New York Law Journal

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VOLUME 240—NO. 126 WEDNESDAY, DECEMBER 31, 2008

INTERNATIONAL ARBITRATION LAW

Expert Analysis

'Biwater,' Classic Investment Bases: Input, Risk, Duration

By
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Article 25(1) of the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (the convention) sets out the parameters of the jurisdiction of the International Centre for the Settlement of Investment Disputes (the centre) and thus of arbitral tribunals performing their duties under its aegis.

The interpretation of those jurisdictional requirements has been intensely debated in academic writings and in case law. In particular, the requirement that the dispute "aris[e] directly out of an investment," and more specifically the notion of investment under Article 25(1) of the convention, is currently one of the most controversial topics in ICSID arbitration.

It is in the context of such controversies that, on July 24, 2008, was rendered one of the latest awards contributing to the notion of investment in *Biwater Gauff (Tanzania) Ltd. v. United Republic of Tanzania* (Decision available on the ICSID Web site).

No Definition of 'Investment'

Despite its central character in a convention specifically designed to deal with investment disputes, the notion of "investment" was not defined within the meaning of Article 25(1) of the convention. Instead, the drafters concluded that it would be preferable to leave it to the contracting states to determine the definition of an investment and to exclude certain kinds of disputes from the scope of the convention if they so desired when providing their consent to the centre's jurisdiction. Paragraph 27 of the Report of the Executive Directors states in that respect:

> No attempt was made to define the term 'investment' given the essential requirement of consent by the parties, and the mechanism through which Contracting States can make known in advance, if they so desire, the class of disputes which would or would not consider submitting to the centre (Art 25 (4)).

Against that background one might have expected that when a state has expressed consent in a bilateral investment treaty, the terms of that treaty would define what the parties to the treaty understood to constitute the scope of matters covered by the term 'investment.' In that sense, as long as the requirement of an investment under the treaty is satisfied, the notion of investment within the meaning of the ICSID convention should not give rise to any particular difficulty. Nevertheless, the lack of a definition of the term "investment" in the ICSID convention has given rise to conflicting decisions adopting sometimes radically opposite views.

Finding an Investment

Early ICSID arbitral decisions barely addressed the question of whether the requirement of an investment was met within the meaning of Article 25(1) of the convention. Although a number of arbitral decisions tangentially touched on the point (see, inter alia, *Kaiser Bauxite Company v. Jamaica*, Decision on Jurisdiction and Competence, July 6, 1975, YB Comm. Arb., Vol. IV, p. 207; *Liberian Eastern Timber Corporation (LETCO) v. Government of the Republic of Liberia*, Award, March 31, 1986, 2 ICSID Reports, p. 349), it was not until the decisions in *Fedax* and *Salini* that tribunals conducted a more in-depth analysis of the parameters of the term "investment" under Article 25(1) (see *Fedax N.V. v. The Republic of Venezuela*, Decision on Objections to Jurisdiction, July 11, 1997, para. 25; *Republic of Venezuela and Salini Construttori SpA and Italstrade SpA v. Kingdom of Morocco*, Decision on Jurisdiction, July 23, 2001, para. 52; both decisions are available on the Investment Treaty Arbitration Web site).

More recent ICSID arbitral decisions dealing with the notion of investment within the meaning of Article 25(1) range from adopting a very liberal approach to exhibiting a strict and narrow vision of what should be understood as an investment. Although it is difficult to categorize arbitral decisions based on the conceptual approach adopted by each tribunal, it is possible to point to two main lines of reasoning and an intermediate approach in arbitral case law.

The first line of decisions, which could be described as liberal, favors using typical "characteristics" as guidance in finding an investment. By contrast, the second line underscores the need for a given transaction to satisfy cumulative conditions to qualify as an investment. Adopting somewhat a middle ground, a third line of decisions recognizes the need for objective criteria to determine the existence of an investment, but considers such criteria to be limited in number and scope (for an in-depth analysis of the genesis and evolution of these trends, see E. Gaillard, "Identify or define? Reflection on the evolution of the concept of investment in the ICSID practice," Liber Amicorum Christoph Schreurer, forthcoming 2009). Each of these approaches will be examined in turn.

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Liberal Approach

• Based on Characteristics

The first trend of arbitral decisions leans toward a liberal and flexible approach in finding an investment under Article 25(1). This line of reasoning emphasizes the deliberate decision of the convention's drafters not to define 'investment,' a decision intended to avoid undue restrictions on the parties' understanding of what should constitute an investment. Accordingly, the arbitrators should not impose fixed criteria to determine the existence of an investment, but rather consider various "characteristics" or features for guidance in identifying the existence of an investment. Under this line of approach, the characteristics of an investment may vary from one case to another.

It is argued that the liberal approach allows for flexibility and gives weight to the parties' understanding of the concept of investment, consistent with the spirit of the convention as expressed in the Report of the Executive Directors. The risk, however, is that when taken to the extreme, this approach ultimately places the concept of investment in Article 25(1) as secondary to and dependent upon the concept of consent of the parties. The danger of determining the concept of investment under Article 25(1) exclusively on the basis of the parties' agreement is that it conflates the objective requirement of jurisdiction under Article 25(1) with the subjective requirement of consent given in the bilateral investment treaty (BIT), the former being subsumed in the latter.

Among the arbitral decisions that follow this liberal approach is the decision of the ad hoc Committee in *CMS Gas Transmission Company v. Argentina* (Decision of the ad hoc Committee on the application of Annulment, Sept. 25, 2007, para. 71; available on the ICSID Web site), as well as the decisions of the Arbitral Tribunals in *Fraport AG Frankfurt Airport Services Worldwide v. Republic of the Philippines and M.C.I. Power Group, L.C. and New Turbine Inc. v. Republic of Ecuador* (Award, Aug. 16, 2007, para. 305, and Award, July 31, 2007, para. 165, respectively, both available on the Investment Treaty Arbitration Web site). The tribunal's award in *Biwater* also follows this approach.

The 'Biwater' Arbitration

In that case, a British company that was the majority shareholder in a Tanzanian company resorted to ICSID arbitration in its dispute with the Republic of Tanzania (or Tanzania) in relation to the expropriation of the investment of the Tanzanian company in a project for the improvement and provision of water and sewerage services in Dar Es Salaam. Biwater alleged that the actions of the Tanzanian authorities violated the applicable BIT.

Tanzania objected to the arbitral tribunal's jurisdiction on the ground that the dispute was not in relation to an investment. It argued that the internal rate of return of the project was too low to make it profitable on its own. Thus, there could not be any expectation on the part of the investor of a regular return on investment. It also argued that there was no assumption of risk or a substantial commitment by the investor. Each of these "criteria," claimed Tanzania, must be met in order for the project to qualify as an investment under Article 25(1). Whether the project qualified as an investment under the BIT was irrelevant, because it did not first meet the objective definition of "investment" under Article 25(1).

Jurisdiction terms have been debated. The requirements that the dispute "aris[e] directly out of an investment" and the notion of in-vestment under Article 25(1) of the convention are the hottest topics in ICSID arbitration.

In response, Biwater contended that the five elements identified by investment arbitration commentators as "common features" of projects or transactions that qualify as investment in ICSID case law—namely, duration, regularity of profit and return, risk, substantial commitment, and significance to the host state's economic development—were present. Consequently, the project qualified as an investment under Article 25(1). Also, Biwater relied on the broad definition of "investment" in the Tanzania-U.K. BIT to argue that the project and Biwater's interest in the underlying contracts qualified as an investment under the BIT (Award, para. 288).

The Tribunal's Analysis

The tribunal characterized the parties' arguments on this point as being drawn from the test established in *Salini v. Morocco* under which strict criteria should be met (see below). It did not accept the parties' respective position as to the *Salini* test, concluding that Article 25(1) did not contain a strict criteria test:

> …[T]here is no basis for a rote, or overly strict, application of the five *Salini* criteria in every case. These criteria are not fixed or mandatory as a matter of law. They do not appear in the ICSID convention. On the contrary, it is clear from the travaux préparatoires of the convention that several attempts to incorporate a definition of 'investment' were made, but ultimately did not succeed. In the end, the term was left intentionally undefined, with the exception (inter alia) that a definition could be the subject of agreement as between Contracting States […] (Award, para. 312).

In addition to the support it found in the drafters' unequivocal decision not to define "investment," the tribunal warned against the perils of arbitrarily excluding certain transactions from the scope of the convention by misguidedly elevating various characteristics, as found by the tribunals in individual cases, to the level of fixed and required "categories." Such an approach, the tribunal cautioned, "leads to a definition that may contradict individual agreements (as here), as well as developing consensus in parts of the world as to the meaning of investment (as expressed, e.g., in bilateral investment treaties)." (Award, para. 314).

Instead, the tribunal advocated a "more flexible and pragmatic" approach. Such an approach would take into account the features of the *Salini* test. It would also integrate the content of the instrument where the consent is expressed. The tribunal stated:

> …over the years, many tribunals have approached the issue of the meaning of 'investment' by reference to the parties' agreement, rather than imposing a strict autonomous definition, as per the *Salini* Test.

To this end, even if the Republic could demonstrate that any, or all, of the *Salini* criteria are not satisfied in this case, this would not necessarily be sufficient—in and of itself—to deny jurisdiction. (Award, paras. 317 and 318).

The tribunal concluded to the existence of an investment under Article 25(1) based on an overall analysis taking into account the scope of consent expressed in the BIT. In thoroughly analyzing the elements that militate in favor of the liberal approach, it also underscored the risk created by a narrow and nonflexible definition of investment: the arbitrary exclusion of disputes relating to certain transactions from the jurisdiction of the centre.

Strict Cumulative Terms

The milestone decision of the arbitral tribunal in *Salini v. Morocco* illustrates a contrasting approach whereby fixed and cumulative "criteria" should be satisfied for a transaction to be considered an investment within the meaning of the convention. The decision in *Saipem SpA v. People's Republic of Bangladesh* also illustrates this approach (Decision on Jurisdiction and Recommendation on Provisional Measures, March 21, 2007, para. 99, available on the ICSID Web site). A similar line of reasoning was adopted by the arbitral tribunals in *Jan de Nul NV and Dredging International NVl v. Arab Republic of Egypt* and *Ioannis Kardassopoulos v. Georgia* (Decision on Jurisdiction, June 16, 2006, para. 91, available on the Investment Treaty Arbitration Web site, and Decision on Jurisdiction, July 6, 2007, para. 116, available on the Energy Charter Web site, respectively).

The proponents of this approach consider that there is a genuine definition of investment and thus the analysis of whether there is an investment within the meaning of the convention cannot depend on the recognition of variable characteristics or features typically found in an investment. The arbitral decisions that follow this line of reasoning observe that Article 25(1) has an autonomous meaning under the convention and reject the purely subjective approach, pursuant to which an investment is whatever the parties understood it to be.

Following the test set forth by the arbitral tribunal in *Salini v. Morocco*, this line of decisions require an investment under Article 25(1) to meet several set criteria. However, the number of criteria vary from one decision to another. Some arbitral tribunals, adhering to the *Salini* test, require that a transaction satisfy a four-fold test, namely contribution, risk, duration and contribution to the economic development of the host state. Other decisions raise the number of elements to five by requiring that the contribution to the economic development of the host state be significant.

The requirement of an ever-increasing number of criteria has resulted in an excessively restrictive definition of investment. The decision of the sole arbitrator in *Malaysian Historical Salvors (MHS), SDN, BHD v. Malaysia* illustrates this point (Decision on Jurisdiction, May 17, 2007, paras. 119-146, available on the ICSID Web site). The sole arbitrator in that case considered that he should not only follow the four-fold analysis in the *Salini* test but added a quantitative and qualitative dimension to such analysis. He decided that although MHS had made a contribution, its size was not comparable to that of other investments observed in previous ICSID tribunal decisions and therefore could not constitute a contribution that would support the existence of an investment under Article 25(1).

He also held that while the duration of the contract complied in a quantitative sense with the minimum of two to five years set forth in *Salini*, the requirement was not satisfied in a qualitative sense, as the extension of the initial contract from 18 months to four years was happenstance. Further, MHS was found to satisfy the requirement of risk in a quantitative sense in that there was a risk inherent to the contract, but the commercial risk of the salvage contract was found not to comply with the qualitative aspect of the risk requirement under ICSID jurisprudence.

Finally, the sole arbitrator considered that in assessing whether there was a significant contribution to the economic development of the host state, a political or cultural benefit should not be taken into account. In that respect it was decided that the contribution to the economic development of the host state should be not only significant, but also positive and lasting.

On this basis, the sole arbitrator dismissed the claim and found that it had no jurisdiction under the convention. The extreme positions adopted in this decision have been generally criticized. It can be argued that the inclusion of the qualitative and quantitative thresholds finds no support in the text of convention or in its travaux preparatoires. It can further be argued that this extreme approach is contrary to the ordinary meaning of the term "investment" and is completely at odds with the spirit as well as the object and purpose of the convention.

Criteria Limited in Number

The third line of reasoning can be characterized as a traditional or classical approach to the definition of investment. It recognizes the need to satisfy both the objective requirement of an investment within the meaning of the convention and the requirement of an investment under the applicable instrument.

It considers that there are objective criteria that must be satisfied to find an investment but that the analysis must be a nonrestrictive one. In this respect, it retains the three following criteria: contribution, risk and a certain duration.

Under this approach, the contribution to the economic development of the host state does not constitute a fourth criterion and the reference to the wording "economic development" in the convention's preamble does not purport to introduce another element in the definition of investment. Illustrations of this approach can be found in *Victor Pey Casado v. The Republic of Chile* (Award, May 8, 2008, para. 232, available on the ICSID Web site) and in *LESI SpA and Astaldi SpA v. People's Democratic Republic of Algeria* (Decision on Jurisdiction, July 12, 2006, para. 72, available in the Investment Treaty Arbitration Web site).

This approach avoids the risk of reducing the notion of investment to a subjective test and rendering superfluous the requirement of "investment" under the convention. It strikes the balance between, on the one hand, not presenting the extreme rigidity of the *MHS* or even the *Salini* lines of reasoning and, on the other hand, not contravening the object and purpose of the ICSID convention by giving excessive weight to the parties' understanding of the scope of investment, for example in situations where the parties would want a mere sale-purchase transaction to qualify as an investment under the convention.

Conclusion

This is the reason why, in the author's view, this approach is the most faithful to both the text and the intention of the drafters of the ICSID convention.

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