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NLSTIAM

National Law School Trilegal International Arbitration Moot

CASE STUDY

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SIAC Singapore International Arbitration Centre

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1. Ten wealthy individuals, each with extensive experience in the natural resources extractive industry, created a holding company, BurraCo., in Curaçao, structured under the laws of the Netherlands, for the purposes of investing in mining concessions in underdeveloped markets. Their aim was to leverage their experience in the industry to take underperforming assets, make them profitable, and then sell them on as a consolidated holding.

2. Mr. Cartsen and the other 9 investors ("**Investors**"), are nationals of Vasaniland, a developed Western European State, that has a long history of colonial presence in the Republic of Nappertania, an underdeveloped country in the East.

3. The holding company, BurraCo., is a pass-through entity. Dividends generated by the underlying investments go to BurraCo. and are then immediately distributed to the investors in their bank accounts in Vasaniland.

4. In 2002, the Republic of Nappertania started to privatize its mining industry after having recently privatized its extractive industries. It has a significantly low local expertise in the mining industry. In the early days of the privatization drive, few public tender safeguards existed and there were widespread allegations that the ruling family was a part of all transactions. Whether or not such participation involved private enrichment at public expense is not clear. Some investors claimed that their local counsel informed them that any payments made to officials and their family members were a part of an age-old tradition of rewarding public servants. Certainly, nobody was prosecuted for accepting or giving any such payments.

5. In March 2003, Carsten met with an old university friend Mr. Inzhu, who was a mid-level functionary in the Oil and Gas Ministry of Nappertania ("OGM"). Inzhu had pursued his higher education at the University of Vasaniland, like many others in the educated classes of Nappertania. During their conversation Inzhu suggested that a number of publicly owned oil refineries and wells in Nappertania might be auctioned by the OGM in the coming month. However, he quickly clarified that the information was not public.

6. Carsten thanked his friend profusely and paid for his business class tickets to meet with his colleagues. He also paid for the expenses of Mrs. and Mr. Inzhu. Both of them went on a consumer goods shopping spree before returning to Nappertania.

7. In April 2003, OGM unexpectedly announced the public auctioning of two oil wells ("**OW1**" and "**OW2**") in an ecologically vulnerable part of Nappertania. The residents of the area comprised a national minority that had long been out of favor with the government of Nappertania. While the minority took to the streets in protest, the OGM justified the move stating that the auction would contribute to the development of the oil wells.

8. At the time of the announcement of the auction, the wells were in a bad shape – up to 25% of the crude oil extracted would leak into the local environment. Protests about ecological harm from these oil wells had been a constant feature of the thirty years they had been in operation. Since the wells were so inefficient, the actual volume of such spilled oil was relatively low i.e. less than 10%.

9. There were few local investors with either the money or the skills to operate an oil operation in Nappertania. Most observers did not see the wells becoming profitable, especially in light of the historically low crude prices. International investors had mostly stayed away from Nappertania because they lacked local knowledge or connections.

10. Apart from their bad shape, one of the reasons why OW1 and OW2 did not generate enough investor sentiment, was a 50-year-old law on the books that required a certain percentage of oil to be sold in the form of kerosene to local communities. Due to the unique chemical nature of the oil produced in this region, any crude diverted towards kerosene could not be used for other petroleum products. Local demand for kerosene had been reducing for years and the kerosene produced often sat in drums for months, leaching into the ground. It was an open secret that much of it was smuggled across the border for a profit. Inspectors would visit the wells and would use their discretion to ignore these violations, often after sharing in expensive meals in the local managing director's office.

11. In mid-May 2003, an investigative journalist discovered Mr. Inzhu's foreign trip and it was publicized in the local press. The word on the street was that Mr. Inzhu had not been in the

good graces of the first family when the journalist was tipped off. The scandal led to his resignation, but no charges were brought. Carsten disclaimed any responsibility and after a short investigation, OGM found that no laws had been broken. The journalist questioned the investigation report and asked the OGM if Carsten had prior knowledge of the public auction. The questions were never answered.

12. The auction went ahead in July 2003 and Carsten and his investors submitted a bid through BurraCo.. Their bid was very competitive, and thanks to the one month of advanced notice, they were able to supply detailed schematics.

13. BurraCo.'s bid was large i.e. USD 40m. BurraCo.'s expense forecasts included line items for up to USD 4m in "consultancy fees" for local consultants and entertainment. These were disclosed in the public bid documents. The bid documents also disclosed that one of the proposed consultants would be Ms. Ayna, the niece of the current President of Nappertania. Ayna had a business and marketing degree but no experience in the oil industry, and no official role in the government. According to the bid documents, she would be paid up to USD 1m a year.

14. One month prior to the auction, an international accounting company had valued the wells at under USD 25m. Given the poor forecasts for the wells, there were only two other bids and neither was as close to, or as detailed or favorable to Nappertania.

15. Seeing that low valuation, OGM had promised that tax rates on any production would initially be pegged at the sale price of the oil wells, not on their actual production. That tax rate would increase over time, but would be capped after five years. A royalty of 5% would remain unchanged.

16. BurraCo. won the auction and Carsten flew to Nappertania and met up with his old friend Inzhu, who was now Ayna's secretary. They went out for a night to town and the local press photographed them together. Those photos appeared in the local tabloids.

17. Carsten and his investors, though BurraCo., hired a new board of directors for their newly consolidated company in Nappertania (Melgiri LLC), which was incorporated in

November 2003. That board included both Ayna and Inzhu. Under the tender documents, the bidder was entitled to assign its rights to a third party. Thus, BurraCo. assigned the rights to Melgiri LLC with the consent of the OGM. Carsten and his colleagues did not carry out much on-the-ground management, but used their expertise in the oil industry to lay out a strategic plan for the oil wells that proved hugely successful.

18. By mid-2007, OW1 and OW2 were valued at over USD 250m and were producing ten times as much oil as they had been producing before the sale to BurraCo.. Large portions of the profits were reinvested in the local wells and employment in the area had risen by about 20% since late 2003. Melgiri LLC made investments in the surrounding area's infrastructure and the area was developed substantially. A western journalist, in one of the newspapers compared pictures of 2000 and 2007. The title of the report was "Why don't they privatize the others too?". However, similarly large profits were sent up the chain to BurraCo., and then to the Investors. Ayna's consulting contract was renewed every two years.

19. The tax rates remained low and Melgiri LLC did very well on the back of rising oil prices. However, environmental issues remained a source of concern. Melgiri LLC had a robust environmental statement and sold itself as bringing the best practices of Vasaniland, the former colonial power, to Nappertania. Indeed, they managed to cut the rate of leakage from 25% to under 5%. Unfortunately, since production had increased so substantially, the actual volume of spilled oil increased to 15%. This was reported in the annual report submitted by the inspection officer to the Ministry of Environment. This honest inspection officer even reported that the practices related to sustainable development were virtually non-existent. However, no concrete action was taken. Instead, a notice was issued to Melgiri LLC to comply with the same within a year. Melgiri LLC never formally replied to the notice but hired consultants to suggest compliance. A few months later, Melgiri LLC submitted the consultant's report to the Ministry of Environment. The issue was never raised again.

20. The economic bonanza did not necessarily trickle down to the local community, who were left with most of the negative externalities of the wells. As far as the Investors were

concerned, this had been a successful investment. In early 2008, they sought to vertically integrate the investment by purchasing a controlling share of the local refinery and pipeline for USD 100m. 50% of the capital required for this purchase came from retained profits in Melgiri LLC from OW1 and OW2. Another 40% came from a very favorable unsecured loan from the national bank, which was chaired by the President's brother. The last 10% came from BurraCo.

21. Throughout this purchase process, Ayna worked very hard to connect Carsten and his investors with key government officials. By all accounts, it was her diligent efforts that made the investment possible. State auditors regularly examined the books of Melgiri LLC and found no problems, often after being treated to fancy meals in the company headquarters.

22. Nappertania's arcane regulations made it very difficult for any investor to buy a majority stake in refining and distribution assets. These were designated "strategic," without any clear explanation. Still, other investors in those years had managed to buy controlling stakes by creating what were essentially local shell companies. Local newspapers reported on this, banking regulators knew, but there was no real public controversy. Thus, Carsten and the other investors used this path and signed all of the paperwork for acquiring the new assets. They had bought the assets, but still needed a ministerial approval that everyone understood to be purely a formality.

23. Things changed in mid-2008 for several reasons. The economic crash of 2008 led to a rapid regime change in Nappertania. The President still remained in power, but was reduced to a mere figurehead. His brother was removed from the chairmanship of the bank and Ayna was placed under house arrest. With the government in crisis, falling tax revenues, and burgeoning debt, the political discontent in the ecologically-vulnerable region near OW1 and OW2 became a more pressing problem. The new government was concerned about being portrayed as in the pocket of international businesses at the expenses of local needs. Thus, it promised to end corruption in government offices, and forever end the reign of family politics in Nappertania. All government offices were directed to evaluate and address all environmental concerns immediately. The tax giveaways of the early 2000s

seemed like a particularly bad deal now, especially, when the local press reported on the lavish lifestyles of Carsten and his compatriots. Investigative journalists started to ask questions about how exactly those initial tax incentives were obtained.

24. The global financial crisis dried up liquidity across the board. It turns out that Carsten and the other investors had been hoping to structure OW1 and OW2, along with their refining business, into one corporate structure and then sell that to a third party and exit the market. They had some fears about the softening of the oil market. With the crash, those plans went away. It turned out that BurraCo. had been carrying a large amount of debt in anticipation for the new restructuring that was now becoming uneconomical.

25. Melgiri LLC may have still weathered the crisis if it could have extended its credit with the bank. The new chairman of the bank very publically questioned the motives of Melgiri LLC and its ability to manage assets in Nappertania. Shortly thereafter, credit was not extended. As a result of the collapse of the loan, the purchase of the refinery and pipeline was at risk.

26. The new head of the OGM instituted a snap audit of Melgiri LLC. Shortly thereafter, he declared that Melgiri LLC's finances were not in good enough shape to go through with the purchase of the refinery. This caused the value of OW1 and OW2 to collapse overnight. Melgiri LLC maintained that OW1 and OW2 were lucrative enough and that Melgiri LLC was financially sound. It stated that the OGM audit deliberately included the debt of BurraCo. while determining the financial condition of Melgiri LLC.

27. Melgiri LLC brought suits in local courts challenging the audit without prior notice and denial of the right to purchase the refinery on the basis of defective valuation. Very quickly, though, they realized that cases in local courts would take decades to be resolved. Carsten was regularly flying in and out of Nappertania, trying to meet with government officials. On one such trip, he was stopped at the border for carrying USD 3m in unmarked notes in his suitcase. No charges were brought.

28. By November, even though Melgiri LLC had not defaulted on any of the installment payment, the bank declared the loan account of Melgiri LLC as a 'Non-Performing Asset'

and accelerated the loans. This was unprecedented. In a summary court decision, that Melgiri LLC had no knowledge about, a local court ruled in favor of the bank. Although the loan was unsecured, the court ruled that 40% of the shares of Melgiri LLC had to be transferred to the bank in repayment of the loan, noting that the money the bank had loaned had eventually come from the pockets of Nappertania's citizens.

29. Melgiri LLC appealed against this decision with no luck. Meanwhile, investigators from the tax authority showed up at Melgiri LLC's headquarters and seized computers and papers purportedly under a warrant. However, the same was never shown. In the first few months of 2009, a dizzying array of accusations were brought against Melgiri LLC, Carsten and BurraCo.. These included allegations of violations of routine clerical requirements, all the way to allegations of widespread low-level corruption. Employees, staff and Carsten were subjected to questioning and investigations on a daily basis, including probing connections to Ayna and Inzhu. Nappertania maintained that these were in pursuance of their commitment to 'Corruption-Free Nappertania' and based on complaints from locals in the area.

30. No charges were ever filed, but a tax inspector spoke to the local manager of Melgiri LLC and told her that the charges could go away if the company voluntarily handed 11% of the shares over to the state. There was no official notice of this.

31. As these negotiations were going on, a local political movement was gaining ground. Protests around OW1 and OW2 heated up. There was little pushback from the local police. Melgiri LLC's managers had long ignored local complaints about environmental pollution and had become used to getting protection from the state authorities. Now, despite pleas by Melgiri's LLC managers, the police did not intervene when the local environmental activists shut down OW1 for two weeks to protest the oil spills. The well was severely damaged. Since local political support was necessary for the central government, an amendment in the environmental rules was made adding onerous reporting requirements for oil spills above 5%. The failure to report would lead to criminal prosecution.

32. After repeated requests from the Meligri LLC's managers, the police did finally show up. However, when they did they discovered that the kerosene regulations had been systematically ignored for years at these wells. That was not surprising, since no one wanted to buy that much kerosene anymore. Charges were brought against the Investors, BurraCo. and against Melgiri LLC. Carsten never returned to Nappertania.

33. In a final round of court cases, the government brought charges of serious environmental crimes against Melgiri LLC and sought the transfer of the remaining 60% of the shares to the government, ostensibly to fund remediation work and to create a sustainable local industry. The judge granted a transfer of 20%. Those shares were then transferred to a local political leader who promised to divide future profits in the local community and to check environmental harm.

34. Shortly thereafter, Carsten and the other investors, through BurraCo., brought an investment treaty claim against Nappertania under the Bilateral Investment Treaty (**BIT**) between Vasaniland and Nappertania. Both Vasaniland and Nappertania are signatories to the ICSID Convention.

35. In their notice for arbitration BurraCo. nominated Ángela Acuña Braun, a German national, as the arbitrator. In turn, Nappertania nominated Annie Ruth Jiagge, a citizen of the United Kingdom as the arbitrator. Both parties thereafter gave consent to Cornelia Sorabjie, a Swiss national, as the President of the Tribunal.

36. Annie was born and raised in Nappertania, but had gone to England to pursue her higher education. Thereafter, she settled in England, gave up her citizenship of Nappertania, and is now a British citizen. She has family living in Nappertania and visits them every year for Christmas. Her brother is known to exercise some clout in the current government in Nappertania. She has also been nominated as an arbitrator in two commercial arbitrations by a government enterprise of Nappertania.

37. Carsten and the others were unaware of her dual nationality. It was only later in May 2011, when the record was closed, Inzhu told Carsten about her citizenship. He said that her outstanding achievement in the field of international arbitration was celebrated in the

Nappertania newspapers and television channels in the year 2000. She had also published a few blog posts during her secondary education in Nappertania in which she talks about her dream to rid Nappertania of corruption and free it of western dependence through educating her fellow country residents. It is also rumored that Annie and Cornelia used to study in the same university in England at the same time.

38. As soon as Carsten came to know about this, the claimant challenged the appointment of Annie and also requested that the ICSID Chairman should hear the challenge against Annie and not the Arbitral Tribunal as Cornelia would never uphold the challenge against Annie. However, Nappertania stated that since only one of the members of tribunal has been challenged, the tribunal has jurisdiction to hear the challenge, excluding the participation of Annie.

39. In July 2011, the Tribunal issued Procedural Order No. 1 ("**PO 1**"), dealing with the challenge to the appointment of Annie and bifurcating the proceedings into two phases.

PROCEDURAL ORDER NO. 1

Of 22 July 2011

BurraCo.

v.

Republic of Nappertania

(ICSID Case No. ARB/1947)

Members of the Tribunal

Cornelia Sorabjie, President of the Tribunal

Ángela Acuña Braun, Arbitrator

Annie Ruth Jiagge, Arbitrator

Secretary of the Tribunal

Simon Bolivar

1. This case concerns a dispute submitted to ICSID on the basis of the Agreement between the Government of the Republic of Nappertania and the Government of the Plurinational State of Vasaniland on Promotion and Reciprocal Protection of Investments signed on 5 May 2000 (the "**BIT**" or "Treaty"), which entered into force on 30 June 2001, and the Convention on the Settlement of Investment Disputes between States and Nationals of Other States, which entered into force on 14 October 1966 (the "ICSID Convention"). According to Claimants, citizens of Vasaniland who are owners of BurraCo., the dispute relates to certain alleged actions the Respondent has taken against their investment in the oil industry in Nappertania.

2. By letter dated April 30 2011, the Secretary-General of ICSID informed the Parties that Cornelia Sorabjie, Ángela Acuña Braun, and Annie Ruth Jiagge, had all accepted their appointments as arbitrators and therefore, pursuant to Article 6 of the ICSID Arbitration Rules, the Arbitral Tribunal was deemed to have been constituted and the proceedings to have begun, as of that date. Copies of the arbitrators' signed declarations required under ICSID Arbitration Rule 6(2) were attached to the Secretary-General's letter.

3. On May 31 2011 the Claimant sent a letter to the ICSID Secretariat, requesting Annie to resign from the Arbitral Tribunal pursuant to Article 8 of the ICSID Arbitration Rules.

4. On June 3 2011, the ICSID Secretariat informed the Parties that Annie considered herself independent and impartial and therefore, did not intend to resign from the Arbitral Tribunal. The Secretariat also requested the Claimant to confirm as quickly as possible of its intention to submit a proposal for Annie's disqualification and, in the affirmative, to submit such proposal by June 30 2011.

5. On June 5 2011, the Claimant confirmed that a proposal for the disqualification of Annie would be filed by June 30 2011. On June 30 2011, the Claimant proposed the disqualification of Annie pursuant to Article 57 of the ICSID Convention and Article 9 of the ICSID Arbitration Rules ("**Proposal**").

6. On July 1 2011, the ICSID Secretariat notified the Parties that the proceedings were suspended until a decision has been taken on the Proposal, pursuant to Article 9(6) of the ICSID Arbitration Rules.

7. Both Parties agree that to speed up the proceedings in case the challenge of Ms. Annie is successful either before the Tribunal or by the Chairman, the Respondent appoints Mr. Rustom, in advance, as a potential replacement of Ms. Annie and he will have access to all submissions and will be present at the oral hearings. Mr. Rustom is allowed to participate at the oral hearings as a potential replacement arbitrator.

8. In light of the above, the Tribunal decides to grant Respondent's Request for Bifurcation in respect of (3) and (4) claims only, and the Parties are required to address the following issues at the next date of hearing:

    (1) Whether the Tribunal should hear the challenge against Ms. Annie or should it be heard by the Chairman?

    (2) Should Ms. Annie be removed from the Arbitral Tribunal?

    (3) Whether the Claimant's assets in Nappertania were an "investment" for the purposes of Article 1(2) of the BIT in light of the allegations of illegality directed against Claimants by Respondent?

    (4) Whether the Respondent's regulatory actions against the Claimant constituted a violation of Fair and Equitable Treatment standards under the BIT?

9. In the present context, the Parties agree that they will address the challenge to Ms. Annie's appointment first, and thereafter, address the remaining issues. Both the issues will be presented jointly at the oral hearing. The Tribunal stresses that, at this stage of the proceedings, the Parties must only submit arguments relating to these questions. The record is closed and the Parties are required to reference only those factual materials supplied. Legal arguments may, of course, come from any relevant source.

10. Clarifications to the case-study may be sought no later than 5 March 2018 by sending a mail to nlstiam@nls.ac.in from the email ID of the contact person of the team.

11. The Parties' written submissions should be made no later than 5 April 2018.

Agreement

between the Government of the Republic of Nappertania and the Government of the Plurinational State of Vasaniland

on Promotion and Reciprocal Protection of Investments

(Bengaluru, 5 May 2000)

Entered into force on 30 June 2001

The Government of the Republic of Nappertania and the Government of the Plurinational State of Vasaniland, hereinafter referred to as the "Contracting Parties,"

desiring to promote greater economic cooperation between them for the mutual benefit of both states on a long-term basis,

recognising the need to promote and protect investments in order to create and maintain favourable conditions for investors of one Contracting Party's State within the territory of the other Contracting Party's State,

recognising the central importance of sustainable development and economic development for the healthy and peaceful future of their respective peoples, and

being in agreement that a stable investment framework will ensure maximally efficient utilisation of economic resources and will promote local development,

agreed as follows:

Article 1: GENERAL DEFINITIONS

For the purposes of this Agreement:

1. The term "investor" applies to and includes:

   a) legal entities of the Contracting Parties' States;
   b) citizens and associations of citizens of the Contracting Parties' States;

c) entities controlled by citizens or associations of citizens of the Contracting Parties' States.

2. The term "investment" refers to any kind of asset and the rights thereto, as well as intellectual property rights, invested in accordance with law by investors of one Contracting Party within the territory of the other Contracting Party's State for profit (income) and includes, in particular, but not exclusively:

a) movable and immovable property and related property rights;
b) cash, shares, stocks and other securities, and any form of participation in enterprises, joint stock companies, business partnerships, associations and other legal entities registered in accordance with the laws of each of the Contracting Parties;
c) cash claims and other rights having economic value associated with investments;
d) copyrights, intellectual and industrial property rights, such as inventions, patents, industrial designs and models, trademarks, trade names, indications of origin, technology, knowhow, and others;
e) ownership and usage rights to land (including under lease) and natural resources.

3. Changing the form of investments, made in accordance with the law of the Contracting Party's State at the place of investment, does not change its qualification as an investment.

4. The term "legal entities" refers to any legal entity formed in accordance with the legislation of one Contracting Party's State and making investments within the territory of the other Contracting Party's State.

Article 2: PROMOTION AND PROTECTION OF INVESTMENTS

1. Each Contracting Party shall, in accordance with the laws of its State, allow and encourage investments in the territory of its State by investors of the other Contracting Party's State, as well as guarantee full and unconditional legal protection for these investments.

2. Within the scope of the laws of its State, each Contracting Party will support various forms of mutual investment and ensure their protection within the territory of its State and will not infringe upon these investments by arbitrary control measures, in respect of their operation, use, and placement.

3. If, under the terms of this Agreement, a Contracting Party allowed certain investments into the territory of its State, then, in accordance with the laws and regulations of its State, this Contracting Party shall issue to the investors of the other Contracting Party's State the necessary permissions associated with such investments.

Article 3: NATIONAL TREATMENT AND MOST-FAVOURED NATION TREATMENT

1. Within the territory of its own State, each Contracting Party shall provide investments and returns of investors from the other Contracting Party's State fair and equitable treatment, no less favourable than the treatment it accords to investments and returns of its domestic investors and/or investments and returns of investors from any third State.

2. In respect of investments made by investors of the other Contracting Party's State, each Contracting Party shall be bound by any obligations arising out of its national laws and this Agreement.

3. The provisions of this Agreement with respect to the principle of most-favoured nation treatment shall not be construed so as to oblige one Contracting Party to extend to the investors of the other Contracting Party's State preferential treatment or privileges resulting from:

a) existing or potential future customs, currency, and payments unions, free trade and common tariff zones, common market, or any other form of agreements on regional economic integration, a party to which is, or may become, one of the Contracting Parties;

b) agreements of avoidance of double taxation or other international agreements on taxation.

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