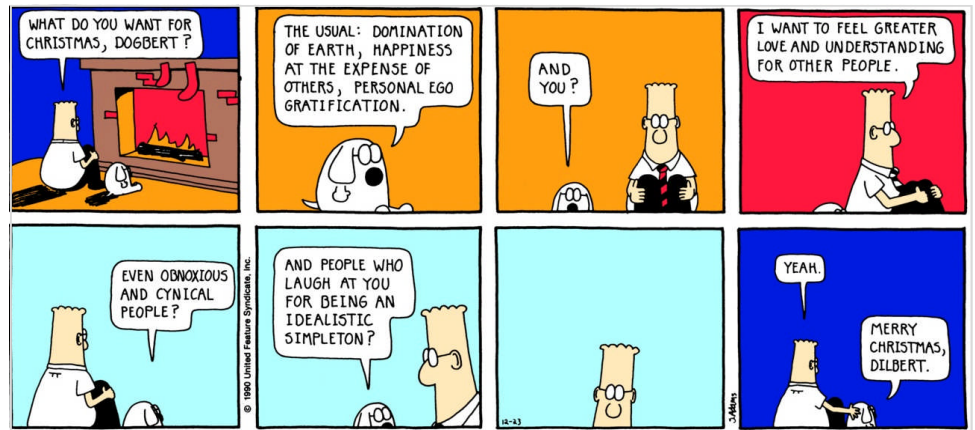


The Arbitrator

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“The Biggest Loser”

by Markus Esly



This title for this article occurred to me because I am on a diet. Excess consumption of food over the Christmas period is reasonably foreseeable, so it may be best to incur some loss in advance.

But the subject of loss is one which leads to legal inspiration. In November 2011, the High Court gave judgment in a case where loss and recoverable damages had to be assessed in very complex factual circumstances. Assessing damages is perhaps the most important part of the judges’ task. Once the innocent party and wrongdoer have been identified, how much compensation should the innocent party receive, in all fairness? Does it still lie in the mouth of the wrongdoer to ‘put the claimant to strict proof’ of damages?

In *Porton Capital Technology Funds v 3M UK Holdings Ltd* [2011] EWHC 2895 (Comm),

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Hamblen J dealt with an argument where counsel for the claimant had reached deep inside the legal box of tricks and pulled out a precedent some 289 years old – so the ghost of quantum past. It was alleged that where proof of loss is complex and evidence is hard to come by, English law may assume the worst in favour of the innocent party, and to the detriment of the wrongdoer. As will be seen, the common law does not in fact go quite so far. The innocent party still has to discharge the burden of proof.

The purpose of an award of damages under English law is to compensate the claimant for loss actually suffered. That loss must be proven, as the House of Lords explained in *Ruxley Electronics Ltd v Forsyth* [1996] 1AC 344 (at 365):

“If [the claimant] has suffered no loss, as sometimes happens, he can recover no more than nominal damages. The object of damages is always to compensate the plaintiff.”

While it is not the purpose of this article to review the English law of damages, it is well-known that in a case for breach of contract, damages should put the claimant in the position he or she would have been in if the contract had been performed. Provided that the relevant loss was caused by the breach, was sufficiently foreseeable (not too remote) and could not have been avoided by taking those reasonable steps in mitigation that the law expects of everyone, damages for breach of contract can (and often do) seek to capture future losses - the chance of profitable revenue streams.

Establishing lost sales, or the value of lost investment opportunities, can never be an exact science. There is an element of conjecture. The Court will decide, on a balance of probabilities, whether the lost sales in question would have taken place, what price they would have fetched, and what the resulting profit would have been.

An ancient tale

The question of how to deal with weighing up the evidence has long exercised the judges. In 1722, the Court, sitting in Middlesex in the height of summer, had to dispense justice in a dispute between an innocent chimney sweep and a pair of altogether more mischievous defendants, a jeweller and his apprentice. Although conspiracy was not pleaded, the master and his apprentice may well have been conniving to cheat the chimney sweep out of some precious stones which the latter had brought in to their shop to have valued. But the stones were lost for all time, and nobody knew quite what they might have been worth. In a model of judicial concision, Pratt CJ handed down the following judgment, all three paragraphs of which are reproduced below (*Armory v Delamirie* [1722] EWHC KB J94):

“The plaintiff being a chimney sweeper's boy found a jewel and carried it to the defendant's shop (who was a goldsmith) to know what it was, and delivered it into the hands of the apprentice, who under pretence of weighing it, took out the stones, and calling to the master to let him know it came to three halfpence, the master offered the boy the money, who refused to take it, and insisted to have the thing again; whereupon the apprentice delivered him back the socket without the stones. And now in trover against the master these points were ruled:

1. That the finder of a jewel, though he does not by such finding acquire an absolute property or ownership, yet he has such a property as will enable him to keep it against all but the rightful owner, and consequently may maintain trover.

2. That the action well lay against the master, who gives a credit to his apprentice, and is answerable for his neglect.

3. As to the value of the jewel several of the trade were examined to prove what a jewel of the finest water that would fit the socket would be worth; and the Chief Justice directed the jury, that unless the defendant did produce the jewel, and shew it not to be of the finest water, they should presume the strongest against him, and make the value of the best jewels the measure of their damages: which they accordingly did.”

It may seem a stretch to go from stating that the ‘claimant has the burden of proof’ to ‘absence of evidence merits the strongest adverse inference’ in a complex commercial trial, but that argument was advanced in our next case, *Porton Capital v 3M*. The crux of the matter was that it was the defendants who had, by their own actions, brought about the lack of evidence. As the authors of their own misfortune, the principle in *Armory v Delamirie* was invoked against them. Hamblen J had to decide whether that was appropriate.

The facts of *Porton Capital v 3M* can be summarised as follows. In February 2007, 3M acquired a company named Acolyte Biomedica. That company had been spun off from the Ministry of Defence. On Acolyte Biomedica's books was an interesting invention, a machine called BaCLite MRSA. It was clinical equipment by which the superbug MRSA (‘methicillin-resistant *Staphylococcus aureus*’) might be detected in a hospital environment.

As part of the sale and purchase agreement under which 3M acquired control over Acolyte Biomedica, 3M might have to make additional payments post-completion that were to be assessed by reference to future sales of BaCLite MRSA. Before Hamblen J, the sellers of Acolyte Biomedica complained that one of the first things 3M did after the acquisition was to mothball the BaCLite MRSA. 3M denied this, explaining to the Court that the BaCLite MRSA had simply been discontinued following poor performance in a clinical environment, which made it commercially unviable.

Hamblen J found that 3M had in fact repudiated the sale and purchase agreement. While English law does not punish a deliberate, culpable, contract breaker any more than an innocent one, this was a case where 3M had made it clear that it did not intend to perform its side of the bargain (so that it met the test for repudiation). 3M had also brought about the situation where there was no sales data for BaCLite MRSA. On

that basis, *Armory v Delamirie* was relied on.

Hamblen J decided that the principle did not operate against 3M. He considered the authorities (discussed further below) and in particular identified a key decision of the Court of Appeal in 2009 which (already) contained the answer. His decision is to be welcomed as two previous High Court decisions from 2010 were altogether less clear on just how relevant the *Armory v Delamirie* principle might be in a commercial dispute.

The principle in *Armory v Delamirie*: when does it apply?

Hamblen J's review and application of the principle was not the first time that it had been relied on. It has reared its head on a number of occasions over the years. The decision of Pratt CJ in *Armory v Delamirie* was described by the Court of Appeal in *Browning v Messrs Brachers* [2005] EWCA Civ 753 as establishing:

"... a general principle to the effect that, in a case where the defendant has wrongfully deprived the claimant of property of value (be it an item of physical property or a chose in action), the court will, save to the extent that it is persuaded otherwise by the defendant, assess the value of the missing property on a basis which is generous to the claimant."

This is a broad statement which, on closer inspection, does not entirely reflect what the jury was actually instructed to do in *Armory v Delamirie*. The goldsmith and the apprentice did not bring the jewel to court, so it could not be inspected. The conduct that led Pratt CJ to give his direction to the jury was the failure to bring the jewel to court, not the deception or the taking of the jewel in the first place. Although one cannot be entirely sure based on the short report, it seems to be assumed that the goldsmith either still had the jewel somewhere (or perhaps had sold it).

That leads to the question whether the principle was ever intended to apply in circumstances where the defendant "deprives" the claimant of contractual rights, or future income, that is never received (and never comes into existence), rather than physical property which exists and may be in the defendant's hands, but is kept out of court.

The High Court considered the principle again in *Double G Communications Ltd v News Group International Ltd* [2011] EWHC 961, a case concerning a "Page 3" inspired adult-themed board game that never made it into production. Likely sales had to be assessed. Eady J commented that he did not think that the principle in *Armory v Delamirie* applied, since the defendant did not have (or hold back) some secret knowledge that would allow damages assessed to be more accurately:

"The situation here is not exactly on all fours, since it is not suggested that [the defendant] is privy to relevant

information, not available to [the claimant], which would help to quantify its loss."

Eady J went on to doubt whether the principle was of much practical help, and focussed on the task of assessing how successful the product would have been on a balance of probabilities, without any further embellishment of the standard he was applying.

While Eady J's comments suggested that the principle required relevant information to be in the defendant's possession, he did refer to other cases that seem to have taken the wider view that the principle (*Fearns v Anglo-Dutch Paint & Chemical Co Ltd* [2010] EWHC 1708 (Ch), a patent infringement case):

"... requires the court to resolve uncertainties by making assumptions generous to the claimant where it is the defendant's wrongdoing which has created those uncertainties."

Eady J was clearly prepared to apply the principle (which remained "alive and well") in the right circumstances, just not in the circumstances before him.

Looking at the (possibly wider) formulation of the principle, the defendant's wrongdoing could of course be said to have "created the uncertainties" simply because the defendant committed a breach of contract which raised complex issues of quantum. Damages might be as uncertain to the claimant as they are to the defendant: nobody knows the answer, and nobody has the corpus delicti to bring before the judge so that it can be valued. One can look at this situation in two ways. One can say that this is a case of a claimant with a speculative claim, or one could seek to invoke *Armory v Delamirie* and blame the defendant for all the uncertainties. It is suggested that the defendant's "wrongdoing" should mean something more than the breach of contract: as will be seen, this is the view that one Court of Appeal finally came to in 2009.

Surveying the field further

The principle in *Armory v Delamirie* has also made appearances in professional negligence cases, for example where solicitors negligently failed to prosecute a claim in court so that the claim was struck out, and lost. The client may claim against the solicitors in negligence, but it might be difficult to assess the true value of the (original) claim. Considering that situation, Diplock LJ has noted that the claimant would be better off pursuing the solicitors for negligence than he or she would have been in pursuing the original defendant (*Allen v Sir Alfred MacAlpine & Sons Ltd* [1968] 2 QB 229). In any claim against the solicitors:

"Not only would there be available to him any advice or material which he had been given or obtained by his solicitor in support of his case in the dismissed action, but

the principle of Armory v. Delamirie ... would apply and would impose on the solicitor the onus of satisfying the court that the plaintiff's claim in the dismissed action would not have succeeded had it been prosecuted with diligence. This would be a heavy onus to sustain after so great a lapse of time."

However, it would be wrong to think that the principle can shift the legal burden of proof (who has to lead evidence) to the defendant solicitors. In *Sharif v Garrett & Company* [2001] EWCA Civ 1269, the Court of Appeal clarified that assessing the claimant's loss was a two-stage test. In the first instance, the claimant had to prove that something that could be of value had been lost. In a professional negligence claim, that meant asking whether the prospects of success of the 'claim-that-never-was' were negligible. Secondly, if that hurdle is overcome, the court has to make a "realistic" assessment of the prospects of success. At this stage:

"the Armory v Delamirie ... principle comes into play in the sense that the court will tend to assess the claimant's prospects generously given that it was the defendant's negligence which has lost him the chance of succeeding in full or fuller measure"

Rather than reversing the legal burden of proof, *Armory v Delamirie* therefore gives the claimant a helping hand when valuing property of which the claimant had been deprived.

The professional negligence cases shed no further light on the question whether, to bring the principle into play, the defendant must have been guilty of any other "wrongdoing" beyond the breach of duty that creates the claim. One way of explaining the ready application of the principle in these types of cases is that the solicitors were bound to advise on and prosecute the claim. In a sense, they are entrusted with the property (the client's cause of action) that is then lost.

A fair wind: how strong does it blow?

If the principle does apply, what effect does it have? As Jonathan Parker LJ said in *Browning v Messrs Brachers*:

"I respectfully agree that the principle in Armory v. Delamirie is not directed at the legal burden of proof; rather it raises an evidential (i.e. rebuttable) presumption in favour of the claimant which gives him the benefit of any relevant doubt. The practical effect of that is to give the claimant a fair wind in establishing the value of what he has lost."

One may pause and consider how 'a fair wind' might operate in practice. Jonathan Parker LJ described the principle as a rebuttable presumption that doubt is to be resolved in favour of the claimant. Assume that on weighing the evidential scales, the judge is almost, but not quite, persuaded that a prediction of future sales would have come to pass –

say the scales show '49%'. How much leeway can the judge give the claimant? The principle would introduce further judicial discretion (in effectively lowering the burden of proof), and therefore a greater element of subjectivity. In reality, assessing the evidence will always depend on how the judge sees it subjectively. However, when it comes to the legal guidance for how that job is to be done, it seems better to rely in all cases on the 'balance of probabilities' test, which is a more tangible concept than the idea of a 'fair wind'.

The principle is said to be a rebuttable presumption that operates when the defendant has deprived the claimant of property – perhaps only if the defendant has done something more than acted in breach of contract. How could the presumption be rebutted? Does the defendant have to lead some evidence as to the value of the property in question? That would seem to be the wrong kind of evidence to rebut the presumption, because it would reduce the uncertainty (presumably in the defendant's favour), by tipping the evidentiary scales. That kind of evidence would reduce the 'doubt', the 'benefit' of which is to be given to the claimant under the principle. Or does the defendant have to rebut the presumption by leading evidence that his wrongdoing was not in fact sufficiently serious (though it might seem otherwise at first glance), so that the principle should not be applied?

A cautionary approach

Neither of the two High Court decisions handed down in 2010 discussing the principle (*Fearn v Anglo Dutch* and *Double G v News Group*) made reference to an earlier decision of the Court of Appeal in which the application of *Armory v Delamirie* was carefully reined in (*Zabih v Janzemini & Ors* [2009] EWCA Civ 851). Moore-Bick LJ stressed that the requirement for the claimant to prove his loss on a balance of probabilities was a crucial part of the common law's approach to damages. It was not generally appropriate for the Court to assume:

"the existence of facts that are most favourable to the claimant. It can, perhaps, be justified in a case where the defendant has wilfully suppressed evidence that would otherwise have been available to the claimant to enable him to prove his case, but I find it difficult to accept that the inability to make the goods available for inspection is of itself sufficient for that purpose. In the absence of evidence to the contrary, it would seem more logical to assume that the goods were of fair average quality rather than the best or worst of their kind."

The Court of Appeal also noted that the defendant's destruction of evidence might need to be deliberate or wilful before the principle could apply.

Returning to Hamblen J and the accusation that 3M had

'wilfully' prevented the BacLite MRSA from being sold, the learned judge referred to the above statement by the Court of Appeal in *Zabihi*. Even though 3M had been found to have repudiated the contract, they were not the kind of wrongdoer. Hamblen J stated that the case before him was neither a case of professional negligence nor a case of someone wantonly destroying or suppressing evidence. Rather, it was an ordinary claim for damages – lost profits, to be exact. Evidence was before the court, and the “evidential playing field was a level one”. Conjecture, or seeking to make the best finding on the available evidence, is a common feature in complex damages claims. In all such cases the defendant’s breach made that conjecture necessary. In light of these observations, Hamblen J held that:

*“As a matter of authority there is no requirement to apply the principle of *Armory v Delamirie* to a case such as the present, and as a matter of principle I consider that there is good reason not to do so and that the application of the principle should not be extended further than is necessary.”*

Conclusion

Hamblen J’s clear statement of principle on the relevance of this venerable rule is to be welcomed. Modern English commercial law has never tended to punish or penalise a deliberate contract breaker (though a claim for repudiatory breach and future profits can be very painful in financial terms). There are two parts to every claim, liability and quantum, and the common law should and does not prejudge matters. Hamblen J was not, of course, able to go against or curtail the Court of Appeal judgments that relate to professional negligence or where there really has been a wanton destruction of evidence. But beyond those two limited categories, it seems clear that now the ghost of *Armory v Delamirie* has been banished to its grave. ©

Legal advice privilege and choice of law in international arbitrations seated in England (Christmas special)

by Robert Blackett



A party to English litigation is usually required to make a reasonable search for documents which are or have been in its control which are relevant to the matters in issue, in the sense of adversely affecting its own case, adversely affecting another party’s case or supporting another party’s case. The existence of these documents

must then be disclosed, and the other parties will then be entitled to inspect and, in practice, to take copies of these documents for use in the litigation.¹

An exception exists for documents which are subject to “legal advice privilege”.² This “... attaches to all communications made in confidence between solicitors and their clients for the purpose of giving or obtaining legal advice ...”.³ And, for this purpose “solicitors” includes foreign lawyers.⁴ The effect of the doctrine and its rationale have been summarised as follows by Baroness Hale:

“Legal advice privilege restricts the power of a court to compel the production of what would otherwise be relevant evidence. It may thus impede the proper administration of justice in the individual case. This makes the communications covered different from most other types of confidential communication, where the need to encourage candour may be just as great. But the privilege is too well established in the common law for its existence to be doubted now. And there is a clear policy justification for singling out communications between lawyers and their clients from other professional communications. The privilege belongs to the client, but it attaches both to what the client tells his lawyer and to what the lawyer advises his

¹ See generally CPR Part 31.

² This article does not consider questions of litigation privilege, joint and common interest privilege, without prejudice privilege or public interest immunity.

³ *Three Rivers District Council v Bank of England* [2003] EWHC 2565 (Comm) HL per Lord Rodger at paragraph 50.

⁴ See e.g. Thanki *The Law of Privilege* (2006) at 2.46: “communications with foreign lawyers also attract legal professional privilege”.

client to do. It is in the interests of the whole community that lawyers give their clients sound advice, accurate as to the law and sensible as to their conduct. The client may not always act upon that advice (which will sometimes place the lawyer in professional difficulty, but that is a separate matter) but there is always a chance that he will. And there is little or no chance of the client taking the right or sensible course if the lawyer's advice is inaccurate or unsound because the lawyer has been given an incomplete or inaccurate picture of the client's position.”⁵

Some countries, whose legal systems are not derived from the English common law, take a very different approach. Their courts may impose no, or only a very limited, obligation to search for adverse documents, with the result that the concept of documents being ‘privileged’ from disclosure either does not exist, or exists only in a very narrow sense, for example through a rule that lawyers may withhold correspondence with their clients from public officials exercising criminal or administrative powers of search and requisition.

When might legal advice-privileged documents be relevant to an issue in a commercial arbitration?

In articles such as this, it is common to talk about ‘privileged documents’ entirely in the abstract. It is important to realise that this is not a dry, academic issue, but that such documents may have a real significance.

A client’s request for legal advice will usually set out their understanding of the factual situation with respect to which they want advice. It will therefore serve to evidence that person’s state of knowledge at the time they made the request, and also their intentions and motives. The advice they receive will usually summarise, or restate, what the lawyer has been told about the factual position. It will also set out the legal advice itself, and so will go to evidence the client’s knowledge of that advice.

When might any of these facts (as to the client’s knowledge and state of mind) be relevant to an international commercial arbitration? Most such arbitrations are concerned with contracts which, at least in English law, impose strict obligations – a liability will follow if one breaches a contract, whatever one’s state of mind in doing so. It would, however, be wrong to conclude that the parties’ states of mind will therefore never be relevant to commercial, contractual disputes. The following are just a few examples of how a party’s knowledge or state of mind might become relevant to such a dispute:

(a) When interpreting a written contract, one asks what the

document would convey to reasonable person having all the background knowledge which would reasonably have been available to the parties at the time.⁶ A privileged document might go to evidence what this was.

- (b) In some jurisdictions, different measures of damages may be available, depending on the state of a party’s knowledge when it breached a contract, distinguishing between cynical, deliberate, knowing breaches, and innocent breaches.
- (c) Depending upon the tribunal, evidence as to a party’s thoughts and motives, even if these are of no relevance to any of the issues in dispute, may be taken as going to character and credibility, and serve a purely prejudicial purpose.
- (d) Many arbitrations concern contracts for the provision of professional services and claims that these were performed negligently, or in breach of a contractual duty of care. A tribunal applying the English law will enquire as to what a reasonably careful, skilful and competent professional would have done in the circumstances, and the facts which were known to the professional will form part of those circumstances.
- (e) States of mind may be relevant in claims involving fraud, claims under the *Misrepresentation Act 1967* or claims in the tort of negligent misstatement and similar claims in other legal systems. A privileged document might, for example, show whether a party really relied on some statement made by another, or might show whether a person who made a statement knew or believed it to be untrue, or was reckless as to its truth.
- (f) Contractual exclusion and limitation clauses often provide that they do not apply to e.g. “wilful” “deliberate” or “reckless” breaches, and a party’s knowledge and intentions will be relevant to determining whether its breaches fall into these categories.
- (g) In some cases, a party will be seeking to recover in respect of settlement monies it has paid to a third party, and the question will arise whether the settlement was “reasonable”.⁷ It is sometimes argued that the legal advice which a party received at the time, in deciding whether to make the settlement, is relevant to this issue.

How might a question as to whether a relevant document is legal advice-privileged arise for decision by the arbitral tribunal?

In international arbitration, an issue as to whether a relevant document is ‘privileged’ might arise in one of three main ways:

⁵ *Three Rivers District Council v Bank of England* [2003] EWHC 2565 (Comm) HL per Baroness Hale at paragraph 61.

⁶ *Investors Compensation Scheme v West Bromwich Building Society* [1997] UKHL 28.

⁷ Such claims might arise by way of contribution, or under the principle in *Biggin v Permanite* [1951] 2 KB 314. Similar issues can sometimes arise in respect of contracts of liability insurance.

- (a) The parties may agree that there is to be a formal disclosure process, in the course of which one party identifies that it is withholding a document, on the grounds of privilege. The other party applies to the tribunal, for an order that a copy of the document be provided.
- (b) A party may seek to rely on part only of a privileged document, or a course of privileged correspondence, in its evidence. Alternatively a witness might give evidence as to the advice which they received. The other party applies to the tribunal seeking the unredacted document, the rest of the correspondence, or the documents containing the advice the witness referred to.
- (c) A party may obtain a document and seek to rely on it evidence. The other party raises an objection and asks that the tribunal exclude this evidence on grounds of privilege. This scenario might arise, for example, where the other party has stolen the document, obtained it through duress, trickery or bribery or simply been sent the document by mistake.

How does this give rise to a conflict of laws question?

A typical dispute will be as follows. One party will claim that the tribunal should apply the law of (say) Lapland to decide whether the document is privileged, and will further claim that according to this law the document is not privileged. The other party will deny that this is the law of Lapland but will argue that, in fact, the law of (say) the North Pole should be applied to determine the question and that according to that law, the document is definitely privileged. The first party may in turn deny that this is the effect of the law of the North Pole.

(Aside: I know that Lapland is a region which includes parts of Norway, Sweden, Finland and Russia, that it is not a country and that it has no single system of law. I also know that the North Pole is not a country and is technically in international waters. I have nonetheless chosen these to serve as “countries” for the purpose of my above example, in an attempt to make this article more festive, since Father Christmas is now commonly portrayed as living in one or other of these places. Usually with elves.)

Of course, in theory, there are at least six different systems of law which one party or another might assert as having some claim to determining the question whether a particular document is privileged:

- (a) the law applicable to the substantive agreement which is the subject of the arbitration;
- (b) the law of the seat;
- (c) the law of the arbitration agreement;
- (d) the law applicable to any contract which governed the relationship between the lawyer and the client, and pursuant to which the advice was sought or given;

- (e) the law of the place in which the lawyer practiced; and
- (f) the law of the place where the advice was received.

Conflict of laws in arbitrations seated in England, Wales or Northern Ireland

Part I of the *Arbitration Act 1996* applies to arbitrations which have their seat in England and Wales, or Northern Ireland. Sections 34 and 46 of that Act are potentially relevant to the question of what law the arbitrator should apply to determine the question as to whether a document is privileged from disclosure / inadmissible.

“34 Procedural and evidential matters

34(1) It shall be for the tribunal to decide all procedural and evidential matters, subject to the right of the parties to agree any matter.

(2) Procedural and evidential matters include-

...

(d) whether any and if so which documents or classes of documents should be disclosed between and produced by the parties and at what stage;

...

(f) whether to apply strict rules of evidence (or any other rules) as to the admissibility ... of any material sought to be tendered ...”

“46 Rules applicable to substance of dispute.

(1) The arbitral tribunal shall decide the dispute—

(a) in accordance with the law chosen by the parties as applicable to the substance of the dispute, or

(b) if the parties so agree, in accordance with such other considerations as are agreed by them or determined by the tribunal.

(2) For this purpose the choice of the laws of a country shall be understood to refer to the substantive laws of that country and not its conflict of laws rules.

(3) If or to the extent that there is no such choice or agreement, the tribunal shall apply the law determined by the conflict of laws rules which it considers applicable.”

Is a question as to whether a document is admissible / disclosable in an arbitration by reason of privilege properly to be characterised as a “procedural and evidential matter”? Section 34(2)(d) and (f) suggest that it is.

Assuming that is correct, one must therefore ask whether the parties have themselves agreed as to how questions of privilege are to be dealt with and, in particular, whether the law of Lapland or the law of the North Pole is to apply in order to

determine that question. The question of when there might be said to be such an agreement is returned to below.

Assuming no such an agreement, the issue of whether a document is privileged would be “*for the tribunal to decide*”. But s.34 is silent on the question of *how* the tribunal is to decide that question (i.e. according to what law). Presumably, therefore, the tribunal must apply s.46 to determine this question.

Section 46 first requires the tribunal to ask whether the parties have made any agreement as to what law the tribunal is to apply to determine issues of privilege. If the parties have already been held to have made no agreement for the purposes of s.34, then it will be difficult to argue that there is an such agreement for the purpose of s.46. Absent an agreement, then, the tribunal must: (i) decide which conflict of law rules it considers are applicable; and (ii) apply those rules.

What conflict of laws rules might a tribunal “*consider applicable*”? There is no clear answer. EC Regulations 593/2008 (“*Rome I*”) and 864/2007 (“*Rome II*”) govern choice of law before the courts of all the EU Member states, but do not offer any guidance on what law should apply to govern a claim of privilege. Before the English courts, the answer would be simple:

“The cases demonstrate that the English courts apply the simple rule under English conflict of law rules that it is the lex fori that applies to determine whether a communication is privileged”⁸

Dicey, Morris & Collins suggests that, for an arbitration, the appropriate conflict of law rule is that questions as to privilege are to be determined according to the “*lex arbitri*”, which usually means the law of the seat (emphasis added):

“in general arbitral proceedings are governed by the law of the seat of the arbitration.”⁹

“The concept of the procedural law of an arbitration (or lex arbitri) is not adequately explained as merely synonymous with procedural law in litigation, and is not to be circumscribed by the same rules which apply to distinguish procedure from substance in the conflict of laws generally. In essence the procedural law of an arbitration deals with two sets of issues: (a) the internal procedure of the arbitration itself: commencement of the arbitration, appointment of arbitrators, pleadings, provisional measures, evidence, hearings and awards; and (b) the external intervention of national courts in the arbitral process.”¹⁰

Therefore the law which an English seated tribunal should apply to decide the question of whether a document is privileged, such that it may be withheld from disclosure or not admitted in evidence, should be the law of England. But it is necessary to be clear about what the law of England means in this context.

There is no English law, in any strong sense, on most procedural and evidential questions in arbitration. For example, what is the law of England as to what the timetable for an arbitration is required to be, whether witnesses should give evidence orally or in witness statements in an arbitration, whether there is to be a disclosure obligation and how extensive it is to be? The law of England on these questions is really only that they are to be decided by the tribunal in its discretion, subject to the tribunal’s duty under s.33 of the *Arbitration Act 1996*.¹¹

There is, of course, extensive English law on the question of when documents will be privileged from disclosure in *court proceedings*, but there is no English law on the question of when documents will be privileged from disclosure in arbitrations, any more than there is English law on what must be disclosed in arbitrations. If this reasoning is correct, then it seems to follow that an English seated tribunal can therefore discount all the English authorities as to when documents are privileged, and simply decide what it thinks is fair.

The problem with such a conclusion is that we are accustomed to thinking and talking about a party’s privilege in a document as if it were a substantive – and fundamental – right of that party – to retain that document and to have no adverse inference drawn as a result. So Baroness Hale (in the quote at the beginning of the article) speaks of privilege as “*belonging*” to a client, and of the public interest the right serves.

A question of privilege is thus unlike any other procedural question. If a party to an arbitration wishes a hearing to be held on a particular day, or for witnesses to give their evidence orally rather than in writing, it will seek to persuade the tribunal to exercise its discretion accordingly, by arguing that (for whatever reason) one course of action is to be preferred over another. It will not claim that it actually has a positive *right* to have these questions determined in a particular way.

Also, consider the position where parties have expressly agreed that e.g. “*any dispute as to the privileged status of any document is to be determined according to the law of England and Wales*”. It would be surprising if this were held to mean that privilege was to be determined according to the tribunal’s discretion because, strictly, the English law on privilege was

⁸ Thanki *The Law of Privilege* 2nd Ed. (2011) at 4.79.

⁹ Dicey Morris & Collins *The Conflict of Laws* 14th Ed. (2006) at 16R-001 Rule 57(2).

¹⁰ Dicey Morris & Collins *The Conflict of Laws* 14th Ed. (2006) at 16-029.

¹¹ Section 33 provides that the tribunal shall “(a) *act fairly and impartially as between the parties giving each party a reasonable opportunity of putting his case and dealing with that of his opponent, and (b) adopt procedures suitable to the circumstances of the particular case, avoiding unnecessary delay or expense, as to provide a fair means for the resolution of the matters falling to be determined*”.

concerned solely with whether documents had to be disclosed in court proceedings.

The fact a document is privileged as a matter of English law should be taken to mean something more than just that it may be withheld from disclosure in English court proceedings. Rather, one could argue that this is a right to withhold the document from disclosure in *any* proceedings, at least absent clear, express law to the contrary. So, for example, when statutory search powers are exercised the privilege holder usually has a right to withhold privileged.¹²

In support of the view that an English seated tribunal is required to extend the same protection to privileged documents as would an English court, one can point to s.68 of the *Arbitration Act 1996* which permits an award to be challenged for ‘serious irregularity’, which is defined so as to include “*the award or the way it was obtained being contrary to public policy*”. Thanki argues that, in deciding whether documents must be disclosed under s.34(2)(d):

“If privilege is properly regarded as a matter of overriding public policy, then the tribunal would be obliged to give protection at least as wide as the English rules.”

If that is correct then, rather than deciding the question in its discretion, the tribunal would be required to consider whether the document would be privileged from disclosure before the English courts and – if so – to hold that it is also privileged from disclosure in the arbitration.

An agreement as to how the tribunal is to decide issues of privilege

The exercise described above only falls to be carried out if there is no agreement between the parties as to what law the tribunal should apply to determine issues of privilege.

In a commercial context, the position will usually be that there is a contract between the parties which will contain both a choice of law and an arbitration clause. Of course, it is unlikely that a party will have thought to say expressly in a choice of law clause “*any dispute about the privileged status of a document which arises in the course of any arbitration in respect of this contract shall be determined in accordance with the law of the North Pole*”.

Suppose that the law of the North Pole did not recognise the concept of privilege (it perhaps being thought irrelevant in a land where the final tribunal always knows whether one has been bad or good anyway, and where almost everyone is good,

for goodness sake). It does not really seem arguable that a tribunal faced with a clause like that above should nonetheless apply English law as the law of the seat, and uphold the privilege in the contested document. There would seem to be no public policy interest in imposing the English law standard in the face of a contrary prior agreement.

One will not come across a clause like the one above very often. Nonetheless, it will often be possible to read the choice of law clause in a contract as extending to a dispute about the privileged status of a document. Consider a clause which read: “*this contract and any dispute arising out of or in respect of it or its subject matter shall be governed by the law of the North Pole*”. A dispute about the disclosability of a document in the context of an arbitration about the rights and obligations of the parties under the contract is arguably a dispute which itself ‘arises out of’ the contract.

Suppose the choice of law clause were worded more narrowly: “*this contract shall be governed by the law of the North Pole*”. Even then, it must be arguable that a dispute about privilege which arose in the context of a dispute about the contract is covered by these words, or that further words to that effect fall to be implied as the unspoken intention of the parties, it being unlikely that they would have wanted a multiplicity of laws to apply in the context of any subsequent arbitration.

There is no direct authority on the point, but a useful analogy can be seen in Lord Hoffmann’s judgment in the *Fiona Trust* case.¹³ His Lordship referred to a number of past decisions which concerned the interpretation, not of choice of law clauses, but of arbitration clauses. In these cases parties had variously (and on occasion successfully) argued that phrases such as “*arising out of*”, “*arising under*”, “*arising in connection with*” bore different meanings, and that certain disputes might be caught by one but not by another. His Lordship stated that: “*I do not propose to analyse these and other such cases any further because in my opinion the distinctions which they make reflect no credit upon English commercial law.*” His Lordship went on to set out the common sense principles which are henceforth to be applied to the construction of arbitration clauses:

“In my opinion the construction of an arbitration clause should start from the assumption that the parties, as rational businessmen, are likely to have intended any dispute arising out of the relationship into which they have entered or purported to enter to be decided by the same tribunal. The clause should be construed in accordance with this presumption unless the language makes it clear that certain questions were intended to be excluded from

¹² So, for example, the investigative powers of the police under the *Police and Criminal Evidence Act 1984* do not extend to privileged documents. In *AM&S v Commission of the European Communities* 155/79 it was held that the confidentiality of communications between lawyer and client was a common principle of community law, and the investigative powers of the Commission did not permit it to seize or compel the production of such documents, albeit that the protected class of documents is defined more narrowly in EU law than under the laws of England and Wales.

¹³ *Premium Nafta Products Limited and Ors. v Fili Shipping Company Limited and Ors.* [2007] UKHL 40.

the arbitrator's jurisdiction."

In addition to *Fiona Trust*, the argument also draws support from the approach which is taken when seeking to determine what law applies to govern the arbitration agreement:

*"Where the substantive contract contains an express choice of law clause, but the agreement to arbitrate contains no express choice of law clause, the latter agreement will normally be governed by the body of law expressly chosen to govern the substantive contract."*¹⁴

*"In the absence of exceptional circumstances, the applicable law of an arbitration agreement is the same as the law governing the contract of which it forms a part."*¹⁵

*"Since the arbitration clause is only one of many clauses in a contract, it would seem reasonable to assume that the law chosen by the parties to govern the contract will also govern the arbitration clause. If the parties expressly choose a particular law to govern their agreement, why should some other law – which the parties have not chosen – be applied to one of the clauses in the agreement, simply because it happens to be the arbitration clause?"*¹⁶

*"If there is an express choice of law to govern the contract as a whole, the arbitration agreement will also normally be governed by that law."*¹⁷

*"there is a very strong presumption in favour of the law governing the substantive agreement which contains the arbitration clause also governing the arbitration agreement. This principle has been followed in many cases. This could even be implied as an agreement of the parties as to the law applicable in the arbitration clause."*¹⁸

The case can, however, be argued the other way, and the reasoning in *Fiona Trust* and the arbitration clause cases can be distinguished as follows. Any time a contract is made subject to the law of one country, but provides for the arbitration to be seated in another, then the parties have necessarily chosen to have at least two different laws apply to govern different aspects of their relationship, because a different law will apply to the substance of the dispute to that which governs the

procedure of the arbitration.

A party which has chosen to arbitrate in England rather than at the North Pole, even though the contract is subject to the law of the North Pole, has arguably done so for a reason. It might well be that the procedural safeguards offered by English law as the *lex arbitrii* and the supervisory jurisdiction of the English court were part of that reason. The parties may well have expected that, by arbitrating in England rather than resolving their dispute entirely according to the laws of the North Pole, they would thereby escape the procedural laws of the North Pole, with its refusal to recognise legal privilege. There would seem to be a strong argument, therefore, in favour of privilege being determined according to the law of the seat, absent a clear indication to the contrary. Ultimately, though, it will be question of the construction of the individual agreement.

It has to be borne in mind that not all arbitrations are arbitrations about contracts, and that not all contracts feature choice of law clauses. In those cases one could not say that the parties had made an agreement as to how questions of privilege would be decided. Rather, those issues would probably fall to be decided according to the law of the seat, for the reasons already discussed.

Of course, the way to avoid all the conflict of laws problems discussed in this article is for the parties to make sure that the law of the seat and the applicable law of their contract are the same. So the contract would expressly provide for disputes to be subject to arbitration in London, and also for the contract to be subject to the law of England. Then the question of whether privilege is properly a matter for the governing law of the contract or for the law of the seat falls away, because both are the same.

Could other legal systems nonetheless operate to determine a question of privilege in an English seated arbitration?

The choice of law rule in s.46 of the *Arbitration Act 1996* provides that there is to be no *renvoi* – a choice of laws of a country shall be understood to refer to the substantive laws of that country, and not its conflict of laws rules.

In the privilege field, the distinction between conflict of laws rules and substantive law might not be obvious, at least in theory. Consider a situation where the parties have agreed that the law of the North Pole is to apply to determine issues of privilege. Then assume that the North Pole's courts recognise legal advice as privileged unless it would not have been treated as privileged before the courts of the place where it was created. Is that a rule of substantive law (which the tribunal should apply) or a choice of law rule (which the tribunal should ignore)?

It is increasingly common for parties to arbitrations to agree (though usually after the event rather than in advance) that

¹⁴ *Sonatrach Petroleum Corporation (BVI) v Ferrell International Limited* [2001] EWHC 481 (Comm) per Coman J.

¹⁵ *Svenska Petroleum Exploration AB v Government of the Republic of Lithuania (No. 2)* [2005] EWHC 2437 (Comm) at paragraph 76 per Gloster J.

¹⁶ A. Redfern and M. Hunter (eds.) *Law and Practice of International Commercial Arbitration* 4th Ed. (2004) at 2-86.

¹⁷ Dicey Morris & Collins *The Conflict of Laws* 14th Ed. (2006) at 16-017.

¹⁸ Lew QC *The Law Applicable to the Form and Substance of the Arbitration Clause* ICCA Congress Series No. 14, 1998, Paris quoted in *Redfern & Hunter on International Arbitration* 5th Ed. (2009) at 3.12.

their dispute will be subject to the IBA Rules on the Taking of Evidence in International Arbitration. This article is not the place to attempt a detailed commentary, but it is worth noting the following provision:

“Article 9 Admissibility and Assessment of Evidence

2. *The Arbitral Tribunal shall, at the request of a party or of its own motion, exclude from evidence or production any Document ... for any of the following reasons:*

...

(b) legal ... privilege under the legal ... rules determined by the tribunal to be applicable.”

...

3. *In considering issues of legal impediment or privilege under Article 9.2(b), and insofar as permitted by any mandatory legal or ethical rules that are determined by it to be applicable, the Arbitral Tribunal may take into account:*

(c) the expectations of the Parties and their advisors at the time the legal impediment is said to have arisen.”

Assume an English seated arbitration, where the *lex causi* and the *lex arbitri* are both English law but which concerns a dispute between two parties from Lapland, and which the parties have agreed is to be subject to the IBA Rules. Assume that disclosure is sought of a document (say a Christmas list sent to the Santa Corporation) which would not be privileged before the courts of England, because it was not made for the purpose of seeking legal advice. Suppose however, that the law of Lapland recognises an absolute confidence in such documents, and permits them to be withheld from disclosure in court proceedings, and that the list was made and received in Lapland.

In these circumstances, an English court would ignore the law of Lapland, and hold that the document was not privileged. An English seated tribunal, however, might consider that Article 9.3(c) operates to allow the law of Lapland into the arbitration via the back door (or down the chimney, if one would prefer), and apply to the document the wider protection which would the law of Lapland would apply.

Article 9.2(b) only permits the parties’ expectations to be considered “*insofar as permitted by any mandatory legal rules that are determined by it to be applicable*”. As such, it seems that this Article might cause a privilege to arise where it would not exist under the applicable law, but probably couldn’t deprive a party of a minimum protection which arose under the applicable law. So, assume a tribunal has found that issues of privilege fall to be determined according to the law of England and that a particular document is privileged according to that law. The party seeking disclosure could not succeed in an

argument that there should nonetheless be no such protection, because they were domiciled in and were dealing in a country which would not recognise such a privilege.

Is the English position satisfactory?

Born argues that:

“The conflict of laws principles developed in the context of international litigation [before the US courts]¹⁹ should, in principle, be relevant to in international arbitral proceedings. This litigation has usually concerned the privileges associated with legal advisers. In the United States, courts have looked to the centre of gravity or base of communications, often applying the law of the jurisdiction in which the lawyer whose communications are at issue is qualified. Other authorities have looked to the jurisdiction with which communications have their “closest connection”, often applying the law of the place where the communication was made or the client is located.

Where legal privileges are concerned, applying the law of the place where the lawyer is qualified to practice is generally the better solution, from the perspective of predictability and conforming to the parties’ expectations. The place where the communication was made is often fortuitous, in international matters, and may have little to recommend it.”²⁰

A first point to note is that the position described does not reflect the approach of the English courts and (for the reasons set out at length in this article) is also not the approach which should properly be followed in an international arbitration seated in England.

It is also hard to see why a rule based on the place where the lawyer is qualified to practice should necessarily be predictable or reflective of the parties’ expectations:

- (a) Many international lawyers are dual qualified – what rules of privilege should a client expect to apply to the advice which it receives from them? Even more often, the final advice which a client receives will represent an amalgamation of advice from different sources, and lawyers qualified in a variety of jurisdictions will have contributed to it. In the international arbitration field, it is very common for lawyers to be qualified in the laws of one jurisdiction but to live and work in another.
- (b) A company is proposing to enter a contract subject to the

¹⁹ That Born is principally concerned with the conflict of laws rules applied before courts in the US is apparent from the accompanying footnote, which refers to Born and Rutledge *International Civil Litigation in United States Courts* 4th Ed. (2007).

²⁰ Born *International Commercial Arbitration* (2009) at p1914.

laws of a foreign country, and seeks the advice of locally qualified lawyers. Is that company expected to ascertain what the local law on privilege is before seeking such advice? Most people would never even consider what the local law on privilege might be, and so the idea that it will “conform with their expectations” is unsustainable.

- (c) A commercial party will often obtain its legal advice from a single law firm from the same country as itself which, when foreign law advice is needed, will procure this for the client and deal with the foreign lawyers. The client’s relationship is with the firm and, again, so far as it has any expectations regarding the advice it receives, they are unlikely to involve the local law on privilege.
- (d) The idea of adopting a rule which “conforms with the parties expectations” is, in any event, somewhat suspect. What the parties expect will be shaped by their knowledge and experience. I expect an English court to apply the *lex fori* to determine questions of privilege. A US lawyer, by Born’s account, might variously expect that a US court will apply the law of the place where the communication was made, the law of the place where it was received, or the law of the place where the lawyer was qualified. Is one expectation somehow more sensible, or natural than the other? Is one rule ‘true’ *a priori*, such that it is that rule which one would expect a tribunal to adopt if one were ignorant of the approach which it takes in practice?
- (e) As noted above, a party will presumably have chosen the seat of the arbitration for a reason, probably on the recommendation of its lawyers who will be accustomed to disputes in that jurisdiction and (usually) also familiar with its substantive law. English lawyers (if they consider the point at all) will tend to assume that the law of the seat will govern questions of privilege, in line with the simple, straightforward rule which is adopted by the English courts, and will make their choice in light of that expectation.

Conclusion

In practice, it is very common for parties from different legal cultures to raise arguments about privilege and for a party seeking documents to argue that the law of its home territory (or something very similar) is appropriate, in an attempt to gain an advantage before the tribunal.

In English seated arbitration, questions of privilege are likely to be determined according to either to the law of the seat or, possibly, according to the *lex causi*, the latter being deemed to be the law which the parties intended should apply to resolve all their disputes, including disputes as to privilege which arise in the context of arbitration. In many cases there will be scope for argument and so disputes about which law to apply will continue to arise.

Parties which were unsatisfied with this position, and wished to avoid such disputes, could include an express provision in their arbitration clause, e.g.: “*The tribunal shall apply English law (excluding its conflict of law rules) to determine any issue as to legal privilege, or any analogous issue, which arises in the arbitration.*” In practice, such clauses are not in common use. Perhaps consider amending the arbitration clause in your Christmas list accordingly. ☺

“Good King Wenceslas walked out – and the Kingdom was split in two.” - State Succession and Bilateral Investment Treaties

by Melanie Willems



Foreign investors who lose out through the actions of the host state where they have made their investment may be able to bring a claim under a bilateral investment treaty (“BIT”). But what happens if the host state ceases to exist, or splits - so that part of its territory becomes independent? A state may be extinguished through revolution or conquest, it may be annexed by another state, or it may split through secession. Does the investor’s protection under international law vanish together with the original state party to the BIT? What happens if a new government comes to power and renounces the treaties or state concession contracts of its predecessors?

Recent events in Sudan, Egypt and Libya serve to highlight the issue of whether there has been ‘state succession’, and— if so—what the effect of a succession might be on the former state’s obligations under BITs. Obviously enough, a mere change of government is not the same as state succession. In this article, we consider the general position under international law when new states are created.

An uncertain area

Questions of state succession can give rise to considerable uncertainty. Commentators have noted a lack of consensus amongst state practice in this field. Some 35 years ago, *Jennings* remarked that there was a “*rich diversity of practice*”, which meant that the outcome of any analysis of the rules of state succession could be “*surprisingly varied*” (General Course

on Principles of International Law, 1967). More recently, *Brownlie* noted that “... it is perfectly possible to take the view that not many settled legal rules have emerged as yet.” (Principles of Public International Law, 2008).

This lack of certainty is due to the nature of international law. If states cannot agree on a uniform practice, and there are no treaties that provide the answer, then it becomes difficult to identify any legal principle with precision. The Statute of the International Court of Justice (“ICJ”) lists the key sources of international law: treaties, and ‘customary’ rules. Article 38.1 states that in deciding disputes between sovereign states, the ICJ will apply:

“ ... (b) international custom, as evidence of a general practice accepted as law.”

The ICJ explained in the *Asylum* case (ICJ Reports (1950), 116) that custom must accord with a “constant and uniform usage practised by the States in question, and that this usage is the expression of a right appertaining to the State ...”.

In matters of succession, states do not act uniformly and consistently and there are no clear customary rules.

The consensual nature of international law also creates a conceptual stumbling block when it comes to laying down rules governing state succession in the form of treaties. This was pointed out by the International Law Commission in its draft articles on state succession to treaties, where it was noted that:

“Since a succession of States in most cases brings into being a new State, a convention on the law of succession in respect of treaties would ex hypothesi not be binding on the successor State unless and until it took steps to become a party to that convention; and even then the convention would not be binding upon it in respect of any act or fact which took place before the date on which it became a party. Nor would other States be bound by the convention in relation to the new State until the latter had become a party.”

This brings to mind a ‘chicken and egg’ situation.

A clean slate for a new state

Nonetheless, there has been an attempt to codify the position as regards succession of states to treaties. The Vienna Convention on Succession of States in Respect of Treaties of 1978 sets out what is understood to be the position for new, independent states. They start with a clean slate, and are not bound by any treaties to which their ‘predecessor’ state was a party. Article 16 of the 1978 Convention states that:

“A newly independent State is not bound to maintain in force, or to become a party to, any treaty by reason only of the fact that at the date of the succession of States the treaty was in force in respect of the territory to which the

succession of States relates.”

Here, at least, there seems to be reasonably firm ground. There is no doctrine of ‘automatic succession’ to treaties when it comes to new states. The law of treaties is the equivalent of the international law of contract. The Vienna Convention on the Law of Treaties of 1969 codified the key principles. It declared in Article 6 that: “Every State possesses capacity to conclude treaties.” Article 25 states that all treaties are binding on the parties to them, and must be performed in good faith – “*pacta sunt servanda*”. This presupposes that a state must consent or accept the ‘*pacta*’ in question.

Separation is the hardest thing

The 1978 Vienna Convention was the result of decolonisation. Once freed from colonial powers, states were considered to start their international life unburdened by any earlier treaty obligations. The reference to ‘newly independent states’ in Article 16 must be read in that context.

When it comes to an existing state separating, forming two separate states, the 1978 Vienna Convention suggests that the position might be different. Article 35 provides that where separation of states occurs, any treaty that was in force for entire territory of the predecessor state also continues in force in respect of each successor state. The Convention recognises an exception to this, where “... it appears from the treaty or is otherwise established that the application of the treaty in respect of the successor State would be incompatible with the object and purpose of the treaty or would radically change the conditions for its operation.”

It has been suggested, by *Shaw* amongst others (International Law, 2003), that this does not sit well with the rule that there is no automatic succession. *Shaw* states that the notion underlying Article 35 cannot be taken to reflect customary international law. It would not be prudent to rely on automatic succession to treaties, including BITs, where one state splits into two. It must also be recalled that only 22 member states have acceded to the 1978 Vienna Convention, so it is difficult to regard that treaty as being declaratory of a uniform, customary view amongst states.

‘Contracting Parties’ to the ICSID Convention and international treaties

Many BITs provide for arbitration under the ICSID Convention. This requires the host state against which a claim brought to be a party to the ICSID Convention. It is questionable whether a successor state, or a newly independent state, would automatically become a party to the ICSID Convention. *Schreuer* doubts whether a successor state is a “Contracting State” for that purpose, and he also queries whether the consent to ICSID arbitration given by the predecessor could somehow be imputed to the successor state

(The ICSID Convention: A Commentary, 2001).

This chimes with the approach taken by the tribunal in *Mytilineos Holdings SA v (1) The State Union of Serbia & Montenegro and (2) Republic of Serbia* (UNCITRAL, 2006) as to who was a ‘contracting party’ to a BIT. The claimant, a Greek investor, sought to bring a BIT claim against both Serbia & Montenegro and the Republic of Serbia. The original state parties to the BIT were Greece and the Federal Republic of Yugoslavia. In 2003, Yugoslavia changed its name to Serbia & Montenegro (continuing to be bound by all of Yugoslavia’s treaty obligations). The tribunal found, however, that it did not have jurisdiction over Serbia, since:

“ ... *Serbia, as a constituent part of the Federal Republic of Yugoslavia (Serbia and Montenegro), is not a ‘Contracting Party’, it cannot be made the subject of arbitration proceedings under the BIT.*”

That leaves the question whether a state may be held responsible for acts committed by an ‘organ’ of that state, or a constituent part (where the state is a union or federation). This question would fall to be answered by reference to the international law of state responsibility, discussed previously (see *Arbiter*, Issue 4, December 2010). In *Mytilineos*, the tribunal duly noted in its award on jurisdiction that the rules of state responsibility might lead to Serbia & Montenegro being liable (vicariously) for the acts of Serbia.

In 2006, Montenegro (as part of its declaration of independence) announced that it wished to be bound by the international treaty obligations of Serbia & Montenegro—leading to a ‘voluntary’ succession, which was accepted by the international community. This illustrates that in some circumstances, successor states might deem it to be politically expedient to accept that they are the international ‘alter ego’ of their predecessor state.

Similarly, as the ICSID Convention is a multilateral treaty, it may be open to the successor state to make a unilateral declaration that it will continue to abide by the ICSID Convention. However, in the absence of such a declaration, an investor is unlikely to have recourse against a successor state under the auspices of ICSID.

Can the theory of ‘acquired rights’ assist the aggrieved investor?

So what arguments could a foreign investor make in circumstances where there has been state succession?

Some commentators, notably *O’Connell* (International Law, 1970), have suggested that there is a principle of ‘acquired’ or ‘vested rights’ that goes with the territory (so to speak). At its heart, this principle states that a change of sovereignty over a particular territory (so the creation of a new state in that territory) should not affect rights already vesting in foreign nationals at the time of the change of sovereignty.

It is said that the municipal law, and (for example) concession contracts granted under it, do not change unless the new sovereign takes steps to alter the position. *O’Connell* states that “*the principle of respect for acquired rights in international law is no more than a principle that change of sovereignty should not touch the interests of individuals more than is necessary*”. He suggests that a successor state which seeks to alter or cancel acquired rights must comply with ‘minimum standards of international law’.

Of course, the requirement for fair and equitable treatment found in numerous BITs can be said to be a reflection of the minimum standard under customary international law as regards the treatment of foreign nationals. However, even if the successor state is bound by that minimum standard, it does not follow that a breach would give an investor a right to commence arbitration proceedings under a BIT, or the ICSID Convention.

It is easy to see why a successor state should be bound by the customary minimum standard under international law. After all, the new state could hardly enter the international stage as a sovereign actor without being bound by norms that have been created by the uniform practice of other sovereign actors. The new state cannot exist in a legal vacuum. That being said, it would be a leap of logic to go from that proposition to accepting that the new state has also implicitly consented to submit to arbitration with private investors concerning any ‘vested rights’. Investment claims by private parties are treaty creatures. They exist under BITs, and not pursuant to customary norms. Absent a BIT, a foreign investor could only be saved by his home state exercising a claim for diplomatic protection at the state-to-state level.

Will nothing work?

There has been an inter-state arbitration in which a state was held responsible for violations committed in a territory before that state exercised sovereignty over it. In the *Lighthouses Arbitration* (ILR 23 (1956)), the Permanent Court of Arbitration (“PCA”) considered a dispute between France and Greece as regards certain acts committed by Crete, when Crete was an autonomous state, and before it acceded to Greece. The tribunal held that:

“ ... *Greece, having adopted the illegal conduct of Crete in its recent past as autonomous state, is bound, as successor State, to take upon its charge the financial consequence of the breach of the concession contract. Otherwise, the avowed violation of a contract committed by one of the two States ... with the assent of the other, would, in the event of their merger, have the thoroughly unjust consequence of ... sacrificing the undoubted rights of a private firm holding a concession to a so-called principle of non-transmission of debts in cases of territorial succession,*

which in reality does not exist as a general and absolute principle.”

That decision of the PCA might be used to support an argument based on an ‘estoppel’: if the successor state accepts the succession, it should not be allowed to deny responsibility for the acts of the predecessor. However, it is doubtful that this would be persuasive in the absence of a specific acceptance of responsibility.

When considering whether a state is responsible for a particular act that caused an investor to suffer loss, the first step is to identify who committed the act (a state, or one of its organs). The next question to consider is whether that state, which is responsible for the breach, still exists. If a state party to a BIT separates, the original state may not be extinguished. Therefore, the investor may still have a remedy against *that* state (but not the new sovereign territory that has split off). So if the part of the host state in which the investment is located secedes or separates, the remaining part of the host state could still be bound by the BIT. If that state committed the breach, the investor can still bring a claim.

But consider a situation where a state separates, and the new independent state (which is not bound by the BIT in question), expropriates the investment post-separation. What impact does the fact that the original state did not manage to hold on to the relevant territory (where the investment was) have on its obligations under BITs? Can the original state be held responsible for giving up control over the territory where the investment was located, and where it was (subsequently) expropriated. Many BITs, including those entered into by the United Kingdom, require that investments enjoy ‘protection and security’, along the following lines:

“... Investments of nationals or companies 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.”

BITs generally envisage that the territory of a state may be extended (and they can apply to any such extension), but it is much less likely that a BIT addresses the situation where a state sheds part of the ‘territory’. The investor could argue that the BIT required the state to provide protection and security based on the territory as it was at the time of the investment, and the territory was not meant to change so that the investor is left out in the cold.

The United Kingdom’s BITs tend to define ‘territory’ as including Great Britain and Northern Ireland, but also any parts of the continental shelf over which the United Kingdom might (in future) exercise sovereignty. If the United Kingdom were to cede Kent to France, however, might one argue that the United Kingdom could no longer (by definition) provide full protection and security for investments made there that had previously qualified for BIT protection?

The ‘United Kingdom of Great Britain and Northern Ireland’ of course includes England, Wales and Scotland as part of ‘Great Britain’. The question of Scottish devolution is less fanciful in this context. If Scotland were to become independent, would the (diminished) United Kingdom be in breach of all of its BITs for existing investments, assuming there was a nationalisation spree by the newly independent Scotland?

A number of BIT tribunals have expressed the view that the obligation to provide protection or security requires a state to exercise ‘due diligence’ to protect the investment. It is not to be equated with strict liability. This was accepted in *AWG Group v Argentina* (UNCITRAL) (2010), where the tribunal explained that:

“Traditionally, the cases applying full protection and security have dealt with injuries to physical assets of investors committed by third parties where host governments have failed to exercise due diligence in preventing the damage or punishing the perpetrators.”

How this standard of liability, limited to due diligence, might apply to a situation where a part of the state separates has yet to be considered in detail by a BIT tribunal. If the state sought to resist the separation, perhaps even using military force, but failed to do so, has there been a failure to exercise due diligence? The answer is, quite possibly, ‘no’.

There is, however, one situation where the investor is likely to still have a claim. A change of government, as occurred in Egypt and Libya, would not allow the new government to deny that it is bound by BITs entered into by the predecessor. Treaties bind the state, and new elections do not create a new sovereign entity under international law. Investors face risks if a new independent state comes into existence in the territory where their investment is located. That is, however, still a fairly momentous event rather than a regular occurrence. Sovereignty is not easily acquired under international law, and depends (amongst other things) on recognition by other states – a topic for a different article altogether. In each case, investors will need to consider carefully whether the new entity really is a different state altogether. ☺

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