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PCA CASE NO. 2016-74

PERMANENT COURT OF ARBITRATION

In The Matter of an Arbitration Pursuant to the Bilateral Investment Treaty between the Government of Basheera and the Republic of Mercuria

ATTON BORO LIMITED
(Complainant)

and

REPUBLIC OF MERCURIA
(Respondent)

SUBMISSION FOR THE RESPONDENT

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Articles

Gastrell, L and Cannu, P. 2015 "Procedural Requirements of 'Denial-of-Benefits' Clauses in Investment Treaties: A Review of Arbitral Decisions", ICSID Review, Vol. 30

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STATEMENT OF FACTS

The following is the set of facts that gave rise to the present dispute;

1. In April 1998, Atton Boro Group, a leading drug discovery and development enterprise in the People's Republic of Reef established a wholly owned subsidiary, Atton Boro Limited in the Kingdom Basheera. Atton Boro was as such organised under the laws of Basheera. In 2003, Mercuria experienced increased incidence of greyscale (a sexually Transmitted Infection) among the working age population across the country. As a result of this, In November 2004, Atton Boro concluded a contract with The Republic of Mercuria's National Health Authority (NHA) for the supply of greyscale medication. This contract, termed the Long Term Agreement (LTA), was for a period of 10 years, subject to the supplier's satisfactory performance, with a standing discount of 25%.

2. In 2007, the demand for sanior doubled with each quarter, necessitating a higher supply. Early 2008, the NHA informed Atton Boro that it would need to renegotiate the prices for sanior. In these renegotiations, the NHA demanded a further discount of 40%. In these renegotiations, Atton Boro offered an additional 10% discount. The NHA rejected this offer and insisted on the 40% discount. On the 10th June 2008, The NHA then unilaterally terminated the LTA, citing unsatisfactory performance as a ground for termination.

3. Atton Boro took the dispute before a tribunal seated in Reef and in January 2009, an award was granted in favour of Atton Boro. In March 2009, the claimant filed enforcement proceedings before the High Court of Mercuria. The High Court entertained every delay tactic employed by the respondent and to date, the award has not been enforced.

4. In October 2009, legislation was promulgated by the President of Mercuria (Law No.8458). In this law, there was a provision legalising the use of patented inventions without prior authorization of the owner. A month later, a Mercurian generic drug manufacturer, HG-Pharma applied before the High Court to be granted a licence to

manufacture Valtervite. The matter was heard through a fast tracked process. The licence was granted in April 2010 until greyscale no longer poses a threat. The court further ordered that the royalty to be paid to Atton Boro as the owner of the patent was to be 1% of the total earnings.

CLAIM A (Jurisdiction)

Issue: whether the PCA has jurisdiction to enforce the arbitral award given by a Reef tribunal

Submissions

5. After the unilateral termination of the LTA, Atton Boro took the matter before a tribunal seated in Reef. This tribunal awarded in favour of Atton Boro. It is from the foregoing that this issue arises.

   It is submitted on behalf of the respondent state that the PCA does not have jurisdiction to enforce an arbitral award. The claimant seeks protection from the Mercuria-Basheera BIT, which is an investment treaty. The arbitral award would as such have to qualify as an investment under the BIT to be worthy of protection in investment treaty arbitration.

6. The GEA Aktiengesellschaft group v Ukraine case

   In the case of **GEA Aktiengesellschaft group v Ukraine**[1], the same issue was addressed. This case was given rise from the German-Ukraine BIT. After an alleged violation of the BIT by Ukraine, the claimant, a German oil company took the dispute before an ICC tribunal which awarded in its favour. The claimant then sought to enforce that award before an ICSID tribunal.

   The tribunal held that an arbitral award and an investment are analytically distinct. In the words of the tribunal,

   The ICC award is nothing but a legal instrument which provides for the disposition of rights and obligations arising out of the settlement agreement and could not itself be an investment

[1] ICSID Case No. ARB/08/16

7. The arbitral award given by the tribunal in Reef was for the purposes of disposing off any rights and obligations that were accrued to the claimant under the Long Term Agreement.

8. The tribunal went on further to clarify that the fact that the award arises out of an investment does not equate the award with the investment itself. In line with that decision, the Respondent submits that even though Atton Boro has investments in Mercuria, not all monies that accrue from that particular investment are investments themselves and as such are not worthy of protection under the Mercuria-Basheera BIT. The Respondent asks that the PCA tribunal in this case align itself with the reasoning given in the case afore-mentioned.

9. Article 25 of the ICSID rules leaves the term "investment" open for interpretation. There have however been cases that gave guidelines as to what qualifies as an investment under Article 25 of the ICSID rules.

   In **Salini et al v Morocco**[2], a leading case on the subject matter, formulated a four-part test. The Salini test defines four elements; contribution of money or assets, certain duration, an element of risk and lastly, contribution to the economic development of the host state that must be present for the existence of an investment to come about.

<u>Contribution to economic development of the host state</u>

10. The main focus here will be on the last leg of the test; to prove that the said arbitral award has no contribution towards the economy of Mercuria and as such cannot be an investment under the BIT. In the Salini case, it was held that an investment should at all material times have a contribution to the economy or at least be relevant to the economic activity in the host state.
11. The award given by the Reef tribunal involves no contribution to or relevant economic activity in the Republic of Mercuria and therefore cannot qualify as an investment.

[2] ICSID Case No. ARB/00/4

The respondent is aware of cases that are contrary to its submissions, such **as Quiborax v Bolivia**[3], which argue that contribution to economic development is not a necessary element of investment. The approach in Salini however is the one that must be adopted by the PCA as that will promote the spirit of the Mercuria-Basheera BIT.

12. The Vienna Convention on the law of treaties at Article 31 is an advocate of the textual approach to interpretation. It requires that treaties be interpreted in good faith and in accordance with the ordinary meaning to be given to the terms of the treaty in their context and the light of its object and purpose. The Article goes on in no uncertain terms to state that the preamble qualifies as part of the text for the purposes of interpretation.

    The preamble of the BIT states that,

    …recognizing that the agreement on the treatment to be accorded to such investment will stimulate the flow of private capital and the economic development of the contracting parties

13. From the above quotation, it can be derived that the BIT is a treaty that was signed for the purposes of fostering economic development by encouraging and protecting international investments. The interpretation that is proposed on behalf of the respondent accepts the language of the preamble and as a result promotes the purpose and the spirit of the BIT.

    If any other interpretation were to be adopted in the present case there would be three fatal effects.

<u>Extension of protection under the BIT</u>

14. Firstly, protection under the BIT would be extended over and beyond the stated and intended purpose, that is, protection would be extended to cover so-called investments that bring absolutely no contribution to the economic development of the host state, contrary to the purpose stated in the preamble. At International law, the provisions and general text of treaty must be respected; this is known as the Doctrine of *Pacta Sunt Servanda (*sanctity of the contract). Extending the scope of protection beyond the stated purpose would be an unjustifiable violation of the sanctity of the BIT.

[3] ICSID Case No. ARB/06/2

Unjustifiable extension of the PCA's jurisdiction

15. The second effect would be the unnecessary and unjustifiable extension of the PCA's jurisdiction beyond the scope stated in the BIT. At International law, parties to a treaty are allowed to determine on their own the scope of jurisdiction given to arbitration bodies settling their disputes. The BIT is a treaty for the protection of investments and as such, any dispute brought under the BIT should be in relation to protection of investments, and that is the limit of the PCA's jurisdiction in relation to any dispute given rise from the BIT. Going outside the scope of protection of investments would be an extension of jurisdiction that is not provided for under the BIT.

The Stability Argument

16. The last effect that would come about is the lack of stability in law. If the PCA accepts an arbitral award as an investment under the BIT, that would leave a lot of uncertainty in the interpretation of 'investment' under the BIT. The approach to interpretation argued for herein would benefit the parties to the BIT in the settlement of any dispute that would arise from the BIT in the future. It provides a more uniform, stable and predictable rule for the parties to operate on and arbitrators a lesser hustle in interpretation.

CLAIM B (Denial of Benefits)

Issue: Whether the Claimant has been denied the benefits of the Mercuria-Basheera BIT by virtue of the Respondent's invocation of Article 2 of the BIT

Submissions

17. The respondent state shall deal with this issue in two phases. Firstly, it shall show that the Complainant falls squarely within Article 2(1) of the BIT and secondly, that the Respondent is legally permitted to invoke the denial of benefits clause retrospectively.

Application of Article 2(1) of the BIT

18. The Republic of Mercuria can invoke Article 2.1 of the BIT to deny Atton Boro Ltd benefits of the BIT.

    Atton Boro Ltd is an *"investor"* as defined under Article 1.2 of the BIT. However, under Article 2.1 of the BIT, Mercuria reserves the right to deny benefits of the BIT to a legal entity on a condition of two tests. The first test is the '*ownership or control*'[4] test i.e. Mercuria reserves the right to deny benefits of the BIT to a legal entity that is owned or controlled by citizens of a third state. The second test is the '*substantial business activity*'[5] test i.e. under Article 2.1 of the BIT Mercuria reserves the right to deny benefits of the BIT to a legal entity that has no substantial business activity in the territory of the Contracting Party in which it is organized.

19. In applying the first test, Atton Boro Ltd fails to pass the test and *ergo* cannot claim benefits granted under the BIT. Atton Boro Ltd is wholly owned by the Atton Boro Group.[6] The Atton Boro Group is a legal entity of a third state, therefore its ownership of Atton Boro Ltd precludes Atton Boro Ltd from claiming benefits granted under the BIT as contained in Article 2.1. Therefore, Atton Boro Ltd fails to pass the ownership test in Article 2.1 of the BIT.
20. In applying the second test, Atton Boro Ltd fails to pass the test and *ergo* cannot claim benefits granted under the BIT. Atton Boro Ltd does not have any substantial business activity in the Kingdom of Basheera, in which it is organized. Factually, Atton Boro Ltd's substantial or principal business activities have been with States and State agencies including Mercuria and the National Health Authority (NHA)[7] i.e. Atton Boro Ltd's substantial business activity has been outside the territory of the Kingdom of Basheera. On close inspection, Atton Boro Ltd does not have any substantial business activities in the country which it is organized i.e. the Kingdom of Basheera.
21. According to Article 31(1) of the **Vienna Convention on the Law of Treaties**, a treaty should be interpreted *"in good faith in accordance with the ordinary meaning to be given to the terms"*. When analysing the test in Article 2 of the BIT, it must be

[4] The BIT, Article 2.1
[5] Ibid
[6] The Problem, line 859-860
[7] The Problem, Statement of Uncontested Facts, para. 5

appreciated that the use of "*substantial*" in the business activity test brings about a relative and comparative analysis of the business activity undertaken.

22. *In casu,* Atton Boro has engaged in no substantial business activity in Basheera. A look at Atton Boro's business activity in Mercuria shows that Atton Boro established a robust manufacturing base in Mercuria[8]. Atton Boro's business activity was the manufacturing and supply of essential medicines in the pharmaceutical sector. Additionally, in third states Atton Boro's business activity was the manufacturing and supply of essential medicines[9]. However, a look at Atton Boro's business activity in Basheera reveals that they merely set up an office, and then hired a manager and accountant. Relative to Atton Boro's known business activity, Atton Boro's activity in Basheera cannot be comparatively found to constitute substantial business activity.

23. To militate for the submission that it has substantial business activity in Basheera as required in Article 2 of the BIT, there is a submission that the Claimant might present. The submission is the case of **AMTO v Ukraine***[10]*.In the event that the case is found to be a proponent for Atton Boro's establishment of substantial business activity, the case can be distinguished from the present case.

24. In the case of **AMTO v Ukraine**, the tribunal found that having a premise and a small but permanent staff could constitute substantial business activity[11]. However, the same cannot be found with regard to Atton Boro hiring a manager and an accountant. In the **AMTO v Ukraine** case, the Claimant was an investment company. Having a premise and small permanent staff was enough to constitute substantial business activity relative to the kind of business that it engaged in i.e. investment related activities[12].

25. However, for a pharmaceutical manufacturing business such as Atton Boro it cannot be found that a rented office, manager and account constitute substantial business

[8] Supra(fn4)
[9]Ibid
[10]Limited Liability Company AMTO v Ukraine, Arbitration Institute of the Stockholm Chamber of Commerce, Arbitration No. 080/2005
[11] Supra(fn8), at para 69
[12] Ibid

activity. Therefore, Atton Boro Ltd fails to pass the substantial business activity test under Article 2.1 of the BIT.

Atton Boro Ltd fails to pass the two tests encapsulated in Article 2.1 of the BIT. Therefore, the Republic of Mercuria can deny Atton Boro Ltd the benefits of the BIT.

Article 2 of the BIT has retroactive effect

26. A hurdle that might present itself is that of the retroactive effect of Article 2 of the BIT i.e. the denial of benefits clause. A strong proponent for the hurdle is the case of **Plama Consortium Limited v Republic of Bulgaria**[13]. In that case, the tribunal found that a denial of benefits clause cannot have retroactive effect, and must have prospective effect[14]. The reasoning behind this is that an investor has legitimate expectations of the advantages to be derived from a BIT, and reasonable notice must be given to an investor before invoking a denial of benefits clause.[15] However, this logic must not find application in the present case.

27. *In casu*, that reasoning must be defeated by the logic of the case of **GAI and Rurelecplc v Plurinational State of Bulgaria**[16]. In that case, the tribunal held the view that whenever a BIT has a denial of benefits clause, all investors are aware of the possibility of that denial.[17] Therefore, a denial of benefits does not frustrate any legitimate expectations they may have had.[18]

28. In fact, an invocation of a denial of benefits clause at the time when arbitration arises, and having retroactive effect to investments made prior to its invocation cannot be found to be wrong. This is because a denial of benefits clause is essentially made to allow a host state to withdraw benefits of a BIT from an investor that seeks them but

[13]Plama Consortium Limited v Republic of Bulgaria, ICSID Case No. ARB/03/24, Decision on Jurisdiction
[14]Id, para 179 and para 240
[15] Id, para 161
[16]Guaracachi America, Inc. (U.S.A.) and 2.Rurelecplc (United Kingdom) v Plurinational State of Bolivia, UNCITRAL, Award, 31 January 2014
[17]Id, para 372
[18]Ibid

does not qualify[19]. It therefore follows, that the invoking of a denial of benefits clause must be done when the benefits of a BIT are claimed[20].

29. Further, it is logical to assess the eligibility of an investor under a denial of benefits clause and possibly deny benefits, at the time arbitration arises, when benefits are claimed. This is because an investor's fulfilment of the requirements under a denial of benefits clause is not static, and such investor may fulfil the requirements in the course of time.[21]

30. In the present case, the Republic of Mercuria invoked Article 2 of the BIT, at the time arbitration arose, in its response to the notice of arbitration[22]. However, Atton Boro Ltd's legitimate expectations cannot be found to have been frustrated by the retroactive effect of invoking Article 2 of the BIT. Atton Boro Ltd was aware of the denial of benefits clause in the BIT. Atton Boro Ltd made its investment after the BIT's entry into force[23] and thus, it was aware of its eligibility status under Article 2 of the BIT. An argument that militates for legitimate expectation of Atton Boro being devastated by invoking Article 2 with retroactive effect cannot stand. Therefore, Article 2 of the BIT can have retroactive effect.

Atton Boro Ltd is a treaty shopping vehicle.

31. The primary purpose of a denial of benefits clause is to exclude mailbox companies of third country nationals from treaty protection[24]. This preventative measure is put in place because mailbox companies give their owners an unfair enjoyment of treaty protections whereby there is no reciprocity between their home state of national origin and the host state.[25] The logic is to prevent mailbox companies of third country origin

[19]Guaracachi America, Inc. (U.S.A.) and 2.Rurelecplc (United Kingdom) v Plurinational State of Bolivia, UNCITRAL, Award, 31 January 2014, para 376
[20] Ibid
[21]Guaracachi America, Inc. (U.S.A.) and 2.Rurelecplc (United Kingdom) v Plurinational State of Bolivia, UNCITRAL, Award, 31 January 2014,para 379
[22] The Problem, Response to the Notice of Arbitration, para 5
[23] The Problem, Statement of Uncontested Facts, para 9
[24]Gastrell, L and Cannu, P. 2015 "Procedural Requirements of 'Denial-of-Benefits' Clauses in Investment Treaties: A Review of Arbitral Decisions", ICSID Review, Vol. 30, No. 1 p 81
[25]Ibid

from enjoying benefits of a treaty whose obligations their home state has not bound itself to.[26]

32. *In casu,* Atton Boro Ltd is a mailbox company. Atton Boro Ltd was incorporated by the Atton Boro Group as a mere *'vehicle'* for carrying on business[27].Atton Boro Ltd was set up just four(4) months after the conclusion of the BIT[28].Atton Boro Ltd has had no substantial business activity in the state in which it was constituted i.e. the Kingdom of Basheera, which is typical of treaty shopping vehicles. Instead, inclusive of Atton Boro Ltd's principal dealings is collaboration with the Mercurian government and the NHA.[29]

33. In light of the stated facts, Mercuria has invoked the denial of benefits clause under Article 2 to protect itself from treaty shopping by Atton Boro Ltd. Therefore, its invocation of Article 2 must be viewed as not only within its rights under the BIT, but as a measure to protect itself from treaty shopping.

CLAIM C (Fair and Equitable Treatment)

Issue: Whether the enactment of Law No. 8458/09 and/or the grant of a license for the Claimant's invention amount to a breach of the Mercuria-Basheera BIT, in particular, the Fair and Equitable Treatment standard;

34. The Respondent state enacted Law No. 8458/09 which permits the use of patented inventions without the authorization of the owner. The Respondent state further granted a license to manufacture a patented product belonging to a company incorporated in the Complainant state without the consent of the company.

35. Fair and Equitable Treatment

[26]Supra (fn5)
[27]Supra (fn3)
[28]Supra (fn3)
[29]Supra (fn4)

Article 3(2) of the BIT states that:

Investments and returns of investors of each Contracting Party shall at all times be accorded fair and equitable treatment and shall enjoy full protection and security in the territory of the other Contracting Party. Neither Contracting Party shall, without prejudice to its laws, in any way impair by unreasonable or discriminatory measures the 1050 management, maintenance, use, enjoyment or disposal of investments in its territory of investors of the other Contracting Party.

Meaning of Fair and Equitable Treatment

36. In **ADF Group Inc. v United States of America**, it was held that (a) fair and equitable treatment was to be found "within international law;" and (b) the reference to international law was a reference to "the international minimum standard at customary international law."[30]

    The Tribunal considers that a breach of Article 1105 occurs only when it is shown that an investor has been treated in such an unjust or arbitrary manner that the treatment rises to the level that is unacceptable from the international perspective.

37. That determination must be made in the light of the high measure of deference that international law generally extends to the right of domestic authorities to regulate matters within their own borders[31]. In the same case, the violation of Art 1105 of NAFTA was alleged. To determine the minimum standard, the tribunal looked to other provisions of the same agreement. The tribunal held that Art 1102 which creates the National Treatment obligation under the agreement, when violated, would also infer violation of the fair and equitable treatment provision.[32] What this entails is that if a state action is envisaged within the BIT, it cannot be said to be in violation of the international minimum standard.

38. The same was held by the tribunal in the **Metalclad Corporation v. United Mexican States** where the violation of Art 1110 was inferred to also violate Art 1105 of the NAFTA.[33]This is in line with the definition in ADF Group Inc. since it is permissible for the minimum standard of protection to be found within international law. Since the BIT would serve as an international agreement between the complainant and

[30]ICSID Case No ARB(AF)/00/1
[31]*S.D. Myers, Inc. v. Canada, (*November 13, 2000), Partial Award. International Legal Materials 408.
[32]ibid
[33]

respondent state, standards created therein would serve to create the minimum requirements to be enforced by the states.

39. This would in turn mean that whatever is permissible or is envisaged by the BIT cannot be in violation of Art 3(2). Art 6(2) of the BIT envisages a situation where an investment is expropriated for national interests. The provision further stipulates that such expropriation is not to be done on a discriminatory basis. The Respondent state has denied the investor his rights due to the high demand of sanior in the Respondent state. This being a drug and as such being vital to the health of the people of the Respondent state means the national interest would be threatened if its nationals were unable to access the drug due to the prices.

40. It is true that the Claimant's invention deserves protection under Article 28(1) of the **Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS**)[34], but it must be noted that while the BIT clearly conforms to Article 28(1) of the TRIPS Agreement, Article 6(2) also anticipates exceptions to the general rule by noting circumstances where deviation may be warranted and national interest is one such circumstance. The tribunal must also note that the Respondent, through its Judiciary, did award compensation at 1% of Complainant's total earnings. The Respondent submit this was a fair appraisal as provided for under Article 6(3) of the BIT.

41. The Respondent state also stopped the patents of all other products which therefore means there was no discrimination. Thus, the violation of Art 3(2) cannot be inferred if the very BIT envisaged the situation. The tribunal in ADF further stated that an act of bad faith as viewed by a reasonable person against an investor would amount to breach of Art 3(2) of the BIT.[35] However, bad faith cannot be inferred if this was done in the national interest of the respondent state. It can therefore not be claimed that the respondent state has breached Art 3(2) of the BIT.

[34] 1995
[35]Ibid 1

CLAIM D (Attribution of Judiciary's conduct to Mercuria)

Issue: Whether Mercuria is liable under Article 3 of the BIT for the conduct of its judiciary.

Submissions:

42. The Respondent commences its defence with the acknowledgement that in the ordinary course of international law, under Article 4(1) of the of the Responsibility of States for Internationally Wrongful Acts, states are liable for actions of all of their arms of government and state actors. Consequentially, in the event that the judiciary of Mercuria was to found to have acted in contravention of any of the international obligations of the state of Mercuria, then the state would be liable at international law.
43. Furthermore, the state of Mercuria is cognisant of the fact that it is obligated under Article 3 of the BIT to provide a favourable investment climate for the prosperity of the investments of Basheera within the Mercurian territory. Further acknowledgment is made of the fact that a properly functional judiciary is a necessity for a favourable investment climate is made by the Respondent.

Doctrine of Margin of Appreciation

44. The state of Mercuria submits that its judiciary did not act in a manner inconsistent with its obligations under Article 3 of the BIT. In reviewing whether the Respondent has acted contrary to its obligations under the BIT the Respondent invited the court to invoke the doctrine of the margin of appreciation as the standard of review. The doctrine of the margin of appreciation prescribes that some latitude of deference or error and some room to manoeuvre must be given to a state when reviewing whether the state in question has complied with its international obligations.[36]The room to manoeuvre or defer from obligations under invocation of the margin of appreciation is done with reference to two main guiding factors, the first being the state's understanding of the requirements of its obligation,[37] the second being the

[36]Lawless v Ireland, no. 332/57, ECHR 1961
[37]ibid

circumstances that are prevalent in the state at the relevant time.[38]The Respondent in this matter relies on the latter.

45. The Respondent invites the court to be mindful of the fact that it is a state still in development and as such certain facilities within the state are not in a state which is expected at international level. The Respondent accepts that its judiciary is the epitome of the foregoing sentence. The Respondent however submits that the inadequacy of its judiciary while an impediment to the protection of the investment of Basheera within the territory of Mercuria does not represent a violation of the obligation to provide a good investment climate because it is the best that the state of Mercuria can provide at this relevant time.

46. The Respondent wishes to persuade the court by citing the holding of the tribunal in **Continental Casualty v Argentina**.[39] In that case the tribunal applied the margin of appreciation in determining whether Argentina's expropriation was lawful and found that given the dire financial state that Argentina was labouring under, they had to be given room to defer from their obligations under the US-Argentina BIT. Similarly, the Respondent invites the court to find that when considering its level of development the state of Mercuria be allowed to temporarily manoeuvre from its obligations under Article 3 of the BIT and therefore find that Mercuria is not liable for its judiciary's shortcomings.

47. The court is also asked to be mindful of the fact that pursuant to its obligations under Article 3 of the BIT, the Respondent state has established a new branch in its courts, specifically tailored to handle matters of a commercial nature[40] hence investors such as Atton-Boro and other Basheera originating entities will be able to enjoy speedy resolution of future disputes that may arise. This is evidence of Mercuria striving to improve the investment climate within its territory. The steps to improve the state of the judiciary serve as evidence that the state of Mercuria does not seek to invoke the margin of appreciation in bad faith or in an arbitrary manner. Without bad faith,

[38]Continental Casualty v Argentina, case no. ARB/03/9, 2006
[39]ibid
[40]Undisputed facts, para 14, page 8

arbitrariness or discrimination the margin should prevail in accordance with the decision in **Frontier Petroleum v Czech Republic**.[41]

CLAIM E (Violation of Article 3(3))

Issue: Whether the termination of the LTA by the NHA amounted to a violation of Article 3(3) of the BIT.

Submissions

48. Article 3(3) of the BIT provides that the contracting parties shall observe any obligations it may have towards the investments of investors of the other contracting party[42]

49. On the 25th November 2004, the National Health Authority (NHA) of Mercuria entered into a Long Term Agreement (LTA) with Atton Boro Limited for the manufacture and supply of medication for the treatment of greyscale. Under this agreement, particularly in clause 5, the NHA undertook to order a prescribed minimum amount of Sanior annually. It made a further undertaking in clause 6 that this agreement would be for the duration of 10 years subject to the supplier's satisfactory performance. However, on the 10th June 2008, hardly four years into the contract the NHA unilaterally terminated the LTA[43]. It is from this termination that this issue arises.

50. There are two establishments to be made. The first is whether Atton Boro is an investor as defined in the definition clause of the Basheera-Mercuria BIT. The second is whether Atton Boro has an investment in Mercuria as per the BIT. The respondent admits that Atton Boro is an investor of Mercuria and further that it has investments in Mercuria as defined under the definition clause of the Basheera-Mercuria BIT.

[41]IIC 465 (2010)
[42] Annexure 1- The Bilateral Agreement on the Protection of Investments between Basheera and Mercuria, 1998
[43]Paragraph 17 of the statement of uncontested facts

Fundamental Change of Circumstances

51. The respondent however invokes 'fundamental change of circumstances' together with unsatisfactory performance as a defence to rebut the unlawfulness of the LTA termination by the NHA. Also known at International law as the Doctrine of Rebus Sic Stantibus, this doctrine allow a contracting party to deviate from its obligations where circumstances have changed so much from the time of the conclusion of the contract.

52. The LTA was concluded in November 2004 and as such, all the undertakings that were made by the NHA in the LTA were founded on the situation that prevailed at that time. The demand for Sanior was for the treatment of around 20 485, hence clause 5 of the LTA. After 3 years, the number of people in need of treatment was 266, 298, nearly 13 times more than the initial number[44].

The circumstances as a foundation of the contract

53. For this defence to stand, the first requirement that must be met is that the circumstances that have changed should have formed the basis for the conclusion of the contract.

    Fundamental change of circumstances can only be invoked as a ground of termination if only the existence of those circumstances constituted an essential basis for the consent of the parties to be bound[45]

54. This shows that the defence of fundamental change of circumstances can only be raised if the circumstances that the respondent claims to have changed had in the first instance played a significant role in the conclusion of the contract. It is submitted on behalf of the respondent state that the number of cases in greyscale formed a basis for consent to the material terms of the LTA.

55. At the time of concluding the contract, the NHA could afford to perform their obligations under the LTA and simultaneously meet the health demands of the people of Mercuria. Had the NHA been aware that within a space of just two years, they

[44] Annexure 3-National Health Authority Annual Report 2006
[45] Hamid.A.C, The law of treaties Chapter 8 : Importance of the Law of Treaties, p203

would need to provide medication for almost 13 times the initial number, there would have never been consent to the 25% discount that was offered the claimant entity.

56. In **ICC Award No: 1512**[46], the dispute was between an Indian Cement Company and a Pakistan bank. The arbitration was given rise from the failure of a Pakistan bank to execute a guarantee in favour of an Indian company. The defendant bank claimed that the armed conflict which opposed India and Pakistan had created a situation which has freed it from its obligations.

    Although the defendant's argument was rejected, the tribunal in that case recognised in no unclear terms that indeed a fundamental change of circumstance can be a defence at International law and can free a disadvantaged party of its obligations[47].

57. Schmithoff, an International law writer argues that there must be such a radical change of circumstances that the foundation of the contract has gone[48]. It is as such the Respondent's argument that the demand for Sanior went to the root of the contract and its drastic change rendered the original contract gone.

Forseeability of the change in circumstances

58. The second requirement to be met is that the change in circumstance should not have been forseen by the party seeking to invoke fundamental change of circumstance as a defence. In **ICC Award No 8486**[49], the tribunal made it clear that this defence could only stand if the circumstances were unforeseen.

59. It submitted on behalf of the respondent state that the upsurge in the demand of sanior was not forseen and could not reasonably have been foreseen by Mercuria. This submission flows from the fact that, as soon as greyscale became a threat in Mercuria, the NHA engaged in parallel efforts to promote prevention of sexually transmitted diseases like greyscale. The NHA campaign involved actively conducting awareness workshops in educational institutions and workplaces to encourage people to be tested regularly. It specifically launched a nation-wide campaign focused on the treatment and prevention of greyscale.

[46] ICC Award NO: 1512, YCA 1976 at 128
[47] ibid
[48] Schmithoff. The Export Trade, p97
[49] ICC Award No 8486 YCA 1999

Mercuria could not have forseen that even after such an aggressive approach in dealing with greyscale, the demand would rise as much as did.

Unsatisfactory performance

60. In its notice of termination, the NHA cited unsatisfactory performance as a ground for the termination of the LTA[50]. This unsatisfactory performance by Atton Boro flows directly from the fundamental change of circumstances that Mercuria faced. Amongst others, performance has under its ambit the requirement of meeting the demand at affordable prices. Atton Boro's failure to provide a further discount to the NHA meant the NHA could not afford its prices.

61. The respondent here does not wish to undermine the sanctity of the LTA. However, its submission is that under the new unforeseen circumstances, Atton Boro should have tried to meet the NHA halfway and negotiate prices that would be affordable, taking into account the demand.

Balancing of interests

62. The respondent does not turn a blind eye to financial interest that Atton Boro has under the Long Term Agreement. Now, where both parties have interests and their interests cannot be concurrently observed, that calls for a balancing of interests. Economic Interests versus Nation Health Interests.

63. In **Noruma Affiliate Saluka Investments v Czech Republic[51]**, a case arising out of a violation of the Netherlands-Czech Republic BIT, it was held that a host state has a legitimate regulatory right in social, economic, environmental and health and competition issues that are not to be constrained by BIT investment protection completely.

The protection of foreign investments is not the sole aim of the Treaty…for a balanced approach to the interpretation of the Treaty's substantive provisions for the protection of investments, since an interpretation which exaggerates the protection to be accorded to foreign investments may serve dissuade host states from admitting

[50] Paragraph 10 of the statement of uncontested facts
[51] IIC 210

foreign investments and so undermine the overall aim of extending and intensifying the parties' mutual economic relations[52]

64. From the foregoing quotation, it can be concluded that where a host state has a right to take actions in order to regulate its health issue. The respondent here is aware that a part of its sovereignty was forfeited when it signed a treaty, however its regulatory right in its health issues cannot be completely restrained by its obligations under the BIT.

    The respondent therefore submits that the national health interests of its people takes precedence over the financial interests that the claimant has as an investor in the state of Mercuria.

The textual Argument

65. The claimant seeks recourse from the Basheera-Mercuria BIT by claiming a violation of its Article 3(3). The claimant however fails to recognise that Mercuria cannot observe its obligations toward Atton Boro if that observation would threaten the national health interests of Mercuria. The Basheera-Mercuria BIT as a treaty[53] is generally governed by the principles codified in the **Vienna Convention on the Law of Treaties**[54] which allows a purposive approach to be taken in the interpretation of treaty provisions. The preamble of the BIT is very clear; the objectives of the BIT need to be carried out in a manner that is consistent with protection of health, safety and the environment.

66. Had Mercuria observed its obligations towards Atton Boro as prescribed by Article 3(3) of the BIT, the NHA would have to carry on with its obligations under the LTA. This would see the NHA not being able to cater for all the people who are in need of greyscale treatment. This would be very detrimental to the people of Mercuria. It has to be noted that if greyscale was not put under control, it would be a national health crisis within a period of 10 years.[55] Mercuria is entitled as per the preamble to engage

[52] Ibid at p300
[53] Article 2(1) of the Vienna convention provides that a treaty is an international agreement concluded between states in written form and governed by international law, whether embodied in a single instrument or in two or more related instruments instrument or in two or more related instruments…
[54] Signed on 23 May 1969
[55] Statement of uncontested facts

in behaviour that is inconsistent with the objectives of the BIT, if the alternative would threaten the national health interests of its people.

67. It is therefore submitted on behalf of the respondents that an interpretation of Article 3(3) of the BIT when read together with the preamble justifies the respondent not observing its obligations towards the claimant as prescribed by Article 3(3).

ARGUMENT ON COSTS

68. The Respondent submits that it be awarded costs for this arbitration as it has been successfully shown that the Claimant has no case against the Respondent and the Complainant's claim should therefore be dismissed. Article 42 (1) of the PCA Rules[56] stipulate that the costs of arbitration shall in principle be borne by the unsuccessful party. However the costs may be apportioned between the parties should the tribunal find the apportionment reasonable, taking into account the circumstances of the case.

69. The Respondent avers that there is no reason to apportion the costs of this arbitration as the Claimant had no reason to lodge this arbitration but instead wasted all the parties' concerned time with frivolous and costly litigation, which ought to be dismissed. It is submitted consequently that the unsuccessful party bear the costs on the principle that costs follow the event.

[56] 2012

REQUEST FOR FINDINGS

The respondent requests the tribunal to make the following findings:

1. The PCA does not have Jurisdiction to enforce the arbitral award made in The People's Republic of Reef;
2. The respondent has been denied the benefits of the Basheera-Mercuria BIT by invocation of Article 2(1) of the BIT;
3. Where the Tribunal does not grant the second prayer, declare that no act of Mercuria's violates the substantive protections of the BIT;
4. Find that Mercuria is entitled to restitution by Atton Boro of all costs related to these proceedings; and
5. Grant such further relief as counsel may advise and that the Tribunal deems appropriate