School of International Arbitration

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International Arbitration Case Law

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ALPS FINANCE AND TRADE AG V. THE SLOVAK REPUBLIC
AD HOC ARBITRATION (UNCITRAL RULES)
AWARD ON JURISDICTION

Case Report by Maria Falivena** and Charles B. Rosenberg***
Edited by Ignacio Torterola

A decision rendered on March 5, 2011 in an *ad hoc* arbitration under the "Agreement between the Czech and Slovak Federal Republic and the Swiss Confederation on the promotion and reciprocal protection of investments" and in accordance with the UNCITRAL Arbitration Rules.

Tribunal:	Professor Antonio Crivellaro (Chairman), Mr. Hans Stuber, Mr. Bohuslav Klein
Claimant's counsel:	Redacted
Defendant's Counsel:	Mr. David A. Pawlak, DAVID A. PAWLAK LLC; and THE MINISTRY OF FINANCE OF THE SLOVAK REPUBLIC

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1. Facts of the Case

On June 15, 2007 Alps Finance and Trade AG (the "Claimant") entered into a contract with a Slovak company for the assignment of certain "receivables" (the "Assignment Contract"). The receivables consisted of sums payable to the assignor by a debtor, who at the time of the assignment of the receivables had been declared bankrupt. The Assignment Contract was acknowledged by the bankruptcy trustee, thus resulting in a creditor claim against the bankrupt debtor. However, on September 15, 2007 the Regional Court of Bratislava overruled a June 7, 2007 decision of the District Court of Bratislava. The Claimant complained that as a consequence of the Regional Court's decision, its claims' acknowledgment by the bankruptcy trustee ceased to be effective and the Claimant was unable to enforce its creditor claim.[1]

The Claimant maintained that the Regional Court of Bratislava – when deciding on the appeal filed against the bankruptcy decision by the District Court – breached the Slovak Constitution, the Bankruptcy Act, the Commercial Code, and the Code of Civil Procedure and deprived the Claimant of its "investment" in the Slovak Republic.[2] The Claimant contended that the Slovak Republic had an obligation under the "Agreement between the Czech and Slovak Federal Republic and the Swiss Confederation on the promotion and protection of investments" ("BIT") to protect its investment, but the Slovak Republic did nothing to prevent the Regional Court from issuing its decision, thereby failing to secure enforcement of the Slovak laws by its judiciary. The Claimant therefore initiated arbitration proceedings under the BIT alleging violations of the fair and equitable treatment, full protection and security, and expropriation protections.

2. Legal Issues Discussed in the Decision

(a) Applicable law (¶¶ 193-199)

The Tribunal decided that the applicable law was international law, rather than Slovak law. The Tribunal found that "the rules of international law, be they treaty or customary rules, cannot be disregarded in the resolution of investor-to-

[1] Award ¶¶ 122, 123.
[2] Award ¶¶ 133.

State disputes that arise from an alleged breach of an investment treaty by the host State."[3]

The Tribunal reasoned that the main issues in the case (*i.e.*, whether the Claimant qualified as an "investor", whether its operations qualified as an "investment", and whether it is plausible that the Slovak Republic breached its international duties) could not be resolved if the Tribunal had to be guided by Slovak law provisions. The Tribunal found that "the 'international case-law on investment disputes' does indeed show that the rules of international law, be they treaty or customary rules, cannot be disregarded in the resolution of investor-to-State disputes that arise from an alleged breach of an investment treaty by the host State."[4] The Tribunal further explained that "[t]he notion of investor or investment protected by a BIT are exclusively governed by the BIT itself and by international customary rules implicitly or explicitly referred to in the BIT."[5]

The Tribunal, however, clarified that domestic law and the way it is enforced by State organs may be relevant, but only as factual circumstances to be considered in deciding whether the host state committed a breach of its international duties under the applicable treaty or general international law. The Tribunal explained that "reference to internal law is necessary to establish whether the host State is liable for a violation of an international obligation under the applicable treaty or general international law."[6]

(b) Admissibility (¶¶ 200-212)

The Tribunal held that the Claimant sufficiently complied with the requirements in Articles 9(1) and 9(2) of the BIT that in case of dispute: (i) the parties should first try to settle it by consultations; and (ii) the investor may commence arbitral proceedings if the dispute is not settled within six months following the investor's first request for consultations. While the Tribunal noted that the Claimant's compliance with these provisions had some defects, the Tribunal rejected the Respondent's objection that such defects rendered the State's consent

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[3] Award ¶ 195.
[4] *Id.*
[5] Award ¶ 196.
[6] Award ¶ 197(ii).

to arbitral jurisdiction ineffective because "[t]he relevant case-law endorses a less formalistic view."[7]

For instance, in *Ethyl v. Canada* the tribunal dismissed the objection based on the six-month provision because any further negotiation would have been pointless and in *Salini v. Marocco* the tribunal stated that an attempt to reach an amicable settlement was sufficient enough for the commencement of the arbitral proceeding. A similar approach was followed by *SGS v. Pakistan, Bayindir v. Pakistan* and *Occidental v. Ecuador* where the consultation periods were found not to be mandatory.

Further, the Tribunal emphasized that in the present case the BIT did not impose specific formalities for the consulatations. The Tribunal interpreted Articles 9(1) and 9(2) of the BIT as simply requiring that consultations be at least attempted and that six months lapse without any resulting solution. This is precisely what had occurred in this case. The Tribunal found relevant that between 2007 and 2008 the Claimant sent five letters to the Government of the Slovak Republic in which it expressed its availability to settle the dispute. However, no negotiations took place between the parties. The Tribunal found that this set of correspondence "abundantly fulfils" the BIT's requirements because it "avoid[ed] that a State be brought before an international investment tribunal all of a sudden, without being given the opportunity to discuss the matter with the other party."[8] The Tribunal also noted that the Slovak Republic could have entered into negotiations with the Claimant after the appointment of the first arbitrator, but it failed to do so. Thus, the Tribunal concluded that the Claimant successfully fulfilled the BIT requirement, and therefore the dispute was arbitrable.

(c) "Investor" (¶¶ 213-228)

The Tribunal ruled that the Claimant was not an "investor" under the BIT. The Tribunal found that in order to qualify as an "investor" under Article 1(1) of the BIT, the Claimant must have established the following requirements: (i) it was "constituted or otherwise duly organized under the laws of Switzerland;"(ii) it had its "seat" in Switzerland; and (iii) it was performing "real economic activities." The Tribunal explained that "Article 1(1) is a special (and rather

[7] Award ¶ 201.
[8] Award ¶ 209.

uncommon) clause by which the two contracting States intended to exclude from treaty-protection 'mailbox' or 'paper companies.'"[9]

The Tribunal found that the Claimant satisfied the first requirement by providing a Commercial Registry excerpt that confirmed that the Claimant was a corporation duly constituted and organized under Swiss law with a registered office in Switzerland. However, the Tribunal found that the Claimant failed to meet the second and third requirements.

Specifically, the Tribunal found that the Claimant provided insufficient evidence to establish the existence of a Swiss "seat" within the meaning of international business law. The Claimant had proved the fact of its incorporation and affirmed that the company's books and other documents were kept in Switzerland. However, the Tribunal found that the mere incorporation in Switzerland is insufficient to establish the existence of a Swiss "seat" in the terms of the BIT. The Tribunal pointed out that "[t]he fact that Article 1(1)(b) of the BIT requires a Swiss 'seat' as a distinct element in addition to 'constitution and organization under Swiss law' demonstrates that the mere incorporation in Switzerland is insufficient to constitute a 'seat' in the terms of the BIT."[10] The proof of a "business seat" would have required additional elements such as proof that: (i) the board of directors or shareholders regularly meet at the seat; (ii) upper management is based at the seat; (iii) a certain number of employees work at the seat; (iv) an address at the seat with phone and fax numbers are offered to third parties; and (v) certain general expenses or overhead costs are incurred for the maintenance of the physical location of the seat and related services.[11] But none of these elements were proven by the Claimant.

Neither was the Claimant able to prove that it performs "real economic activities" in Switzerland. The Tribunal found that the Claimant was unable to establish: (i) the number and type of its clients; (ii) the type of its operations; (iii) the kind of contracts it enters into; (iv) the quantity and type of personnel; or (v) the nature and composition of its managing bodies.[12] Although the Claimant had submitted an affidavit of its sole director explaining that the Claimant "conducts a real business activity," the Tribunal rejected this evidence finding that what

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[9] Award ¶ 224.
[10] Award ¶ 216.
[11] Award ¶ 217.
[12] Award ¶ 219.

instead was "needed was a documentary evidence formed at the time when the activities were conducted, rather than an isolated statement created for the purpose of the *litis*."[13]

Therefore, the Tribunal concluded that the Claimant was not an "investor" under the BIT. This conclusion would have been in itself sufficient to decline jurisdiction. However, the Tribunal analyzed the Respondent's remaining jurisdictional objections, as discussed below, for the sake of completeness.

(d) "Investment" (¶¶ 229-247)

The Tribunal ruled that the Assignment Contract was not an "investment" under either the BIT or under international law rules.

First, the Tribunal ruled that the Assignment Contract cannot be classified as an "investment" under Article 1(2) of the BIT. According to the Tribunal, the only category of "investment" in the BIT which could apply in this case was the definition included in Article 1(2)(c) which referred to "every kind of assets,"[14] in particular "claims and rights to any performance having an economic value."[15] In the practice of investment arbitrations, an "investment" has been found to exist under the category of "claims or rights to money or to performance" in the case of contracts for public works or infrastructures or long-terms loans and similar financing instruments made by the investor with a State or State-entities. In these cases, the object of the dispute was the alleged non-performance or defective performance of the contract obligations by the host-country or its own agencies. The Tribunal found that no such undertakings were satisfied by the Assignment Contract because the Claimant did not complain that it was entitled to any performance by the Slovak Republic. On the contrary, the Slovak Republic was completely extraneous to the transaction and its economy received no benefit from it.

The Tribunal also recalled that in order to interpret the BIT, the only source of law to be applied was the Vienna Convention on the Law of Treaties. Under Article 31 of the Vienna Convention, a treaty must be interpreted not only pursuant to its ordinary meaning but also taking into account the general context and its object and purpose. In the present case, the Tribunal found that the scope

[13] Award ¶¶ 220, 222.
[14] Award ¶ 230
[15] *Id.*

of the BIT was to intensify the economic cooperation to the mutual benefit of both contracting States and attract foreign investments. However, the Tribunal found that the Assignment Contract was a private and speculative business, a contract which exhausted its object and purpose by its sole stipulation. The Tribunal found it difficult to see how the Assignment Contract might have contributed to either the mutual economic cooperation between States or to the growth of Slovak economic prosperity. Therefore, the Tribunal concluded that the Assignment Contract could not be classified as an "investment" under the BIT, and the Tribunal lacked jurisdiction.

Second, the Tribunal ruled that the Claimant's acquisition of receivables was not an "investment" under international law rules. As a preliminary matter, the Tribunal noted that the multitude of investment treaties – although containing different definitions of what constitutes an "investment" – explicitly or implicitly refer to an "objective" definition of "investment" given by international law, as applied by other treaty-based tribunals. Tribunals must therefore be cautious to enforce the true intentions of the Contracting Parties to the specific treaty, without grossly departing from the "objective" case-law definition. The Tribunal warned that such caution is even more necessary in this case because the BIT also allows an investor to submit its dispute to ICSID arbitration, once both Contracting Parties have become members of the ICSID Convention. Thus, according to the Tribunal, "although the BIT gives a broad 'investment' definition, the two Contracting States must have inevitably intended to refer to what constitutes 'investment' under the ICSID Convention as concretely applied in the relevant case-law."[16]

The Tribunal then recalled that an abundant number of cases have clarified that the necessary characteristics to be fulfilled for attributing the quality of "investment" to a contractual relationship include: (i) a capital contribution to the host-state by the private contracting party; (ii) a significant duration over which the project was implemented; and (iii) a sharing of operational risks inherent to the contribution together with long-term commitments. The Tribunal pointed out that trade or financial operations, which are more substantive than the Assignment Contract, have not been accepted by international tribunals as "investments." A recent ICSID case clarified that a transaction undertaken "with the sole purpose of taking advantage of the right contained in such instruments,

[16] Award ¶ 239.

without any significant economic activity, does not satisfy the basic pre-requisite of any investment worth of being protected by international treaties."[17] Another ICSID case, the *Joy Mining* decision, declined jurisdiction on the basis that a contract for the supply of important machinery and equipment was not an "investment" because it was no more than a "sale," although a complex one. In this case, the Tribunal found that the Assignment Contract failed to satisfy the capital contribution, duration, and risks requirements. Rather, the Assignment Contract was a "purely speculative transaction deprived of any significant economic activity in the host country."[18] In sum, "a mere one-off sale transaction" does not qualify as an "investment."[19]

(e) The prima facie test (¶¶ 248-252)

Having declined jurisdiction on the above grounds, the Tribunal opted to limit itself to considering the *prima facie* test to determine whether the Claimant's claims, if proven to be true, were capable of constituting a BIT violation. The Tribunal concluded that the *prima facie* test of a plausible treaty-claim was far from being met. Accordingly, even in the remote case that the Tribunal would retain jurisdiction over this case, it would be highly unlikely that the Claimant's claims would prevail on the merits.

The Claimant alleged that the Slovak Republic was liable based on the incorrect Regional Court decision. The Tribunal, however, found that the Claimant's claims were far from meeting the *prima facie* test. It clarified that what international law prohibits is not a possible error in law, but rather a system of justice which falls below a minimum standard and could consequently lead to a denial of justice. Furthermore, the Tribunal noted that other remedies were still available to the Claimant under Slovak law to try to obtain revision of the judgment that it considered prejudicial to its interests. According to the Tribunal, "[t]he non-exhaustion of local remedies is *per se* sufficient to exclude the States' responsibility in international law for actions or omissions of its judiciary."[20] Therefore, the Tribunal concluded that it would have been very difficult for the Claimant's claims to result in a violation of the BIT, even if it had retained its jurisdiction.

[17] *Phoenix Action Ltd. v. The Czech Republic*, ICSID Case No. ARB/06/5, Award, April 9, 2009, ¶ 93.

[18] Award ¶ 243.

[19] Award ¶ 245.

[20] Award ¶ 251.

(f) *Costs (¶¶ 253-270)*

After noting that Article 9(2)(d) of the BIT and Articles 40(1) and 40(2) of the UNCITRAL Arbitration Rules confer broad powers to the Tribunal in determining the costs issue, the Tribunal opted to apply the general principle according to which "costs follow the event," implying that each Party should bear a share of costs proportional to its own loss.[21]

Since the Tribunal accepted all preliminary objections raised by the Respondent (other than its objection based on non-compliance with the "waiting period" provision, which "was not *prima facie* frivolous"), the Tribunal considered it fair to leave the Respondent totally indemnified of the entirety of the arbitration costs because "[t]he Claimant's original claim was in itself seriously defective" and the Claimant failed to cure such deficiencies during the proceedings.[22] Accordingly, the Tribunal ordered the Claimant to reimburse the Respondent both the 50% share of the costs advanced to the Tribunal and 100% of the costs for defense and representation claimed by the Respondent.

3. Decision

The Tribunal determined that it lacked jurisdiction over the dispute. The Tribunal ordered the Claimant to pay the Respondent the Tribunal's costs advanced by the Respondent, as well as the Respondent's legal costs.

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21 Award ¶ 263.

22 Award ¶¶ 265, 266.