Case note: *Eskosol S.p.A in liquidazione v Italian Republic (ICSID Case No. ARB/15/50) Decision on Respondent's Application under Rule 41(5)*

Ishbel McLachlan, Law Graduate, Clifford Chance

Michael Dias, Paralegal, Clifford Chance

Introduction

In a recent decision under Rule 41(5) of the Arbitration Rules of the International Centre for Settlement of Investment Disputes (**ICSID**), an insolvent Italian company's claims against the Italian Republic (**Italy** or the **State**) under the *Energy Charter Treaty* (the **ECT**) were found not to be "*manifestly without legal merit*".[1] While the Tribunal's decision is the product of a summary process in which a very high standard of proof applies, and does not therefore amount to a final analysis of the issues raised by Italy, it does provide a useful illustration of the temporal aspect of "*foreign control*" in cases where a locally-incorporated company participates as a foreign claimant through Article 25(2)(b) of the *ICSID Convention* (the **Convention**).

Background

The claimant, Eskosol S.p.A. *in liquidazione* (**Eskosol**, the **Claimant**, or the **Company**), is a company that was established in Italy by its shareholders, including Belgian company Blusun S.A. (**Blusun**). Following changes to the Company's legal nature and ownership, Blusun remained the owner of 80% of Eskosol's shares.

The dispute arose out of changes to the Italian regulatory regime that had previously incentivised investment in Italy by guaranteeing fixed payments (known as feed-in tariffs or **FITs**) for a 20-year period for qualifying investments. Eskosol alleges that such changes had a detrimental effect on their investments in a 120 megawatt photovoltaic energy project in Italy, such that the project became economically unviable, resulting in Eskosol being declared bankrupt and placed under receivership in Italy.

In 2014 Blusun independently began international proceedings against Italy (prior to the claim in issue), challenging the adverse effect of Italy's economic measures on the investment that Blusun had made through Eskosol in Italy (*Blusun S.A., Jean-Pierre Lecorcier and Michael Stein v. Italian Republic* (ICSID Case No. ARB/14/3), the **Blusun Case**). The materials from the Blusun Case – including the award, the parties' submissions, orders and documents – are confidential. However, from the excerpts disclosed in the current case it may be seen that Blusun's claims failed on their merits.

Eskosol commenced arbitral proceedings against Italy, relying on Article 25(2)(b) of the ICSID Convention, alleging that Italy was in violation of its obligations under Articles 10 and 13 of the ECT.

Italy's Rule 41(5) application

Italy filed a preliminary objection pursuant to Rule 41(5), seeking dismissal of all Eskosol's claims on the basis that:

[1] *Eskosol S.p.A in liquidazione v Italian Republic* (ICSID Case No. ARB/15/50) (the **Eskosol Case**)

i. Eskosol is not a "*national of another Contracting State*" under Article 25(2)(b) of the Convention, because on the date it submitted its request for arbitration, it was under the control of the Italian bankruptcy receiver (and not a Belgian company, Blusun);

ii. Eskosol does not qualify as an "*investor*" under either the ECT or the Convention, rather it acted as a mere instrumentality in Italy for Blusun and their shareholders;

iii. Italy declines consent under Article 26(3)(b)(i) and Annex ID of the ECT on the basis that in light of the Blusun Case, the claimant has already had the dispute heard in another forum; and

iv. public international law principles of *lis pendens* and *res judicata* prohibit the prosecution of multiple claims in relation to the same prejudice.

Italy's objection regarding Article 25(2)(b) of the Convention

Readers familiar with ICSID arbitration will know that Article 25(2)(b) of the Convention is the provision that gives a company incorporated in the host State standing to bring a claim under the Convention. The general rule is that, to be a "*national of another Contracting State*", an investor must be a person or company of a country *other* than the Contracting State that is the respondent in the claim. The Article 25(2)(b) exception is engaged where the company is a juridical person of the respondent State but "*because of foreign control, the parties have agreed* [the company] *should be treated as a national of another Contracting State for the purposes of this Convention.*"[2]

The Tribunal's construction of Article 25(2)(b) proceeded from the undisputed point that Eskosol is a juridical national of Italy and remained so on the date of its Request for Arbitration.[3] In considering whether "*the parties ... agreed*" that Eskosol was a "*national of another Contracting State*" for the purposes of the Convention, the Tribunal looked at Article 26(7) of the ECT which prescribes two requirements for a host State company to be treated as a qualified foreign national for the purposes of Article 25(2)(b) of the Convention. A textual analysis indicated two separate temporal requirements: firstly, the investor must have the host State's nationality "*on the date of* [its] *consent in writing*" to ICSID; secondly, the claimant must be "*controlled by*" foreign investors "*before a dispute between it and that Contracting Party arises*". The Tribunal considered that, on the facts of the case, the subjective element was clearly met: Eskosol was a company incorporated in Italy at the time of its consent and was controlled by the Belgian-incorporated Blusun before the dispute. Interestingly, the Tribunal noted that foreign control existed immediately before the dispute arose and did not need to persist through the date of consent to arbitration under the Convention.[4]

However, the Tribunal recognised that "*parties do not have unlimited discretion to define as foreign-controlled an entity that objectively is not*".[5] The Tribunal questioned whether it would be inconsistent with either the text of Article 25(2)(b) or with the purposes of the Convention to accept a construction whereby foreign control focuses on the date a dispute arises, rather than the date of consent to arbitration, and whether Eskosol's entry into

[2] *ICSID Convention*, Article 25(2)(b).

[3] Eskosol Case, [86].

[4] Eskosol Case, [87]-[89].

[5] Eskosol Case, [90].

bankruptcy proceedings in Italy before commencing arbitration against Italy affected Eskosol's foreign-controlled status for the purposes of the ICSID Convention.[6]

The Tribunal noted that interpreting the "*ambiguous treaty language*"[7] in accordance with Article 31 of the *Vienna Convention on the Law of Treaties* (the **VCLT**) leads to two alternate constructions, both of which "*have potential doctrinal consequences for future cases that should not be lightly ignored*".[8] A purely grammatical analysis points to the existence of a temporal requirement in the first part of the sentence, "*nationality* [...] *on the date on which the parties consented to submit such dispute*" (emphasis added) which does not carry through into the second part of the sentence which goes only to the parties' agreement. However a contextual analysis points to the importance of the time of consent to arbitration for assessing nationality so as to establish a claimant's *bona fides* as a foreign investor. While the first reading supports a finding that foreign control at the time that the dispute arises would be sufficient for establishing foreign control for the purposes of Article 25(2)(b), the second reading stresses the importance of foreign control at the time of consent to arbitrate.

The Tribunal was "*unconvinced*" [9] by Italy's assertion that Eskosol's bankruptcy filing deprived it of foreign control prior to filing its Request. It seems unlikely that such arguments would succeed were they to be raised at a later stage in the proceedings given that "[t]*he ECT alone would not dictate this result*"[10] and that "*foreign control for the purposes of the ICSID Convention is an issue of international law, not domestic law*".[11] The Tribunal noted that it would be inconsistent with the underlying purpose of the Convention to render an "*otherwise qualified foreign-owned entity suddenly ineligible to access its protections*" on account of national bankruptcy laws regarding control of bankrupt entities.[12]

Italy's objection regarding Eskosol's status as an "Investor"

Italy's second objection was that Eskosol "*lacks the material qualities of an investor*".[13] Italy neither attempted to define such "*material qualities*", nor cited any specific provisions of either the ECT or the Convention to support the exercise of determining an investor's "*material qualities*".[14] The Tribunal interpreted Italy's argument as "*advocating an extension of this notion from the definition of "investment"* [whereby the word "investment" must be given some substantive content, beyond being "a mere label that can be applied at will to *any* form of economic activity"] *to the definition of "investor", such that a certain threshold of material characteristics should be deemed implicit and therefore appropriate for tribunal scrutiny*".[15] Such issues however, were not to be resolved at the Rule 41(5) stage of the case.

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[6] Eskosol Case, [90]-[93].

[7] Eskosol Case, [98].

[8] Eskosol Case, [98].

[9] Eskosol Case, [108].

[10] Eskosol Case, [105].

[11] Eskosol Case, [106].

[12] Eskosol Case, [106].

[13] Eskosol Case, [109].

[14] Eskosol Case, [118].

[15] Eskosol Case, [119]-[120].

Italy's objection regarding Article 26(3)(b)(i) of the ECT

Italy's third objection relied on the argument that Eskosol and Blusun were effectively the same "Investor", repeatedly bringing the same "dispute" under the ECT, conduct which Italy argued is prevented by the ECT's "fork in the road" provision (Article 26(3)(b)(i)). The Tribunal was "*sceptical*" of Italy's construction of ECT Article 26(3)(b)(i), as such provisions imply "*the choice between two different paths, rather than repeated travels down the identical path*".[16] Further, the Tribunal was unwilling to accept that it was "manifest" that Eskosol and Blusun could be deemed to be the same "Investor".[17]

Italy's objection regarding *res judicata*

Italy's final objection also relied on the argument that Eskosol and Blusun are effectively the same "Investor" and that consequently, with reference to the Blusun Case, Eskosol is prohibited by public international law principles from commencing new proceedings on a dispute that was previously submitted to another international arbitral tribunal (*lis pendens*), or was actually decided by such a tribunal (*res judicata* or collateral estoppel). At the time of the decision, the Blusun award had already been handed down so only issues of *res judicata* or collateral estoppel merited consideration (i.e. *lis pendens* fell away because the Blusun Case was concluded). Blusun owns only 80% of Eskosol (rather than 100%). With regards to the Blusun Case, the Blusun claimants neither joined Eskosol itself to the Blusun proceedings, nor did Eskosol consider Blusun to have authority to represent Eskosol's interests on Esksol's behalf. In such circumstances, the Tribunal said it "*would have difficulty concluding* [...] *that Blusun and Eskosol effectively were the same party, so as to preclude the later from attempting any claim after the former already has done so*".[18] Accordingly, the Tribunal found that it was "*far from manifest that the parties were identical*".[19]

Concluding observations

Rule 41(5) was introduced to the ICSID Arbitration Rules in 2006. It is, in effect, a summary dismissal mechanism. To date, it has been invoked sparingly, for the simple reason that the high bar it sets for applicants ("*manifestly without legal merit*") makes Rule 41(5) motions unattractive in most cases. In the sense that it contributes to a relatively sparse jurisprudence, the *Eskosol* decision is likely to be welcomed by practitioners. In terms of its substance, its approach to the temporal dimension of Article 25(2)(b) of the Convention is probably the most interesting aspect of this decision. Although the Tribunal covered a number of the more technical issues arising from this head of Italy's application, the Tribunal appears to have been concerned by a point of principle: whether a host State can use its own law (bankruptcy law) to avoid an international obligation (to arbitrate disputes under the ECT). In the summary context of Rule 41(5), this question did not fall for detailed consideration. But, assuming Italy brings a full jurisdictional objection based on the issue of control under Article 25(2)(b), it is likely this point will be the subject of detailed examination by the arbitrators. As many countries permit or even require foreign investors to establish local companies to hold and operate investments, decisions regarding the procedural rights of such

[16] Eskosol Case, [134].

[17] Eskosol Case, [135].

[18] Eskosol Case, [169].

[19] Eskosol Case, [171].

companies under Article 25(2)(b) have a particular significance for businesses engaged in cross-border investment and their advisers.