

THE ICSID CONVENTION: A COMMENTARY

A Commentary on the Convention on the Settlement of Investment
Disputes between States and Nationals of Other States

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A stipulation by the parties that an existing dispute has arisen directly out of an investment would be strong authority for a commission or a tribunal but would not pre-empt its power to determine its own competence in this respect. On the other hand, a stipulation between the parties, such as the one suggested by the 1981 Model Clause IV¹⁰⁰ (see para. 62 *supra*), that any future dispute relating to their agreement arises directly out of an investment does not appear meaningful. Not only is it futile to characterize disputes that may arise in the future, but in addition the commission or tribunal would not be bound by such a clause since it relates to the Convention's objective requirements for jurisdiction.

Institution Rule 2(1)(e) indicates that a request to institute conciliation or arbitration proceedings should also contain information on the directness of the dispute in relation to an investment (see para. 61 *supra*). No documentation on this point is required at the time of instituting proceedings¹⁰¹ (see Art. 36, paras. 24–27). 86

Art. 2(b) of the Additional Facility Rules authorizes proceedings for the settlement of disputes that are not within the Centre's jurisdiction because they do not arise directly out of an investment (see para. 10 *supra*). This is usually read to refer to disputes that arise from transactions other than investments (see paras. 202–209 *infra*).¹⁰² But a dispute that arises from an investment, though only indirectly, would also be covered by the wording of this provision. Therefore, where the connection between the investment and the dispute appears too remote to satisfy the Convention's requirement of directness, the Additional Facility could serve as an alternative method of dispute settlement.¹⁰³ The ICSID Secretariat has suggested yet another way to deal with arrangements that are related to investments covered by an ICSID consent clause yet fall outside the scope of the Convention. The parties are advised to provide for *ad hoc* arbitration, incorporating the ICSID Rules by reference and designating the Secretary-General as appointing authority. This might lead to parallel ICSID and non-ICSID proceedings, possibly administered by the same arbitrators.¹⁰⁴ 87

2. Direct Disputes or Direct Investments

The requirement of directness refers to the relation of the dispute to the investment. It does not refer to the investment as such. In *Fedax v. Venezuela*, the Respondent argued that the disputed transaction involving debt instruments issued by the Republic of Venezuela was not a "direct foreign investment" and therefore could not qualify as an investment under the Convention. The Tribunal rejected this argument: 88

It is apparent that the term "directly" relates in this Article to the "dispute" and not to the "investment". It follows that jurisdiction can exist even in respect of

100 1 ICSID Reports 201. This clause was omitted from the 1993 Model Clauses.

101 Institution Rule 2(2).

102 Broches, The "Additional Facility", p. 377; Toriello, The Additional Facility, pp. 73/4.

103 See *Fedax v. Venezuela*, Decision on Jurisdiction, 11 July 1997, para. 28.

104 Delaume, G. R., ICSID Arbitration, in: Contemporary Problems in International Arbitration (Lew, J. ed.) 23, 37 (1987). See also News from ICSID, Vol. 1/2, p. 14 (1984).

investments that are not direct, so long as the dispute arises directly from such a transaction.¹⁰⁵

89 Other tribunals have taken the same position and have quoted the above passage from *Fedax*.¹⁰⁶

90 In a number of cases Argentina argued that the dispute did not arise directly from an investment since the investor had made its investment by way of a company incorporated in Argentina.¹⁰⁷ Tribunals have rejected this argument.¹⁰⁸

91 In *CMS v. Argentina*,¹⁰⁹ the Respondent argued that neither TGN, a company incorporated in Argentina in which the Claimant held shares, nor the licence held by TGN, qualified as an investment. Since these assets did not constitute an investment under the applicable BIT, CMS's claims, based on the alleged breach of TGN's rights under the licence, could not be considered as arising directly from an investment.¹¹⁰ The Tribunal rejected that argument. It said:

... the rights of the Claimant can be asserted independently from the rights of TGN and those relating to the License, and because the Claimant has a separate cause of action under the Treaty [the BIT] in connection with the protected investment, the Tribunal concludes that the present dispute arises directly from the investment made and that therefore there is no bar to the exercise of jurisdiction on this count.¹¹¹

92 In *Siemens v. Argentina*, the Tribunal said in response to a similar argument:

There is no doubt that the dispute with Argentina under the Treaty is a dispute which arises directly from the investment as defined by Siemens. The quality of a direct dispute is not affected by Siemens not being the direct shareholder of the local company. This is a separate question. For purposes of Article 25(B), a dispute may arise directly out of an investment made directly or indirectly by an investor. Whether in that situation the investor qualifies as such will depend on the definition of investor in the treaty or the terms of the investment contract. The direct requirement under the ICSID Convention is related to the investment dispute, not to whether the investor [investment] is direct or indirect.¹¹²

3. The General Unity of an Investment Operation

93 An investment operation typically involves a number of ancillary transactions. They may include financing, the acquisition of property, purchase of various goods, marketing of produced goods and tax liabilities. In economic terms, these

105 *Fedax v. Venezuela*, Decision on Jurisdiction, 11 July 1997, para. 24.

106 *CSOB v. Slovakia*, Decision on Jurisdiction, 24 May 1999, paras. 71, 72; *CMS v. Argentina*, Decision on Jurisdiction, 17 July 2003, para. 52. See, however, *ADC v. Hungary*, Award, 2 October 2006, para. 331, which is ambivalent on this point.

107 See also *Alexandrov, S. A.*, The "Baby Boom" of Treaty-Based Arbitrations and the Jurisdiction of ICSID Tribunals: Shareholders as "Investors" and Jurisdiction *Ratione Temporis*, 4 *The Law and Practice of International Courts and Tribunals* 19, 40-45 (2005).

108 *Enron v. Argentina*, Decision on Jurisdiction, 14 January 2004, paras. 58-60; *Enron v. Argentina*, Decision on Jurisdiction (Ancillary Claim), 2 August 2004, para. 22; *Continental Casualty v. Argentina*, Decision on Jurisdiction, 22 February 2006, para. 40.

109 *CMS v. Argentina*, Decision on Jurisdiction, 17 July 2003.

110 At para. 66.

111 At para. 68.

112 *Siemens v. Argentina*, Decision on Jurisdiction, 3 August 2004, para. 150.

189 Some treaties, in their definitions of “investment”, refer to the territory of the parties. For instance, the Argentina-US BIT states that

“investment” means every kind of investment *in the territory* of one Party owned or controlled directly or indirectly by nationals or companies of the other Party, . . .²⁷⁵

190 Similarly, Article 1101(1) of the NAFTA speaks of “investments in the territory” of a Party. Article 26(1) of the Energy Charter Treaty refers to investments “in the Area” of a Party.

191 In some cases respondents have argued that the requirement of territoriality for investments was not met since the would-be investor had not established a significant physical presence in the host State. In *Fedax v. Venezuela*, the investor had acquired promissory notes issued by the host country. The Tribunal rejected the Respondent’s argument that the Claimant had not invested “in the territory” of Venezuela. It said:

While it is true that in some kinds of investments . . . such as the acquisition of interests in immovable property, companies and the like, a transfer of funds or value will be made into the territory of the host country, this does not necessarily happen in a number of other types of investments, particularly those of a financial nature. It is a standard feature of many international financial transactions that the funds involved are not physically transferred to the territory of the beneficiary, but put at its disposal elsewhere. In fact, many loans and credits do not leave the country of origin at all, but are made available to suppliers or other entities. . . . The important question is whether the funds made available are utilized by the beneficiary of the credit, . . .²⁷⁶

192 In *CSOB v. Slovakia*, the Claimant bank had transferred non-performing receivables to a Collection Company (CC) in Slovakia. The CC was to pay CSOB for the assigned receivables. To enable the CC to do so it received the necessary funds from CSOB under the terms of a loan agreement. The repayment of the loan was secured by a guarantee of the Slovak Ministry of Finance. The Respondent argued that there was no expenditure of resources in the territory of a foreign country. The Tribunal noted that the loan did not involve any spending or outlay of resources in the territory of the Slovak Republic.²⁷⁷ Nevertheless, it held:

The Tribunal notes, in this connection, that while it is undisputed that CSOB’s loan did not cause any funds to be moved or transferred from CSOB to the Slovak Collection Company in the territory of the Slovak Republic, a transaction can qualify as an investment even in the absence of a physical transfer of funds.²⁷⁸

193 The two *SGS* cases concerned pre-shipment inspections that were essentially carried out outside the territory of the host country. The Tribunal in *SGS v. Pakistan* relied on the fact that expenditures had been made, even though in a relatively

275 Argentina-US BIT, 1991, Art. I(1)(a). Emphasis added.

276 *Fedax v. Venezuela*, Decision on Jurisdiction, 11 July 1997, para. 41.

277 *CSOB v. Slovakia*, Decision on Jurisdiction, 24 May 1999, paras. 78, 79.

278 At para. 78.

small amount, by the investor in connexion with its activity in the territory of Pakistan.²⁷⁹

In *SGS v. Philippines*, the Respondent objected that the pre-shipment inspection services were not performed “in the territory” of the Philippines as required by the BIT.²⁸⁰ The Tribunal dealt with this issue in some detail.²⁸¹ It found that:

In accordance with normal principles of treaty interpretation, investments made outside the territory of the Respondent State, however beneficial to it, would not be covered by the BIT.²⁸²

The Tribunal rejected a subdivision of activities inside and outside the host country. It found that a substantial and non-severable aspect of the overall service was provided in the Philippines.²⁸³ This and the location of a liaison office in Manila were sufficient to support the finding that there had been an investment in the territory of the Philippines.²⁸⁴

Other cases have addressed this issue only peripherally.²⁸⁵ In *LESI-DIPENTA v. Algeria* and in *LESI & Astaldi v. Algeria* the Tribunals discussed the issue in the context of its discussion of a contribution in the host country. The Tribunals said:

It is often the case that these investments are made in the country concerned, but that again is not an absolute condition. Nothing prevents investments from being committed, in part at least, from the contractor’s home country, as long as they are allocated to the project to be carried out abroad.²⁸⁶

In *Bayview v. Mexico*, a case that was decided not under the ICSID Convention but under the Additional Facility, the Tribunal found that farmers in Texas who claimed water from Mexico were not investors in the territory of Mexico for purposes of Art. 1101(1) NAFTA.²⁸⁷

These case authorities do not yield an entirely clear picture concerning a requirement of territoriality. No such additional requirement should be read into the ICSID Convention. Where the document providing the basis of consent refers to investment in the territory of the State, a certain degree of flexibility is appropriate. Not all investment activities are physically located on the host State. This is particularly true of financial instruments (see para. 149 *supra*). If a treaty includes loans and claims to money in its definition of investment, it would be unrealistic to require

279 *SGS v. Pakistan*, Decision on Jurisdiction, 6 August 2003, at paras. 46, 136.

280 *SGS v. Philippines*, Decision on Jurisdiction, 29 January 2004, at paras. 57, 70, 80–82, 89.

281 At paras. 99–112.

282 At para. 99. Footnotes omitted. The Tribunal mentioned the construction of an embassy in a third State as an example.

283 At para. 102.

284 At paras. 104, 111, 112.

285 In *Gruslin v. Malaysia*, Award, 27 November 2000, paras. 10.3, 13.1–15.9, the issue was discussed extensively but not decided – see para. 26.2; see also *Zhinvali v. Georgia*, Award, 24 January 2003, paras. 377, 381.

286 *LESI-DIPENTA v. Algeria*, Award, 10 January 2005, para. II. 14(i); *LESI & Astaldi v. Algeria*, Decision on Jurisdiction, 12 July 2006, para. 73(i).

287 *Bayview v. Mexico* (AF), Award, 19 June 2007, paras. 105–124.

a physical presence in or a transfer of funds into the host State. Similar considerations apply to intellectual property which is typically included in definitions of investment.

198 Therefore, the interpretation of a territorial requirement will to a large extent depend on the type of investment. Investment in movable and particularly immovable property will require a territorial nexus. In cases involving financial obligations the *locus* of the investment can often be determined by reference to the debtor and its location. In this way financial instruments issued by States have their *situs* in that State. Investment through shareholding may be seen to take place at the company's place of registration or main place of activity. Services may be seen to be located in a State if their chief impact is in that State.

d) Investment and Host State Law

199 Some treaties require that in order to qualify as an investment, the operation must be in accordance with the host State's law. BITs frequently include the formula "in accordance with host State law" or a similar phrase in their definitions of the term "investment".²⁸⁸

200 Host States have sometimes argued that this meant that the concept of "investment", and hence the reach of the protection under the treaty, had to be determined by reference to their own domestic law. Tribunals have rejected this approach. In *Salini v. Morocco*, the Tribunal said in response to this argument:

The Tribunal cannot follow the Kingdom of Morocco in its view that paragraph 1 of Article 1 [of the BIT] refers to the law of the host State for the definition of "investment". In focusing on "*the categories of invested assets (. . .) in accordance with the laws and regulations of the aforementioned party*", this provision refers to the validity of the investment and not to its definition. More specifically, it seeks to prevent the Bilateral Treaty from protecting investments that should not be protected, particularly because they would be illegal.²⁸⁹

201 Other tribunals have also held consistently that the reference to the host State's domestic law concerned not the definition of the term "investment" but solely the legality of the investment.²⁹⁰ In a number of cases tribunals examined whether investments complied with host State law including whether they constituted an "approved project".²⁹¹ In the majority of cases they concluded that the investments

288 For detailed discussion see *Knahr, C.*, Investments "in Accordance with Host State Law", 4 TDM No. 5.

289 *Salini v. Morocco*, Decision on Jurisdiction, 23 July 2001, para. 46.

290 *LESI-DIPENTA v. Algeria*, Award, 10 January 2005, para. II. 24(iii); *Gas Natural v. Argentina*, Decision on Jurisdiction, 17 June 2005, paras. 33, 34; *Bayindir v. Pakistan*, Decision on Jurisdiction, 14 November 2005, paras. 105–110; *Saipem v. Bangladesh*, Decision on Jurisdiction, 21 March 2007, paras. 79–82, 120–124. In *Aguas del Tunari v. Bolivia*, Decision on Jurisdiction, 21 October 2005, paras. 139–155, the reference to host State law was not contained in the BIT's definition of "investment" but in its provision on admission.

291 *Gruslin v. Malaysia*, Award, 27 November 2000, paras. 9.2, 10.7, 17.1, 21.1–25.7.

were legal under host State law.²⁹² In other cases they found that the investment was in violation of host State law and declined jurisdiction.²⁹³

9. Use of the Additional Facility in the Absence of an Investment

a) Conciliation and Arbitration

The Additional Facility offers conciliation and arbitration proceedings for the settlement of legal disputes that are not within the jurisdiction of the Centre because they do not arise directly out of an investment²⁹⁴ (see paras. 9–13 *supra*). It was explained:

. . . among the reasons for the proposal to establish the Additional Facility was the concern that a conciliation or arbitration agreement might be frustrated if a Commission or Tribunal declared itself incompetent on the ground that it considered the underlying transaction not to be an "investment".²⁹⁵

Therefore, the Additional Facility may be used if a transaction does not meet the requirements of an "investment" under the Convention. This does not mean that proceedings under the Additional Facility are open for any type of dispute. An agreement providing for conciliation or arbitration proceedings under the Additional Facility requires the approval of the Secretary-General.²⁹⁶ The Secretary-General may give approval only if he or she is satisfied that the underlying transaction has features that distinguish it from an ordinary commercial transaction.²⁹⁷ In other words, the transaction, even if it falls short of the requirement of an investment, must still be more than an ordinary commercial transaction.

The Administrative Council in approving these provisions attempted to describe the concept of a transaction that is distinguishable from an ordinary commercial transaction:

Economic transactions which (a) may or may not, depending on their terms, be regarded by the parties as investments for the purposes of the Convention, which (b) involve long-term relationships or the commitment of substantial resources on the part of either party, and which (c) are of special importance to the economy of the State party, can be clearly distinguished from ordinary commercial

292 *Tokios Tokelès v. Ukraine*, Decision on Jurisdiction, 29 April 2004, paras. 83–86; *PSEG v. Turkey*, Decision on Jurisdiction, 4 June 2004, paras. 109, 116–120; *Plama v. Bulgaria*, Decision on Jurisdiction, 8 February 2005, paras. 126–131; *Kardassopoulos v. Georgia*, Decision on Jurisdiction, 6 July 2007, paras. 174–184; *Tokios Tokelès v. Ukraine*, Award, 26 July 2007, para. 97. See also the non-ICSID case *Saluka v. Czech Republic*, Partial Award, 17 March 2006, paras. 183, 202–221.

293 *Inceysa v. El Salvador*, Award, 2 August 2006, paras. 184–244; *Fraport v. Philippines*, Award, 16 August 2007, paras. 300, 306–307, 319, 323, 332, 335, 350, 383, 385, 396–398, 401–404. See also *World Duty Free v. Kenya*, Award, 4 October 2006 and *Plama v. Bulgaria*, Award, 27 August 2008, paras. 130–146, where the Tribunals dismissed the claims on the ground of illegality not as a matter of jurisdiction but on the merits.

294 Art. 2(b) Additional Facility Rules. The Additional Facility Rules are available at: <http://www.worldbank.org/icsid/facility/facility.htm>.

295 Comment (iv) to Art. 4 of the Additional Facility Rules, 1 ICSID Reports 220. See also *Broches*, The "Additional Facility", pp. 377/8.

296 Art. 4(1) Additional Facility Rules.

297 Art. 4(3) Additional Facility Rules. See also *Shihata/Parra*, The Experience, pp. 344 *et seq.*

transactions. Examples of such transactions may be found in various forms of industrial cooperation agreements and major civil works contracts.²⁹⁸

204 This description makes the classification independent of whether the parties thought their transaction was an investment. It presents a long-term relationship or the commitment of substantial resources as possible alternatives. A commitment of substantial resources need not be made by the investor but may be made by the host State. Most significant is the element that the transaction is of special importance to the economy of the host State. This description has certain similarities to the "Salini-test" discussed above (see paras. 152–174 *supra*) but appears to be somewhat wider.

205 The Additional Facility is not designed as a means to avoid the application of the Convention where access to the Centre is available. Also, there may be genuine borderline cases where it is unclear whether the transaction meets the requirements of an "investment" under the Convention or has to be brought under the Additional Facility. In a situation of this kind, proceedings under the Convention must be tried first. If the Secretary-General is of the opinion that it is likely that an ICSID conciliation commission or arbitral tribunal will hold that the dispute arises directly out of an investment, he or she may make approval of the agreement providing for proceedings under the Additional Facility conditional upon consent by both parties to submit any dispute in the first instance to the jurisdiction of the Centre.²⁹⁹

206 In actual practice, submissions to the Additional Facility are made to overcome non-participation in the Convention of either the host State or the investor's State of nationality. The Model Clauses offer ways to submit to the Additional Facility where the jurisdictional requirements *ratione personae* have not been met (paras. 224–226, 300–301 *infra*) and for fact-finding (para. 34 *supra*) but not for disputes that do not arise directly out of an investment.

207 Decisions in some cases, in which tribunals decided that there was no investment and that hence there was no jurisdiction, underscore the potential of the Additional Facility for this type of situation. If the parties have doubts as to whether their transaction amounts to an investment, they may draft a combined submission clause, which after submitting to the jurisdiction of the Centre makes the following addition:

In case the [Conciliation Commission]/[Arbitral Tribunal] decides that the jurisdictional requirements *ratione materiae* of Art. 25 of the Convention are not fulfilled because the dispute does not arise directly out of an investment, the Parties hereby consent to [conciliation]/[arbitration] under the Additional Facility [Conciliation]/[Arbitration] Rules of the Centre.

208 Many bilateral investment treaties provide for proceedings under the Additional Facility. But they also contemplate the lack of participation in the Convention by either of the parties (see paras. 226, 301 *infra*) and not the submission of disputes that do not arise directly out of investments. Nevertheless, even where

298 Comment (iii) to Art. 4 of the Additional Facility Rules, 1 ICSID Reports 220.

299 Art. 4(4) Additional Facility Rules.

the Additional Facility is used to remedy the lack of participation by one side in the Convention, it also opens the door for the settlement of disputes that are covered by the BIT but excluded from the Convention *ratione materiae*.³⁰⁰ A possible example would be disputes relating not to an existing investment but to pre-investment activities.³⁰¹

209 Where the parties to an agreement entertain doubts as to whether their transaction qualifies as an investment and whether a submission clause to ICSID would therefore be appropriate, they have several possibilities. They may make a special statement in their contract designating their project as an investment, possibly adding a brief description of those features that support this characterization (see paras. 129, 130 *supra*). They may draft a combined jurisdictional clause submitting to the Additional Facility in case the competent ICSID organs determine that the Convention's requirements *ratione materiae* have not been met (see para. 206 *supra*). Finally, they may combine such an ICSID/Additional Facility Clause with a clause referring to another arbitral institution or submitting to *ad hoc* arbitration.

b) Fact-Finding

210 Unlike conciliation and arbitration, fact-finding under the Additional Facility³⁰² is not subject to any jurisdictional requirements *ratione materiae*. The requirement that the underlying transaction have features distinguishing it from an ordinary commercial transaction (see para. 202 *supra*) does not apply to fact-finding. The Secretary-General has no power to approve or disapprove arrangements for fact-finding proceedings.³⁰³ The omission of any indication of the type of facts to be clarified is somewhat surprising at first sight. It may be due to the circumstance that both in the Convention and in the Additional Facility, jurisdiction *ratione materiae* is always described in terms of a dispute. Fact-finding is designed to be preventive and hence, by definition, does not require a dispute. The Introductory Notes to the Fact-Finding (Additional Facility) Rules contain a reference to a long-term relationship and to national or international guidelines or codes of conduct relating to foreign investment.³⁰⁴ This would indicate that there must be some relationship to an investment. A contextual reading of the relevant provisions would also suggest that there should be at least some connection with the Centre's or the ICSID Convention's general scope of activities. But it is also arguable that the lack of restrictions *ratione materiae* should be taken at face value and that, hence, fact-finding under the Additional Facility is available for any question in proceedings between a State and a national of another State.

300 See also *Golsong, H.*, Dispute Settlement in Recently Negotiated Bilateral Investment Treaties – The Reference to the ICSID Additional Facility, in: *Realism in Law-Making: Essays on International Law in Honour of Willem Riphagen* 35 (1986); *Shihata/Parra*, The Experience, p. 358.

301 See *Parra*, Provisions on the Settlement, pp. 325, 329.

302 Generally see *Shihata/Parra*, The Experience, p. 357.

303 Art. 4(1) of the Additional Facility Rules. 304 1 ICSID Reports 215.