CASES

Treaties – Chile–Malaysia Bilateral Investment Treaty, 1992 – Fair and equitable treatment provision – Most-favoured-nation clause – Standard of fair and equitable treatment – Whether obligation to grant planning permission part of fair and equitable treatment – Whether obligation to observe contractual obligations part of fair and equitable treatment – Investment approved for a project against current government policy

Foreign investment – Investment in land zoned as rural – Urban planning – Whether authorization to invest in specified land giving rise to legitimate expectation that change of use possible – Respective roles of foreign investment authority and planning authority

MTD EQUITY SDN BHD AND MTD CHILE SA *v.* REPUBLIC OF CHILE [1]

(ICSID Case No. ARB/01/7)

Award. 25 *May* 2004

(*Arbitration Tribunal*: Rigo Sureda, *President*; Lalonde and Oreamuno Blanco, *Members*)[2]

SUMMARY: *The facts*: — Following discussions with various officers of the Republic of Chile ("the Respondent"), MTD Equity Sdn Bhd (a Malaysian company) and its wholly owned subsidiary, MTD Chile SA (a Chilean company) (collectively "the Claimant"), decided to pursue negotiations concerning a mixed-use planned community in the small town of Pirque, south of Santiago. The proposed site was zoned for agricultural use and, as the Claimant knew, would require rezoning in order to be developed. Subsequent to negotiations with the Chilean owner of the land, Mr Jorge Fontaine Aldunate ("Mr Fontaine"), and with the Foreign Investment Commission ("FIC"), the Servicio de Vivienda y Urbanización ("SERVIU") and the Secretario Regional Ministerial ("SEREMI"), the Claimant entered into a Promissory Contract on 13 December 1996. The Promissory Contract was conditional upon FIC's approval of the Claimant's investment. It provided for the development

[1] The Claimant was represented by Oscar M. Garibaldi, Eugene D. Gulland, Fernando Campoamor Sánchez, Eric J. Pan and Karin L. Kizer, Covington & Burlington, Washington DC, and Micahel Grasty Cousiño, Jorge Bofill Genzsch and Pablo Mir Balmaceda, Grasty Quintana Majlis & Cía, Santiago, Chile. The Respondent was represented by Karen Poniachik, Claudio Castillo Castillo, Andrés Culagovski Rubio, Liliana Macchiavello Martín, Carola Trucco Horwitz and Francisco Javier Díaz Verdugo, Foreign Investment Committee, Republic of Chile, Ronald E. M. Goodman and Abby Cohen Smutny, White & Case LLP, Washington DC, and Francisco J. Illanes, Cariola, Diez, Pérez-Cotapos & Cía Ltda, Santiago, Chile.

The decision of the *ad hoc* Committee on the Respondent's Request for a Continued Stay of Execution and its decision in the subsequent annulment proceedings will be reported in a future volume of the *ICSID Reports*.

[2] The arbitration was constituted pursuant to Article 6(1) of the Agreement between the Government of Malaysia and the Government of the Republic of Chile for the Promotion and Protection of Investments of 11 November 1992 ("the BIT") and the ICSID Convention. The Spanish text of the BIT can be found online at http://www.unctad.org/sections/dite/iia/docs/bits/chile_malasia_sp.pdf.

of the land in two tranches and the creation of a Chilean corporation, El Principal Inversiones SA ("EPSA") to be owned 51 per cent by the Claimant and 49 per cent by Fontaine.

On 14 January 1997, the Claimant filed an application with the FIC for approval of an initial investment of US $17.136 million, for a project described as development of houses, apartments, schools, hospitals, universities, supermarkets and services in the location of Pirque. The application was approved by the FIC on 3 March 1997. A standard Foreign Investment Contract, specifying the location of the project, was signed by the FIC and the Claimant on 18 March 1997. After signature of this first contract, the Claimant made a US $8.4 million capital contribution to EPSA and with US $8.736 million purchased 51 per cent of the shares in EPSA from Fontaine.

The Claimant submitted a second application with the FIC on 6 April 1997 for the investment of additional working capital of US $364,000, which was approved. A second standard Foreign Investment Contract, likewise specifying the location of the project, was signed on 13 May 1997.

The zoning of the site at Pirque was covered by the Plano Regulador Metropolitano de Santiago ("PMRS") and zoning changes for the Project were handled by SEREMI. On 16 April 1998, the Claimant was informed that the Project was inconsistent with the Government's urban development policy. On 3 June 1998, SEREMI notified the Claimant that the PMRS would not be changed: therefore the zoning changes required for the Project to go ahead were not approved. The Claimant's request for assistance from the FIC was rejected. On 4 November 1998, SEREMI formally rejected the Project.

On 2 June 1999, the Claimant notified the Respondent that an investment dispute existed under the BIT. At the end of the three-month negotiation period required by the BIT before the dispute could be brought to arbitration, the dispute remained unresolved. At the Respondent's request, the negotiation period was extended by thirty days but no agreement was reached.

On 26 June 2001, the Claimant filed the request for arbitration. The Claimant alleged that the Respondent had breached the fair and equitable treatment provision in the BIT when it created and encouraged the strong expectation that the Project was feasible from a regulatory viewpoint in the specific proposed location and when it entered into a contract specifying that location, but subsequently disapproved that location after the Claimant had irrevocably committed its investment. The Respondent argued that the meetings the Claimant had with government officials clearly indicated the difficulty in changing the PMRS. Further, the role of the FIC was to approve only the capital transfer, not the project itself.

Secondly, the Claimant claimed under the most-favoured-nation ("MFN") clause. Article 3(1) of the BIT provided that investments "shall receive treatment which is fair and equitable, and not less favourable than that accorded to investments made by investors of any third State". The Claimant argued that the MFN clause covered several provisions of other Chilean BITs. It argued that under Article 3(1) of the BIT with Denmark,[3] the Respondent was required to observe its obligations under

[3] The Agreement between the Government of the Republic of Chile and the Government of the Kingdom of Denmark concerning the Promotion and Reciprocal Protection of Investments was signed

the Foreign Investment Contracts and hence provide the necessary permits. The Claimant also contended that the Respondent had breached Article 3(3) of the treaty with Croatia,[4] which related to impairment by unreasonable and discriminatory measures. It further argued that the Respondent had breached Article 3(2) of the treaty with Croatia, which provided that when a contracting party had "admitted an investment in its territory, it shall grant the necessary permits in accordance with its laws and regulations".

Thirdly, the Claimant argued that the refusal to grant the necessary permits amounted to an indirect expropriation in breach of Article 4 of the BIT.

The Respondent submitted that any damage suffered was caused by a lack of due diligence by the Claimant. The trust placed in Mr Fontaine, the lack of professional advice in the urban sector and the acceptance of an exorbitant land valuation at the time of making the investment were the effective causes of the Claimant's losses. At no stage did the Respondent or any of its officers commit to grant the planning approval which, as the Claimant knew, or at least ought to have known, was required by law.

Held: — The Respondent had breached its obligations under Article 3(1) of the BIT, but the Claimant for its part had failed to protect itself from business risks inherent in its investment in Chile. Responsibility for the loss being equally divided, the Respondent should pay damages in the amount of US $5,871,322.42 plus compound interest. Each party should pay its own costs and 50 per cent of the costs of arbitration.

(1) MTD Equity was an investor under the terms of Article 1(c)(ii) of the BIT as a corporation organized under the laws of Malaysia. MTD Chile was wholly owned by MTD Equity and was deemed to be a Malaysian national for purposes of arbitration proceedings in accordance with Article 6(2) (paras. 92–4).

(2) The provisions of the Croatia BIT and the Denmark BIT which dealt with the obligation to award permits subsequent to approval of an investment and to fulfilment of contractual obligations were part of fair and equitable treatment within Article 3(1) of the BIT (paras. 100–4).

(3) Under the terms of the BIT, fair and equitable treatment should be understood to be treatment in an even-handed and just manner, conducive to fostering the promotion of foreign investment. The unqualified approval of an investment by the FIC for a project against the urban policy of the Government breached the obligation to treat an investor fairly and equitably (paras. 107–67).

(4) The Claimant must bear the consequences of its own actions as experienced businessmen. Its choice of partner, the acceptance of a land valuation based on future assumptions without protecting itself contractually in case the assumptions did not materialize (including the issuance of the required development permits) were risks that the Claimant took irrespective of the actions of the Respondent (paras. 168–78).

on 28 May 1993 and entered into force on 3 November 1995. The text can be found online at http://www.unctad.org/sections/dite/iia/docs/bits/chile_denmark.pdf.

[4] The text of the Agreement between the Government of the Republic of Chile and the Government of the Republic of Croatia concerning the Reciprocal Promotion and Protection of Investments of 28 November 1993 can be found online at http://www.unctad.org/sections/dite/iia/docs/bits/chile_croatia.pdf.

(5) The Respondent did not breach the BIT on account of breach of the Foreign Investment Contracts. The authorization to invest was only the initiation of a process to obtain the necessary permits and approvals from the various agencies and departments of the Government, and the Government had to proceed in accordance with its own laws and policies in awarding such permits and approvals (paras. 179–89).

(6) There was no basis for considering the modifications to the PMRS as discriminatory (paras. 190–6).

(7) The Respondent did not breach the MFN clause (and Article 3(2) of the Croatia BIT) by not changing the PMRS as required for the Project to proceed. The provision did not entitle the Claimant to a change of the normative framework of the country where it invested. All that the Claimant could expect was that the law be applied (paras. 197–205).

(8) The claim for expropriation was dismissed. The Claimant did not have a right to the amendment of the PMRS, and the issue in this case was not one of expropriation but of unfair treatment by the State when it approved an investment against the policy of the State itself (paras. 207–14).

(9) The Claimant made decisions that increased its risk and for which it bore responsibility, regardless of the treatment given by the Respondent. The Claimant should bear 50 per cent of the damage suffered after deduction of the residual value of the investment (paras. 242–3).

(10) Compound interest was more in accordance with the reality of financial transactions and a closer approximation to the actual value lost by the investor (paras. 250–1).

(11) Taking into account that neither party succeeded fully in its allegations, each party should bear its own expenses and fees related to this proceeding and 50 per cent of the costs of arbitration (para. 252).

The following is the text of the Award:

AWARD (25 MAY 2004)

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I. PROCEDURE

1. *Registration of the Request for Arbitration*

1. By letter of June 26, 2001, MTD Equity Sdn ("MTD Equity"), a Malaysian company, and MTD Chile SA ("MTD Chile"), a Chilean company (collectively "the Claimants" or "MTD"), filed a request for arbitration with the International Centre for Settlement of Investment Disputes ("ICSID" or "the Centre") against the Republic of Chile ("the Respondent" or "Chile"). The request invoked the ICSID Arbitration provisions of the 1992 Agreement between the Government of Malaysia and the Government of the Republic of Chile for the Promotion and Protection of Investments ("the BIT").

2. The Centre, on June 27, 2001, in accordance with Rule 5 of the ICSID Rules of Procedure for the Institution of Conciliation and Arbitration Proceedings ("Institution Rules") acknowledged receipt of the request and on the same day transmitted a copy to the Republic of Chile and to the Chilean Embassy in Washington, DC.

3. On July 17, 2001, the Centre requested further information from the Claimants, with regard to the fulfillment by both Claimants of the requirement set forth in Articles 6(3)(i) and (ii) of the BIT concerning an attempt to resolve the dispute amicably through consultation and negotiation at least three months before the request for arbitration. The Centre also sought confirmation from the Claimants

that neither of them had submitted the dispute to courts or administrative tribunals of Chile, as precluded by Article 6(3)(ii) and (iii) of the BIT; and that the majority of the shares in the second Claimant, MTD Chile, were, for purposes of Article 6(2) of the BIT, owned by investors of Malaysia before the dispute arose. The Claimants responded by a letter of July 30, 2001.

4. The request was registered by the Centre on August 6, 2001, pursuant to Article 36(3) of the ICSID Convention, and on the same day the Acting Secretary-General, in accordance with Institution Rule 7, notified the parties of the registration and invited them to proceed to constitute an Arbitral Tribunal as soon as possible.

2. *Constitution of the Arbitral Tribunal and Commencement of the Proceeding*

5. There were two successive arbitral tribunals in this case, the present Tribunal having been appointed upon the joint resignation of the first set of arbitrators.

6. Following the registration of the request for arbitration by the Centre, the parties agreed on a three-member Tribunal. The parties had agreed that each would appoint an arbitrator and that the third arbitrator, who would be the president of the Tribunal, would be appointed by agreement of the parties.

7. The Claimants appointed Mr James H. Carter Jr, a national of the United States of America, and the Respondent appointed Professor W. Michael Reisman, also a national of the United States of America. By agreement, the parties appointed Mr Guillermo Aguilar Alvarez, a national of Mexico, as the presiding arbitrator.

8. All three arbitrators having accepted their appointments, the Centre by a letter of March 5, 2002, informed the parties of the constitution of the Tribunal, consisting of Mr James H. Carter Jr, Professor W. Michael Reisman, and Mr Guillermo Aguilar Alvarez ("the first Tribunal"), and that the proceeding was deemed to have commenced on that day, pursuant to ICSID Arbitration Rule 6(1).

9. As agreed between the first Tribunal and the parties, in consultation with the Centre, the first Tribunal held its first session in New York on May 29, 2002, with the parties attending.

10. In advance of that session, the parties, by a joint letter dated May 24, 2002, communicated to the Tribunal their agreement on several items on the agenda proposed for the session. Those agreements by the parties were affirmed at the meeting and incorporated in the minutes.

11. Arbitrators had requested a rate of remuneration higher than the Centre's current rate. The Respondent and the Claimants, by letters dated September 17, 2002 and September 24, 2002, respectively, advised the Tribunal that they were unable to offer the rate of remuneration proposed by the Tribunal members.

12. By a letter dated October 2, 2002, the Tribunal notified the parties that it would not be able to serve on the basis of the fees agreed by the parties and that each of its members would be resigning his appointment. By a joint letter of October 17, 2002, members of the first Tribunal tendered their resignation to the Secretary-General of the Centre.

13. On October 18, 2002, the Centre notified the parties of the resignations of Mr Aguilar Alvarez, Mr Carter and Professor Reisman and informed them that the proceeding was suspended pursuant to ICSID Arbitration Rule 10(2). In

accordance with Arbitration Rule 11, the parties were by that letter invited to appoint new arbitrators by the same method by which the initial arbitrators were appointed.

3. *Appointment of the Present Tribunal*

14. By a letter of November 26, 2002, the Claimants informed the Centre of their appointment of Mr Marc Lalonde, a Canadian national, to fill the vacancy created by the resignation of Mr James H. Carter, and invited the Respondent to appoint a replacement for Professor W. Michael Reisman and to engage in consultations aimed at reaching an agreement on the person to replace Mr Guillermo Aguilar Alvarez as the presiding arbitrator.

15. By a letter of December 16, 2002, the Respondent notified the Centre that it had appointed Mr Rodrigo Oreamuno Blanco, a national of Costa Rica, to fill the vacancy created by the resignation of Professor W. Michael Reisman.

16. The parties, by separate letters of January 23, 2003, notified the Centre of their appointment, by agreement, of Mr Andrés Rigo Sureda, a national of Spain, to fill the vacancy created by the resignation of Mr Guillermo Aguilar Alvarez as the presiding arbitrator.

17. All three arbitrators accepted their appointments and, on January 29, 2003, the Centre notified the parties that the Tribunal had been reconstituted and the proceeding recommenced on that day, in accordance with ICSID Arbitration Rule 12.

4. *Written and Oral Procedure*

18. At the first session of the first Tribunal on May 29, 2002, it was agreed that the proceeding would be in English and Spanish. Documents filed in one language would be followed within five business days by a translation in the other language. The procedural arrangements agreed by the first Tribunal have been adhered to by the Tribunal.

19. The following schedule was also agreed for the exchange of written submissions: the Claimants to file their Memorial by October 1, 2002; the Respondent to file its Counter-Memorial by February 1, 2003; the Claimants to file their Reply by April 15, 2003; and the Respondent to file its Rejoinder by July 1, 2003.

20. It was also agreed that a hearing would be held from Monday August 4 to Thursday, August 14, 2003, including Saturday, August 9, 2003.

21. The Claimants filed their Memorial on October 1, 2002, followed on October 8, 2002 by a Spanish language translation. These submissions were not transmitted to the first Tribunal but were sent to the present Tribunal after it was constituted.

22. Upon the resignation of the members of the first Tribunal, the proceeding was suspended on October 18, 2002, pursuant to ICSID Arbitration Rule 10(2) which provides:

> Upon the notification by the Secretary-General of a vacancy on the Tribunal, the proceeding shall be or remain suspended until the vacancy has been filled.

23. Arbitration Rule 12 further provides:

> As soon as a vacancy on the Tribunal has been filled, the proceeding shall continue from the point it had reached at the time the vacancy occurred.

24. On December 26, 2002, the Respondent wrote to the Centre suggesting that the effect of ICSID Arbitration Rules 10(2) and 12 was that suspension of the proceeding upon the resignation of the first Tribunal meant a suspension of the schedule established for the filing of submissions, and requested an extension for the filing of its Counter-Memorial. The Claimants in a letter of January 10, 2003 rejected the Respondent's interpretation of Arbitration Rule 10(2), but agreed with the Respondent that the matter should be determined by the new Tribunal upon its constitution.

25. After the present Tribunal was constituted, by Procedural Order No. 1 of February 3, 2003, issued in English and Spanish, the Tribunal requested the parties to present, no later than by February 14, 2003, any observations that they may have on the effect of the suspension of the proceeding on time limits for filing pleadings. On that day, the parties simultaneously filed submissions.

26. On February 18, 2003, the Claimants requested the Tribunal "to address one new argument" asserted in the Respondent's submission of February 14, 2003.

27. By Procedural Order No. 2, dated February 20, 2003, the Tribunal decided:

> that the meaning of the term "suspension" in Rules 10 and 12 of the [ICSID] Arbitration Rules applies to all matters related to the proceeding, including time limits, and not only to matters related to action required from the Tribunal, that the time limit to present the counter-memorial originally fixed [for] February 1, 2003 [be] extended by 103 days [the duration of the suspension] to May 15, 2003.

28. The Tribunal in that Order then directed the parties:

> (a) to consult each other on the subsequent schedule of the proceeding and other pending matters, including the matter related to business records, and
> (b) advise the Tribunal of the result of their consultations not later than March 14, 2003.

29. By a letter of March 14, 2003, the Claimants notified the Tribunal that the parties were still in discussions on the modified schedule.

30. By a letter of March 17, 2003, the Claimants advised the Tribunal of their agreed schedule for the submission of the remaining pleadings and notified the Tribunal that the parties had resolved the matter related to the business records referred to in Procedural Order No. 2. The Respondent in a letter of March 18, 2003, confirmed the agreement of the parties as communicated in the Claimants' letter of the previous day.

31. Following a request by the Tribunal that the hearing commence a day later than that proposed by the parties, and correspondence with the parties in that regard, the Tribunal, by a letter dated April 21, 2003, formally took note of the agreed schedule for the submission of the remaining pleadings and proposed dates of the hearing from December 9, 2003 to December 19, 2003, including Saturday, December 13.

32. On June 9, 2003, the Respondent filed its Counter-Memorial in English and the Spanish version on June 16, 2003.

33. By letters of July 11, 2003 and July 14, 2003, respectively, the Claimants and the Respondent notified the Tribunal of each other's witnesses and experts that should be made available for cross examination at the oral hearing.

34. On September 15, 2003, the Claimants filed their Reply in English language, followed on September 23, 2003 by Spanish translations.

35. On October 14, 2003, counsel for the Respondent wrote to the Tribunal concerning their participation in the proceeding stating that:

> due solely to budgetary constraints faced by the Republic of Chile, White & Case LLP must withdraw as counsel of record for the Respondent in respect of [this] case. For the avoidance of doubt we wish to emphasize that our withdrawal does not relate in any way to the merits of the issues raised in the case. We shall assume limited role as advisor to the Republic of Chile with regard to this matter.
>
> All communications and service of documents henceforth may continue to be addressed to us, as well as the other advisors of the Republic in regard to this matter.

36. On November 21, 2003, the Respondent filed its Rejoinder in Spanish language, followed by the English language version on December 1, 2003.

37. As previously agreed, the hearing on merits was held from December 9 to 19, 2003, in Washington, DC, at the seat of the Centre. The hearing was conducted in English and Spanish and full verbatim transcripts in both languages were made and distributed to the parties.

38. Pursuant to Rule 38(1) of the Arbitration Rules, on March 26, 2004, the Tribunal declared the proceeding closed, having deliberated by various means.

II. THE FACTS

39. The facts described below follow the narrative of the Claimants and, unless noted, have not been contested by the Respondent.

40. In 1994 Dato'[1] Nik of MTD visited Chile as a member of a trade delegation organized by the Malaysian Ministry of Public Works. During this visit, he met with government officials and business leaders who emphasized Chile's encouragement of foreign investment. Dato' Nik so reported to the Management Committee of MTD. He also met with Mr Musa Muhamad, the Malaysian External Trade Commissioner in the Malaysian embassy in Santiago, who encouraged MTD to invest in Chile.[2]

41. In April 1996, Dato' Nik heard from Mr Muhamad about "an opportunity to build a large planned community near Santiago". Dato' Nik informed Dato' Azmil Khalid who at the time was traveling in the United States. Dato' Azmil Khalid traveled directly from the United States to Chile to investigate this opportunity. There he met with Messrs Muhamad and Antonio Arenas, a local businessman.

[1] "Dato"' is a Malaysian title of honor. [2] Memorial, para. 13.