INTRODUCTORY NOTE TO THE INTERNATIONAL CENTRE FOR SETTLEMENT OF INVESTMENT DISPUTES: MALAYSIAN HISTORICAL SALVORS SBN., BHD. V. GOVERNMENT OF MALAYSIA & PHOENIX ACTION LTD. V. CZECH REPUBLIC

BY CHARBEL A. MOARBES*

[April 15-16, 2009]
+Cite as 48 ILM 1081 (2009)+

Introduction

The concept of investment, left intentionally[1] undefined by the drafters of the 1965 Washington Convention, has developed in a rather confusing and inconsistent manner. Some critics have even qualified it as ''mysterious''[2] and ''damned.''[3] The successive rulings of two different ICSID panels reaching varied conclusions about the notion of investment confirm that a consensus is far from being reached. The first panel[4] issued its ruling in a dispute between Phoenix Action, Ltd. (''Phoenix'') and the Czech Republic. The second panel, an *ad hoc* committee[5] asked to review an annulment application filed by Malaysian Historical Salvors (''Malaysian Historical Salvors'') against the Government of Malaysia (''Malaysia''), annulled a 2007 ICSID award that dismissed the dispute for lack of jurisdiction.

While both decisions are significant in their analysis of ''investment,'' the different rationales followed by the two panels warrant separate reviews.

I. Malaysian Salvors v. Malaysia

Article 52(1)[6] of the ICSID Convention is the mechanism under which a losing party can request the annulment of an ICSID award. The procedure, to be distinguished from an appeal,[7] envisions a narrow review of the award by an *ad hoc* annulment committee, which reviews the legitimacy of the arbitration process[8] without reconsidering the jurisdiction or merits of the award.[9] To fully understand the tribunal's annulment decision, a rare occurrence at ICSID, one must understand the facts that led to the annulment application.

1. History of the Dispute

Malaysian Historical Salvors, an English company incorporated under the laws of Malaysia, entered into a ''no find no pay'' contract with Malaysia to locate and salvage the cargo of a British vessel, *Diana*, that sunk in Malaysian waters. The salvage operation lasted forty-three months and was a success, with the government of Malaysia receiving the Chinese porcelain recovered by Malaysian Historical Salvors. A disagreement between the parties ensued when Malaysian Historical Salvors claimed that it had not received the agreed[10] upon amount of money from the operation. After the parties failed to reach settlement, Malaysian Historical Salvors instituted ICSID proceedings against Malaysia pursuant to the United Kingdom bilateral investment treaty with Malaysia (''UK-Malaysia BIT'').

The threshold issue before the sole arbitrator, Michael Hwang, was whether the tribunal had jurisdiction to hear the case, and specifically, whether there was an investment under Article 25(1) of the ICSID Convention *and*[11] the UK-Malaysia BIT. In this respect, the arbitrator undertook a two step approach requiring a claiming party to prove the existence of investment within the meaning of the Convention and the BIT.

To determine whether an investment under the ICSID Convention existed, the arbitrator, ''adopting a fact-specific and holistic assessment,''[12] relied heavily on five factors of investment enumerated in *Salini v. Morocco*.[13] The arbitrator concluded that the alleged investment had not met the requirements of Article 25(1) of the ICSID Convention. As a result, he found it unnecessary to discuss the UK-Malaysia BIT[14] investment requirements and dismissed the claim for lack of jurisdiction.[15] The approach adopted by the arbitrator was ''in strict if not literal adherence''[16] to the *Salini* factors.

2. The Annulment Proceedings

Malaysian Historical Salvors requested annulment of the award pursuant to Article 52(1)(b) of the ICSID Convention on the ground that the tribunal manifestly exceeded its powers by failing to rely, *inter alia*, on the landmark ICSID

---

* Associate at George Munoz Law Offices, PLLC. The author is currently working in the field of international investment arbitration. He holds a LL.M. from the George Washington University Law School and a specialized diploma in international arbitration.

case *Vivendi v. Argentine Republic*.[17] In a significant and anticipated decision[18] that applies the correct historical, jurisprudential, and teleological principles, a divided panel issued a judgment granting the annulment. The majority concluded that the sole arbitrator had exceeded his powers by failing to exercise jurisdiction over the case.

The decision will be cited for years to come for several reasons. First, the *ad hoc* committee's definition of investment is in accordance with the main sources of the ICSID Convention, mainly the *Travaux Préparatoires* and the Report of the Executive Directors on the Convention. A review of these sources demonstrates an absence of a monetary limit in defining investment and the consent of the parties as a "critical criterion"[19] and "cornerstone"[20] for finding jurisdiction. In fact, the drafters of the Convention had unsuccessfully attempted to incorporate a definition of investment; rather the definition was left subject to agreement between States.

Secondly, the decision puts the notion of investment on the right jurisprudential track. Notably, the majority of the *ad hoc* committee disagreed with the arbitrator's exclusive reliance on *Salini* to determine whether an investment in fact existed. While the *ad hoc* committee agreed with the application of the *Salini* test identifying a list of "typical characteristics" of investment, it rejected the arbitrator's decision to elevate these characteristics to the rank of "jurisdictional requirements," thus making them fixed or mandatory. The *ad hoc* committee reasoned that this expansion would render the *Salini* test "problematic."[21] Furthermore, referring to the *Biwater v. Tanzania* award,[22] the *ad hoc* committee added that this would deprive the parties of their right to agree to a different definition and also hamper the "developing consensus in parts of the world as to the meaning of 'investment' (as expressed, e.g., in bilateral investment treaties)." The majority concluded that the notion of investment should be based on both Article 25(1) and *Salini*, "along with all the circumstances of the case, including the nature of the instrument containing the relevant consent to ICSID." Consequently, the majority maintained that, since Article 1 of the U.K.-Malaysia BIT defined investment "capaciously"[23] to include "every kind of asset,"[24] and the contract between the parties obligated Malaysia to compensate Malaysian Historical Salvors for services rendered, the work performed pursuant to such agreement is within the meaning of investment of both the Convention and the BIT. According to the majority, even the ordinary meaning of the term investment—which is generally understood to mean a "commitment of money or other assets for the purpose of providing a return"[25]—would include the services rendered by Malaysian Historical Salvors to the government of Malaysia. Simply put, the *ad hoc* committee advocates a flexible definition of "investment" as opposed to the narrow reading advanced by the sole arbitrator. Thus, for the majority, an investment should be analyzed on a case by case basis rather than be limited to a specific definition.[26] Notably, this approach is in line with the liberal construction of the notion of investment proposed by a great number of scholars and practitioners.[27]

Finally, the decision provides a teleological and pragmatic review of ICSID jurisdiction. In this respect, the majority stressed that, unlike many other BITs, the UK-Malaysia BIT expressly limited third-party dispute settlement to ICSID. This limitation, the majority reasoned, if coupled with a narrow and restrictive definition of investment, would render "nugatory"[28] the recourse to ICSID, and would leave the investor with no other remedy, thus destroying the security of investment.

Judge Mohamed Shahabuddeen zealously dissented. In his view, the *ad hoc* committee had acted as an appeals tribunal[29] disregarding its mandate to annul an award only in cases where there is a "manifest" excess of powers. According to him, no such abuse had taken place. Relying on the notion of investment under Article 25 of the ICSID Convention, which had not been "made subject to any definition in another instrument,"[30] Judge Shahabuddeen argued that it was "logical"[31] to start with this definition. Furthermore, unlike the majority, which reasoned that the definition of investment was flexible and not definite, he believed there were "outer limits to the Centre's jurisdiction that are not subject to the parties' disposition."[32] In particular, according to Judge Shahabuddeen, the ICSID Convention definition of investment was "controlling."[33] Applying the Convention, he concluded that there was no substantial investment that promoted the development of Malaysia as required by Article 25.

Shahabuddeen's line of reasoning is based upon an extremely narrow notion of investment. Arguably, the majority of the *ad hoc* committee salvaged the decision from an unreasonably limited interpretation.

II. Phoenix v. Czech Republic

One day before *Malaysian Salvors* was decided, an unanimous three member ICSID tribunal dismissed the claims of an Israeli company ("Phoenix") wholly owned by a Czech national, Vladimír Beňo.

As background, Phoenix had purchased two Czech companies, Benet Praha (''BP'') and Benet group (''BG'') while both were involved in domestic legal proceedings[34] in the Czech Republic. Shortly after this purchase, Phoenix instituted ICSID proceedings accusing the Czech government of violating the Israel-Czech Republic bilateral investment treaty (Israel-Czech BIT). The Czech government argued, *inter alia*, that Beňo established Phoenix solely to benefit from the Israel-Czech BIT and the ICSID Convention; that Phoenix was ''nothing more than an *ex post facto* creation of a sham Israeli entity''[35] established by Beňo ''to create a diversity of nationality;''[36] and that the whole scheme was part of ''treaty shopping.''[37] To decide the dispute, the Tribunal had to determine whether Phoenix's alleged investment was within the meaning of Article 25 of the ICSID Convention and Article 7 of the Israel-Czech BIT.

The Tribunal applied a six-factor test to determine whether there was a bona fide investment ''which deserves protection'' [38] under either the ICSID Convention or the Israel-Czech BIT. On this issue, the Tribunal stressed the importance of timing of the investment and the claim, the substance of the transaction, and the true nature of the operation. The Tribunal, noting that BP and BG were owned by Beňo's wife and daughter respectively, concluded that the supposed investment was ''a mere redistribution of assets''[39] within the same family, ''not a bona fide transaction and [therefore] cannot be a protected investment under the ICSID system.''[40] After an extensive analysis and modification of the so called *Salini* test, the Tribunal, which labeled Phoenix's application before ICSID a ''*detournement de procedure*,''[41] or abuse of process, dismissed the case for lack of jurisdiction.

While this outcome has been generally praised, the reasoning employed by the Tribunal could face possible criticism for its limited analysis of to the notion of investment under the ICSID Convention. Arguably, the rationale employed by the Tribunal is partly based on similar factors that led to the annulment in *Malaysian Salvors*. In this respect, a few analytical inconsistencies are worth mentioning.

First, the Tribunal unnecessarily narrowed the definition of investment. In its analysis of whether there was a legitimate investment under the ICSID Convention and the Israel-Czech BIT, the Tribunal not only disregarded ICSID jurisprudence but also longstanding legal scholarship on this issue. Most notably, the Tribunal failed to give weight to the *Travaux Préparatoires* of the ICSID Convention, deciding that it could not ''agree'' with Phoenix's argument that ''it was the intent of the Convention's drafters to leave to the parties the discretion''[42] to decide what constitutes an investment. The Tribunal stressed that the parties were ''not free to decide in BITs that anything . . . is an investment.'' Instead, the Tribunal concluded that six elements—a ''full test to determine the existence of a protected investment''[43] —had to be applied to determine whether an investment should ''benefit from the international protection of ICSID.''[44]

These six elements are based on the *Salini* test, with some changes and additions. The *Salini* elements are: 1) a contribution in money or other assets; 2) certain duration of the investment; and 3) an element of risk. A fourth *Salini* element—''contribution to the host state's development''—was ''impossible to ascertain.''[45] As a result, the Tribunal replaced it with a new element: ''operation made in order to develop an economic activity in the host state.''[46] The additional factor, the Tribunal noted, was ''shaped by the elements of contribution/duration/risk'' and was ''therefore [to] be presumed.''[47] In this regard, the Tribunal considered whether ''significant economic activity, which is the fundamental prerequisite of any investor's protection,''[48] had resulted from Phoenix's investment. The other two elements necessary in determining the existence of investment, according to the Tribunal, were the presence of ''good faith''[49] and the requirement that the investment be in accordance with the law of the host state.[50]

Remarkably, the six-part test, coupled with the Tribunal's statement that parties can ''confirm the ICSID notion or restrict it, but cannot expand it in order to have access to ICSID,'' narrows the notion of investment. This reasoning arguably freezes the parties' autonomy to determine the meaning of investment, an important element the drafters intended as the cornerstone or *raison d'être* of the ICSID Convention. In fact, the drafters deliberately assumed that ICSID Member States would agree on a definition that would fit their particular circumstance.

What is even more troubling is the Tribunal's misquoting of *Biwater v. Tanzania*. According to the Tribunal, *Biwater* stands for the proposition that ''article 25 has an autonomous meaning which cannot be expanded.''[51] This conclusion, however, completely contradicts *Biwater*, where it was decided that there is no ''fixed or autonomous definition of investment.'' The *Phoenix* Tribunal misattributed the above citation to the *Biwater* tribunal, when it was actually Republic of Tanzania, not the tribunal, which had advanced this argument.

Another analytical inconsistency is the Tribunal's extensive review of the fifth element of investment (assets invested in accordance with the law of the host state). While generally a tribunal can review any issue raised by the parties, in this particular instance neither party had mentioned this issue in their arguments. Nonetheless, the Tribunal unilaterally decided that "violation of a national principle of good faith"[52] was at stake. It even stressed that the principle that the investment be in conformity with national laws is "implicit even when not expressly stated in the relevant BIT."[53] This conclusion may lead to more questions than answers.

A final criticism relates to the fact that the Tribunal's analysis would have been clearer had it approached the issue of bona fides with respect to the ICSID proceedings rather than the underlying investment. The Tribunal's analysis of this issue can be interpreted as being in contradiction with the Israel-Czech BIT, which did not impose a requirement that the investment be bona fide. BITs and other treaties are the source of ICSID jurisdiction, and tribunals should not restrict or expend express treaty language.

In sum, while the *Phoenix* Tribunal may have reached the correct conclusion by dismissing the case for lack of jurisdiction, it single-handedly and needlessly restricted the notion of investment. In doing so, it departed from the well-founded principle of party autonomy. Interestingly, the Tribunal based its investment analysis on the "double-barreled test"[54] established by the original 2007 *Malaysian Salvors* award that was annulled one day after the *Phoenix* award was issued (see above). The Tribunal, in relying on the annulled award, noted that the "double-barreled test entails that the jurisdiction *ratione materiae* of the Tribunal rests on the intersection of the two definitions."[55]

It is tempting to conclude this review with a historical "what if"—what if the *Phoenix* award had been rendered after the *Malaysian Salvors* annulment? If the timing of the award had been different, the confusing analysis in *Phoenix* could have been avoided.

ENDNOTES

1 *See* Report of the Executives Directors on the Convention on the Settlement of Investment Disputes between States and National of other States, ¶ 27 (1965).

2 Walid Ben Hamida, *La notion d'investissement: la notion maudite du systeme CIRDI? in* 349 GAZETTE DU PALAIS 33 (Dec. 15, 2007).

3 *Id.* ¶ 40. The literal English translation for the French term "maudite."

4 The panel was composed of Brigitte Stern (president), Andreas Bucher, and Juan Fernandez-Armesto.

5 The *ad hoc* committee was composed of judges Stephen Schwebel (president), Mohamed Shahabuddeen, and Peter Tomka.

6 The grounds for annulment under the ICSID Convention are narrow. Article 51(1) reads:

> Either party may request annulment of the award by an application in writing addressed to the Secretary-General on one or more of the following grounds: (a) that the Tribunal was not properly constituted; (b) that the Tribunal has manifestly exceeded its powers; (c) that there was corruption on the part of a member of the Tribunal; (d) that there has been a serious departure from a fundamental rule of procedure; or (e) that the award has failed to state the reasons on which it is based.

7 *See* CHRISTOPH SCHREUER, THE ICSID CONVENTION: A COMMENTARY 901 (2009).

8 *Id.*

9 *Id.*

10 Pursuant to the agreement, the title of the recovered property was to pass to the Malaysian government; the applicant was entitled only to a service fee of seventy percent of the proceeds of an auction at Christie's. The porcelain was auctioned for an amount of $2.98 million, but Malaysian Historical Salvors allegedly received only forty percent of the auction proceeds. Malaysian Historical Salvors also accused Malaysia of retaining $400,000 worth of items by withholding them from the auction.

11 Malaysian Historical Salvors, Sdn., Bhd. v. Government of Malaysia, ICSID Case No.ARB/05/10, Award ¶ 147 (May 17, 2007). *available at* http://ita.law.uvic.ca/documents/MHS-jurisdiction.pdf.

12 Malaysian Historical Salvors, Sdn., Bhd. v. Government of Malaysia, ICSID Case No. ARB/05/10, Annulment Award ¶ 107 (Apr. 16, 2009), *available at* http://arbitration.fr/resources/ICSID-ARB-06-5.pdf [hereinafter *Malaysian Salvors* Annulment Award].

13 Salini Costruttori S.p.A. & Italstrade S.p.A. v. Kingdom of Morocco, ICSID Case No. ARB/00/4, Jurisdiction (July 23, 2001), 42 I.L.M. 609 (2003) [hereinafter *Salini*]. The five criteria are benchmarks originally suggested by the arbitral tribunal in Fedax N.V. v. Republic of Venezuela, ICSID Case No. ARB/96/3, Decision on Jurisdiction (July 11, 1997), 5 ICSID REP. 183 (2002), 42 I.L.M. 609 (2003).

14 *Id.* ¶ 148.

15 *Id.* ¶ 146.

16 Yulia Andreeva, *Malaysia: Malaysian Historical Salvors v. Malaysia –Interpretation of the Term "Investment"*, 11 INT'L ARB. L. R. 36, 37-39 (2008).

17 Compania de Aguas del Aconquija S.A and Vivendi Universal S.A v. Argentine Republic, ICSID Case No. ARB/97/3, Annulment Award (July 3, 2002), 41 I.L.M. 1153 (2002).

18 Andreeva, *supra* note 16, at 39. *See also* Emmanuel Gaiilard, *Identify or Define? in* INTERNATIONAL INVESTMENT LAW FOR THE 21st CENTURY 415 (2009).

19 *Malaysian Salvors* Annulment Award, ¶ 71.

20 *Id.* (citing ¶ 23 of the Report of the Executive Directors).

21 *Malaysian Salvors* Annulment Award, ¶ 79 (citing the *Biwater* case, *infra* note 22).

22 Biwater Gauff (Tanzania) Ltd. v. United Republic of Tanzania, ICSID Case No. ARB/05/22, Award (July 24, 2008), *available at* http://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC770_En&caseId=C67.

23 *Malaysian Salvors* Annulment Award, ¶ 59.

24 Agreement between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of Malaysia for the Promotion and Protection of Investments art. 1(a), May 21, 1981. The text is *available at* http://www.miti.gov.my/cms/storage/documents/569/com.tms.cms.document.Document_9eebbd0a-c0a81573-f8e0f8e0-7a847b1a/1/uk.pdf.

25 *Malaysian Salvors* Annulment Award, ¶ 57.

26 For a study of the intuitive and deductive approaches, *see* Gaiilard, *supra* note 18, at 407.

27 *See* Devashish Krishan, *A Notion of ICSID Investment, in* INVESTMENT TREATY ARBITRATION AND INTERNATIONAL LAW 61-84 (Todd Weiler ed., 2008). *See also* Gaillard, *supra* note 18, at 409; Ibrahim Fadlallah, *La notion d'investissement: vers une restriction a la competence du CIRDI?, in* LIBER AMICORUM ROBERT BRINER 267 (2005); and SCHREUER, *supra* note 7.

28 *Malaysian Salvors* Annulment Award, ¶ 62.

29 *Id.* ¶ 39 (Shahabuddeen, J., dissenting).

30 *Id.* ¶ 43.

31 *Id.*

32 *Id.* ¶ 44.

33 *Id.* ¶ 42.

34 The two disputes were Benet Praha against the Czech fiscal authorities and Benet Group against a private party.

35 Phoenix Action, Ltd. v. Czech Republic, ICSID Case No. ARB/06/5, Award ¶ 34 (Apr. 15, 2009), *available at* http://www.arbitration.fr/resources/ICSID-ARB-06-5.pdf [hereinafter *Phoenix*].

36 *Id.*

37 *Id.*

38 *Id.* ¶ 135.

39 *Id.* ¶ 139.

40 *Id.* ¶ 142.

41 *Id.* ¶ 143.

42 *Id.* ¶ 82.

43 *Id.* at 45.

44 *Id.* ¶ 114.

45 *Id.* ¶ 85.

46 *Id.* ¶ 114.

47 *Id.* ¶ 85.

48 *Id.* ¶ 93.

49 The principle of good faith, the Tribunal emphasized, required that a legitimate investment be in accordance with the laws of the host state and bona fide.

50 *Id.* ¶ 113.

51 *Id.* ¶ 97, n.67.

52 *Id.* ¶ 113.

53 *Id.* ¶ 101.

54 *Id.* ¶ 74.

55 *Id.*