitration to proceed to the merits phase.

Although the predicted wave of investor-state disputes feared by opponents of CAFTA-DR has not materialised, foreign investors

23 ICSID Case No. ARB/09/12 (registered 15 June 2009).

24 ICSID Case No. ARB/09/17 (registered 21 August 2009).

25 Fernando Cabrera Diaz, 'El Salvador Government Considers Ban on Mining as Permit Freeze Leads to CAFTA Arbitration', *Investment Treaty News* (2 September 2009).

26 Under the UNCITRAL Arbitration Rules.

27 2 *International Arbitration Reporter* 4, pages 12 to 13 (28 February 2009).

28 2 *International Arbitration Reporter* 4, pages 12 to 13 (28 February 2009).

in the region should be aware of, and plan their investments in light of, the important protections afforded by the Treaty. The cases above illustrate the kinds of government measures that may affect foreign investors, and that can be the subject of CAFTA-DR arbitration.

As foreign direct investment continues to grow within the region, investors from all CAFTA-DR countries should carefully consider their treaty-based rights when seeking to address adverse treatment by a host state.



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