Blaney McMurtry LLP

PUBLICATION

No More Mining - Reflections from Pacific Rim Cayman v El Salvador (ICSID)

Date: February 16, 2017

The Ontario Arbitrator

Introduction

An International Centre for Settlement of Investment Disputes ("*ICSID*") tribunal recently dismissed a mining company's claim against the government of El Salvador for refusing to allow it to exploit certain mineral reserves. The Tribunal also ordered the company to pay $8M to cover the country's costs.

In *Pac Rim Cayman LLC v. Republic of El Salvador* (ICSID Case No. ARB/09/12),1 Pacific Rim ("*Pac Rim*") (later acquired by the Australian-Canadian company OceanaGold) claimed that El Salvador had unfairly refused to grant it a mining permit. The company argued that the government encouraged it to spend "tens of millions of dollars" in mineral exploration only to withhold the required mining permit. The company sought damages exceeding $300M. The Respondent Government maintained that the company had simply failed to meet regulatory requirements. The Tribunal ultimately accepted this position.

Pac Rim Cayman raises interesting jurisdictional issues as well as environmental and social justice issues in the context of resource development in developing countries. The focus of the article is on those issues and what may say about international arbitrations as a process.

Background

A predecessor company of Pac Rim discovered gold in El Salvador in 2002. The government of former President Francisco Flores awarded it an exploration permit in what was one of the poorest areas of the country. This area also contains a rich gold vein that is believed to run across El Salvador, Guatemala, Honduras and Nicaragua. Incoming President Mauricio Funes later rejected the company's application for a further permit - this one an exploitation or mining permit - based on the risk of cyanide contamination of one of the country's main rivers. Rather

than pursue the case in the local courts, Pac Rim Cayman ("*Cayman*"), a related entity, filed an international arbitration on April 30, 2009.

In order to receive a mining permit the company needed to meet certain conditions. The company did not meet the regulatory requirements necessary to obtain such a permit and instead principally relied on political pressure and lobbying. Cayman's main argument was that in granting the earlier exploration license to its predecessor, El Salvador had also given Cayman a green light on the mining permit and that it had been assured of such support throughout by government officials. The essence of its complaint was that through what was effectively a ban on all mining (imposed in March 2008), the government had unlawfully ignored its own regulatory regime, depriving the company of the value of its investment. El Salvador's response was that the company was using arbitration as a lever to force it to grant the permit, something that Cayman never had a right to obtain.

The way the claim was framed is interesting. Cayman sought a declaration that the government had not only breached its foreign investment law but also its Constitution and the general principles of international law.

The Arbitration

Cayman brought the case to ICSID under the Dominican Republic-Central American Free Trade Agreement ("CAFTA")2 of which the US is a member [N.B.: Pac Rim had set up a US subsidiary. Cayman's parent was Canada- based Pac Rim Mining Corp. and Canada is not a member of CAFCA]. A case-specific ICSID tribunal was set up composed of three arbitrators. The arbitration also took place under the arbitration agreement in Article 15(a) of El Salvador's investment law (translation):

"In the case of disputes arising among foreign investors and the State, regarding their investments in El Salvador, the investors may submit the controversy to: (a) The International Centre for Settlement of Investment Disputes (ICSID), in order to settle the dispute by ... arbitration, in accordance with the Convention on Settlement of Investment Disputes Between States and Investors of Other States (ICSID Convention) ... "

Preliminary Objections

The case was also submitted to arbitration under El Salvador's foreign investment statute. As an initial determination, the Tribunal found that Cayman could not invoke CAFTA: notwithstanding Cayman's nationality having been changed to the USA, the Tribunal found that Cayman had *no real connection* to the United States and, as such, Cayman should not be able to take the benefit of CAFTA. This left the Claimant having to argue its case mainly on the basis of the local Salvadoran investment law.

A number of important consequences flowed from this: Cayman could not avoid some limitations in the local statute. For example, only claims regarding the rights and obligations in

the investment law would be arbitrable, Salvadoran law would be the applicable substantive law and the local courts had jurisdiction in relation to mining matters.

El Salvador's position was that Salvadoran law was the *only* law that applied because it would breach the principle of equality in Article 5 of its Investment Law if foreign investors could invoke rules of international law while domestic investors could only rely on Salvadoran law. The Respondent also took the understandable position that all investments in El Salvador are subject to its laws and therefore all investors in the country necessarily accepted that Salvadoran law will apply to their investments.

The counter-position was instructive. According to Cayman, since the Parties did not agree to the application of any particular law and El Salvador's Investment Law was silent on the same question, the matter should proceed under Article 42(1) of the ICSID Convention and apply the law of the Contracting State party to the dispute "and such rules of international law as may be applicable". In other words, *both* domestic and international laws were to be applied and, as a matter of interpretational priority, international law was to prevail over domestic law in the event of any inconsistency. It should be noted that the Investment Law did, indeed, state that investor treatment was "specifically intended to be consistent with international law", including the principle of fair and equitable treatment and the protection of the legitimate expectations of foreign investors based on the existing legal framework in the country (the "*FET standard*").

With respect to the claim that the actions of the government violated its own Constitution, the argument was that a constitution was "of fundamental importance in construing and applying the protections and guarantees provided to foreign investors" under any domestic law and that, accordingly, the domestic statute should be interpreted in accordance with the principles set out in the Constitution (such as legality, non- arbitrariness, proportionality, economic freedom, protection of property right and due process) and generally recognized in international investment law.

In the result, the Tribunal dismissed El Salvador's challenge to jurisdiction based on Article l5(a) of the Investment Law and on Article 25(1) of the ICSID Convention. Invoking the notion of a full and inherent authority to determine its own competence as "confirmed" by Article 41(I) of the Convention (….the Tribunal "shall be the judge of its own competence."), the ruling distinguished between the law applicable to the company's claims and the law applicable to the merits.

Interestingly, in deciding in this way, the Tribunal refused to be bound by El Salvador's interpretation of its own statute and further held that it would not give effect to any other legislative provision "that would override an expression of jurisdictional consent that is valid, clear and unambiguous *as a matter international law*." (*emphasis added*).

The Tribunal then went on to also reject the argument that the exclusive jurisdiction of the Salvadoran courts mandated by domestic law could oust the Tribunal's jurisdiction (it did so on the basis that the company had never been a permit holder under the Mining Law and would

have had had no standing to bring legal proceedings against the government before a Salvadoran Court).

The Merits

The merits hearing was held *in camera*. The merits were fairly narrow focusing mainly on whether Cayman met the conditions for the exploitation permit it had applied for. The Tribunal ultimately ruled that Cayman had no legal entitlement to the permit and that the government had no legal obligation to grant it.

As such, the company claimant could have no claim for damages from the government under the provisions of the Investment Law (including the country's Constitution). The claim for damages under customary international law also failed for want of any enforceable right to the land under either Salvadoran law or international law.

Some reflections

For many in this small Central American country this case was epic. El Salvador is a country where almost a third of the population lives under the poverty line. In *Pac Rim Cayman,* the damages sought were almost twice the amount the country receives in international aid in any given year. It's also a country where the slogan, "*No to mining, yes to life*" is (now) a national rallying cry.

At the conclusion of the case, El Salvador's Minister of Economy declared that "Our country should be called [the river at issue] . . . because the river is everything." Similarly, *the Mesa Nacional Frente a la Minería Metálica* (National Group against Metallic Mining) stated that the ruling "reaffirms the need to establish a mining ban in the country." El Salvador's attorney general for his part said: "*It is an important step for the country to have been victorious in this lawsuit*".

The award at the end of the day was a bit odd: having proceeded with the claims founded on domestic law, the Tribunal decided the case by applying international law. In this instance (and fortunately) the outcome was well received in that country. Still, it's not difficult to envisage cases where the opposite might be the case.

A more complex social and political context for an international commercial arbitration is hard to conceive. In the same way that "hard cases make bad law", complicated cases strain the dispute-resolution mechanism used to adjudicate them. The question I pose is whether cases such as this one, rooted in ongoing complex social and political contexts, would benefit from a reconsideration of the established model for resolving international commercial disputes.

Pac Rim Cayman is, of course, one of many cases filed against governments under the ICSID system. Investor-state dispute settlement mechanisms are found in many international trade and bilateral and regional investment treaties. They are there to enable foreign investors to sue a host country as a means to protect its investment, particularly in areas of the world where

judicial and political systems lack some of the transparency, safeguards, certainty and effectiveness of those in the First World. Not surprisingly, this type dispute resolution mechanism, seen as it often is as existing for the benefit of foreign corporations, has become a flashpoint for opposition from social and political activists and, more recently, also to all manner of similar trade agreements such as the Transatlantic Trade and Investment Partnership between the US and Europe.

A number of aspects of this type of case can lead to difficulties:

a. A lack of uniformity. The various trade agreements contain their own definition of the process. While this creates both challenges and opportunities for the specific parties, it can leave remaining stakeholders with a jaundiced view of the entire exercise;

b. The decisions and rulings by tribunals in a variety of circumstances are giving rise to a myriad of rules of customary international law; and

c. Host nations craft their foreign investment laws based on different levels of regard for the value of harmonization with international law and norms.

Given the sheer freight that can be associated with this type of proceeding, and the potential impact of the final awards that can be made, there is also an argument for such things as:

i. openness and transparency in tribunal proceedings (there was little of this in *Pac Rim Cayman*); ii) tailor-made requirements for arbitrators; and iii) perhaps even establishing approved lists of arbitrators for specific types of cases.

Questions come to the fore:

- Are international law experts with academic backgrounds always the best suited to this kind of dispute, particularly if they have also acted as counsel and/or written weighty tomes relevant to some of the issues in the dispute?
- Should we look also, in this type of case, for arbitrators who are also versed in the socio-economic and political environment from which these cases originate, in addition to legal and subject-matter expertise?

Any legal dispute with a cross-cultural dimension will also suffer from this, of course, but the issue can be most acute in cases like *Pac Rim Cayman* which also involve a sovereign State. The problem can be this: concepts central to investor-state cases such as “fair and equitable treatment” - found in most trade agreements - become increasingly difficult to apply the more complicated the social and political context of the dispute becomes. Interpreting and applying concepts like this asks a great deal of arbitrators. Establishing, in advance, a range of meaning and a tailored approach for such concepts in specific types of cases, for example, whether in the original trade agreement, the relevant foreign investment law or as part of the agreed-upon DR process should prove helpful.

A similar process of purpose-tailoring could be taken to the *procedures* of the arbitration itself. The oft-seen “*push-me-pull-you*” dynamic between the civil versus the common law approaches,

for example, lands in a different place in each case. This leads to uncertainty and ultimately perhaps also and, more importantly, to inconsistency in outcomes.

The problem could be lessened or even avoided if there were to be already in place more uniform, established and certain sets of approaches and procedures for the adjudication of specific types of disputes.

In closing, one example of movement along the lines I'm suggesting is the promulgation, as of January 1, 2017, of the SIAC (Singapore International Arbitration Committee) Investment Arbitration Rules. These rules attempt to address issues that are unique to international investment arbitration proceedings and represent significant change from earlier versions. The focus of the 2017 version is on the particular concerns that arise in arbitral proceedings involving States, State-controlled entities and intergovernmental organizations.