Omani Construction Company Wins Substantial Damages Against Yemen in Investment Treaty Arbitration

The recent Award in the case of Desert Line Projects LLC v. The Republic of Yemen (ICSID Case No ARB/05/17) is noteworthy in several respects. The Award considered certain jurisdictional pre-conditions that must be satisfied before the protection afforded by a bilateral investment treaty (“BIT”) can be triggered. It re-examined what are known as “fork in the road” provisions, whereby investors are commonly required to make an irrevocable choice between different dispute resolution mechanisms as an exclusive means of pursuing remedies against host governments. The Award also included ground-breaking relief in the form of “moral damages” as part of the substantial compensation awarded to the claimant.

Desert Line Projects LLC (“Desert Line”) is a company, organized under the laws of Oman, which constructs asphalt roads. Between 1999 and 2002, Desert Line embarked upon several road construction projects in Yemen. A contractual dispute arose in connection with sums due under the various agreements between Desert Line and Yemen. The dispute was exacerbated by harassment, threats and thefts committed by Yemeni armed forces and non-State armed groups and by the incarceration of some of Desert Line’s personnel.

In June 2004, Desert Line and Yemen agreed to submit their contractual dispute to arbitration in Yemen. The arbitration concluded and Desert Line was awarded substantial compensation. Yemen failed to comply with the award and coerced Desert Line into a settlement agreement in December 2004 under which Desert Line relinquished nearly half of the sums that had been awarded to it in the contractual arbitration proceedings. In August 2005, Desert Line commenced ICSID arbitration at the World Bank, complaining that Yemen had breached its obligations under the Yemen-Oman BIT and/or international law as a result of its actions before and after the settlement agreement.

A pre-condition to seeking relief under the Yemen-Oman BIT is that an investor should have obtained an “investment certificate” (Article 1(1) of the BIT). Yemen argued that the ICSID tribunal lacked jurisdiction because no such certificate had been issued. The tribunal disagreed. The “threshold inquiry” according to the tribunal, was “whether Article 1(1) corresponds to mere formalism or to some material objective”. In deciding that Article 1(1) constituted the latter, the tribunal felt that “a purely formal requirement would by definition advance no real interest of either signatory State; to the contrary, it would constitute an artificial trap depriving investors of the very protection the BIT was intended to provide”. Ultimately, the tribunal found that Desert Line would have been given an investment certificate had it asked for one, particularly given the general endorsement of the investment at the highest level of the Yemeni State.

Yemen also asserted that the ICSID tribunal lacked jurisdiction by virtue of the “fork in the road” provision set out in Article 11 of the BIT, under which a qualifying investor is required to choose between a number of dispute resolution mechanisms, including local arbitration as an alternative to ICSID arbitration. The tribunal rejected Yemen’s arguments, finding that the Yemeni arbitration and the ICSID proceedings “were brought pursuant to fundamentally different causes of action”. Yemen’s conduct “amounted to the deprivation of [Desert Line’s] fundamental rights under the BIT. There can be therefore no res judicata effect”.

In the ICSID proceedings, Desert Line sought a declaration that the settlement agreement was null and void and/or rescinded. It also advanced various claims for damages to compensate it for, inter alia, Yemen’s breaches of contract, the illegal blocking of Desert Line’s equipment and the loss of business opportunities. Desert Line’s largest claim was for “moral damages”. By way of support for its claims, Desert Line pointed to the physical and economic duress that had resulted from the illegal acts committed by Yemen and stated that Yemen had failed to protect Desert Line from harassment and theft by armed groups and tribes. Desert Line contended that Yemen took advantage of the duress that it had generated to impose the unfavourable settlement agreement.
The ICSID tribunal’s conclusions on the moral damages claims are of particular interest. The tribunal noted that “even if investment treaties primarily aim at protecting property and economic values, they do not exclude, as such, that a party may, in exceptional circumstances, ask for compensation for moral damages.” The tribunal considered that Yemen’s violations of the BIT were “malicious”, particularly considering the physical duress exerted on Desert Line’s executives. As a result, the tribunal awarded Desert Line US$1 million in moral damages (and US$24 million in all).

This case serves as a reminder to sovereign States of the obstacles that they often face in objecting to jurisdiction in investment arbitrations, and of the broad range of remedies that are increasingly available to international investors under BITs.

United States Supreme Court Rejects Expanded Judicial Review of Arbitral Awards

On March 25, 2008 the United States Supreme Court issued its decision in Hall Street Associates LLC v. Mattel Inc., clarifying the scope of judicial review over arbitral awards under the Federal Arbitration Act (“FAA”). Asked whether parties can contractually expand judicial review over arbitral awards to include errors of law, the Supreme Court held that “[Sections] 10 and 11 respectively provide the FAA’s exclusive grounds for expedited vacatur and modification”. Accordingly, parties may no longer contractually expand judicial review beyond the grounds enumerated in the FAA.

The case arose out of a landlord-tenant dispute. Under the terms of the lease, Mattel had to indemnify Hall Street Associates LLC (“Hall Street”) for costs associated with any violation of environmental laws during Mattel’s tenancy. After Mattel gave notice to terminate the lease, Hall Street demanded that Mattel indemnify Hall Street under the lease for the costs of an environmental clean-up following violation of a state statute.

Before the United States District Court, the parties agreed to a court-approved arbitration agreement for the dispute. As part of the arbitration agreement, the parties consented to judicial review of an arbitral award for errors of law and fact. In due course, the arbitrator ruled that Mattel need not indemnify Hall Street because its conduct was a violation of a “human health” statute and not an environmental law. Relying on the arbitration agreement’s judicial review mechanism, Hall Street successfully moved the District Court to vacate the arbitrator’s legal finding. On remand, the arbitrator ordered Mattel to indemnify Hall Street.

The case was eventually appealed to the Ninth Circuit, which ruled that the parties’ agreement to expand judicial review was unenforceable because the enumerated grounds for vacatur and interpretation in Sections 10 and 11 of the FAA were exclusive. The Supreme Court granted the writ of certiorari in light of the split amongst the Circuit Courts on whether parties could contractually expand judicial review under the FAA.

The Supreme Court first addressed Hall Street’s contention that review beyond the FAA’s enumerated grounds had been judicially accepted since the 1953 decision of Wilko v. Swan. While dicta in Wilko suggested judicial acceptance that an arbitral award could be vacated if it was made in “manifest disregard” of the law, the Court rejected any suggestion that Wilko supported the parties’ ability to expand the scope of judicial review. The Court suggested that “manifest disregard” might have been shorthand to the Section 10 grounds collectively, rather than an enlargement of the accepted grounds for review under the FAA.

The Supreme Court then discussed whether party autonomy permits parties to expand review contractually. It first analyzed the text of Sections 10 and 11, which only permits vacatur or modification in extreme circumstances (such as “corruption”, “fraud”, “evident partiality” and “evident material mistake”). It would strain interpretive principles, reasoned the Supreme Court, to add legal error to that list. Ultimately, the Court’s interpretation of the FAA centered on the purpose of Sections 9-11, which “substantiate[e] a national policy favoring arbitration with just the limited review needed to maintain arbitration’s essential virtue of resolving disputes straightaway”. The Court concluded that “the statutory text gives us no business to expand the statutory grounds”.

Although the case appears to render a straightforward ruling that Sections 10 and 11 comprise the exclusive grounds for vacatur and modification under the FAA, it leaves certain important questions unanswered. The Court’s treatment of Wilko may lead some to argue that the “manifest disregard” standard has been eliminated. It remains to be seen, however, if the Court’s discussion of Wilko will be interpreted in that manner. Notably, the Court made clear that its holding related only to review under Sections 9-11 of the FAA, and decided “nothing about other possible avenues for judicial enforcement of arbitration awards”. In fact, the Court specifically stated that statutory schemes other than the FAA could lead to a different result.

In the wake of the Supreme Court’s decision, parties should avoid stipulating for expanded judicial review in their arbitration agreements. If review is a critical component of the decision to use arbitration as a dispute resolution mechanism, parties should consider incorporating alternative non-judicial means of review into their arbitration agreement or providing for arbitration in jurisdictions that will permit expanded review.
Facilitation of Cross-Border Mediation in Europe

The EU’s Directive on mediation in civil and commercial matters (COD/2004/0251) entered into force in June 2008. EU Member States have three years to implement the Directive in their domestic legal systems.

The purpose of the Directive is to facilitate access to alternative dispute resolution and to promote the amicable settlement of disputes by encouraging the use of mediation. Mediation is a structured process, whereby the parties to a dispute attempt, on a voluntary basis, to reach agreement with the assistance of a mediator. It can facilitate the rapid and cost-effective extrajudicial resolution of disputes through processes tailored to the needs of the parties. Agreements resulting from mediation are more likely to be complied with voluntarily and to preserve an amicable and sustained relationship between the parties. These benefits can be even more pronounced in cross-border disputes.

The Directive applies to civil and commercial mediations in cross-border disputes everywhere within the EU (except Denmark, which opted out). The Directive ensures that parties having recourse to mediation in cross-border disputes can rely on a predictable legal framework by providing a minimum degree of compatibility of civil procedural rules.

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The Directive does not apply to matters such as pre-contractual negotiations, certain processes of an adjudicatory nature, processes administered by bodies issuing a formal recommendation, and disputes concerning rights and obligations that the parties are not free to decide themselves (e.g., revenue and customs matters, rights under family law, and employment law).

Confidentiality

Mediation is intended to take place in a manner that respects confidentiality. The Directive requires that, unless parties agree otherwise, neither mediators nor those involved in the administration of the mediation process shall be compelled to give evidence relating to a mediation process, in either civil or commercial judicial proceedings. The only exceptions to this rule arise where necessary due to overriding public policy reasons or where disclosure of the content of the agreement resulting from mediation is necessary to implement or enforce that agreement.

Limitation and Prescription Periods

The Directive obliges Member States to ensure that their rules on limitation and prescription periods do not prevent the parties from going to court or to arbitration if their mediation attempt fails. However, provisions on limitation and prescription periods in international agreements as implemented in the Member States (for instance in the area of transport law) continue to apply.

Enforcement of Agreements Resulting from Mediation Proceedings

The Directive requires Member States to ensure that the parties to a written agreement resulting from mediation can have the content of their agreement made enforceable in a similar manner as a court judgement under national law. The Directive provides that a Member State may only refuse to make an agreement enforceable if its content is contrary to law or if that Member State’s law does not provide for the enforceability of the content of the specific agreement.

The Directive does not directly affect the rules in Member States concerning enforcement of agreements resulting from mediation in other Member States. However, the content of an agreement resulting from mediation that has been made enforceable in a Member State should be recognised and declared enforceable in other Member States in accordance with applicable EU or national law.

Conclusion

The Directive facilitates resort to mediation in cross-border disputes by providing a minimum degree of compatibility of civil procedural rules. It promises significantly to enhance the legal infrastructure supporting the mediation process in EU Member States.

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• **Canada legislates to implement the ICSID Convention, paving the way for World Bank arbitration of investment disputes.** The national parliament has passed the requisite legislation. However, pursuant to Canada’s federal system, each of its provinces and territories must also enact implementing legislation before Canada can ratify the ICSID Convention. Once the ICSID Convention is ratified by Canada, many Canadian investors in foreign States (and many foreign investors in Canada) will be able to submit investment disputes for arbitration at the World Bank (including under many BITs and the North American Free Trade Agreement). Currently, Canada is the only G-8 State not to have ratified the ICSID Convention.

• **US and India discuss a new bilateral investment treaty.** It is reported that the two States are trying hard to reach an agreement despite a number of differences in relation to issues such as the scope of binding investor-State arbitration rights. India has a number of existing BITs in force with other States, including Russia, UK, France and Germany, only a limited number of which currently provide foreign investors in India with effective international arbitration rights.

• **Mongolian windfall tax subject to an investment treaty arbitration.** A Russian gold mining venture has submitted a request for arbitration in response to a windfall tax levied by Mongolia. In 2006, Mongolia introduced a windfall tax of 68% where gold is sold above US$500 an ounce. The Russian investors claim that the windfall tax violates the Russia-Mongolia BIT. The investors also take issue with demands for increased local hiring.

• **Venezuela serves Netherlands with notice to terminate Venezuela-Netherlands BIT.** Venezuela has given the Netherlands formal notice of its intention to terminate the much-used BIT between the two countries. Over recent years, investors such as Conoco, Eni and Exxon Mobil have invoked the treaty in disputes with Venezuela. Venezuela plans to terminate the treaty on November 1, 2008. The communication refers to the BIT’s incompatibility with Venezuela’s national policies on investments. The Dutch government is reportedly attempting to renegotiate the terms of the BIT.

• **English High Court enforces ICC award against Chad, requiring money to be taken from account holding World Bank loan repayments.** The Court ordered Chad to pay the Egyptian telecoms company, Orascom Telecom, approximately US$7.3 million to satisfy an arbitral award. The Court ruled that the bank account, which is used to hold repayments for a World Bank loan, is used partly for “commercial purposes”. Therefore, Chad could not claim sovereign immunity over the funds as a means of resisting enforcement under the State Immunity Act 1978.