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International Energy Dispute Resolution:

What Every Company Should Know Before Signing Cross-Border Contracts and Investing Abroad

November 18, 2014

Oil, Gas and Mineral Law Section
Houston Bar Association
Houston, Texas

Types of international energy dispute resolution

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1. Mediation
2. Litigation in national courts
3. International arbitration

Today, international arbitration is the primary way that international energy disputes are resolved

Order of Presentation

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I. Commercial international arbitration

- Why your company should include arbitration clauses in international contracts and what they should say

II. Investment-treaty arbitration

- How your company can trigger investment treaties to protect its cross-border investments against political risk in foreign countries

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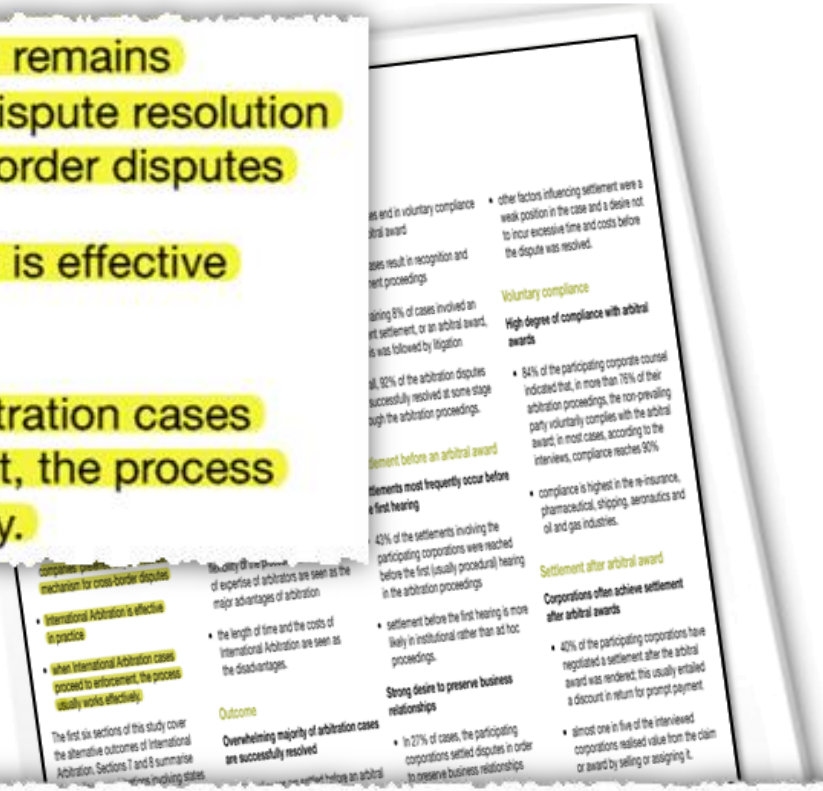
Part I

Commercial Int'l Arbitration:

Why your company should include arbitration clauses in international contracts and what they should say

International arbitration is the preferred dispute resolution mechanism for cross-border disputes

- International Arbitration remains companies' preferred dispute resolution mechanism for cross-border disputes
- International Arbitration is effective in practice
- when International Arbitration cases proceed to enforcement, the process usually works effectively.



- 86% of the participating corporate counsel said they are satisfied with International Arbitration

Source:
PwC Study, International Arbitration: Corporate Attitudes and Practices, p. 2.

Why international arbitration?

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- International arbitration has excellent “international currency”…
- …because of the New York Convention of 1958 on the Recognition and Enforcement of Foreign Arbitral Awards
- Court judgments do not “travel” well across borders because of the lack of reliable treaties on the enforcement of foreign court judgments

Why international arbitration?

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Other benefits:

- Avoid litigating in counterparty's national courts
- Confidentiality
- Selection of arbitrators with particular knowledge or skill

What should be included in an international arbitration clause?

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- Arbitral institution and/or rules
- The seat (place) of the arbitration
- Number of arbitrators
- The language of the arbitration
- Choice of law (if not specified elsewhere in the contract)
- Optional clauses include discovery limitations, confidentiality, interim relief, etc.

Enforcement and vacatur of international awards

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- New York Convention of 1958 and national laws
  - Addresses enforcement of arbitral awards; does not address vacatur of arbitral awards
- Vacatur is required to take place in a national court of the place of arbitration
  - For this reason, the “seat” (place) of the arbitration should be a jurisdiction with a well-developed and predictable arbitration law

What major arbitral rules and institutions are available?

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- International Chamber of Commerce (ICC)
- American Arbitration Association (AAA), including International Centre for Dispute Resolution (ICDR)
- European centers (London Court of International Arbitration (LCIA), Vienna International Arbitration Centre (VIAC), Stockholm Chamber of Commerce (SCC))
- Singapore International Arbitration Centre (SIAC)
- China International Economic and Trade Arbitration Commission (CIETAC)
- Hong Kong International Arbitration Centre (HKIAC)
- United Nations Commission on International Trade Law (UNCITRAL)

The most popular arbitral institutions are the ICC, the ICDR, and the LCIA

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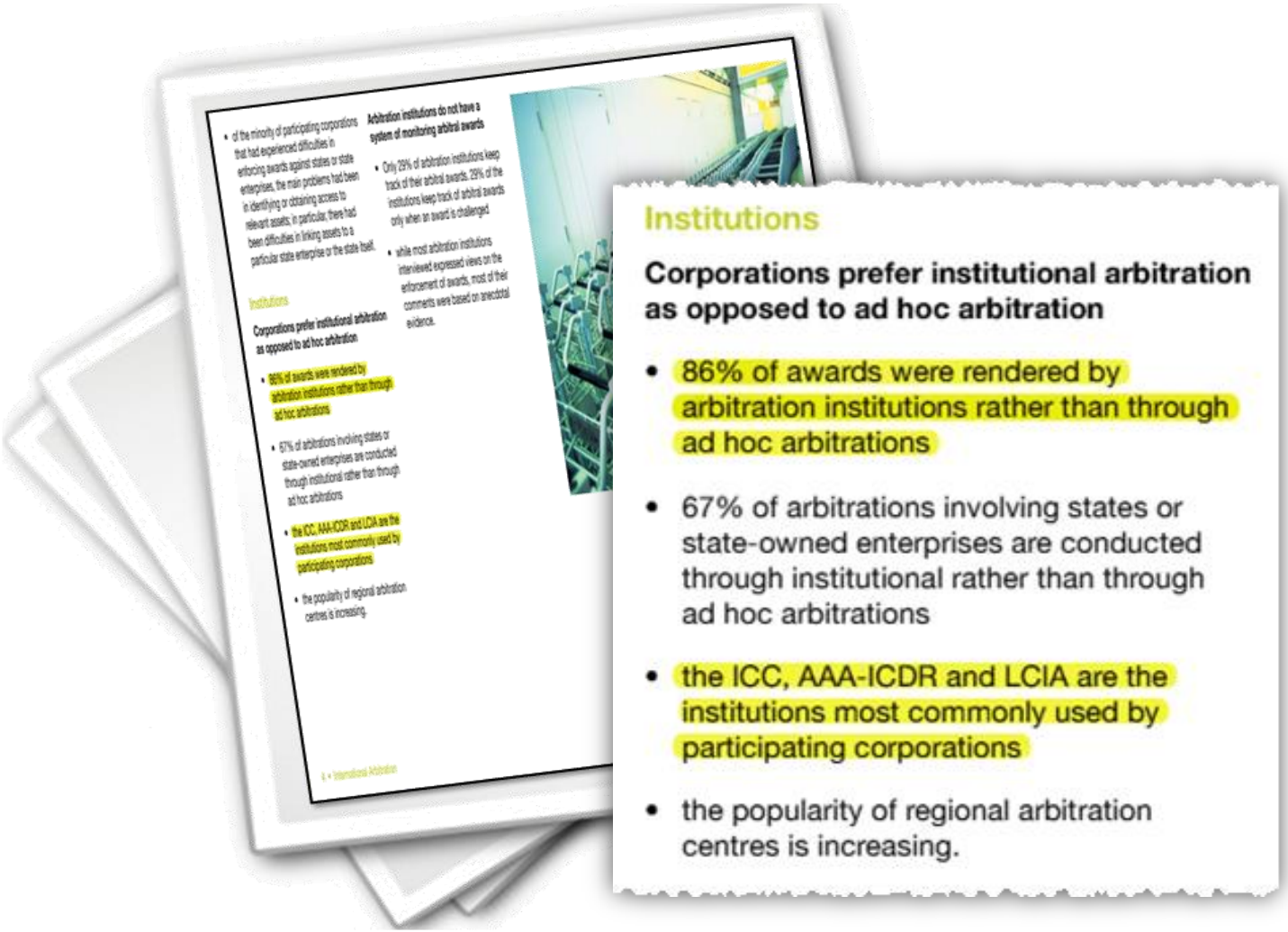

Source:
PwC Study, International Arbitration: Corporate Attitudes and Practices, p. 4.

The “typical” process

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- The Parties can “write” their process on a blank slate
- Typically, the process includes:
  - Claimant’s Request for (Notice of) Arbitration
  - Respondent’s Answer
  - The Parties’ Memorials
    - Claimant’s Statement of Claim
    - Respondent’s Statement of Defense
    - Claimant’s Reply
    - Respondent’s Rejoinder
  - Hearing
  - Closing Arguments/Post-Hearing Briefs
  - Issuance of the Award

Cost control

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[A]rbitration has become more sophisticated and more "regulated" with "control" over the process moving towards law firms – and away from the actual users of this process.

-- PWC: Corporate Choices in International Arbitration (2013)

Key cost drivers

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I. Electronic discovery

- "The proliferation of electronically stored information is a major cost driver in U.S. litigation, and it's becoming a major cost driver in international arbitration." – ABA Journal (April 2013)

II. Traditional American-style discovery

III. Hearings – oral testimony and cross-examination

- "In the U.S., much more credence is given to testimony than in civil law countries." -- ABA Journal (April 2013)

IV. Duration - briefing

V. Administration fees

Controlling costs

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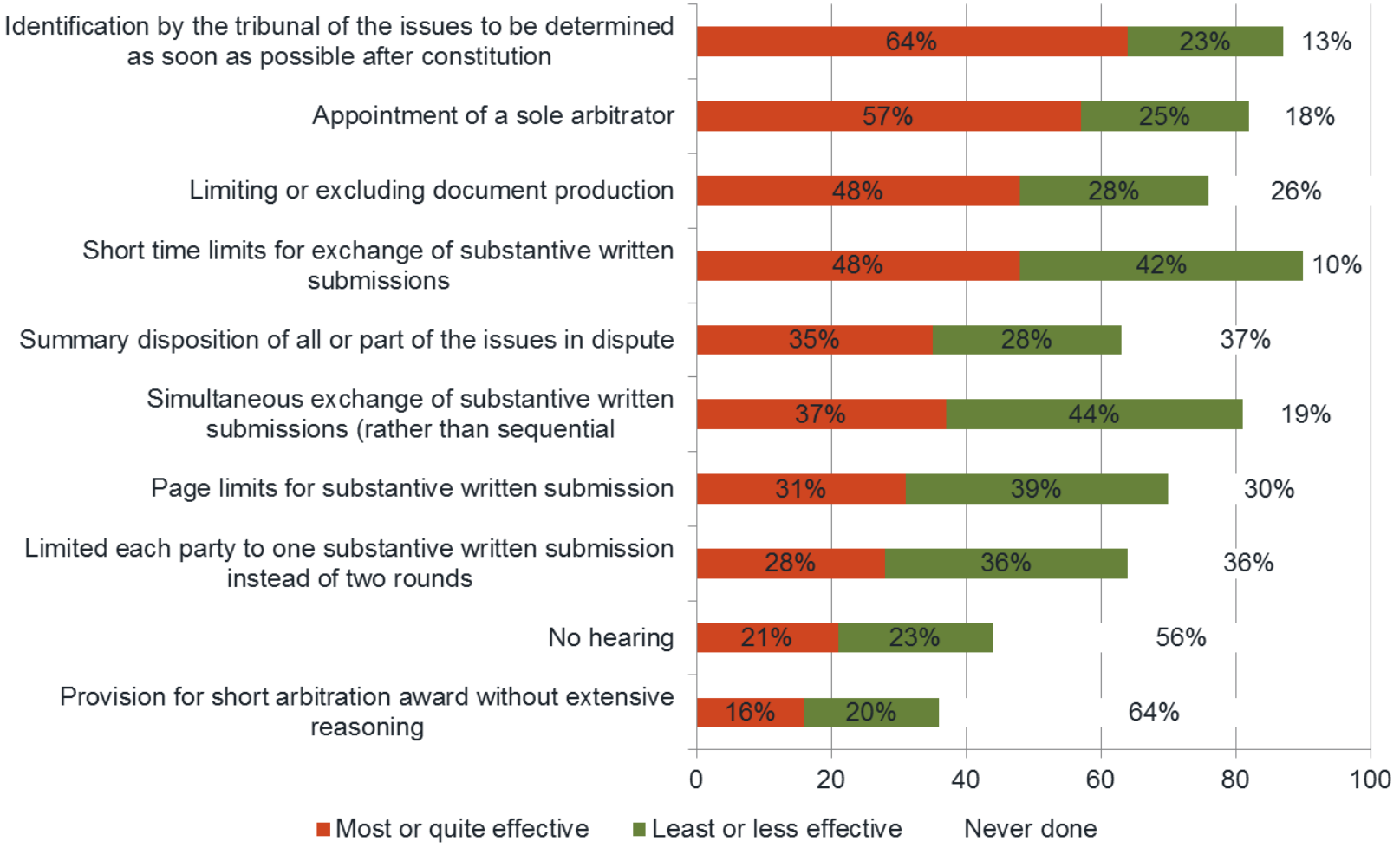
- Exaggerating the value of a claim
- Appointing multiple arbitrators
- Excessive discovery
- Filing dispositive applications (motions)
- Postponing deadlines
- Postponing hearing dates
- Failing to stipulate to evidence
- Filing meritless petitions to set-aside/vacate

Controlling costs



Gas price review arbitrations

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- The contracts and price review clauses permit arbitrators to adjust the contract price formula but not to change the contract terms
- Review of price generally occurs every three years
- No breach or “other wrong” at issue; simply re-pricing the contract
- Intent of parties at commercial inception is not necessarily determinative
- Awards generally confidential
- As a group, perhaps the largest arbitrations in the world—usually involving hundreds of millions or billions of dollars

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Part II

Investment-Treaty Arbitration:

How your company can trigger investment treaties to protect its cross-border investments against political risk in foreign countries

Historical perspectives

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- Historically, foreign investors were concerned that, if a dispute arose with the host State regarding their investment, they had no effective legal remedy.

- Customary international law applied to protect foreign investment, but there was no international forum in which to seek redress against the host State.

- Investors had to proceed against the host State in local courts, where they feared discrimination.

Friendship, commerce, and navigation treaties

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- Bilateral friend, commerce, and navigation treaties ("FCNs") have existed since the 18th century
- FCNs covered a wide range of matters, including navigation, diplomatic relations, trade, and investment protection
- The US signed a number of FCNs after World War II
- Some FCNs included similar standards to those found in modern-day BITs (and many are still in existence)
- No investor-State arbitration clause; only State-versus-State dispute resolution

Diplomatic protection

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- No direct recourse by investors against a foreign State
- Investor's “home” State can claim reparation from the other State on behalf of the investor
- Not requirement that the home State espouse the claim, and political concerns may (and usually did) outweigh the home State’s interest in doing so
- Subject to the procedure rule of exhaustion of local remedies

Failed attempts to develop a multi-lateral framework for investment protection

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- 1930: League of Nations organized a conference to codify a multi-lateral treaty on investment, but no agreement was reached because of disagreements on the minimum standard of treatment
- 1948: Havana Charter for the International Trade Organization
- 1959: Abs/Shawcross Draft Convention on Investments Abroad
- 1961: Harvard Draft Convention on Responsibility of States
- 1967: OECD Draft Convention on the Protection of Foreign Property
- 1995-1998: OECD Draft Multilateral Agreement on Investment

The first investment-exclusive treaty: 1959 Germany-Pakistan BIT

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- Unlike FCN treaties, the first BIT, between Germany and Pakistan, focused only on investment
- Substantive provisions included compensation for expropriation, non-discrimination, "protection and security," observance of undertakings
- No provision for investor-state arbitration
- Disputes submitted by States to the ICJ or State-State arbitration

Establishment of ICSID

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- 1965: ICSID Convention established a new international institution to resolve disputes between foreign investors and host States
- 1966: Enters into force after 20 states ratified
- 2014: 159 states had ratified the ICSID Convention
- Additional Facility Rules: provides dispute resolution framework even for non-member states.

Map of the ICSID contracting States

Source:
The ICSID Caseload Statistics (2014-2), p. 6.

The first “real” BITs

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- Indonesia-Netherlands BIT (1968)
  - Refers to qualified ICSID arbitration, stating that the host State “shall assent” to ICSID arbitration
- Chad-Italy BIT (1969)
  - First BIT providing unqualified consent to investor-State arbitration.
  - Considered the first “real” BIT, combining investor protections with direct investor-State arbitration

Source:
Newcombe and Paradell, Law and Practice of Investment Treaties

Investor-State arbitration

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- Investor-state arbitration: investor has direct recourse against a State to enforce its rights in an international arbitration
- Not generally subject to a procedural rule of exhaustion of local remedies
- Different in this respect from diplomatic protection, where:
  - No direct recourse by investors against a foreign State
  - Investor's state can claim reparation from the other state on behalf of the investor
  - Subject to the procedural rule on exhaustion of local remedies

Statistics: Number of BITs 1959-2013

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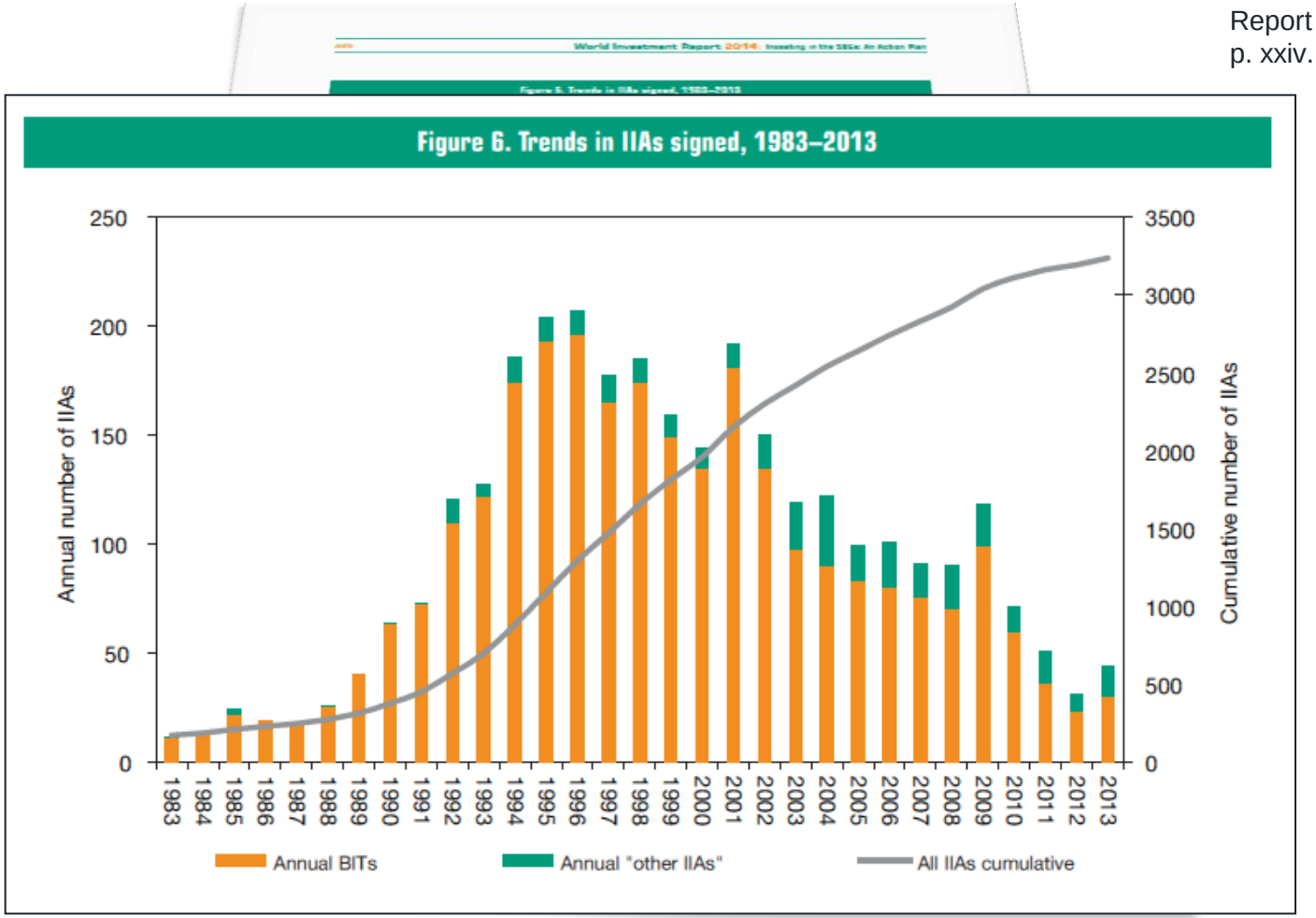
Year	Number of BITS
1959	1
1969	72
1979	165
1989	385
1999	1,857
2013	3,236

Source: UNCTAD, Bilateral Investment Treaties: 1959-1999 UNCTAD, World Investment Report 2014 (2902 BITs and 334 FTAs).

Annual statistics on BITs

Source:
World Investment Report 2014, p. xxiv.



What is an investment protection treaty?

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- Each State pledges to provide investors from the other State certain minimum protections.
- Each State agrees that, if an investor believes the host State has failed to provide it with the minimum protections pledged in the treaty, the investor can bring an international arbitration against the host State.
- If the arbitral tribunal finds that the State violated the treaty, then the tribunal can order the State to pay the investor the damages caused by its violation of the treaty.

Common substantive provisions in BITs

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- Fair and equitable treatment
- Full protection and security
- No arbitrary or discriminatory measures impairing the investment
- National and “most favored nation” treatment
- No expropriation without compensation
- Observance of specific investment undertaking

Types of investment protection treaties

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- Bilateral investment treaties (BITs)
  - Over 3,200 (signed by at least 179 States).
- Multilateral investment treaties
  - NAFTA, CAFTA, the Energy Charter Treaty (“ECT”)

The explosion of BIT claims and cases

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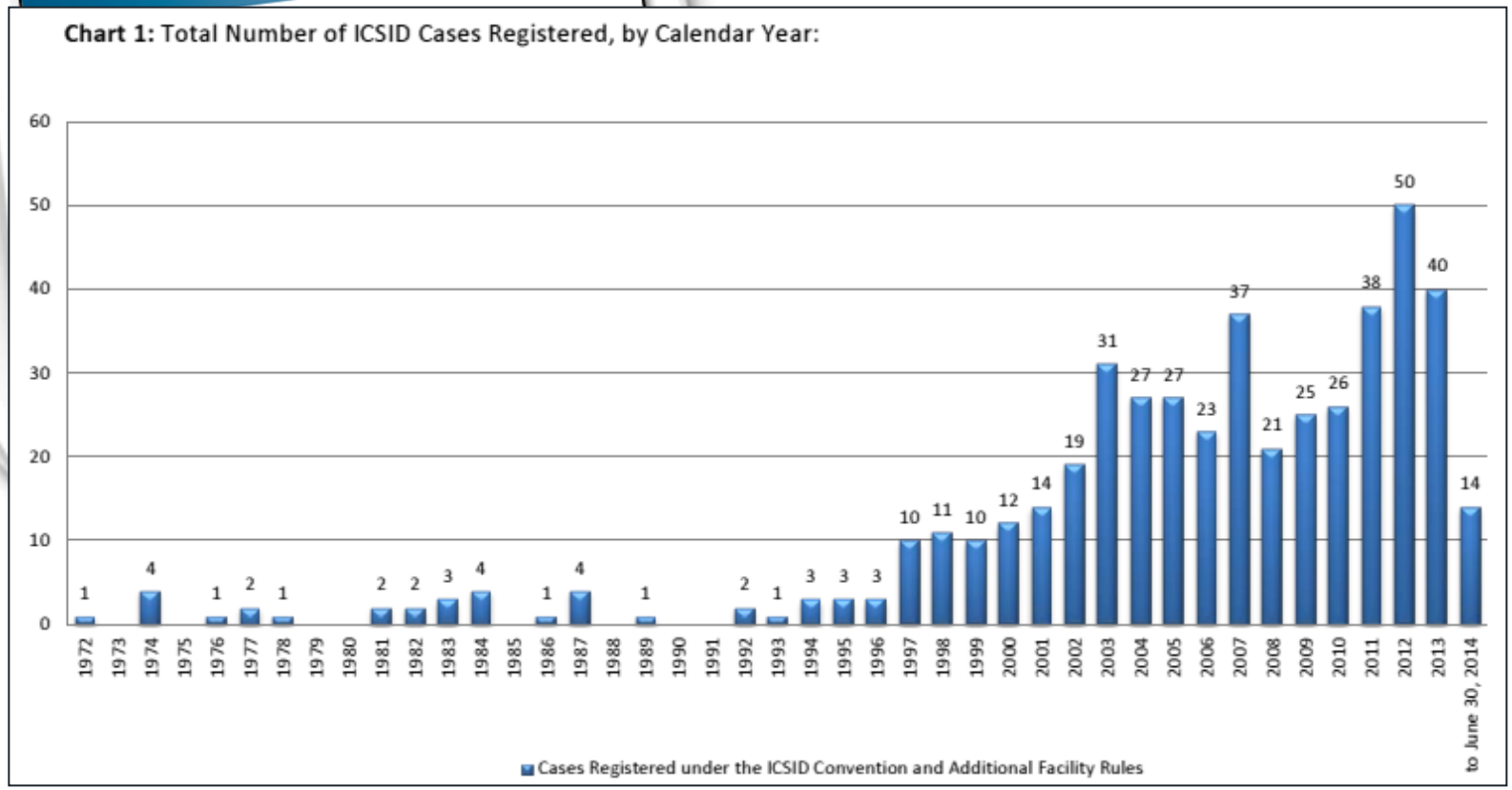
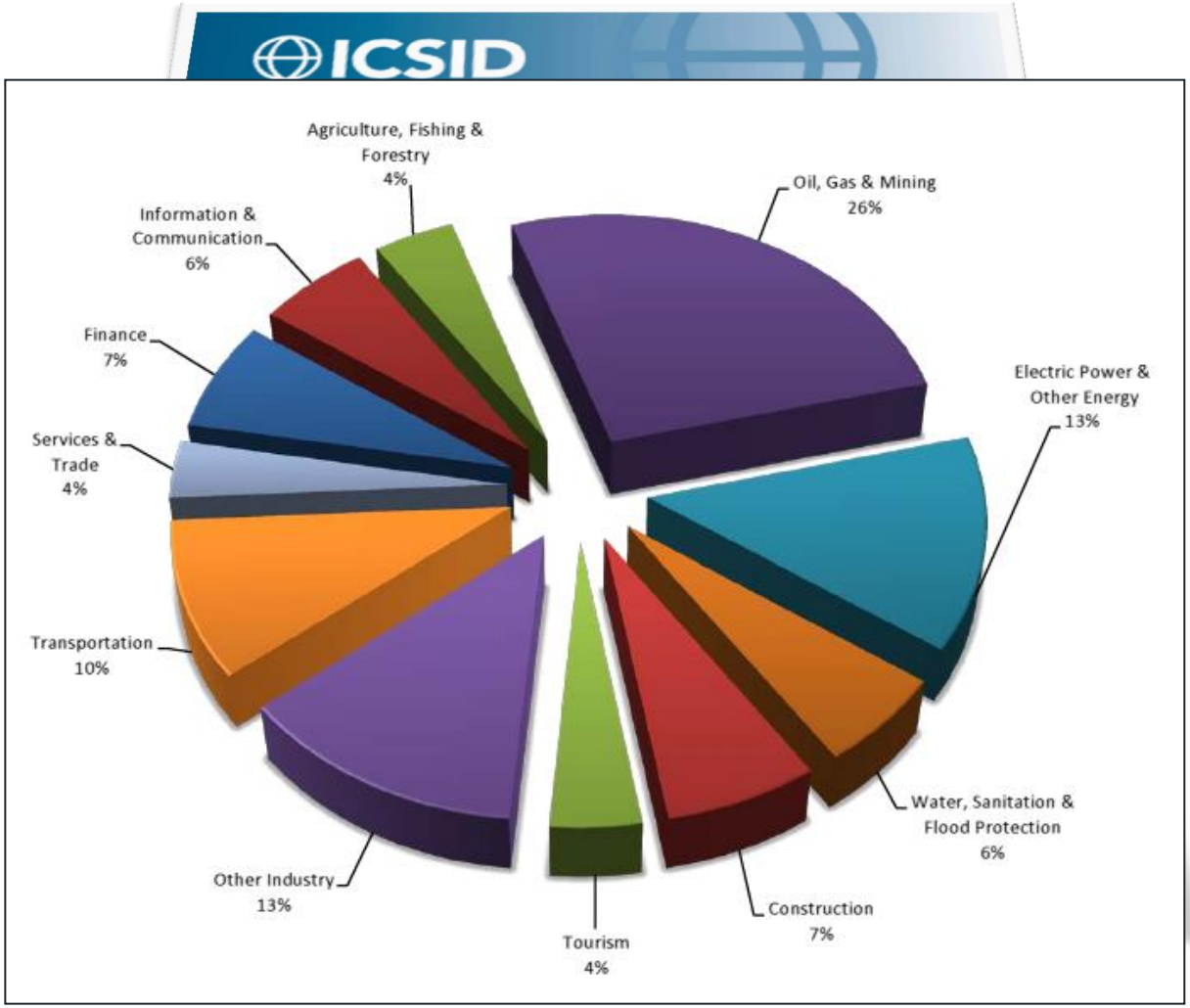
- As a result of the proliferation of BITs, investors began commencing arbitration directly against host States, resulting in an explosion of BIT claims.
- The result has been the development of a substantial body of case law regarding investment protection treaties.
- These decisions have interpreted the substantive protections in BITs and explained the scope of State responsibility under them.

Cases registered by ICSID

Source:
The ICSID Caseload Statistics (2014-2), p. 7.



Distribution of ICSID cases by economic sector



Source:
The ICSID Caseload Statistics (as of March 2014), p. 12

Definition of “investor” in investment treaties

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- “Investor” is often defined to include:
  - Natural person – national of one of the Contracting States
  - Legal entity – incorporated in one of the Contracting States (or with its seat under the laws of one of the Contracting States), including Special Purchase Vehicles (“SPVs”)

Definition of “investment” in investment treaties

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- “Investments” are defined very broadly as any kinds of assets; e.g.,
  - Shares
  - Physical assets
  - Contract rights

Tokios Tokelés v. Ukraine

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- Ukraine entity sought to invest in Ukraine
- Ukraine has a BIT with Lithuania
- Ukraine entity incorporated an SPV in Lithuania, which then held its investment in Ukraine
- The tribunal held that the alleged investment is protected by the Lithuania-Ukraine BIT

Tokios Tokelés v. Ukraine

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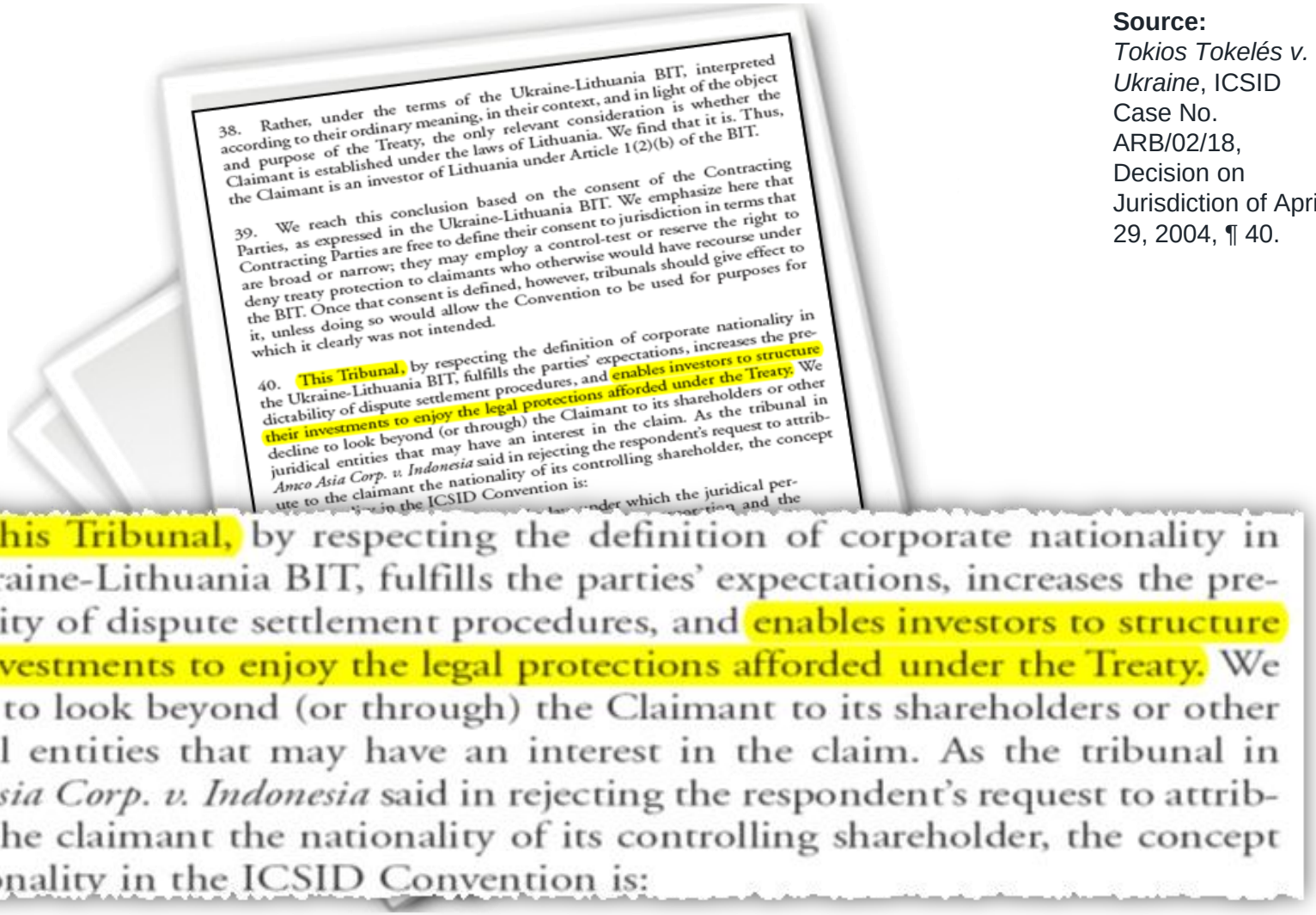

38. Rather, under the terms of the Ukraine-Lithuania BIT, interpreted according to their ordinary meaning, in their context, and in light of the object and purpose of the Treaty, the only relevant consideration is whether the Claimant is established under the laws of Lithuania. We find that it is. Thus, the Claimant is an investor of Lithuania under Article 1(2)(b) of the BIT.

39. We reach this conclusion based on the consent of the Contracting Parties, as expressed in the Ukraine-Lithuania BIT. We emphasize here that Contracting Parties are free to define their consent to jurisdiction in terms that are broad or narrow; they may employ a control-test or reserve the right to deny treaty protection to claimants who otherwise would have recourse under the BIT. Once that consent is defined, however, tribunals should give effect to it, unless doing so would allow the Convention to be used for purposes for which it clearly was not intended.

40. This Tribunal, by respecting the definition of corporate nationality in the Ukraine-Lithuania BIT, fulfills the parties' expectations, increases the predictability of dispute settlement procedures, and enables investors to structure their investments to enjoy the legal protections afforded under the Treaty. We decline to look beyond (or through) the Claimant to its shareholders or other juridical entities that may have an interest in the claim. As the tribunal in *Amco Asia Corp. v. Indonesia* said in rejecting the respondent's request to attribute to the claimant the nationality of its controlling shareholder, the concept of nationality in the ICSID Convention is:

Source:
Tokios Tokelés v. Ukraine, ICSID Case No. ARB/02/18, Decision on Jurisdiction of April 29, 2004, ¶ 40.

Phoenix Action Ltd. v. The Czech Republic

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- Czech national invested in the Czech Republic
- A dispute arose with the Czech Republic concerning the investment
- The Czech Republic has a BIT with Israel
- Czech national incorporated an SPV in Israel that then bought the investment in the Czech Republic
- The Israel SPV then brought the dispute to international arbitration under the Israel-Czech BIT
- The tribunal held that the Israeli SPV cannot bring such a claim

Phoenix Action Ltd. v. The Czech Republic

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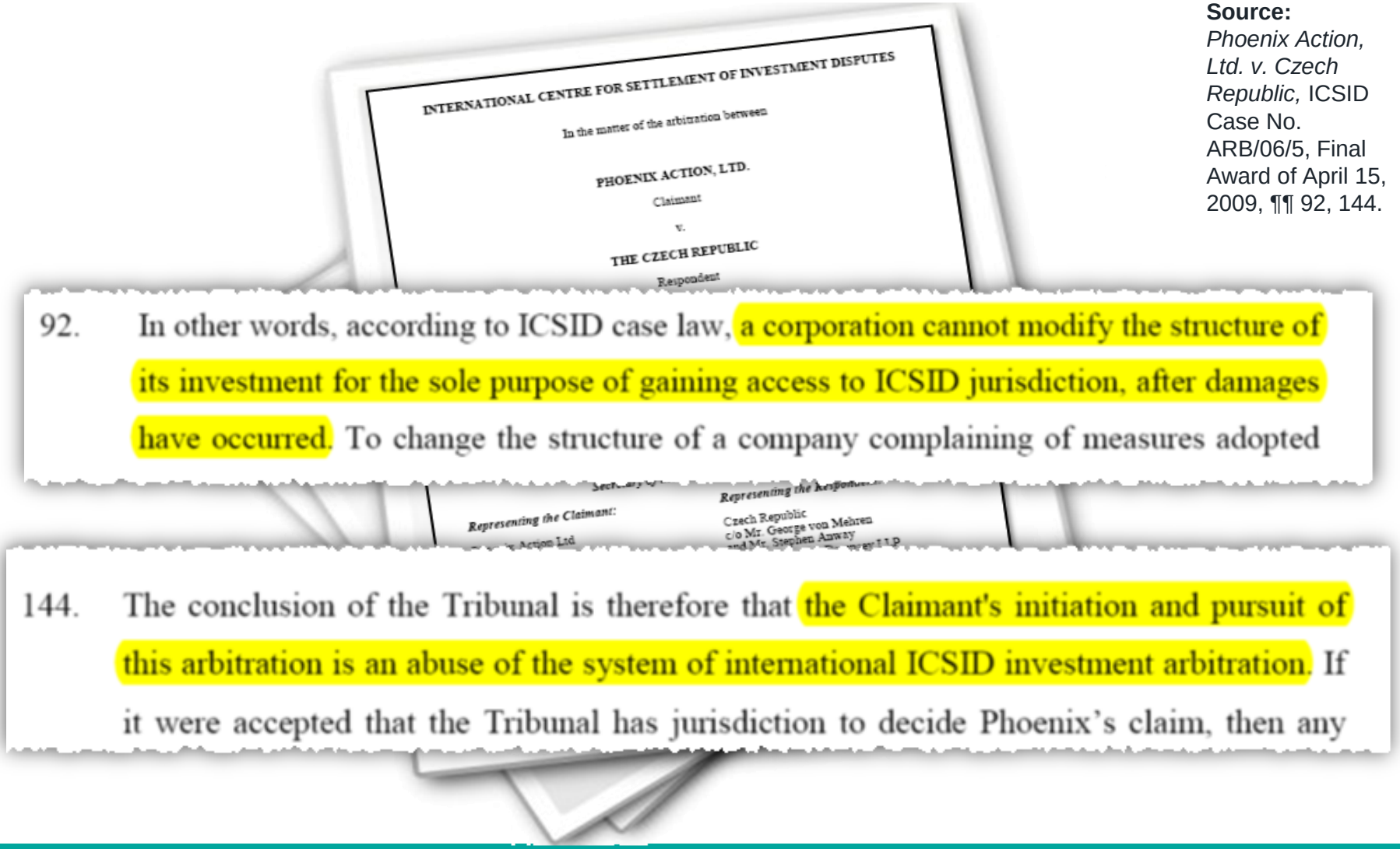
Source:
Phoenix Action, Ltd. v. Czech Republic, ICSID Case No. ARB/06/5, Final Award of April 15, 2009, ¶¶ 92, 144.



INTERNATIONAL CENTRE FOR SETTLEMENT OF INVESTMENT DISPUTES

In the matter of the arbitration between

PHOENIX ACTION, LTD.

Claimant

v.

THE CZECH REPUBLIC

Respondent

92. In other words, according to ICSID case law, a corporation cannot modify the structure of its investment for the sole purpose of gaining access to ICSID jurisdiction, after damages have occurred. To change the structure of a company complaining of measures adopted

Representing the Claimant:

Czech Republic
c/o Mr. George von Mehren

144. The conclusion of the Tribunal is therefore that the Claimant's initiation and pursuit of this arbitration is an abuse of the system of international ICSID investment arbitration. If it were accepted that the Tribunal has jurisdiction to decide Phoenix's claim, then any

Treaty Shopping / Treaty Planning

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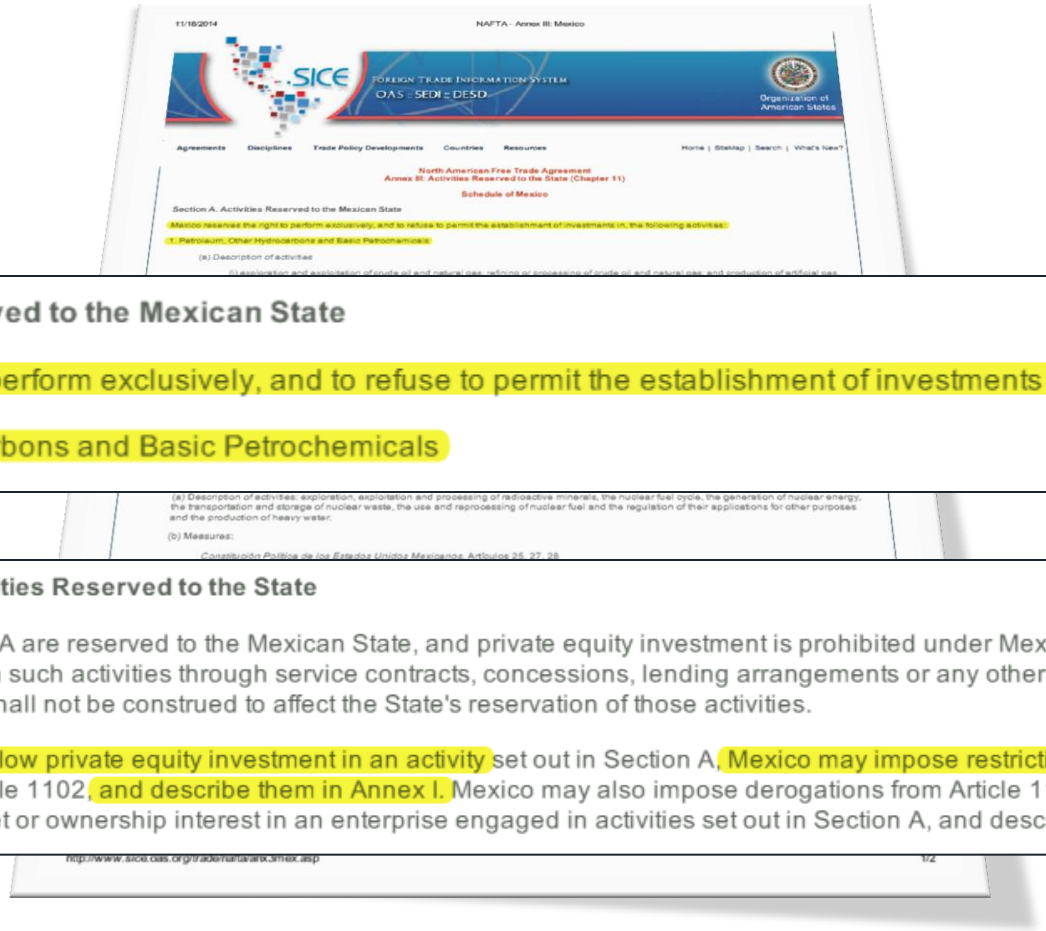
- "The reality is that states have created a BIT network ***that permits investors to structure their investments in order to obtain treaty protection***."
  - Kenneth J. Vandevelde, *International Decision: Aguas del Tunari*, *S.A. v. Bolivia*, 101 A.J.I.L. 179, 184 (2007) (emphasis added).
- ***"[I]nternational legal practices now customarily advise their clients that***, in addition to familiar and undeniably important tax and regulatory considerations, ***strategic structuring can ensure that an investment benefits from the protection of an effective investment treaty should a dispute arise."***
  - Robert D. Sloane, *Breaking the Genuine Link: The Contemporary International Legal Regulation of Nationality*, 50 Harv. Int'l L.J. 1, 41 (Winter 2009) (emphasis added).

Mexico's reservations under NAFTA

Source:
NAFTA, Annex III (Activities Reserved to State).



Section A. Activities Reserved to the Mexican State

Mexico reserves the right to perform exclusively, and to refuse to permit the establishment of investments in, the following activities:

1. Petroleum, Other Hydrocarbons and Basic Petrochemicals

Section B. Deregulation of Activities Reserved to the State

1. The activities set out in Section A are reserved to the Mexican State, and private equity investment is prohibited under Mexican Law. Where Mexico allows private investment to participate in such activities through service contracts, concessions, lending arrangements or any other type of contractual arrangement, such participation shall not be construed to affect the State's reservation of those activities.

2. If Mexican law is amended to allow private equity investment in an activity set out in Section A, Mexico may impose restrictions on foreign ivestment participation notwithstanding Article 1102, and describe them in Annex I. Mexico may also impose derogations from Article 1102 on foreign equity investment participation when selling an asset or ownership interest in an enterprise engaged in activities set out in Section A, and describe them in Annex I.

Mexican energy reform

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Midstream & Downstream

- Government issued project permits (no arbitration clause)
- Commercial contracts – issued by the parties

Upstream Oil and Gas Exploration and Production Contracts

- Hydrocarbon Law (Aug. 11, 2014)
  - Article 97, 21
- Termination for Breach:
  - Gross non-performance of the contractor is **NOT** subject to arbitration
  - Litigated in Mexican federal courts
- Arbitration clause
  - Mexican law
  - Spanish language
- Public comment on Form of the Agreement prior to Issuance

Mexican energy reform

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Article 21.

For controversies related to Exploration and Production Agreements, with the exception of what has been stated in the preceding article, alternative dispute resolution methods may be included, including arbitration agreements in terms of Title Four of Book Five of the Commerce Code and those international conventions executed by Mexico on the subject matter.

The National Hydrocarbons Commission and the Contractors will, in no case, be subject to foreign law. In all cases, the arbitration procedure shall be subject to:

I. The applicable laws will be the Federal Laws of Mexico;

II. The arbitration will be held in Spanish; and

III. The award must be issued in strict compliance with applicable law and will be binding on both parties.

Mexico's BITs

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Worldwide Locations (including independent network firms)

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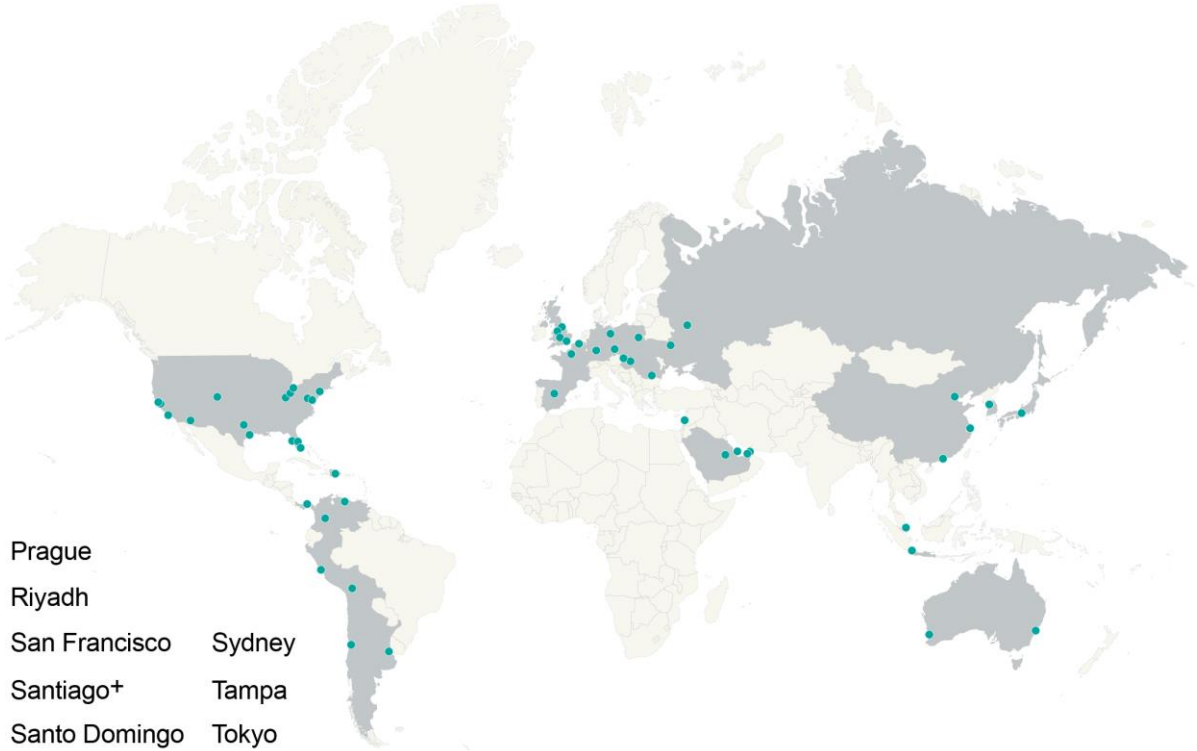

+ Independent Network Firm