School of International Arbitration, Queen Mary,
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International Arbitration Case Law

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JOSEPH CHARLES LEMIRE
v.
UKRAINE
(ICSID CASE NO. ARB/06/18),
DECISION ON JURISDICTION AND LIABILITY

Case Report by Alejandro Turyn[**]
Edited by Claudia Frutos-Peterson[***]

In a decision on Jurisdiction and Liability rendered on January 14, 2010, the Tribunal dismissed Respondent's objections to the jurisdiction of the Centre and the competence of the Tribunal and declared that Ukraine had breached the Fair and Equitable standard established in Article II.3 of the Ukraine-US BIT. In reaching this conclusion, the Tribunal determined that Respondent acted in a discriminatory and arbitrary manner by distorting fair competition between applicants of radio frequency licenses, allegedly favouring applicants with political connections and facilitating the secret awarding of licenses. The Tribunal decided to defer the question of reparation—including issues on quantum— for a later phase.

Tribunal:	Professor Juan Fernández-Armesto (President), Mr. Jan Paulsson and Dr. Jürgen Voss.
Claimant's Counsel:	Dr. Hamid G. Gharavi, Mr. Julien Fouret and Ms. Nada Sader of Derains & Gharavi (Paris, France).
Defendant's Counsel:	Mr. John S. Willems, Mr. Michael A. Polkinghorne and Ms. Olga Mouraviova of White & Case LLP (Paris, France); Mr. Sergii Svyryba, Ms. Marta Khomyak and Ms. Olha Yaniutina, Magisters (Kyiv, Ukraine).

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1. Facts of the Case

Joseph Charles Lemire, a citizen of the United States, indirectly owned and controlled "Radiocompany Gala" ("Gala"), a radio station licensed to broadcast on various frequencies in Ukraine.

On November 14, 1997, Mr. Lemire ("Claimant") filed with the International Centre for Settlement of Investment Disputes ("ICSID" or the "Centre") a first request for arbitration (the "First Arbitration") against Ukraine, with regard to the same investments that underlie the present arbitration. The First Arbitration concluded with a Settlement Agreement (the "Settlement Agreement"), which was recorded by the tribunal in a consent award dated September 18, 2000 (the "2000 Award") (See ICSID Case No. ARB (AF) 98/1). The Settlement Agreement provided that disputes arising from or in connection thereof would be submitted to arbitration under the ICSID Additional Facility Rules (the "Arbitration Clause").

Pursuant to the Settlement Agreement, Gala was awarded several broadcasting licenses. However, after the First Arbitration was settled, the company participated in more than 200 tenders for additional broadcasting licenses, all of which – except for one – were awarded to its competitors.

On September 11, 2006, Mr. Lemire filed a second request for arbitration (the "Second Arbitration") against Ukraine. The request, which was supplemented by Claimant on November 14, 2006, was registered by the Centre on December 8, 2006.

In the Second Arbitration, Claimant alleged breaches of the Settlement Agreement (i.e. the 2000 Award) and the US-Ukraine BIT. Specifically, Claimant complained that Ukraine had not complied with its obligations under the Settlement Agreement, and that it (1) failed to provide fair and equitable treatment in awarding of the radio frequencies, (2) continuously harassed Mr. Lemire, (3) breached the treaty's "umbrella clause", and (4) breached the prohibition of local purchasing requirements.

The Tribunal was constituted on June 14, 2007. On March 26, 2008, the Tribunal notified the parties that it had decided to join the issue of jurisdiction to the merits.

Respondent challenged the allegations of breach of the BIT and the Settlement Agreement, and raised a number of jurisdictional objections: (1) that the Centre lacked jurisdiction to hear claims arising out of the Settlement Agreement; (2) that there was no investment underlying the claims related to the tenders for

additional frequencies; (3) that the capital invested by Claimant did not emanate from abroad; and (4) that Claimant had not presented a *prima facie* case of expropriation.

2. *Legal Issues Discussed in the Decision*

(a) Jurisdiction in General (¶¶ 45-46)

In order for the Centre to have jurisdiction and for the Tribunal to have competence with regard to the claims advanced by Claimant, four well known conditions must be met, three deriving from Article 25 of the ICSID Convention and a fourth resulting from the general principle of law of non-retroactivity:

- first, a condition *ratione personae*: the dispute must involve opposition of a Contracting State and a national of another Contracting State;
- second, a condition *ratione materiae*: the dispute must be a legal dispute arising directly out of an investment;
- third, a condition *ratione voluntatis*: the Contracting State and the investor must consent in writing that the dispute be settled through ICSID arbitration;
- fourth, a condition *ratione temporis*: the ICSID Convention must have been applicable at the relevant time. (¶ 45)

The jurisdictional requirements of Article 25 of the ICSID Convention must be read in conjunction with those of the BIT. (¶ 46)

(b) Jurisdiction Ratione Materiae – transfer of funds from abroad (¶¶ 51-59) – "arising directly out of an investment" (¶¶ 92-98)

Respondent contested the *ratione materiae* jurisdiction of the Tribunal arguing that Mr. Lemire didn't have an investment in Ukraine because, *inter alia*, he had not proven that the funds invested in the country came from abroad. The Tribunal held that neither the BIT nor the ICSID Convention includes an origin-of-capital requirement, and that such a requirement cannot be inferred from the purpose of these instruments. (¶ 56) In fact, the BIT's provision on reinvested earnings suggests exactly the opposite: that the funds invested do not necessarily have to come from abroad. (¶ 57)

Respondent also argued that the dispute related to the allocation of new frequencies – while arguably within the ambit of the BIT – did not arise directly out of an investment, and therefore, fell short of the requirements of Article 25(1) of the ICSID Convention. To determine whether Claimant's case could be considered as "arising directly out of an investment", the Tribunal distinguished the scenario where an investor intends to enter a market for the first time, from one where the investor makes further investments after the initial commitment of capital. Although the issue of whether pre-investment activities merit treaty protection is debatable (¶ 89), it was clear in this case that

Mr. Lemire already had an investment in Gala and his applications for additional licenses were simply the implementation of a business plan in connection with this investment. (¶¶ 92-98)

(c) Jurisdiction Ratione Voluntatis (¶¶ 75-83)

Claimant commenced arbitration proceedings under the Arbitration Clause in the Settlement Agreement (2000 Award) and under the Ukraine-U.S BIT. Accordingly, the Tribunal analyzed the *ratione voluntatis* requirement for jurisdiction pursuant to each instrument. (¶ 60)

The Arbitration Clause in the Settlement Agreement provided for arbitration under the ICSID Additional Facility Rules. However, these Rules were superseded by the ICSID Rules as a result of Ukraine's ratification of the ICSID Convention. The Tribunal stated that imprecise arbitration clauses are a frequent occurrence in commercial arbitration and that arbitrators must interpret them in order to restore the true intention of the parties, which could potentially be distorted by their ignorance of the mechanics of arbitration, errors in designating the correct institution or rules, or – as here – by supervening legal developments. For the Tribunal, the true intention of the parties in this case was very clear; the Arbitration Clause stipulated that either party could submit to ICSID its application for resolution of the dispute. Thus, for the Tribunal, the very wording of the Arbitration Clause evidenced the parties' intention that disputes arising from and in connection with the Settlement Agreement be settled through arbitration administered by ICSID, and not through any other dispute settlement mechanism, nor by any national Court. (¶¶ 75-81)

The Tribunal found that in the Arbitration Clause, the parties correctly referred to the Rules applicable at the time the Settlement Agreement was executed – i.e. the ICSID Additional Facility Rules. However, when the Settlement Agreement was recorded as an award a couple of months later, they failed to take into account that Ukraine had just ratified the ICSID Convention and that the applicable arbitration rules were, by that time, the ICSID Arbitration Rules, instead of the ICSID Additional Facility Rules. For the Tribunal, the ambiguity overlooked by the parties when recording the Settlement Agreement as an award was purely technical and ancillary, and could not distort their real intent: that any dispute arising from or in connection with the Settlement Agreement be settled by arbitration administered by ICSID, and governed by the appropriate rules approved by the Centre (i.e. before Ukraine had ratified the ICSID Convention, the ICSID Additional Facility Rules; thereafter, the ICSID Arbitration Rules.) (¶¶ 82-83)

(d) UNIDROIT Principles (¶¶ 106-111)

The Tribunal discussed the UNIDROIT Principles in the context of determining the law applicable to the Settlement Agreement. The choice of law provision in the Settlement Agreement provided that the applicable law would be determined in accordance with Article 54 of the ICSID Additional Facility Rules. The Tribunal held that, by incorporating substantial parts of the UNIDROIT Principles into the Settlement Agreement, the parties had in fact made a negative choice of any municipal legal system. Accordingly, the Tribunal decided it was proper to submit the Settlement Agreement to the rules of international law, and within these, to have particular regard to the UNIDROIT Principles. (¶¶ 108-109)

(e) Interpretation of the Obligations in the Settlement Agreement (¶¶ 114-208)

Before analyzing whether Respondent had breached its obligations under the Settlement Agreement, the Tribunal went on to interpret the meaning and scope of these obligations in accordance with the UNIDROIT Principles. The Tribunal held that the text of the Settlement Agreement was the only source of obligations, and that any expectations Claimant had during the negotiation process, unless reflected in the text, did not give rise to contractual obligations. (¶ 115) The Tribunal analyzed each of the alleged breaches of the Settlement Agreement and held that Respondent had not violated any of its obligations. (¶¶ 117-208)

(f) Fair and Equitable Treatment (¶¶ 240-285)

Claimant contested that Respondent had violated the Ukraine-U.S. BIT by failing to accord fair and equitable treatment ("FET") to Claimant's investment. In particular, Claimant complained about the successive rejection by the authorities of more than 200 applications submitted by Gala for additional broadcasting licenses.

The Tribunal started by defining the FET standard in the BIT. It traced the origins of the FET provision to the 1994 US Model BIT from which it was literally taken, with only the addition of the phrase referring to judicial review. (¶¶ 243-246) The Tribunal observed that the relationship between the FET standard and the international minimum standard of protection of aliens in customary international law has been a highly debated issue. The very definition of the minimum standard is fraught with difficulties. (¶¶ 247-248)

The Tribunal noted that in the context of NAFTA, a binding interpretation issued on July 31, 2001 addressed the issue. NAFTA's interpretative note set the minimum standard as a ceiling of FET. This same proposition was later adopted in the 2004 US Model BIT. (¶¶ 250-251) However, the Tribunal found

that this interpretation was not applicable to the Ukraine-US BIT. In the Tribunal's view, the text of the BIT clearly showed that the US and Ukraine agreed that the minimum standard should operate as a floor – and not as a ceiling – of FET. Thus, investments protected by the BIT should in any case be awarded the level of protection offered by customary international law. However, this level of protection could be transcended if the FET standard provided the investor with a superior set of rights. Finally, the Tribunal found that the actions and omissions of a host State may qualify as unfair and inequitable, even if they do not amount to an outrage, wilful neglect of duty, egregious insufficiency of state actions, or even subjective bad faith. (¶¶ 252-254)

The Tribunal went on to analyze the specific meaning of the FET provision in the BIT (Article II.3). An inquiry into the ordinary meaning of the expression "fair and equitable treatment" did not clarify the meaning of the concept. Given that FET is a term of art, any effort to decipher the ordinary meaning of the words only leads to analogous terms of almost equal vagueness. (¶ 258)

A literal reading of Article II.3 of the BIT was more helpful. According to the words used, Ukraine assumed a positive and a negative obligation: the positive was to accord FET to the protected foreign investments, and the negative was to abstain from arbitrary or discriminatory measures affecting such investments. Although any arbitrary or discriminatory measure, by definition, fails to be fair and equitable, the reverse is not true. An action or inaction of a State may fall short of fairness and equity without being discriminatory or arbitrary. Moreover, the Tribunal explained that to violate FET, it is sufficient for a measure to be either discriminatory or arbitrary (¶¶ 259-260)

The Tribunal then addressed the meaning of Article II.3 in the context of the BIT. In the Preamble of the BIT, the contracting Parties stated "that fair and equitable treatment of investment is desirable in order to maintain a stable framework for investment…." For the Tribunal, it followed that the FET standard is closely tied to the notion of legitimate expectations. Actions or omissions by a host State are contrary to the FET standard if they frustrate legitimate and reasonable expectations on which the investor relied at the time of the investment. (¶ 264)

Finally, the Tribunal considered the object and purpose of the BIT. According to the Tribunal, the object and purpose of the BIT was to stimulate foreign investment and the accompanying flow of capital. (¶ 272) However, for the Tribunal, this purpose was not sought in the abstract, but it was rather inserted in a wider context: the economic development of both signatory countries. Economic development is an objective which must benefit all, primarily national citizens and national companies, and secondarily foreign investors. Thus, for the Tribunal, the object and purpose of the BIT was not to protect foreign investments *per se*, but to promote the development of the domestic economy,

which on its part, requires that the preferential treatment of foreigners be balanced against the legitimate right of a host State to pass legislation and adopt measures for the protection of what, as a sovereign, it perceives to be its public interest. (¶ 273)

In sum, the Tribunal defined FET as an autonomous treaty standard. A breach of FET requires that the acts or omissions of the State violate a certain threshold of propriety. Such threshold is to be defined by each tribunal on the basis of the applicable BIT, and the analysis of an alleged breach should bear into consideration whether the State has failed to offer a stable and predictable legal framework; whether due process was denied to the investor; whether there has been harassment, coercion, abuse of power and other bad faith; whether the actions of the State can be considered arbitrary or discriminatory, among other factors. However, a tribunal must also consider other countervailing factors, such as the State's sovereign right to pass legislation and to adopt decisions for the protection of its public interests, and the investor's conduct in the host country (¶¶ 284-285)

(g) Discrimination (¶ 261)

The Tribunal held that to amount to discrimination, a case must be treated differently from similar cases without justification. (¶ 261)

(h) Arbitrariness (¶¶ 262-263)

The Tribunal observed that arbitrariness has been described as "founded on prejudice or preference rather than on reason or fact"; "…contrary to the law because … [it] shocks, or at least surprises, a sense of juridical propriety"; "wilful disregard of due process of law, an act which shocks, or at least surprises a sense of judicial propriety"; or conduct which "manifestly violate[s] the requirements of consistency, transparency, even-handedness and non-discrimination". Also, Professor Schreuer defined (and the Tribunal in *EDF v. Romania* accepted his definition) as "arbitrary":

> "a. a measure that inflicts damage on the investor without serving any apparent legitimate purpose;
> b. a measure that is not based on legal standards but on discretion, prejudice or personal preference;
> c. a measure taken for reasons that are different from those put forward by the decision maker;
> d. a measure taken in wilful disregard of due process and proper procedure." (¶ 262)

Finally, the Tribunal explained that arbitrariness, in essence, is when prejudice, preference or bias is substituted for the rule of law. (¶ 263)

(i) Legitimate Expectations (¶¶ 266-268)

The Tribunal succinctly considered the historical background of the radio industry in Ukraine and analyzed the moment in which Mr. Lemire made his investment. The Tribunal concluded that on a general level, Claimant could have expected regulatory system for the broadcasting industry to be consistent, transparent, fair, reasonable, and enforced without arbitrary or discriminatory decisions. Although Ukraine and the U.S. reserved the right to make or maintain limited exceptions to the national treatment in the radio sector, Mr. Lemire was in any case entitled to expect that, once he had been awarded the necessary administrative authorization to invest in the Ukrainian radio sector, there would be a level playing field, and that the administrative measures would not be inequitable, unfair, arbitrary or discriminatory. (¶¶ 265-267)

Furthermore, the Tribunal stated that Mr. Lemire undoubtedly had the legitimate expectation that Gala, which at that time was only a local station in Kyiv, would be allowed to expand, in parallel with the growth of the private radio industry in Ukraine. (¶¶ 266-268)

(j) Pursuit of Local Remedies (¶¶ 274-283)

Respondent argued that Claimant was precluded from pursuing his claims in international arbitration due to Claimant's failure to pursue local remedies to challenge the tender decisions. The Tribunal rejected this objection finding that the BIT did not include any clause requiring the initiation or exhaustion of local remedies before the filing of an investment arbitration. The Tribunal distinguished this case from the facts at issue in *Generation Ukraine v. Ukraine* – on which Respondent relied. The Tribunal explained that the test proposed by *Generation Ukraine* was based on reasonableness. A claimant is only required to put in a reasonable effort to obtain the correction of a wrong decision. The Tribunal held that, in the circumstances of the present case, it would have been unreasonable to require Claimant to have fought in Ukrainian Courts the radio frequency adjudication decisions.

(k) Analysis of Claims for Breach of FET (¶¶ 287-421)

The Tribunal explained that its powers were limited to judging whether Respondent had acted in ways that affected Claimant and breached the FET standard enshrined in the BIT. In exercise of such power, the Tribunal analyzed the general legal framework within which the specific conduct took place. (¶ 315)

The Tribunal found that the administrative procedures for the issuance of licenses had several shortcomings: the votes of the members of the National Council were not public, its decisions were not reasoned and there were no clear criteria to evaluate the tenders. These shortcomings jeopardized the possibility of public scrutiny and judicial review, compromised the transparency of the

process, and facilitated arbitrary decision making. While none of these features alone stigmatized the entire tender process as arbitrary, there was a risk that the shortcomings had mutually reinforced each other. (¶ 316)

At the macro level, the Tribunal noted that in 6 years, Gala had presented more than 200 applications for all types of frequencies and was only able to secure a single one. Although these statistics did not provide conclusive evidence that Respondent, in awarding radio licences, violated FET, in combination with other factors – such as the performance of Gala's competitors and the shortcomings in the tendering process – pointed to the fact that at least some decisions of the National Council when it awarded frequencies were arbitrary and/or discriminatory. (¶ 420)

The Tribunal went on to analyze in detail five tenders for radio frequencies and the administrative practice for awarding licences between 1999 and 2000 (period during which the National Council was not operative) to determine whether Respondent had breached the FET standard. The Tribunal concluded that in three of the tenders analyzed, Respondent violated FET. In one case, the President of Ukraine interfered in favour of two competitors, preventing the National Council from taking an impartial decision in violation of the "arbitrariness" test articulated in *Saluka v. Czech Republic*. (¶ 356) In another tender, the Council denied Gala's application only to later award the frequency to another station presumably owned by individuals with political connections. (¶¶ 368-369) In a third case, the tendering requirements were blatantly ignored and the license awarded to one of Gala's competitors, who did not met the necessary criteria. Although not every violation of domestic law necessarily translates into an arbitrary or discriminatory measure under international law and into a violation of the FET standard, in the Tribunal's view, a blatant disregard of applicable tender rules, that distorts fair competition among tender participants, does. (¶ 385) Finally, the Tribunal found that the procedure for awarding licences during the Council's 1999-2000 interregnum also breached the BIT because it facilitated the secret awarding of licences, without transparency or possibility of judicial review, and with total disregard of the process of law. (¶ 418)

(l) Moral Damages in Investment Arbitrations (¶¶ 449- 453, 475-479, 486)

The Tribunal explained that in most legal systems, recoverable damages include not only the *damnum emergens* and *lucrum cessans*, but also moral damages. The Tribunal shared the conclusions reached in the award in *Desert Line Projects v. Yemen* which held that: "Even if investment treaties primarily aim at protecting property and economic values, they do not exclude, as such, that a party may, in exceptional circumstances, ask for compensation for moral damages." However, the Tribunal observed that the circumstances in *Desert Line* were exceptional given the fact that the claimant there had been subjected to physical duress. Conversely, in this case, Claimant did not make any allegation of physical

duress. The question of whether the facts of this case constitute "exceptional circumstances" that merit an award of moral damages was deferred to a further stage in the proceedings. (¶ 486)

(m) The "Umbrella Clause" (¶ 498)

The Tribunal agreed with Claimant in that the umbrella clause brought the Settlement Agreement into the ambit of the BIT, so that any contractual violation became *ipso iure* a violation of the treaty. However, this had no effect on the meaning or scope of the Settlement Agreement. Consequently, since the Tribunal came to the conclusion that Respondent had not breached the Settlement Agreement, then it also concluded Respondent could not have violated the BIT on the basis of the umbrella clause. (¶ 498)

(n) Performance Requirements (¶¶ 505-506, 510-511)

Claimant also argued that a 50% Ukrainian music requirement imposed by Ukrainian law breached the BIT, which does not allow the host state to impose performance requirements. The Tribunal rejected Claimant's contention holding that as a sovereign State, Ukraine had the inherent right to regulate its affairs and adopt laws in order to protect the common good of its people. This right includes the enactment of regulations which define the State's own cultural policy. The promotion of domestic music may validly reflect a State policy to preserve and strengthen cultural inheritance and national identity. Given that other countries also protect national culture by imposing minimum broadcasting requirements, and considering that the 50% Ukrainian music rule is applied to all broadcasters, the Tribunal held that the measure was compatible with the FET standard. (¶¶ 505-506) Similarly, the Tribunal did not find a breach of the prohibition to impose performance requirements. According to the Tribunal, the purpose of this obligation is trade-related: to prevent States from imposing local content requirements as a protection of local industries against competing imports. Conversely, the 50% Ukrainian music rule was meant to protect local culture, and thus, it did not violate the local content rule contained in Article II.6 of the BIT which prohibits "performance requirements … which specify that goods or services must be purchased locally". (¶¶ 510-511)

3. Decision

The Tribunal dismissed Respondent's objections to the jurisdiction of the Centre and the competence of the Tribunal and found that Respondent had not breached any obligations assumed in the Settlement Agreement. However, the Tribunal held that Respondent breached the FET standard under the BIT. All other claims where dismissed. (¶ 513)

Questions regarding the appropriate redress for the breach, including questions of *quantum*, were deferred to a further stage in the proceedings for which the Tribunal retained jurisdiction. (¶ 514)