LATHAM & WATKINS

March 2008

International Dispute Resolution

A Publication from Latham & Watkins' International Dispute Resolution Practice

ICSID Annulment Committee Rules on Interpretation of Umbrella Clauses in Bilateral Investment Treaties

On 25 September 2007, an ad hoc Committee of the World Bank's International Centre for Settlement of Investment Disputes (ICSID) partially annulled an award rendered in favour of a US investor, CMS Gas Transmission Company (CMS), in its bilateral investment treaty (BIT) dispute against Argentina. The annulment decision provides a clear illustration of the narrow scope of annulment procedures at ICSID. It may also have important implications for the scope of protection provided to international investors under BITs.

In 2003, CMS filed a claim against Argentina under the US-Argentina BIT. CMS, a minority shareholder in Argentinean gas transportation company TGN, alleged that certain measures taken by Argentina in response to the 2001 financial crisis violated various investment protections in the US-Argentina BIT. An ICSID arbitral tribunal ultimately found in favour of CMS, awarding it compensation in excess of US$133 million.

Argentina applied to have the award annulled pursuant to Article 52 of the ICSID Convention. Ad hoc annulment committees established under the ICSID Convention have only a limited remit to annul ICSID awards. Broadly, an award may only be annulled if an applicant can show that the original tribunal manifestly acted beyond its powers or failed to observe certain standards of due process. Even if a ground for annulment is shown to exist, an annulment committee retains discretionary power to uphold or annul the award. The CMS annulment committee, like other annulment committees before it, took pains to distinguish the limited form of review under the ICSID annulment procedure from an appeal on the merits, which is not allowed under the ICSID Convention.

Article II(2)(c) of the US-Argentina BIT provides that each State Party "shall observe any obligation it may have entered into with regard to investments" (a so-called "umbrella clause"). The original tribunal's award found that Argentina's obligations under the domestic legal regime for the gas industry, and under certain contractual commitments given to TGN under its licence agreement, were actionable by CMS under the umbrella clause of the BIT. The annulment committee, however, noted several deficiencies in the interpretation given to the umbrella clause by the tribunal. In particular, the annulment committee considered that the words "entered into" in Article II(2)(c) meant that the umbrella clause applied only where an investor and a State had entered into binding contractual undertakings. The annulment committee doubted that CMS could properly claim for changes made by Argentina to the general legislative landscape for the gas industry. Additionally, given that contractual obligations were entered into between Argentina and TGN, the annulment committee questioned CMS' ability, as a shareholder, to enforce those obligations in its own right.

The annulment committee considered that the umbrella clause applied only where an investor and a State had entered into binding contractual undertakings.

Inside This Issue

Ultimately, the annulment committee found that the original tribunal had not adequately explained its reasoning on these issues. That part of the award relating to the umbrella clause was therefore annulled under Article 52(1)(e) of the ICSID Convention for failure to state reasons. However, since the original tribunal's determination of the level of compensation due to CMS had been calculated on the basis of violations of other provisions of the BIT, the amount of compensation was unaffected by the partial annulment.

Umbrella clauses are a common feature of BITs worldwide. The reasoning of the annulment committee may therefore influence other tribunals' interpretation of such clauses in future cases.

Attorneys in Latham & Watkins' International Dispute Resolution Practice Group have considerable expertise advising clients on the scope of investment protections under BITs and associated investor-State arbitral procedures. ■

US Court of Appeals Confirms Enforcement of Arbitral Awards Against Sovereign State

On 27 November 2007, the United States Court of Appeals for the District of Columbia Circuit issued a short decision in Democratic Republic of Congo v. FG Hemisphere Associates LLC. *The case concerns FG Hemisphere's attempts to enforce arbitral awards secured against the Democratic Republic of Congo (DRC) and held that the DRC had waived its right to contest service of process by not raising the issue in a timely manner.*

FG Hemisphere had brought two suits in the Federal District Court in Washington, D.C., attempting to serve the DRC both by registered mail to the Ministry of Foreign Affairs in Kinshasa and through the United States Secretary of State. The DRC, however, did not appear in the cases. The District Court consequently entered default judgments against the DRC in September 2004 and January 2005 and issued writs of execution against two DRC properties in the District of Columbia.

In May 2005, the DRC finally appeared in the District Court and argued that the properties were exempt from execution. The DRC also engaged in other litigation against FG Hemisphere concerning discovery requests on the location of assets.

More than a year later, in June 2006, the DRC moved to vacate the default judgments for lack of personal jurisdiction, arguing that the service of process had been defective. The District Court denied the motion and the DRC appealed.

The D.C. Circuit held that the DRC had waived its right to contest the manner in which FG Hemisphere had attempted to serve the DRC. The Court noted that the Federal Rules of Civil Procedure require that objections to personal jurisdiction and service of process be made at the earliest possible stage, the rationale being "that defendants should raise such preliminary matters before the court's and parties' time is consumed in struggle over the substance of the suit". Here, the Court observed that 13 months had elapsed between the DRC's initial appearance in the case and its argument that the service of process had been inadequate. The DRC had not only engaged in litigation concerning the execution of the judgment, but had also filed oppositions to the plaintiff's discovery motions. Accordingly, the Court found that the cumulative delay, "encompassing disputes over both the properties and discovery, effected a waiver".

The case indicates that sovereign States may be held to the standards of private litigants . . . and accordingly must satisfy the procedural requirements of the Federal Rules of Civil Procedure, including raising any objections to the court's jurisdiction at the earliest possible stage.

The case is important for entities that may be engaged in attempting to enforce arbitral awards against sovereign States in US courts and for sovereign States seeking to defend themselves against such enforcement. The case indicates that sovereign States may be held to the standards of private litigants when defending against execution of arbitral awards and accordingly must satisfy the procedural requirements of the Federal Rules of Civil Procedure, including raising any objections to the court's jurisdiction at the earliest possible stage. ■

The United States' Arbitration Fairness Act and Enforceability of Arbitration Agreements

In December 2007, the Arbitration Fairness Act of 2007 was debated by the United States Senate Judiciary Sub-Committee. This proposed legislation would restrict the scope of enforceable arbitration agreements under the Federal Arbitration Act by voiding all pre-dispute arbitration agreements in consumer, employment and franchise contracts, and adding statutory language affecting separability.

The Federal Arbitration Act (FAA) was enacted in 1925 in an effort to change the hostility of US courts to arbitration clauses by expressly placing arbitration agreements on the same footing as other contracts. Since then, US courts have steadily expanded the scope and application of the FAA and, based on a policy favouring arbitration, have consistently held that consumer and employment contracts are subject to arbitration.[1] At the same time, US companies have increasingly inserted binding arbitration clauses into many routine contracts, including consumer and employment contracts. Concerns have been raised that the new, industry-specific arbitration fora often used to resolve such consumer and employment disputes do not sufficiently guarantee fairness and impartiality in their procedures.

. . . the protections proposed by the AFA could lead to substantial uncertainty in a broad set of agreements by limiting the ability of arbitrators to decide on their own jurisdiction.

The Arbitration Fairness Act (AFA) seeks to address these concerns by invalidating pre-dispute arbitration agreements in "(1) an[y] employment, consumer, or franchise dispute; or (2) disputes arising under any statute intended to protect civil rights or to regulate contracts or transactions between parties of unequal bargaining power".[2]

The AFA would also add a new sub-section (c) to Section 2 of the FAA mandating that "the validity or enforceability of an agreement to arbitrate shall be determined by the court, rather than the arbitrator, irrespective of whether the party resisting arbitration challenges the arbitration agreement specifically or in conjunction with other terms of the contract containing such agreement".

The US Supreme Court has held that arbitrators, rather than courts, should generally decide issues of validity and enforceability in contracts containing an agreement to arbitrate. *See Prima Paint Corp. v. Flood and Mfg. Co.*, 388 US 395, 403-04 (1967) (holding that parties to a contract with an arbitration clause must arbitrate any claims related to the validity of the contract, unless there is a specific claim that the party was fraudulently induced into agreeing to the arbitration clause); and *Howsam v. Dean Witter Reynolds, Inc.*, 537 US 79, 83-84 (2002) (holding that whether a dispute is arbitrable is only for courts to decide where the contracting parties would likely have expected a court rather than an arbitrator to make that determination). The proposed amendments to Section 2 of the FAA would effectively overrule these cases. Moreover, because new sub-section (c) is not expressly limited to consumer, employment or franchise contracts, its adoption could lead to substantial uncertainty as to whether the longstanding doctrine of the separability of arbitration clauses is still valid, even in contracts between parties of equal bargaining power. Additionally, because the AFA is proposed to apply retroactively, these amendments could lead to ambiguity with respect to the enforcement of numerous arbitration agreements.

There is increasing support for establishing protections for those who agree to arbitration clauses in standardized contracts that are not subject to meaningful negotiations by amending the FAA. However, the protections proposed by the AFA could lead to substantial uncertainty in a broad set of agreements by limiting the ability of arbitrators to decide on their own jurisdiction. Any revisions or additions to this legislation will be closely monitored by arbitration practitioners as it moves through the US Congress.

Endnotes

1 *See Circuit City Stores, Inc. v. Adams*, 532 US 105 (2001) (holding that the FAA applies to employment contracts); *Buckeye Check Cashing, Inc. v. John Cardegna et al.*, 126 S. Ct. 1204 (2006) (enforcing an arbitration agreement in a contract challenged as unenforceable under consumer protection laws); *Green Tree Financial Corp. v. Randolph*, 500 US 20 (1991) (enforcing a pre-dispute binding arbitration agreement in a loan agreement).

2 H.R. 3010, 110th Cong. § 4(b) (2007); S. 1782, 110th Cong. § 4(b) (2007). ■

News in Brief

- **UK investor uses most-favoured nation (MFN) clause in UK-Russia bilateral investment treaty (BIT) to benefit from an arbitration clause in another BIT.** The UK-Russia BIT contains a restrictive investor-State dispute resolution provision. However, in a recent investment arbitration brought by a UK investor under the treaty, a tribunal accepted that the MFN clause in the BIT entitled the investor to import the more generous dispute resolution clause contained in the Denmark-Russia BIT. MFN clauses entitle investors to treatment no less favourable than that accorded to investors from third States. The tribunal found that, in this case, there was no reason why the MFN clause should not apply to dispute resolution matters.
- **ExxonMobil secures a US$12 billion freezing injunction on the assets of PDVSA, Venezuela's state-owned oil company.** ExxonMobil filed arbitration proceedings at the World Bank (ICSID) and the International Chamber of Commerce. In January 2008, ExxonMobil satisfied the English High Court that there was a real risk that PDVSA would dissipate its assets, rendering any eventual arbitration award in ExxonMobil's favour ineffective, and thereby managed to secure a freezing injunction which prevents PDVSA from disposing of US$12 billion-worth of assets worldwide. The injunction is subject to ongoing challenge by PDVSA in the English Court.
- **The Dubai International Financial Centre (DIFC) has proposed amendments to its arbitration legislation.** The current arbitration legislation, introduced in 2004, was based on the 1985 UNCITRAL Model Law on International Commercial Arbitration (the Model Law). The proposed revisions to the DIFC law reflect certain of the amendments to the Model Law which were adopted in 2006 (including, for example, some of the new Model Law provisions concerning interim measures). The DIFC also recently announced a joint venture with the London Court of International Arbitration to establish a centre for the administration of international arbitration and mediation in Dubai. The UAE recently completed its draft law on arbitration, which is again based on the Model Law. As required by the Convention on the Recognition and Enforcement of Foreign Arbitral Awards 1958 (the New York Convention), to which the UAE acceded in August 2006, the draft law supports the enforcement of arbitral awards in the UAE.
- **Indian Supreme Court judgment allows foreign arbitral awards to be challenged.** The Indian Supreme Court held that Part 1 of the India Arbitration Act 1996 applies to foreign arbitrations, unless the parties have agreed otherwise. This extends the broad scope for judicial intervention in domestic arbitrations, sanctioned by earlier decisions of the Supreme Court, to foreign arbitral awards. An award may be challenged on the grounds that it is contrary to the public policy of India. "Public policy" has been given a relatively broad interpretation in previous cases.
- **Morocco adopts new mediation and arbitration law.** In December 2007, Morocco amended the previous arbitration and mediation law that had been in force since 1974. The new law, which provides separate rules for domestic and international arbitration, will only apply to agreements to arbitrate made after the new law entered into force. ■

Barcelona
Brussels
Chicago
Frankfurt
Hamburg
Hong Kong
London
Los Angeles
Madrid
Milan
Moscow
Munich
New Jersey
New York
N. Virginia
Orange County
Paris
Rome
San Diego
San Francisco
Shanghai
Silicon Valley
Singapore
Tokyo
Washington, D.C.

International Dispute Resolution is published by Latham & Watkins as a news reporting service to clients and other friends. The information contained in this publication should not be construed as legal advice. Should further analysis or explanation of the subject matter be required, please contact the attorneys listed below or the attorney whom you normally consult. A complete list of our publications can be found on our Web site at www.lw.com.

If you wish to update your contact details or customise the information you receive from Latham & Watkins, please visit www.lw.com/LathamMail.aspx to subscribe to our global client mailings program.

If you have any questions about this edition of *International Dispute Resolution*, please contact the co-chairs of our International Dispute Resolution Practice Group: **Mark Beckett** (NY), **Philip Clifford** (LO), **Sebastian Seelmann-Eggebert** (HH) or **Robert Volterra** (LO). Alternatively, please contact the attorney with whom you normally consult.

The editorial board of this publication consists of Sebastian Seelmann-Eggebert (HH), Stephen Fietta (LO), Jeroen Van Kwawegen (NY) and Aimee-Jane Lee (LO).

Mark D. Beckett
New York
+1.212.906.1200
mark.beckett@lw.com

Philip Clifford
London
+44.20.7710.1000
philip.clifford@lw.com

Sebastian Seelmann-Eggebert
Hamburg
+49.40.4140.30
sebastian.seelmann@lw.com

Robert G. Volterra
London
+44.20.7710.1000
robert.volterra@lw.com

Barcelona
+34.93.545.5000

Brussels
+32.2.788.6000

Chicago
+1.312.876.7700

Frankfurt
+49.69.6062.6000

Hamburg
+49.40.41.4030

Hong Kong
+852.2522.7886

London
+44.20.7710.1000

Los Angeles
+1.213.485.1234

Madrid
+34.91.791.5000

Milan
+39.02.3046.2000

Moscow
+7.495.785.1234

Munich
+49.89.20.80.3.8000

New Jersey
+1.973.639.1234

New York
+1.212.906.1200

Northern Virginia
+1.703.456.1000

Orange County
+1.714.540.1235

Paris
+33.1.40.62.20.00

San Diego
+1.619.236.1234

San Francisco
+1.415.391.0600

Shanghai
+86.21.6101.6000

Silicon Valley
+1.650.328.4600

Singapore
+65.6536.1161

Tokyo
+81.3.6212.7800

Washington, D.C.
+1.202.637.2200

Complete details of attorney bios can be found on our Web site at www.lw.com/attorney.