THE ARBITRATION INSTITUTE
OF THE STOCKHOLM CHAMBER OF COMMERCE

CARLISSIAN & CO., INC.

Claimant

v.

THE FEDERAL REPUBLIC OF DAGOBAH

Respondent

MEMORIAL FOR RESPONDENT
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<td>exempli gratia, for example</td>
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<td>et al.</td>
<td>et alteri, and others</td>
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<td>et seq.</td>
<td>et sequentes, and the following</td>
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<td>i.a.</td>
<td>inter alia, among others</td>
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<td>i.e.</td>
<td>id est, that is</td>
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<td>Ibid.</td>
<td>Ibidem, in the same place</td>
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<td>id.</td>
<td>idem, the same</td>
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<td>versus, against</td>
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STATEMENT OF FACTS

1. The Federal Republic of Dagobah ("Respondent") is an emerging state, which restored democracy in the late 1960s and since then was making every effort to keep a stable economy, free markets and develop. In 2001 Respondent was hit by an economic crisis, which forced it to restructure its sovereign debt. As part of the restructuring program Respondent exchanged its outstanding bonds to new ones with lower net value.

2. The restructuring process induced a disagreement between Respondent and its close, developed neighbor, the Corellian Republic, regarding the scope of protection under the Agreement between the Corellian Republic and the Federal Republic of Dagobah for the Promotion and Protection of Investments ("BIT"). The disagreement led to a dispute before the Permanent Court of Arbitration ("PCA Tribunal"). A divided panel eventually decided that the bonds exchanged by Respondent constituted investment in the understanding of BIT.

3. In 2003, after the crisis ended, Respondent issued a new series of sovereign bonds ("Bonds"). The Bonds included, among others, a forum selection clause, subjecting the claims arising from or relating to the Bonds to the jurisdiction of the courts of Dagobah. The Bonds did not include any kind of stabilization clauses or other representation suggesting that their legal framework would never change.

In 2005 Calrissian & Co., Inc. ("Claimant"), a Corellian hedge fund acquired some of the Bonds issued by Respondent.

4. In 2010 a new wave of global crisis reached the shores of Respondent, once again devastating its economy. Respondent struggled to save its financial liquidity, but in by the end of 2011 it was clear that its sovereign debt is unsustainable. As a result, following the IMF recommendations on 28 May 2012 Respondent enacted the Sovereign Debt Restructuring Act ("SRA"). SRA provided that the modification of outstanding sovereign bonds of Respondent required the consent of 75% of the aggregate nominal value of all Bonds.

5. Consequently, Respondent offered bondholders an option to exchange the outstanding Bonds to new ones with approximately 30% lower net value. The offer was accepted by the majority of 85% of the bondholders. By the virtue of SRA Claimant was also bound by the decision of the majority.

6. The new Bonds had lower net value, they included a forum selection clause granting the exclusive jurisdiction to the courts of the Kingdom of Yavin and contained a Collective Action
Clause providing that initiation of any legal action regarding the Bonds would require the consent of at least 20% of the aggregate nominal value of the issue.

SUMMARY OF ARGUMENT

1. **This Tribunal lacks jurisdiction to hear the dispute**

8. This Tribunal does not have the jurisdiction over the present case. This is because the Bonds are not investments in the meaning of the BIT. The Bonds do not possess features of an investments. This precludes the Tribunal from hearing the dispute. Moreover, this Tribunal can independently decide on the scope of the BIT definition of an “investment”. It is not bound by the PCA Tribunal's decision, which has no effect on the proceeding at hand.

2. **Claims submitted by Claimant are not admissible**

9. The claims are inadmissible due to the forum selection clause contained in the Bonds. First, this forum selection clause is a waiver of Claimant's right to arbitrate disputes pertaining to the Bonds. Second, in any case the claims at hand are contractual claims. Thus, they are not encompassed by the BIT dispute resolution clause. The proper forum to resolve this dispute are the courts of Dagobah.

3. **Claimant is not entitled to compensation of any losses resulting from the sovereign debt restructuring program**

10. Respondent is not liable for the losses incurred by Claimant. First of all, Claimant was not forced by Respondent to exchange the Bonds. It was just a result of the decision taken by the overwhelming majority of bondholders. Consequently, Respondent did not coerce Claimant to accept the exchange offer. Second, Respondent did not contradict any legitimate expectations of Claimant regarding the Bonds. Finally, Respondent acted in good faith, without the intention to harm Claimant.

11. However, even if the Tribunal found that Respondent violated the obligation of fair and equitable treatment, it should still dismiss the claims submitted in the current proceedings. Contrary to what Claimant may suggest, Art. 6(2) of the BIT constitutes a self-standing ground of exemption from liability, independent from customary international law. As Respondent restructured the sovereign debt in order to protect its financial stability from the worldwide crisis, it cannot be held liable for Claimant’s losses.
ARGUMENT ON PROCEDURE

I. THIS TRIBUNAL LACKS JURISDICTION TO HEAR THE DISPUTE

12. Claimant in the Request for Arbitration submitted that this Tribunal is the proper forum to hear the dispute between the Parties. Claimant states that it made an investment as it purchased sovereign bonds issued by Respondent. As the dispute at hand arose in connection with these bonds, Claimant attempts to prove that the BIT dispute resolution clause gives this Tribunal the jurisdiction to hear the case. However, Claimant errs in this submission.

13. First, Claimant did not make an investment in the meaning of the BIT. This is because the Bonds are a purely commercial transaction (A). Secondly, the Bonds cannot be deemed an investment in the meaning of the BIT on the basis of the PCA Tribunal's decision. This is because the PCA Tribunal's decision has no effect on the dispute at hand (B).

A. Bonds are a purely commercial transaction

14. Claimant argued that this Tribunal has jurisdiction to hear the case. It invokes art. 8(2)(c) of the BIT which expresses the contracting States’ consent to submit disputes between an investor of one Party and the other Party to arbitration. It is undisputed that this consent to arbitrate is limited to disputes arising in connection with an investment in the meaning of the BIT.

15. According to Claimant its acquisition of the Bonds issued by Respondent amounts to an investment. Yet, this contention is unsubstantiated. In fact, contrary to Claimant’s allegations, the purchase of Bonds is not tantamount to an investment in the meaning of the BIT. Such a purchase is a purely commercial transaction.

16. That is for several reasons. First, nothing implies that the drafters of the BIT wanted to protect bonds (i). Second, the Bonds fail to satisfy the characteristics of an investment provided in Art. 1 of the BIT (ii). Second, the Bonds lack the requirements of an investment developed in the doctrine and case law (iii). Most importantly, the Bonds lack the territorial link (iv).

   i. Nothing implies that the drafters of the BIT wanted to protect Bonds

17. Claimant argued that its claims are in connection with an investment protected under the BIT. Nevertheless, the wording of the BIT’s definition of an investment as well as the circumstances surrounding the conclusion of the treaty show otherwise.
18. The main reason to conclude a bilateral investment treaty is to protect an investment made between a developed and a developing country. Such treaties usually provide for investor–host state arbitration. However, in order to pursue international investment arbitration the existence of an investment is necessary. The drafters of the treaty can define this term according to their needs, including or omitting certain instruments. Several bilateral investment treaties, such as 2012 U.S. Model Bilateral Treaty expressly include sovereign bonds. Where the term is not expressly included, a comprehensive analysis of the definition needs to be carried out.

19. The definition of investment is included in Art. 1 of the BIT. It defines investment as:

   every asset that an investor owns or controls, directly or indirectly, that has the characteristics of an investment, including such characteristics as the commitment of capital or other resources, the expectation of gain or profit, or the assumption of risk.

20. The above definition further lists some of the forms an investment may take. Bonds are not included in this list. What is more, nothing suggests that the drafters of the treaty envisaged their protection. First, no information regarding the drafting of the treaty was provided. Second, the Corellian Republic is known for its sophisticated financial and banking industry. Therefore, it is a developed country, as opposed to the Federal Republic of Dagobah, which is an emerging market. Thus, it is reasonable to assume that the parties to the BIT foresaw that the flow of capital would take place mainly in one direction - from Corellia to Dagobah. Since Corellia is renowned for its financial industry, Corellian nationals would be most likely to invest in first place in financial instruments. As a consequence, the omission of bonds as well as other financial instruments in the definition of an “investment” under the BIT could not have been accidental.

21. In sum, nothing implies that Corellia and Dagobah intended sovereign bonds to be investments pursuant to the BIT. The BIT does not expressly encompass bonds. What is more,

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1 Subedy, p. 84
2 Voss, p. 52
3 Douglas p. 162.
4 The BIT, Record, p. 7.
5 Record, Uncontested Facts, p. 1, ¶2
6 see Record, Uncontested Facts, p. 1, ¶1-2
circumstances surrounding the conclusion of the treaty indicate that this omission was not accidental. Therefore, the circumstances indicate that the Parties to the treaty did not want to the BIT to encompass bonds.

ii. The Bonds fail to satisfy the characteristics provided in Art. 1 of the BIT

22. Even if this Tribunal finds that the definition of an investment provided in the BIT should be interpreted as extending to the Bonds, they would still lack the necessary characteristics of an investment.

23. The determination whether a transaction constitutes an investment is possible by examining the relevant treaty’s provisions. The definition of an investment included in Art. 1 of the BIT lists three requirements: commitment of capital or other resources, the expectation of gain or profit, or the assumption of risk. Therefore, it is necessary assess whether the Bonds satisfy those elements.

24. First, the commitment of capital or other resources may amount to various types of contributions. Such contributions may be financial or technical. They may also come in form of know-how, equipment, personnel or services. In any event, these contributions should be substantial. As bonds are usually purchased with discounts from their face value in the secondary markets, the last criterion is usually not fulfilled.

25. Nothing in the factual background of the case suggests that non-financial contributions have been made. As for the commitment of capital, the acquisition of Bonds did not generate a transfer of funds between Claimant and Respondent. Claimant purchased Bonds in the secondary market in Corellia. Therefore, it was a third party, the original owner of Bonds, that benefited from the transaction. Even if this Tribunal otherwise, it is impossible to assess whether the contribution was substantial. That is because the price paid by Claimant was not disclosed. As a result, the Bonds do not fulfill the element of contributions.

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7 Voss, pp. 115-116.
8 Voss, p. 125.
9 Schreuer, p. 130.
10 Ibid.
11 Waibel, p. 722.
12 Record, PO 2, p. 50, ¶11.
26. Second, the requirements of expectation of gain and profit and the assumption of risk should be considered together as they are interrelated. That is because “risk means that the activity at issue involves a certain regularity of profit and return”\(^1\). Furthermore, investments’ success relies on the outcome of the operation to which the capital was committed\(^2\). Such operation is managed by both the investor and the host state\(^3\). On the other hand, bonds are only tied to the “general macroeconomic condition of the issuing state”\(^4\). Therefore, the only risk that a bondholders face is the one of default\(^5\). Such risk is no different from the one associated with an ordinary commercial transaction\(^6\).

27. The purchase of the Bonds granted Claimant no management rights of any kind. Claimant is not entitled to change the Bonds’ terms, nor to decide how the funds that were obtained through their original purchase are to be used by Respondent. There was also no underlying operation or a project. Therefore, the acquisition of the Bonds carries risk no greater than the one that is associated with a contract of sale. Consequently, the purchase of the Bonds lacks the risk that would qualify them as investment.

28. In conclusion, the Bonds fail to meet the requirements explicitly provided by the BIT’s definition. First, there was no commitment of capital. Second, risk associated with the acquisition of the Bonds can be described as an ordinary commercial risk.

iii. The Bonds lack the requirements of an investment developed in the doctrine and case law

29. The wording of the BIT’s definition of investment (“such characteristics as”\(^7\)) is open for the assessment of additional characteristics. Most tribunals nowadays apply the so-called Salini\(^8\) test in order to identify them. This test includes two additional requirements, namely the contribution to the economic development of the host state of the investment and the duration

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\(^1\) Voss, p. 132.

\(^2\) Waibel, pp. 726-728.

\(^3\) Ibid.

\(^4\) Ibid.

\(^5\) Ibid.

\(^6\) Ibid.

\(^7\) Ibid.

\(^8\) Joy Mining v. Egypt, p. 12, ¶57.

\(^9\) Record, BIT, p. 7.

of performance of the contract. Another element that has to be considered is the territorial link between the investment and the host state\textsuperscript{21}.

30. First, with regard to the requirement of duration, the transfer of capital or resources has to be long-term\textsuperscript{22}. Short-term transactions, such as sale of goods, are not regarded as an investment\textsuperscript{23}. Due to the high volatility of the secondary markets the ownership of sovereign bonds can change rapidly\textsuperscript{24}. In such a case, each transaction should be treated separately\textsuperscript{25}. Some scholars suggest that in order to meet this requirement thirty-year government bonds should be held by one investor from their issuance to maturity\textsuperscript{26}.

31. The Bonds in dispute have the maturity of 12 years\textsuperscript{27}. They were purchased by Respondent in 2005, less than less two years from their issuance\textsuperscript{28}. In consequence, the Bonds proved to be a volatile capital. In addition, Claimant did not own the Bond’s right from their issuance. His ownership would last for at most 10 years, only one-third of what has been suggested in the doctrine. In consequence, Bonds fail to meet the duration requirement.

32. Second, the requirement of contribution to the economic development of the host state is universally recognized\textsuperscript{29}. Both scholars\textsuperscript{30} and case law\textsuperscript{31} underline that the impact of such a contribution should be significant. As the assessment of this element may prove difficult, an indirect approach has been proposed\textsuperscript{32}. It assumes that the above requirement is fulfilled, if the underlying transaction has other characteristics of an investment, such as risk sharing and duration\textsuperscript{33}.

\begin{footnotesize}
\begin{itemize}
\item[\textsuperscript{21}] McLachlan, p. 180.
\item[\textsuperscript{22}] Waibel, p. 724.
\item[\textsuperscript{23}] Voss, p. 129.
\item[\textsuperscript{24}] Ostřanský, p. 41.
\item[\textsuperscript{25}] Waibel, p. 725.
\item[\textsuperscript{26}] Ibid., p. 726.
\item[\textsuperscript{27}] Record, PO 2, p. 50, ¶14.
\item[\textsuperscript{28}] Record, PO 2, p. 50, ¶11.
\item[\textsuperscript{29}] Schreuer, p. 129; Sornajah, pp. 308 et seq.
\item[\textsuperscript{30}] Voss, p. 134.
\item[\textsuperscript{31}] \textit{Malaysian Historical Salvors v. Malaysia}, p. 43, ¶123.
\item[\textsuperscript{32}] Waibel, p. 724.
\item[\textsuperscript{33}] Ibid.
\end{itemize}
\end{footnotesize}
33. As it was demonstrated above\textsuperscript{34}, the Bonds were purchased in the secondary market. Therefore, there was no transfer of capital from this transaction to the host state. As a result, the purchase of Bonds had no impact on host state’s development, let alone positive. Moreover, the transaction also fails to satisfy any other characteristics of an investment. Therefore, applying the indirect approach leads to clear conclusion that the above element is not present with regards to Bonds.

\hspace{1cm} \textbf{iv. Bonds lack the territorial link}

34. The last characteristic that needs to be analyzed is the territorial link between Bonds and the host state.

35. Art. 1 of the BIT in the definition of an “investor” requires the existence of a link with the host states territory. It provides that an “investor” is (…) “\textit{a national of a Party that (…) has made an investment in the territory of the other Party}”\textsuperscript{35}. Also, most investments require physical assets to be present in the host country’s territory\textsuperscript{36}. Bond usually lack such a feature. Moreover, bonds purchased in the secondary market lack even the element of the flow of funds to their country of origin\textsuperscript{37}. In \textit{SGS v. Philippines}\textsuperscript{38} the tribunal contended that \textit{“investments made outside the territory of the Respondent State, however beneficial to it, would not be covered by the BIT.”}

36. In the case at hand, the performance of the Bonds is not even remotely close to Dagobah’s borders. First, no services or any other activities were performed by Claimant in Respondent’s territory. Second, the Bonds were purchased in the secondary market from a third party\textsuperscript{39}. As a result, no funds transferred during this transaction were obtained by Respondent. Lastly, even the payment of Bonds will take place outside of the host state as place of payment of the Bonds is Yavin\textsuperscript{40}. Taking all the above circumstances into consideration it is clear that the Bonds lack any territorial link with the host state.

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\textsuperscript{34} Supra ¶25.
\textsuperscript{35} Record, BIT, p. 8
\textsuperscript{36} Waibel, p. 727.
\textsuperscript{37} Ibid.
\textsuperscript{38} \textit{SGS v. Philippines}, p. 38, ¶99.
\textsuperscript{39} Record, PO 2, p. 50, ¶11.
\textsuperscript{40} Record, PO 2, p. 56, ¶33.
37. In sum, the Bonds fail to meet the requirements of an investment stipulated in the BIT’s definition. Similarly, they do not satisfy the characteristics further acknowledged by case law and doctrine of international investment arbitration. Consequently, the purchase of the Bonds was an ordinary commercial transaction. As a result, they are not investments in the meaning of the BIT. Thus, this Tribunal’s lacks jurisdiction over the claims pertaining to the Bonds.

   B. The PCA Tribunal's decision has no effect on the dispute at hand

38. Contrary to Claimant's submission\(^{41}\), the proceedings at hand are not affected by the PCA Tribunal's decision rendered on April 29, 2003\(^ {42}\). In the Request for Arbitration, Claimant suggested that this Tribunal is bound by the PCA Tribunal's decision issued in accordance with Art. 7 of the BIT\(^ {43}\). According to Claimant, the PCA Tribunal's decision should be fully accepted by this Tribunal\(^ {44}\).

39. However, these contentions are erroneous. The PCA Tribunal's decision does not affect the proceedings at hand for two reasons. This because purely interpretative awards are not permissible (i). Alternatively, because in any case, the PCA Tribunal's decision is not binding upon this Tribunal (ii).

   i. Purely interpretative awards are not permissible

40. Claimant stated that the PCA Tribunal's decision affects the proceedings before this Tribunal\(^ {45}\). The PCA Tribunal's decision was purely interpretative. As such, it cannot affect the proceedings in the case at hand.

41. It is a principle that international courts are not created to interpret in abstract any disputes between the parties\(^ {46}\). This rule was recognized in the Ecuador v US. In this case the interstate tribunal dismissed the proceedings because the dispute was purely abstract\(^ {47}\). Similarly, the

\(^{41}\) Record, RFA, p. 29, ¶10.

\(^{42}\) Record, PCA Award, p. 13.

\(^{43}\) Record, RFA, p. 29, ¶17-10.

\(^{44}\) Record, RFA, p. 29, ¶10.

\(^{45}\) Record, Uncontested Facts, p. 4, ¶22; Record, RFA, p. 29, ¶8-10.

\(^{46}\) Cameroon v. UK, pp. 98 – 99.

\(^{47}\) Roberts, p. 54.
Iran-US Claims Tribunal rendered its interpretative decisions taking into account the litigation proceedings between an investor and the State, thus securing a certain level of concreteness.  

42. Moreover, when there are two proceedings concerning a similar dispute, way should be given to the court or tribunal that resolves a concrete dispute. This is because the implications of an abstract decision are likely to be vague in the absence of specific facts. Such problems also may arise if an old interpretative decision is applied in a new case that arose in new circumstances.

43. In the case at hand, this Tribunal is faced with a concrete dispute. The dispute concerns specifically the Bonds that Claimant purchased. In contrast, the PCA Tribunal's decision referred to bonds in general. It did not take to account that sovereign bond may vary. This generalization was criticized by professor Jeger in his dissenting opinion to the PCA Tribunal's decision.

44. Moreover, the PCA Tribunal's decision was rendered in light of the 2001 sovereign debt restructuring in Dagobah. Corellia began these PCA proceedings in 2001 being pressured by Corellian holders of Dagobah bonds. Claimant was not among them. In the end, the PCA Tribunal's decision was "a broad pronouncement based solely on the unique facts related to a specific type of bond". There is no doubt that the Bonds were not taken into account in this decision. This is because they were issued in August 2003 and they simply did not exist when the PCA Tribunal's decision was rendered in April 2003.

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48 Roberts, p. 56.
49 Roberts, p. 55; see Trevino, p. 9.
50 Ibid.
51 Record, Uncontested Facts, p. 4, ¶22.
52 Record, PCA Award, p. 15.
53 Record, Dissenting Opinion, p. 20, ¶154.
54 Record, Uncontested Facts, pp. 1-2, ¶¶4-6.
56 Record, PO 2, p. 50, ¶13.
57 Record, Dissenting Opinion, p. 20, ¶154.
58 Record, PO 2, p. 50, ¶11.
59 Record, PCA Award, p. 13.
45. As a consequence, the PCA Tribunal's decision has no effect on the proceedings at hand. This is because the PCA Tribunal's decision was purely interpretative. Such decisions are not permissible. Moreover, it was rendered in circumstances of the 2001 sovereign debt restructuring and with regard to the bonds that were affected by this restructuring. The dispute at hand arose in the light of the 2010 sovereign debt restructuring and with regard to the Bonds that did not exist back in 2001. Thus, the PCA Tribunal's decision cannot affect investor-state proceedings.

   ii. **The PCA Tribunal's decision is not binding upon this Tribunal**

46. Claimant argues that this Tribunal must follow the PCA Tribunal's decision as it was final. However, Claimant does not provide any arguments that would lead to such a conclusion. And quite to the contrary, there are various reasons why this Tribunal is not bound by the PCA Tribunal's decision.

47. First, there is no doctrine of precedence in investment arbitration. Thus, decisions rendered by tribunals in previous proceedings are not binding upon investment tribunals. As it was stated by the tribunal in the *SGS v. Philippines*, "there is no good reason for allowing the first tribunal in time to resolve issues for all later tribunals." Especially, unless it is explicitly stated in the BIT, a state-to-state tribunal's decision cannot be binding upon investor-state tribunals.

48. Secondly, interpretative decisions do not amount to a binding amendment of an investment treaty. For instance, such decisions are not subject to registration of treaties under Art. 102 of the UN Charter. Also, there are limits to the power of state-to-state tribunals with regard to treaty interpretation. Tribunals can interpret treaties only within the reasonable textual reading of the treaty. As a consequence, such interpretations are subject to a subsequent tribunal's

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60 Record, RFA, p. 29, ¶10.
61 Schreuer/Weiniger, p. 1189.
63 SGS v. Philippines, p. 37, ¶97.
64 Potesta, p. 762.
65 UNCTAD Notes, p. 5.
67 Trevino, p. 27.
assessment whether they were correct and within the limits to the state-to-state tribunal's power.  

49. Thirdly, a binding character of state-to-state arbitration would introduce the effect of *res judicata* in subsequent investor-state arbitration. However, this effect cannot arise in such a situation. The preclusive effect of *res judicata* of one proceedings towards another in order to be validly invoked must fulfill two main requirements. First, the parties to the disputes must be identical and second, causes of action must also be identical in both proceedings. Moreover, such an effect would in fact strip an investor-state tribunal from its right to decide upon its own jurisdiction in accordance with the *competence-competence* rule.  

50. In the case at hand, the parties to the BIT never explicitly stated that investor-state tribunals are to be bound by the decisions issued pursuant to Art. 7 of the BIT. No provision of the BIT envisages such an effect. This means that there is no basis in the BIT for this Tribunal to be bound the PCA Tribunal's decision.  

51. Moreover, this Tribunal has the power to assess whether the PCA Tribunal's decision was correct. As it was already stated above, the PCA Tribunal in its decision did not take into account the variety of sovereign bonds. It simply stated that all sovereign bonds are investments in the meaning of the BIT. A statement that the Bonds are investments pursuant to the BIT is in itself faulty. Thus, the PCA Tribunal erred in its decision that all sovereign bonds are investments in the meaning of the BIT. In effect, the PCA Tribunal in its decision exceeded its power. Hence, the PCA Tribunal's decision is not binding upon this Tribunal.  

52. What is more, in the case at hand there is no place for the effect of *res judicata*. This is because the two requirements for this effect have not been met.  

53. First, the parties in the two proceedings were not identical. The arbitration before PCA Tribunal involved the dispute between the state parties Corellia and Respondent. However, the

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68 Ibid.  
69 Trevino, p. 17.  
70 Record, BIT, pp. 7-12.  
71 Supra ¶43.  
72 Record, PCA Award, p. 15.  
73 Supra ¶¶14 et seq.
proceedings before the present Tribunal concern the dispute between Claimant and the Respondent.

54. Second, the subject matter and cause of action also are not identical. The dispute before PCA Tribunal involved a matter concerning a general and abstract interpretation of a term “investment” provided within the framework of the BIT in the context of the Respondent's first financial crisis. The current proceedings however, involve a controversy whether Respondent arising due to Respondent's refusal to pay the face value of the Bonds, affected by the second financial crisis.

55. For all the above reasons, the PCA Tribunal's award is not binding. Moreover, Claimant by persistently insisting to the contrary is trying to apply indirectly the effect of res judicata. In its view the circumstances of the case at hand might create a new legal structure called "interpretative award with binding effect". The main reason for such a creation is to impose the effect of res judicata through a back door, since directly it is impossible. In effect, Claimant attempts to bar this Tribunal from effectively examining whether the Bonds constitute an investment in current proceedings on its own.

II. CLAIMS SUBMITTED BY CLAIMANT ARE NOT ADMISSIBLE

56. Alternatively, even if this Tribunal decides that the Claimant was an investor in the meaning of the BIT and that the purchase of Bonds constituted an investment in the meaning of the BIT, it still cannot hear the dispute at hand. The Bonds contain a forum selection clause pointing out to the courts of Dagobah. By purchasing the Bonds Claimant agreed to all the terms of the Bonds. Thus, it explicitly agreed to refer all disputes arising in connection with the Bonds to the courts of Dagobah. In effect, due to this forum selection clause, the claims at hand are inadmissible. This is for two independent reasons.

57. First, because the forum selection clause amounts to a waiver of Claimant's right to arbitrate disputes in connection with the Bonds (A). Second, because the claims are arise under the Bonds and not the BIT (B) and as such they are not encompassed by the BIT arbitration clause.

A. Respondent waived its right to arbitrate disputes in connection with the Bonds

58. In the RFA Claimant stated that it accepts Respondent's offer to arbitrate investment disputes expressed in the BIT. At the same time, Claimant decided to omit the fact that it waived it's

74 Record, Uncontested Facts, ¶20, p. 4.
75 Record, RFA, p. 28, ¶6.
right to arbitrate disputes arising in connection with the Bonds. This waiver took place as Claimant agreed to the forum selection clause contained in the Bonds.

59. The foundation of arbitral proceedings is the consent of the parties. It is obvious that where there is no such consent there can be no arbitration. When assessing the arbitration agreement, all circumstances must be taken into account. Such circumstances include the assessment of other parties' agreements as to the manner of resolving disputes.

60. With regard investment treaty arbitration, an investor may waive its right to arbitrate disputes that fall within the scope of the State's offer to arbitrate. This waiver may take place even before any dispute arose.

61. Moreover, such a waiver may be either explicit or implicit. An implicit waiver may take place by virtue of a dispute resolution clause contradictory to the arbitration offer contained in an investment treaty. Especially, when the contradictory clause is exclusive and construed broadly, so that it also covers the investment treaty all disputes arising in connection with an investment. A clause is broadly construed when it uses phrases such as "any dispute" arising "in connection with" or "relating to" a contract.

62. What is more, general dispute resolution clauses should yield to more specific ones. An offer to arbitrate investment disputes is general and does not refer to any specific investments. On the other hand, a contractual dispute resolution clause refers to a specific contractual relationship. As such it should prevail over the general, treaty dispute resolution clause.

63. Additionally, when an investor waives its right to arbitrate a dispute by agreeing to a contradictory forum selection clause, which is binding upon both a State and an investor, it

76 Moses, p. 2.
77 Born, p. 201; Lew, p. 100, ¶ 6-1.
78 Spiermann, pp. 186-187.
79 Ibid.
80 Håkansson v. Sweden, ¶ 67; McGonnell v. UK, ¶ 44.
81 Gaillard, p. 1.
82 SGS v. Philippines, p. 54, ¶ 141.
83 Ibid.
84 Ibid.
85 Ibid.
cannot unilaterally revoke this waiver. This is because "a freely and validly concluded contract between parties is binding upon the parties in their mutual relationship"\(^\text{86}\).

64. In the case at hand, Claimant by purchasing the Bonds in 2005 agreed to all their terms. This includes the exclusive forum selection clause pointing to the court's of Dagobah\(^\text{87}\). This clause was broadly worded. It states that "any dispute arising from or relating to this contract will be exclusively resolved before the Courts of Dagobah"\(^\text{88}\). Thus, this clause was expressly contradictory to the offer to arbitrate contained in Art. 8 of the BIT. The BIT dispute resolution clause stated that "any disputes" "in connection with" an investment shall be subject to arbitration\(^\text{89}\). Both clauses were broadly worded and cover, in the case at hand, the same claims - claims relating to the purchase of Bonds.

65. What is more, the contractual forum selection clause is more specific than the BIT clause. It does not encompass investments in general. It refers to disputes arising in relation to specific bonds - the ones purchased by Claimant. As a consequence, the forum selection clause contained in the Bonds supersedes the BIT arbitration clause.

66. In conclusion, Claimant waived its right to arbitrate disputes arising in connection with the Bond. It did so by agreeing to the exclusive jurisdiction of the Dagobah's courts. In effect, this Tribunal cannot hear the dispute at hand.

**B. Claimant's claims arise under the Bonds**

67. Claimant seems to state that the dispute at hand arose under the BIT. It alleged that Respondent breached its BIT obligations\(^\text{90}\). If such allegations were true Claimant might have been entitled to commence arbitral proceedings pursuant to Art. 8 of the BIT. However, the circumstances of the dispute between Claimant and Respondent quite different. In fact, the dispute at hand is essentially contractual. As a consequence, the proper forum to hear this dispute are the courts of Dagobah, as stated in the contractual forum selection clause.

\(^{86}\) *LIAMCO v. Libya*, p. 101.

\(^{87}\) Record, Uncontested Facts, p. 4, ¶20.

\(^{88}\) Record, PO 2, p. 50, ¶16.

\(^{89}\) Record, BIT, p. 10.

\(^{90}\) Ibid.
68. If the parties agreed to two conflicting clauses, one in an investment treaty and one in a contract, the proper forum should be asserted with regard to the character of the claims. Claims in disputes arising in connection with an investment may be either treaty based or contractual based. At times, contract-based and treaty-based claims may be highly intertwined. In such a situation, a test for the fundamental basis of the claims should be applied. If the claims are found to be essentially contract-based arbitration pursuant to an investment treaty cannot be conducted. This is because in principle contractual claims do not fall within the scope of investment treaty arbitration.

69. Moreover, a tribunal, when determining the basis of claim is not bound by the characterization made by a claimant. The tribunal has to decide objectively what is the essential character of the claim.

70. In the case at hand, Claimant's claims are objectively contractual claims. Claimant by virtue of these proceedings seeks a compensation for the losses it incurred due to Respondent's debt restructuring. These losses in fact might amount to no more and no less than the value that Respondent refused to pay, as the net value of the Bonds was reduced. Thus, the dispute at hand is at most a dispute over payment. As such, this is a commercial dispute rather than a treaty-based one.

71. This conclusion cannot be affected by the fact that the decision to reduce the value of the Bonds was announced in a state act - the SRA. This act was simply an official statement of Respondent's position with regard to payment under the Bonds. It was an offer to change the contractual terms and it was accepted by most of the bondholders. Only by an official act like SRA Respondent could have present this offer. This is because Respondent is a state. Claimant and other bondholders were aware that by purchasing bonds they entered into a commercial

91 Vivendi II, p. 42, ¶98.
92 Ibid.
93 Waibel, p. 733.
94 Yannaca-Small, p. 347.
95 Weiler, p. 293.
96 Waibel, p. 733.
97 Record, RFA, p. 30, ¶17.
98 Record, Uncontested Facts, p. 3, ¶18.
99 Record, Uncontested Facts, p. 3-4, ¶19.
relationship directly with Respondent acting as a state. Thus, they were aware that any decision
with regard to the bonds they purchased would take place through official acts such as the SRA.

72. In effect, the claims in the case at hand are fundamentally contractual claims. They are
commercial claims arising in connection with a dispute over payment. As a consequence, the
proper forum to hear the case are the courts of Dagobah, as stated in the contractual forum
selection clause.

73. For all the above reasons, Claimant claims are inadmissible. Respondent waived its right to
arbitrate all disputes relating to the Bonds. Moreover, the dispute at hand is essentially based
on the Bonds contract. As a consequence, the exclusive proper forum to decide this dispute are
the courts of Dagobah.
ARGUMENT ON MERITS

III. RESPONDENT IS NOT LIABLE FOR THE LOSSES INCURRED BY CLAIMANT

74. Respondent bears no responsibility for losses sustained by Claimant as a result of the sovereign debt restructuring program. Claimant states that the measures adopted by Respondent were unreasonable, coercive and contrary to previous warranties. As a consequence, it requests the Tribunal to determine that Respondent violated its obligation to accord Claimant’s investment fair and equitable treatment. This request, however, should be rejected.

75. Respondent has never violated the standard of fair and equitable treatment. It treated Claimant’s investment with due regard and on the same level as any other foreign investment. However, even if the Tribunal did not share Respondent’s position with regard to the first point and found that Respondent violated the obligation to treat Claimant’s investment fairly and equitably, it would still have to deny Claimant’s request. This is because Respondent introduced the sovereign debt restructuring program in order to save its financial system from bankruptcy and therefore it is exempt from liability on the grounds of the defense of necessity.

76. As a result, the Tribunal should dismiss the claims if it only finds that Respondent prevails in either of those points. Claimant, on the other hand, will not succeed unless the Tribunal finds that Respondent both violated the fair and equitable treatment standard and was not exempt from responsibility on the basis of the defense of necessity. As Claimant fails to determine any of it, the Tribunal should rule for Respondent.

A. Respondent treated Claimant’s investment fairly and equitably

77. Respondent has always treated Claimant’s investment in accordance with its treaty obligations: fairly and equitably. Yet Claimant now maintains that Respondent violated that standard of protection. It argues that Respondent contradicted Claimant’s legitimate expectations concerning the investment, coerced it into accepting an unfavorable exchange offer and acted in bad faith.

78. Claimant’s position is not supported either by law or the facts of this case. First of all, Respondent did not coerce Claimant to exchange the Bonds. It did not harm its investment either. Any possible losses Claimant incurred were caused by the decision of other bondholders, not Respondent (i). Second, Claimant could not expect that Respondent would never change

100 Record, RFA, p. 30, ¶13.
101 Record, RFA, p. 29, ¶¶12-13.
the law concerning Bonds, especially in face of the collapse of its financial system (ii). Finally, Respondent did not intend to harm Claimant’s investment and thus it did not act in bad faith (iii).

i. Respondent did not harm Claimant’s investment

79. Claimant argues that its losses arise from the exchange of Bonds. However, Respondent did not have direct control over the decision of the bondholders. All the more, it did not coerce Claimant to exchange the Bonds. As a result, Respondent’s actions did not damage Claimant’s investment and did not violate fair and equitable treatment standard.

80. Respondent shares Claimant’s view that freedom from coercion constitutes one of the basic elements of fair and equitable treatment standard. Nevertheless, it cannot share the view that any of its actions constituted coercion. Case law provides several examples of actions taken by the states attempting to force investors to making certain decisions, however Respondent’s actions are not even close to them.

81. In Desert Line v. Yemen an investor was forced to accept an unfavorable settlement offer by “the subjection of the Claimant’s employees, family members, and equipment to arrest and armed interference”. Consequently, the investor agreed to diminish the amount of award it previously obtained by half.

82. Another example of coercion was found by the tribunal in Pope & Talbot v. Canada. SLD, a Canadian government agency conducted a review process concerning the investment of Pope & Talbot. As the tribunal found:

“[t]he relations between the SLD and the Investment during 1999 were more like combat than cooperative regulation, and the Tribunal finds that the SLD bears the overwhelming responsibility for this state of affairs. It is not for the Tribunal to discern the motivations behind the attitude of the SLD; however, the end result for the Investment was being subjected to threats, denied its reasonable requests for pertinent information, required to incur unnecessary expense and disruption in

102 Record, RFA, p. 30, ¶14.

103 Desert Line v. Yemen, p. 45, ¶179.
meeting SLD’s requests for information, forced to expend legal fees and probably suffer a loss of reputation in government circles”104.

83. In *Vivendi v. Argentina* a host state was found to have attempted to coerce an investor to negotiate by the improper use of state powers. One of the regulatory bodies imposed 78 fines and laid 101 separate charges in order to “put pressure” on the investor who declined to renegotiate a binding contract105. As the state used its power to intentionally put pressure on an investor and its actions went far beyond regulatory proceedings the tribunal found that Argentina violated fair and equitable treatment standard.

84. Summing up, the examples of coercion include arrest, physical harassment of the employees and family members of investors, abuse of power by government agencies, imposing fines and conducting abusive review proceedings. All these actions are motivated by the will of a host state to force an investor to make certain decision.

85. None of these factors is present in the case at hand. There is nothing in the Record that would suggest that Claimant was in any way threatened by Respondent or that Respondent intended to force it into making any decisions. Quite to the contrary, Claimant could freely express its will regarding the exchange of the Bonds as any of the bondholders. The basis of the claims submitted in the case at hand is just the fact that Claimant was in the minority of bondholders who did not want to accept Respondent’s offer106. Additionally, Respondent did not intend to put pressure on Claimant with regard to its decision concerning exchange of the Bonds.

86. Claimant may argue that Respondent infringed procedural propriety and due process by, *inter alia*, failing to include the bondholders in the legislative process leading to the enactment of SRA. Nonetheless, Respondent acted within its sovereign legislative power. Thus, it did not have such obligation. Yet it informed the bondholders “of the ongoing draft and the different versions of the text were constantly published on relevant agencies ’ websites”107.

87. Claimant might also maintain that Respondent did not consult the exchange offer with all the bondholders. However, such expectation hardly ever could be met108. Nevertheless, Respondent made a reasonable effort to confer with the representation of bondholders. It created

104 *Pope & Talbot v. Canada*, p. 87, ¶181.
105 *Vivendi v. Argentina*, p. 211, ¶7.4.24.
106 *Record, Uncontested Facts*, p. 4, ¶22.
107 *Record, PO 2*, p. 51, ¶21.
108 Simões, p. 25
a consultative committee of the bondholders, joined by approximately 50% of them\textsuperscript{109}. Claimant could have joined the committee as well, however it failed to make a submission on time\textsuperscript{110}.

88. Finally, Respondent acknowledges that case law recognizes certain circumstances in which actions of the state entities struggling with the consequences of the financial crisis may constitute coercion. In \textit{Total v. Argentina} “the investor was offered a choice: either to exchange some of the receivables to shares or to hold unpaid receivables”\textsuperscript{111}. Claimant may even argue that in the case at hand it was not given such alternative. It had to comply with the decision of the majority of bondholders.

89. This last statement is crucial in the present dispute. Claimant was not made by Respondent to exchange its Bonds, Respondent did not impose any law requiring Claimant to decrease the value of its Bonds, but it was merely bound by the decision of other bondholders.

90. As a consequence, Respondent cannot be held responsible for violation of the fair and equitable treatment standard. Investment protection under the BIT applies, in principle, to the relations between a host state and an investor, not an investor and other persons. Hence, Respondent cannot be liable for the consequences of actions taken by the bondholders who agreed on the exchange.

91. In conclusion, Respondent did not coerce Claimant to accept its exchange offer. Claimant was merely outvoted by other bondholders. Respondent did not use any means to force Claimant to exchange the Bonds. In fact, Claimant freely expressed its will in the vote of the bondholders. Consequently, Respondent did not violate the fair and equitable treatment standard.

\textbf{ii. Claimant could not rely on the expectation that legal framework of the Bonds would never change}

92. Claimant had to comply with the bondholders’ decision, not Respondent’s one. It was argued above that as a result Respondent did not coerce Claimant to exchange the Bonds. However, this conclusion has another essential consequence. It means that the only act of Respondent which Claimant may challenge in the current proceeding is not the failure to pay the full sum

\begin{itemize}
\item \textsuperscript{109} Record, PO 2, p. 51, ¶21.
\item \textsuperscript{110} Record, PO 3, p. 56, ¶35.
\item \textsuperscript{111} \textit{Total v. Argentina}, p. 154, ¶338.
\end{itemize}
stipulated in the Bonds, but the enactment of law enabling the majority of bondholders to impose their decision on the holdout minority.

93. Claimant submitted that its expectation was practically the fulfillment of the obligations arising from Bonds by Respondent. Nonetheless, Claimant cannot prove that Respondent violated any of its obligations. Since the Bonds have a maturity of 12 years\textsuperscript{112} and they were issued in 2003\textsuperscript{113}, the payment will not be due until 2015. As a result, at the time being, Claimant was not denied any rights arising from the Bonds. However, even if Respondent pays the diminished sum stipulated in the exchanged Bonds, it will still duly fulfill its obligation. This is because the Bonds were exchanged legally, with observance of the applicable law and they are the exclusive source of Respondent’s obligation.

94. As a result, the only expectation on which Claimant theoretically could rely in the current case is not the fulfillment of contractual obligation by Respondent but rather preservation of the legal framework concerning the Bonds. Nonetheless, the circumstances of the current dispute indicate, that Claimant could not reasonably expect that Respondent would never change the law concerning its Bonds.

95. Respect for investor’s legitimate expectations is without a doubt an essential element of the fair and equitable treatment standard. However only legitimate expectations fall within the scope of protection. It is noted by scholars that such expectations must be induced by a host state at the moment investment is made by specific and unambiguous actions\textsuperscript{114}. Case law requires that a host state make “an unambiguous affirmation”\textsuperscript{115} or “definitive, unambiguous and repeated assurance”\textsuperscript{116}. Consequently, as the tribunal in Parkerings v. Lithuania noted: “[i]t is evident that not every hope amounts to an expectation under international law”\textsuperscript{117}. Only if such hope was induced by specific and unambiguous action of a host state, an investor may rely on it.

96. This is particularly important with regard to the expectation of legal stability. The power to legislate is unquestionably one of the attributes of a sovereign state. By concluding a bilateral investment treaty a state does not give up that power. It only undertakes not to change the law

\textsuperscript{112} Record, PO 2, p. 50, ¶14.

\textsuperscript{113} Record, PO 2, p. 50, ¶11.

\textsuperscript{114} Newcombe/Paradell, p. 281; McLachlan, p. 237, ¶7.109.

\textsuperscript{115} GAMI v. Mexico, p. 27, ¶76.

\textsuperscript{116} Feldman v. Mexico, p. 61, ¶148.

\textsuperscript{117} Parkerings v. Lithuania, p. 73, ¶344.
in an arbitrary manner. What violates the fair and equitable treatment standard is not an ordinary amendment but a “«roller-coaster» effect of legislative changes”\textsuperscript{118}. Consequently, the right to stability of the legal framework is not absolute one, as the states retain their sovereign powers\textsuperscript{119}:

“[i]t is each State’s undeniable right and privilege to exercise its sovereign legislative power. A State has the right to enact, modify or cancel a law at its own discretion. Save for the existence of an agreement, in the form of a stabilisation clause or otherwise, there is nothing objectionable about the amendment brought to the regulatory framework existing at the time an investor made its investment. As a matter of fact, any businessman or investor knows that laws will evolve over time. What is prohibited however is for a State to act unfairly, unreasonably or inequitably in the exercise of its legislative power”\textsuperscript{120}.

97. As a result, Claimant not only has to prove that it relied on certain legitimate expectations, but also that they were induced by Respondent. While the representations of the parties at the contractual level might have affected Claimant’s contractual expectations, it has already been argued that such expectation bears no significance in the current proceeding\textsuperscript{121}. Hence, Claimant needs to demonstrate that Respondent induced its expectation of stability of legal framework.

98. Nevertheless, the facts of the case contradict such contention. First of all, Respondent has never made any representations allowing the investors to believe that there would be no more sovereign debt restructuring\textsuperscript{122}. In particular, the Bonds themselves did not include any kind of stabilization clauses or other representations guaranteeing the stability of the legal framework\textsuperscript{123}.

99. Second, Claimant is a hedge fund, a professional in the field of financial instruments. As a result, it must have been well aware of the situation at the financial markets when it acquired

\textsuperscript{118} PSEG v. Turkey, p. 65, ¶250.
\textsuperscript{119} Dolzer/Schreuer, p. 148.
\textsuperscript{120} Parkerings v. Lithuania, p. 71, ¶332.
\textsuperscript{121} Infra ¶94.
\textsuperscript{122} Record, PO 2, p. 50, ¶18.
\textsuperscript{123} Record, PO 3, p. 56, ¶32.
the Bonds. The financial condition of Respondent was at that time rated B+. While the exact meaning of that rating remains unknown, it may be compared with similar rating scales used by other agencies. In Standard & Poor’s rating category B is described as follows:

“[a]n obligation rated 'B' is more vulnerable to nonpayment than obligations rated 'BB', but the obligor currently has the capacity to meet its financial commitment on the obligation. Adverse business, financial, or economic conditions will likely impair the obligor's capacity or willingness to meet its financial commitment on the obligation”

100. Fitch Ratings describe category B instruments as highly speculative:

“B ratings indicate that material default risk is present, but a limited margin of safety remains. Financial commitments are currently being met; however, capacity for continued payment is vulnerable to deterioration in the business and economic environment”

101. Finally, according to Moody’s Rating Symbols and Definitions category B means that obligations are “considered speculative and are subject to high credit risk”. As a result, the rating of Respondent’s sovereign debt should have been a warning rather than encouragement for investors. If Claimant decided to acquire the Bonds anyway, it must have been aware of the possibility of changes in the legislative framework in case of financial problems of the recovering economy.

102. Third, Claimant relies on the PCA Tribunal’s award claiming that the reason why Bonds constituted an investment is the fact that their acquisition was connected with the assumption of risk. Hence, it concedes that it was aware of the possible losses connected with the trading of financial instruments.

103. To conclude, Respondent did not make any specific, unambiguous representations or assurances guaranteeing that it would not change the legal regulations regarding the Bonds. In addition, Claimant was aware of the risk connected with the acquisition of such instruments. As a result, enactment of SRA did not violate the fair and equitable treatment standard.

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124 Record, PO 3, p. 56, ¶31.
125 Standard & Poor’s Ratings Definitions.
126 Fitch Ratings Definitions
127 Moody’s Rating Symbols and Definitions.
iii. **Respondent acted in good faith**

104. Respondent has never intended to harm Claimant’s interests. The aim of the sovereign debt restructuring program was saving Respondent’s economy, not destroying Claimant’s business. As a result, Respondent did not violate its obligation to accord Claimant’s investment fair and equitable treatment.

105. Bad faith is understood as intention to harm investor’s assets on purpose. The tribunal in *Waste Management v. Mexico* characterized an action in bad faith as “conscious combination of various agencies of government without justification to defeat the purposes of an investment agreement.” However, the scholars emphasize that if an action of a host state affects equally foreign and local investors, it is a strong indicator that there was no violation of the fair and equitable treatment standard. In *Bayindir v. Pakistan* the tribunal noted that “standard for proving bad faith is a demanding one, in particular if bad faith is to be established on the basis of circumstantial evidence.”

106. As a result, the standard of determination of bad faith is set at a high level. It is not enough to prove that the host state could have foreseen that certain action would harm the investment. It is necessary to demonstrate that the investment was the main target of such action and that the host state acted with malice and intention to harm.

107. Claimant fails to meet this standard. The main aim of Respondent’s action was saving its economy from bankruptcy. In fact, if Respondent did not restructure its sovereign debt, it is possible that Claimant would lose even more than the deducted amount. Claimant did not present a single piece of evidence that would suggest that Respondent intended to harm Claimant’s investment. What strongly indicates to the contrary is the fact that the program enacted by Respondent applied to all bondholders, both domestic and foreign. Consequently, Respondent did not single out the investor it wished to harm – it acted to save its financial system.

108. To conclude, Respondent did not intentionally infringe Claimant’s investment. It acted with purpose of saving its economy, not damaging any investment. Consequently, Respondent’s

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128 Dolzer/Schreuer, p. 156.


131 *Bayindir v. Pakistan*, p. 40, ¶143.
actions were taken in good faith and did not constitute a violation of fair and equitable treatment standard.

B. **Respondent is exempt from liability for the alleged breach of the BIT pursuant to Art. 6(2) of the BIT**

109. Respondent did not breach Art. 2(2) of the BIT as it provided Claimant with fair and equitable treatment. Thus, Respondent is not liable for any losses incurred by Claimant as a result of Dagobah’s debt restructuring. In any event, even if this Tribunal decided that Respondent breached Art. 2(2) of the BIT, it is exempt from liability because it was acting in order to reduce its debt to a sustainable level and to regain access to the world’s capital markets, observing IMF’s recommendations and without compromising the state’s basic functions.

110. When Respondent issued the Bonds in order to supplement its general state budget\(^\text{132}\), it was naturally willing to pay them off to Claimant together with interest. Unfortunately, due to the economic crisis which led to large-scale dismissals resulting in the increase in unemployment rates up to 10.9%, social unrest and spiking inflation\(^\text{133}\), Dagobah’s net government debt to GDP ratio at the end of 2011 was 124%\(^\text{134}\). Its financial system was at the border of collapse. Because of the severity of the crisis, Respondent had no other option but to restructure its debt. It did that by enacting SRA. Since it was a legitimate action of a government undertaken in the state of necessity, Claimant may not pursue compensation for the losses it incurred as a result of Dagobah’s debt restructuring program.

111. Respondent claims that it is exempt from liability for the alleged breach of the fair and equitable treatment standard pursuant to Art. 6(2) of the BIT. To prove that, it will demonstrate that the defense of Art. 6(2) of the BIT is distinct from the customary necessity (i) and that Art. 6(2) of the BIT constitutes a self-sufficient, treaty-based defense (ii). Finally, Respondent will show that it acted in order to safeguard its own essential security interests (iii).

   i. **Art. 6(2) of the BIT is distinct from the customary defense of necessity**

112. Pursuant to the general principle of international law *pacta sunt servanda* (which has been implemented into Art. 26 of the VCLT), states have to abide by their treaty-based international obligations. However, due to potential extraordinary circumstances, the practice has developed

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\(^{132}\) Record, PO 3, p. 55, ¶30.

\(^{133}\) Record, PO 3, p. 56, ¶38.

\(^{134}\) Record, PO 3, p. 57, ¶37.
certain defenses, such as necessity, *force majeure* or distress that the states are allowed to raise in order to temporarily or permanently refrain from performing their obligations.\(^{135}\)

113. The necessity defense has become a part of customary international law\(^{136}\) which has been reflected in the ILC Draft. Chapter V of the ILC Draft lists circumstances precluding wrongfulness that may be invoked by the states. Although it does not explicitly indicate a possibility of raising necessity, it enumerates circumstances under which the defense may not be invoked. Namely, pursuant to Art. 25(1) of the (ILC Draft):

> “necessity may not be invoked by a State as a ground for precluding the wrongfulness of an act not in conformity with an international obligation of that State unless the act is the only way for the State to safeguard an essential interest against a grave and imminent peril and does not seriously impair an essential interest of the State or States towards which the obligation exists, or of the international community as a whole”\(^{137}\).

114. Thus, in order to successfully raise necessity, a state has to prove that the actions it undertook were the only possible way to safeguard its essential interest against a grave and imminent peril and that the said actions do not impair an essential interest of other states. What is more, Art. 25(2) of the ILC Draft specifies two exceptions, the occurrence of which precludes necessity. Namely,

> “necessity may not be invoked by a State as a ground for precluding wrongfulness if the international obligation in question excludes the possibility of invoking necessity or the State has contributed to the situation of necessity”\(^{138}\).

115. Furthermore, the requirements set forth in Art. 25 of the ILC Draft have to be met cumulatively\(^{139}\). What is more, not only does the state have to prove the fulfillment of the affirmative requirements, but it also bears the burden of showing that none of the exceptions

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\(^{135}\) Crawford, 160–86.

\(^{136}\) *Gabčíkovo-Nagymaros Project Case*, p. 40; *Wall in Palestine case Advisory Opinion*, p. 196.

\(^{137}\) Art. 25(1)(a)(b) of the ILC Draft.

\(^{138}\) Art. 25(2)(a)(b) of the ILC Draft.

applies\textsuperscript{140}. As can be inferred from the above, it is extremely difficult for a state to successfully raise customary necessity\textsuperscript{141}.

116. Observing this difficulty, Dagobah and Corellia have decided to depart from customary necessity and introduce a separate and self-sufficient defense into their BIT which would allow them to refrain from fulfilling their obligations in exceptional circumstances. They executed it by enacting Art. 6(2) of the BIT. This conclusion is inevitable in light of the wording of the said provision.

117. Art. 6(2) of the BIT states that nothing in BIT

\begin{quote}
\textit{“shall be construed to preclude a Party from applying measures that are necessary for the fulfillment of its obligations with respect to the maintenance or restoration of international peace or security, or the protection of its own essential security interests”}\textsuperscript{142}.
\end{quote}

It does not mention \textit{“grave and imminent peril”} or \textit{“impairment of essential interests”}. Therefore, it should not be read merely as a reflection of customary defense of necessity, especially given the fact that the BIT was concluded prior to the ILC Draft. To the contrary, it constitutes a separate, self-sufficient treaty based defense that may be invoked in situations of emergency.

118. This conclusion is supported by a logical explanation – had it been the Parties intention to adopt customary international defense of necessity (assuming that it had existed before its codification into the ILC Draft), there was no need to introduce Art. 6(2) to BIT or, in any event, deviate from the prerequisites which were later laid down in Art. 25 of the ILC Draft. That is because pursuant to Art. 38(1)(b) of the ICJ Statute\textsuperscript{143}, a custom is a binding source of international law. As noted above\textsuperscript{144}, necessity is a part of customary international law so either of the Parties of the BIT would be able to invoke it without any additional reference to it in the treaty. Since they decided to introduce Art. 6(2) of the BIT, it is clear that they shared the intention to constitute a separate, treaty-based defense. In any event, Corellia and Dagobah concluded the

\begin{footnotes}
\item[\textsuperscript{140}] Bjorklund \textit{I}, p. 483.
\item[\textsuperscript{141}] Thjoernelund, p. 477.
\item[\textsuperscript{142}] Art. 6(2) of the BIT.
\item[\textsuperscript{143}] ICJ Statute, Art. 38(1)(b).
\item[\textsuperscript{144}] Supra ¶113.
\end{footnotes}
BIT in 1992145 and the ILC Draft was issued in 2001. Thus, Claimant may not argue that Art. 6(2) of the BIT reflects Art. 25 of the ILC Draft because the BIT had been concluded nine years before the ILC Draft was released. Therefore, when the parties signed the BIT, the customary necessity has not been developed or at least codified yet.

ii. Respondent is exempt from liability pursuant to the treaty based defense (Art. 6(2) of the BIT)

119. In the case at hand, the Tribunal directed the Parties to address the issue whether or not Respondent’s actions are exempt from liability in case that they constituted “a measure necessary to safeguard the Respondent’s essential security interests”146. Therefore, the answer to this question depends on the fulfillment of the requirements of Art. 6(2) of the BIT.

a. Art. 6(2) of the BIT applies to economic emergencies

120. Although the invocation of necessity-like defenses has traditionally been associated with situations concerning armed conflicts or natural disasters, the tribunals agree that the states are also allowed to raise it in case of a severe economic crisis147. Thus, Respondent may raise the defense of necessity protecting it from liability for failing to execute its contractual obligations due to economic crisis.

121. In order to determine the nature of the defense from Art. 6(2) of the BIT, it is desirable to trace the practice of international tribunals in analogous cases. So far, the issue of essential security exceptions in connection with economic crisis has only been raised in cases against Argentina148. The example that this Tribunal should follow was established by the tribunals examining disputes between American investors and the government of Argentina after the 2001 financial crisis – namely CMS v. Argentina Annulment Proceeding and Continental v. Argentina149 which were decided on the basis of the Argentina–US BIT. In Art. XI it provides that

“This Treaty shall not preclude the application by either Party of measures necessary for the maintenance of public order, the fulfillment

145 Record, Uncontested Facts, p. 1, ¶ 2.
146 Record, PO 1, p. 46, ¶4.
147 Bjorklund II, p. 493, UNCTAD Series, p. 8
148 UNCTAD Series, p. 64.
of its obligations with respect to the maintenance or restoration of international peace or security, or the protection of its own essential security interests”\textsuperscript{150}.

When compared with art. 6(2) of the BIT, it is clear that, apart from wording differences, both treaties essentially establish the same rules.

122. The reasoning that Art. XI Argentina–US BIT contains a provision distinct from customary international necessity was presented in \textit{CMS v. Argentina} Annulment Proceeding. This approach was later applied in the \textit{Continental v. Argentina} where it was stated that the suggested equivalence between article XI and the customary international law defense of necessity has to be denied since the latter’s stricter standards, specifically the ones requiring a state to prove that the measures that it took were the “only means” to address the crisis, was inapplicable to situations of economy collapse\textsuperscript{151}.

123. This conclusion was further supported by the \textit{LG&E v. Argentina} tribunal which stated that the “essential security” clause present in many BITs could form an independent basis for a state to justify a suspension or even termination of its obligations\textsuperscript{152}. Therefore, Art. 6(2) of the BIT should be read as a separate, treaty-based defense from liability.

\textbf{b. Art. 6(2) of the BIT permanently exempts Respondent from liability}

124. A successful invocation of the defense based on Art. 6(2) of the BIT permanently discharges Respondent from executing obligations it would otherwise have to fulfill. This conclusion is a consequence of a finding that Art. 6(2) of the BIT constitutes a separate, treaty-based defense.

125. As it was explained in \textit{CMS v. Argentina Annulment Proceeding}, a treaty-based defense contains a “threshold requirement: if it applies, the substantive obligations under the Treaty do not apply”\textsuperscript{153}, while Art. 25 of the ILC Draft is an excuse which is only relevant once it has been decided that there has otherwise been a breach of those substantive obligations\textsuperscript{154}. Therefore, Respondent’s invocation of Art. 6(2) of the BIT leads to a conclusion that Respondent’s actions did not constitute a breach of the BIT at all. An application of a customary

\textsuperscript{150} Argentina–US BIT, art. XI.

\textsuperscript{151} \textit{Continental v. Argentina}, ¶234; Alvarez, p. 326.

\textsuperscript{152} Bjorklund I, p. 503

\textsuperscript{153} \textit{CMS v. Argentina Annulment Proceeding}, ¶129.

\textsuperscript{154} Ibid.
necessity, on the other hand, would only postpone Respondent’s obligation to compensate Claimant until the moment after the state of necessity has passed (provided that the Tribunal would find that there had been a breach in first place).

iii. **Respondent complied with the requirements of Art. 6(2) of the BIT**

126. Respondent complied with the requirements of exemption from liability for the alleged breach of BIT as it applied measured which were necessary to fulfill its obligations with respect to the protection of its own essential security interests.

127. According to the *CMS v. Argentina Annulment Proceeding*, Art. XI of US-Argentina BIT (which, as mentioned above, is almost identical to BIT\(^{155}\)) is distinct from necessity under customary international law and these two are substantively different\(^{156}\). In *LG&E v. Argentina* the tribunal suggested that the treaty-based defenses should be measured against different and less stringent standards than those flowing from customary international law\(^{157}\).

128. Since Art. 6(2) of the BIT leaves room for interpretation, in realm of an economic emergency, a standard of proportionality and adequacy should be applied\(^{158}\). What is more, in case of ambiguities concerning the meaning of the provision of the BIT, it should be resolved “in favor of state sovereignty”.

129. In the case at hand, Respondent undertook debt restructuring actions because of the severe crisis that struck its economy. Namely, after the 2008 crisis there was a major economy set-back which led to large-scale dismissals resulting in the increase in unemployment rates up to 10.9%, social unrest and spiking inflation\(^{159}\). As a result, Dagobah’s debt reached unsustainable level by 2010\(^{160}\) and the net government debt to GDP ratio at the end of 2011 was 124%\(^{161}\). As the *LG&E v. Argentina* tribunal put it:

\(^{155}\) Supra ¶121.

\(^{156}\) *CMS v. Argentina Annulment Proceeding*; ¶130.

\(^{157}\) Bjorklund II, p. 463.

\(^{158}\) Reinisch, p. 201.

\(^{159}\) Record, PO 3, p. 56, ¶38.


\(^{161}\) Record, PO 3, p. 57, ¶37.
“when a state’s economic foundation is under siege, the severity of the problem can equal that of any military invasion”\(^\text{162}\).

This is exactly what Respondent was threatened by in the case at hand. Therefore, the seriousness of this crisis is sufficient to justify an invocation of the necessity defense.

130. As the experts often vary with regard to the assessment of the actions that could be taken against the economic crises\(^\text{163}\), it would not be reasonable to require Respondent to show that its debt restructuring program was the only possible option to overcome the emergency. Respondent submits that enacting SRA was less onerous and less damaging to its economy that other potential measures that could have been resorted to (e.g. dismissal of public servants or raising of taxes) and as such, it qualifies as a necessary measure within the meaning of Art. 6(2) of the BIT\(^\text{164}\).

131. Respondent’s actions aiming at restructuring its sovereign debt, including the enactment of SRA, were legitimate and proportionate in light of severe economic crisis suffered by its economy. Therefore, pursuant to Art. 6(2) of the BIT which was specifically designed to be applied in extraordinary circumstances like the ones in the case at hand, Respondent is exempt from liability for the alleged breach of the BIT on the basis of the self-sufficient treaty-based defense from this provision.

132. Claimant has aggressively challenged Respondent’s response to serious economic crisis suffered by its economy. Respondent strongly denies Claimant’s allegations with this regard and emphasizes that its actions were proportionate and permissible under BIT. Irrespectively, Claimant fails to consider the Dagobah economy crisis in a bigger picture. Claimant argues that Respondent is obliged to compensate for the losses incurred by Claimant as a result of the enactment of SRA. However, it needs to be stressed that not only did Respondent’s actions aim at protecting and healing Respondent’s economy – they also observed Claimant’s legitimate interests as Bondholders. Although it is impossible to estimate the current state of Respondent’s economy had SRA not been enacted and executed, it is reasonable to assume that Dagobah’s economy would have totally collapsed by today. In such a case, Claimant would probably not be able to retrieve any part of its debts against Respondent after the latter had declared bankruptcy.

\(^{162}\) LG&E v. Argentina, ¶238.

\(^{163}\) Thjoernelund, p. 468.

\(^{164}\) Thjoernelund, p. 477.
133. In conclusion, because Respondent’s actions complied with the prerequisites of invoking Art. 6(2) of the BIT, Respondent is exempt from liability for the losses incurred by Claimant as a result of Respondent’s alleged breach of the fair and equitable treatment standard under Art. 2(2) of the BIT.
RELIEF REQUESTED

Respondent respectfully requests this Tribunal to:

I. Decide that this Tribunal does not have jurisdiction over the claims submitted by Claimant.
   Alternatively

II. Decide that the claims submitted by Claimant are not admissible.
    Alternatively

III. Decide that Respondent did not violate Article 2(2) of the BIT.
     Alternatively

IV. Decide that Respondent is exempt from liability on the basis of Article 6(2) of the BIT.
V. Dismiss the claims submitted by Claimant.
VI. Order Claimant to pay any costs incurred by Respondent in this arbitration proceeding pursuant to Article 44 of the SCC Rules.

Counsels for Respondent
TEAM DONOGHUE
20 September 2014