IN THE MATTER OF:

Link-Trading vs. Department for Customs Control of Republic of Moldova
UNCITRAL Arbitration – Chisinau, Moldova

Arbitrators:

Jeffrey M. Hertzfeld, Esq. (Paris), Presiding
Professor Ion Buruiana (Chisinau)
Professor Ivan Zykin (Moscow)

Claimant:

Link-Trading Joint Stock Company
Str. Ghioceilor, 1
2012 Chisinau
Republic of Moldova

Respondent:

Department for Customs Control of the Republic of Moldova
Columna Str. 65
2001 Chisinau
Republic of Moldova

AWARD ON JURISDICTION

In the matter before this Tribunal, Claimant, a US-Moldovan joint venture company established in November 1996 in the Free Economic Zone of Chisinau (hereinafter "the FEZ") in the Republic of Moldova, alleges to have suffered an indirect expropriation for which it seeks compensation pursuant the Bilateral Investment Protection Treaty between the USA and the Republic of Moldova, signed on April 21, 1993 and effective November 25, 1994 (hereinafter "the BIT"). Claimant has named the Department of Customs Control of the Republic of Moldova as Respondent. The Tribunal has been set up under UNCITRAL Arbitration Rules, one of the optional arbitration systems referred to in the BIT.

Claimant's allegation of indirect expropriation is based upon a change in the rates of duties and VAT exemptions introduced in the 1998 Moldovan Law on the Budget the alleged effect of which was to destroy the economic viability of Claimant's business. According to the Claimant, its business consisted essentially of the duty-free import of consumer products into the FEZ for sale to

Moldovan citizens. At the time of Claimant's investment in the FEZ, it appears to be uncontested that Moldovan citizens were permitted to purchase such products in the FEZ and import them into the customs territory of Moldova free of VAT and duties, within the maximum limit of $600.

This limit was subsequently reduced under the 1997 Budget Law to $400 and under the 1998 Budget Law to $250. The 1998 Budget Law was then amended in August 1998 eliminating the exemption altogether. Claimant maintains that the reduction and final elimination of this exemption disregarded governmental guarantees of 10-year stability of the tax and customs regime, which guarantees were contained in the Law on the FEZ and the Moldovan Law on Foreign Investment in effect at the time of Claimant's creation, and constituted an indirect expropriation of its investment. Under such circumstances, it claims entitlement to compensation under the BIT.

Claimant confirmed to the Tribunal by letter of August 9, 2000 that it considers its Notice of Arbitration served on November 27, 1999 as constituting its Statement of Claim under UNCITRAL Rules. Respondent filed a Response to the Statement of Claim on August 30, 2000, setting forth, *inter alia*, certain jurisdictional objections, some of which had been previously raised by Respondent in its letter of April 4, 2000 addressed to the Arbitration Institute of the Stockholm Chamber of Commerce (the appointing authority designated by the Permanent Court of Arbitration in the Hague -- see below).

Both parties have requested the Tribunal to consider Respondent's jurisdictional objections as a preliminary matter before proceeding further with the merits of the case. Neither Party requested an oral hearing on the jurisdictional objections.

By letter of October 16, 2000, the Tribunal posed a series of specific questions to both of the Parties bearing upon the issue of jurisdiction and requested their responses thereto by November 15. Claimant submitted its response on November 14. Respondent has not responded, despite a reminder letter sent by the Tribunal affording Respondent an additional time period to do so.

Respondent's jurisdictional objections may be summarized as follows:

1. That no agreement to arbitrate has been signed by and between Claimant and Respondent.

2. That the Republic of Moldova and the Ministry of Finance should have been or should be invited to join the arbitration.

3. That, pursuant to Article I(2) of the BIT, the Republic of Moldova has the right to deny to any company the advantages of the BIT.

4. That, pursuant to the Article 7 of the Law on Expo-Business-Chisinau FEZ No. 625, Claimant's only recourse in the case of an adverse change of law is to the Moldovan Parliament.

5. That, under the terms of the BIT, Claimant has the right of examination of his claim by a competent judicial or administrative authority of the Republic of Moldova or the USA, but not by an international tribunal.

6. That Claimant did not wait the required six month period under Article VI(3) of the BIT before commencing this arbitration.

7. That the Notice of Arbitration was defective since it fails to make reference to the contract that is the basis of the dispute or to propose the number of arbitrators as required by UNCITRAL rules.

8. That the Claimant's claim does not constitute an expropriation under the BIT.

The Tribunal will address each of these points in sequence.

1. **That no agreement to arbitrate has been signed by and between Claimant and Respondent.**

   The asserted basis for arbitration is not a contract or agreement signed between the Claimant and Respondent, but rather a consent to arbitrate set forth in the BIT.

   Claimant as a US-Moldovan joint venture entity is a proper party claimant thereunder in accordance with Article VI(8) of the BIT which provides:

   > "For purposes of an arbitration held under paragraph 3 of this Article, any company legally constituted under the applicable laws and regulations of a Party or a political subdivision thereof but that, immediately before the occurrence of the event or events giving rise to the dispute, was an investment of companies of the other Party, shall be treated as a...company of such other Party...."

Evidence has been submitted that at the time of its creation and at all times since then Claimant has been owned and controlled by a company established in the United States.

The Department of Customs Control of the Republic of Moldova is likewise a proper party respondent in this arbitration. The Republic of Moldova has given its consent to arbitrate under the terms of the BIT in the circumstances defined in the BIT. In bringing its action against the Department of Customs Control of the Republic of Moldova, the Claimant is, in the opinion of the Tribunal, suing the Republic in the name of its Customs Department. Indeed, Respondent has not contested its standing as a proper party in this arbitration.

2. **That the Republic of Moldova and the Ministry of Finance should have been or should be invited to join the arbitration.**

As indicated above, Respondent has not contested its standing as a proper party. Rather, it has requested that the Tribunal invite the Government of Moldova or the Ministry of Finance to join the arbitration as well. Claimant has expressed no objection to such participation in the arbitration.

It is not the role of the Tribunal to request any particular representatives of the Government or the Ministry of Finance to participate in these proceedings. However, in light of the wishes of both parties, the Tribunal has no objection to such participation on the side of the Respondent, if Respondent considers that its position will be better represented in this way. This being said, in so doing, it should be clear that neither the Government nor the Ministry of Finance would be viewed as a new or separate party from the Respondent, but rather as additional emanations of the same party in interest, the Republic of Moldova.

3. **That, pursuant to Article I(2) of the Treaty, the Republic of Moldova has the right to deny to any company the advantages of the BIT.**

While Article I(2) of the BIT sets forth certain circumstances in which a company (as defined under Article I(1)(b) of the BIT) may be denied the advantages of the BIT, no evidence has been submitted establishing the existence of any of these circumstances in the present case. Consequently, the Tribunal sees no basis for denying the benefits of the BIT to Claimant.

4. **That, pursuant to the Article 7 of the Law on Expo-Business-Chisinau FEZ No. 625, Claimant's only recourse in the case of an adverse change of law is to the Moldovan Parliament.**

The Tribunal finds that this argument which goes to the issue of State authority to deal with disputes arising as a result of adverse changes in legislation is irrelevant in light of the issue before us, which concerns not the fulfilment of national obligations but international obligations.

The BIT does not impose on Claimant an obligation to seek a change in national legislation as a condition to seeking recourse under the BIT.

5. **That, under the terms of the BIT, Claimant has the right of examination of his claim by a competent judicial or administrative authority of the Republic of Moldova or the USA, but not by an international tribunal**

The BIT does not require Claimant to pursue examination of its claim by national judicial or administrative authorities, as opposed to international arbitration.

Article VI(2) of the BIT provides an aggrieved party *the right*, but not *the obligation*, to apply to a national court or administrative authority for examination of his claim. In no way is this intended to deprive such party of the right to arbitrate in appropriate circumstances under the terms of the treaty. In the present case, Claimant chose not to avail itself of the right of examination by a court or administrative authority, and to proceed instead to arbitration under the BIT.

6. **That Claimant did not wait the required six month period under Article VI(3) of the BIT before commencing this arbitration.**

Article VI(3) requires a waiting period of six months "from the date on which the dispute arose" before an aggrieved company may submit an arbitrable dispute under the BIT to binding arbitration.

Respondent argues that the dispute arose only when Claimant submitted its formal complaint on November 5, 1999. Respondent formally responded to the complaint on November 22, 1999 rejecting Claimant's position, and Claimant thereupon served its Notice of Arbitration on November 25, 1999.

In our opinion the format complaint sent on November 5, 1999 represented the culmination, not the inception, of the dispute. The dispute in question

arose at latest upon notification of the elimination of the customs exemption for purchases by Claimant's customers in the FEZ in August 1998. Evidence has been submitted showing that, on August 19, 1998, the Respondent sent its letter no. 583-005 to the FEZ Administration with respect to the implementation of the new legislation relative to the changes in the customs/VAT exemption. Thereafter, according to allegations made by Claimant in its Notice of Arbitration and not rebutted by Respondent, the Customs authorities repeatedly during the period September through November 1998 brought pressures to bear upon Claimant and others in the FEZ to comply with the changed customs rules.

The purpose of the six-month waiting period in the BIT is to encourage parties to exercise reasonable efforts to resolve disputes before resorting to the costly and time-consuming remedy of international arbitration. The Tribunal believes that where, as here, there is an evident refusal of Claimant's position by Respondent, such a waiting period should be interpreted restrictively. Indeed, we are comforted in this view by the fact that a year has passed since the commencement of this arbitration and no peaceful settlement of the dispute has proven possible during this period. The only consequence of adopting a liberal interpretation of the six-month waiting period, as Respondent proposes, would therefore have been to aggravate the possible claim of damages.

7. **That Notice of Arbitration was defective since it fails to make reference to the contract that is the basis of the dispute or to propose the number of arbitrators as required by UNCITRAL Arbitration Rules.**

The Notice of Arbitration invoked the BIT at its page 3: "Another factor ensuring the right of [Claimant]...is the Treaty between the Republic of Moldova and the United States of America concerning the encouragement and reciprocal protection of investments. Art. X(2)(c) of the Treaty foresees that the Party must respect terms (conditions) of a certain investment in his tax policy (the Treaty is annexed – source: Ministry of the Economy and Reforms)." Under the circumstances it was not necessary to make reference to any other contract. The UNICTRAL Arbitration Rules are applicable in a given case to the extent consistent with the Treaty. The Treaty itself may serve and actually serves here as a ground out of or in relation to which the dispute arises (Article 3(3) of the UNCITRAL Rules).

The Notice also proposed the choice of a single arbitrator (with Claimant's suggested names set forth) and the designation of an appointing authority in the event that this should prove necessary.

Under Article 5 of the UNCITRAL Rules, where the parties have not agreed on the number of arbitrators, the number should be three.

When the Respondent failed to respond to Claimant's above-mentioned proposals, Claimant relying upon UNCITRAL Rules – one of the sets of rules stipulated in the BIT -- appointed as its party-designated arbitrator – Professor Ion Buruiana -- by notice served on Respondent on December 13, 1999.

When Respondent failed to appoint a second arbitrator within the 30-day period stipulated in the UNCITRAL rules, Claimant applied to the International Bureau of the Permanent Court of Arbitration in the Hague by communication dated January 18, 2000 for the designation of an appointing authority to select such arbitrator.

Respondent mistakenly refers to Article VII(1) as the basis for asserting that it should have had two months from the date of notice of arbitration to nominate an arbitrator. Article VII concerns only disputes between Parties to the BIT, i.e. inter-governmental disputes. The present case has been brought under Article VI to the BIT for disputes involving a company and a State Party, and the two-month period does not apply.

The Secretary General of the Permanent Court of Arbitration, after establishing its competence and seeking the views of the parties and having received no reply from Respondent, designated the Arbitration Institute of the Stockholm Chamber of Commerce as appointing authority, which then appointed Professor Ivan Zykin as the second arbitrator on April 13, 2000 and ultimately Jeffrey Hertzfeld Esq. as the presiding arbitrator on July 19, 2000.

Respondent has not asserted that the procedures followed by the Hague Court and the Arbitration Institute were in any way improper.

The Tribunal therefore finds that the Notice of Arbitration was proper and adequate. Since the parties had not agreed upon a sole arbitrator, the proper number of arbitrators is three. The Tribunal has been properly constituted.

8. **That the Claimant's claim does not constitute an expropriation under the BIT.**

This is the most difficult aspect of the jurisdictional issue -- firstly, because it touches particularly complex issues of international law and secondly,

because, being presented as a preliminary question, it poses the challenge of separating the jurisdictional element from the substantive element.

The Tribunal must therefore determine whether Claimant presents the elements of a cause of action for expropriation under the BIT, without deciding whether it has sufficient evidence to carry its burden of proof of the actual existence of these factual elements.

The BIT permits claims of expropriation under its Article III(1) to be brought to UNCITRAL arbitration (among other optional dispute resolution systems) if they constitute "investment disputes" under Article VI of the BIT.

An "investment dispute" is defined in Article VI of the BIT as

> "a dispute between a Party and a ...company of the other Party arising out of or relating to (a) an investment agreement between that Party and such...company; (b) an investment authorization granted by that Party's foreign investment authority to such...company; or (c) an alleged breach of any right conferred or created by this Treaty with respect to an investment."

As indicated earlier, under Article VI(8), Claimant as a US-controlled Moldovan company is treated as a US company for purposes to the BIT.

An "investment" is defined in the BIT very broadly, in Article I(1)(a), to include

> "every kind of investment in the territory of one Party owned or controlled directly or indirectly by...companies of the other Party, such as equity, debt, and service and investment contracts; and includes: (i) tangible and intangible property...(v) any right conferred by law or contract, and any licenses and permits pursuant to law."

Claimant has submitted evidence of the existence of such investments, both equity and debt. The fact that an investment consists of debt financing does not appear to affect its characterization as an investment under the BIT.

The Tribunal does not need to determine whether the agreement allegedly concluded by Claimant with the administration of the FEZ and/or the authorization allegedly obtained by Claimant to operate in the FEZ meet(s) the requirements of Article VI, since the Tribunal considers that Claimant would in any event have a sufficient basis for an action under subparagraph (c) of Article VI by alleging "a breach of right conferred or created by this

Treaty with respect to an investment" pursuant to Article III(1), namely the right not to

> "be expropriated...either directly or indirectly through measures tantamount to expropriation...except...upon payment of prompt, adequate and effective compensation...."

According to Article X(2)(a), matters of taxation, if they give rise to expropriation of an investment, may be subject to arbitration. The Tribunal considers the reference to "taxation" here to be broad enough to cover customs duties and other forms of raising revenue that are within the State's power.

Expropriation, including indirect expropriation, is not forbidden by the BIT. The BIT only establishes certain standards with respect to the exercise by a Party-State of its power of expropriation as affecting protected investors. These are standards of fairness and non-discrimination as well as rights of adequate compensation for the company expropriated. The criteria for determining adequate compensation are set forth in Article III(1) of the BIT.

The question then is "what constitutes indirect expropriation?" Here, the BIT gives little guidance and it is necessary to consider international law and practice.

Claimant has noted that it enjoyed a right to tax and customs duty stability for a period of ten years from the date of its investment, by virtue of the law regulating activity in the FEZ as well as the Moldovan Law on Foreign Investment. Claimant has alleged that this right was violated by virtue of the change in customs rules applicable in the FEZ subsequent to its investment, which had an allegedly disastrous impact on the economic viability of its business.

If these allegations were proven to be the case, precedents do exist in international practice that would consider a State's disregard of legislatively granted rights as tantamount to expropriation.

The Tribunal has noted that the 10-year stability provision relates to the customs and tax regimes stipulated by the Law on the Expo-Business-Chisinau Free Enterprise Zone N. 625-XIII as in effect on the date of Claimant's registration in the Free Zone (certificate dated 15 November 1996) and that the regime in effect at that time appears to have envisaged the adoption of annual Budget Laws which might change the applicable rates of

exemptions from one year to the next. To the extent that Claimant seeks to prove that it reasonably relied upon the stability of the $600 exemption that its customers enjoyed in 1996, it would need to demonstrate (1) that the stability provisions of the law extended to this exemption despite reference in the customs regime to the adoption of budget laws on an annual basis and (2) that Claimant did not assume the risk of change in the exemption rates within the framework of the customs and tax regime.

Of course, a dramatic change of legislation that has the effect of depriving an investor of his investment may also amount to an indirect expropriation, even in the absence of an express governmental guarantee against such a change. For example, in certain cases under BITs, it has been found that promulgation of a particularly confiscatory tax may constitute an expropriation even though it is within the State's regulatory powers to do so. The State in such a case may still be responsible for compensating an investor who has lost his investment by virtue of the new regulations. Indeed, commentators on the subject of "indirect expropriation" have noted how difficult it is sometimes to draw the line between non-confiscatory regulation and indirect expropriation.[1]

The Tribunal does not attempt at this stage in the proceedings to make any finding as to the soundness of Claimant's allegation that the stabilization guarantees in the Moldovan regulations prohibited a change in the customs exemption applicable to purchases within the FEZ. Nor do we address the question of whether the changes in exemptions were of such a magnitude as to constitute an indirect expropriation *per se*. It might in this connection be relevant to consider whether the measures taken were reasonable and usual in the light of general practice in other countries of the world, whether the measures had a discriminatory character or were of general application, and other specific facts related to the present circumstances. Clearly, not every change of law constitutes an expropriation, and the Tribunal would stress that Claimant bears the burden of proof that on the facts of this case an indirect expropriation should be found to have taken place.

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[1] See "The BIT won't Bite: The American Bilateral Investment Treaty Program," in 33 Am.U.L. Rev. 931 (1984) p. 931 at p. 963: "indirect expropriatory acts, such as the levying of taxes...or the impairment or deprivation of the...economic value of an investment, are the real risks investors face in LDCs. The line between regulation and expropriation is very thin." For a further discussion of some of the complexities of the concept of "indirect expropriation", see also Dolzer, "Indirect Expropriation of Alien Property," in ICSID Review Foreign Investment Law Journal, Vol. 1, No. 1 (1986) p.41 et seq.

However, the Tribunal does conclude that Claimant has made a colorable claim of indirect expropriation that is arbitrable under the BIT between the USA and the Republic of Moldova.

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For all of the reasons stated above, and in accordance with Articles 21(1) and (4) and 32(1) of the UNCITRAL Rules, the Tribunal hereby

DECIDES:

That the Tribunal has been properly constituted and has jurisdiction over the parties and the subject matter of the dispute before it; and

That the question of the allocation of arbitration costs as between the parties is reserved until the final award in the arbitration.

The present Decision has been taken unanimously.

The Decision has been established and signed by the Tribunal in five (5) originals – one for each arbitrator, one for Claimant and one for Respondent.

Chisinau, February 16, 2001

Jeffrey M. Hertzfeld, Esq.
Presiding Arbitrator

Professor Ion Buruiana
Arbitrator

Professor Ivan Zykin
Arbitrator