"No Equals in Wrong?" The Issue of Equality in a State of Illegality

Some Thoughts to Encourage Discussion

Steffen HINDELANG*

I. INTRODUCTORY REMARKS

The issue of equality in a state of illegality frequently recurs in international investment practice[1] but has rarely surfaced in international investment arbitrations. The Award and Separate Opinion in *Thunderbird v. The United Mexican States*[2] are to some extent exceptional in this sense. In this case a foreign corporation (Thunderbird) and a national one (Guardina) operating gaming facilities were both allegedly in violation of certain Mexican gambling regulations.[3] While the domestic investor had continuing success to fend off any attempts by the respective authority (SEGOB) to interfere with its business, the foreign investor was less fortunate. It appears that it, although equipped with a comfort letter by SEGOB stating that it was not violating national gambling laws

* Ref. jur. (Marburg); LL.M. (Sheffield); Research Fellow, Lecturer and Doctoral Candidate, Eberhard-Karls-University, Tübingen, Germany, Faculty of Law. His research is mainly directed towards the European and International Legal Framework on Foreign Investment. The author thanks Professor Nettesheim and Professor Wälde, Dr Gutbrod, Mr Kurtz, Mr Sliwiok, and the Working Committee of the Research Assistants in Public Law at the University of Tübingen, School of Law, for helpful comments on earlier drafts, as well as Ms Lawler and Ms Oberer for their technical support. The article was partially presented as a paper at the European Public Law Summer School 2006 at "Villa Vigoni–Centro Italo-Tedesco", Italy. The usual disclaimers apply.

The author may be contacted at: ‹st.hi@gmx.de›.

[1] *Cf* for some examples taken from the realities of developing countries: Max Gutbrod and Steffen Hindelang, *Externalization of Effective Legal Protection against Indirect Expropriation—Can the Legal Order of Developing Countries Live up to the Standards Required by International Investment Agreements? A Disenchanting Comparative Analysis*, 7 J.W.I.T. 1 (February 2006), 59 *et seq.*

[2] NAFTA Arbitration under UNCITRAL Rules (2006), *International Thunderbird Gaming Corporation v. The United Mexican States*, Final Award; available at: ‹http://www.naftaclaims.com/Disputes/Mexico/Thunderbird/Thunderbird_Award.pdf›, last visited 12 March 2006; NAFTA Arbitration under UNCITRAL Rules (2006), *International Thunderbird Gaming Corporation v. The United Mexican States*, Separate Opinion of T.W. Wälde; available at: ‹http://www.naftaclaims.com/Disputes/Mexico/Thunderbird/Thunderbird_Dissent.pdf›, last visited 12 March 2006. See also ICSID (2002), *Marvin Roy Feldman Karpa (CEMSA) (U.S. A.) v. United Mexican States*, Award, Case No. ARB(AF)/99/1; available at: ‹http://www.investmentclaims.com/decisions/Feldman-Mexico-Award-16Dec2002-Eng.pdf›, last visited 10 May 2006, paras. 173 *et seq.* In *Feldman*, the issue of equality in a state of illegality was also present but unfortunately not discussed. The circumstances which are of interest for our topic can be summarised as follows: "No cigarette reseller-exporter (the Claimant [Feldman], Poblano Group member or otherwise) could legally have qualified for the IEPS [tax] rebates, since none under the facts established in this case would have been able to obtain the necessary invoices stating the tax amounts separately." [*Feldman*, Award, para. 176]. Thus, both, the foreign as well as the domestic investor were in breach of (national) law. Given that only Feldman's company was asked to pay back the already granted tax rebate, although also domestic investors had received those [*Feldman*, Award, para. 173], it becomes reasonably clear that enforcement actions were not conducted free of prejudice. Note also NAFTA Arbitration under UNCITRAL Rules (2000), *United Parcel Service of America, Inc. v. Canada*, Statement of Claims; available at: ‹http://naftaclaims.com/Disputes/Canada/UPS/UPSStatementOfClaim.pdf›, last visited: 31 July 2006.

[3] *Thunderbird v. Mexico* (Final Award), para. 73.

in the manner it conducted its business, faced enforcement actions considerably more intense and focused, which could raise the impression that some discriminatory elements were actually present.[4]

It is with such kind of situation in mind that I refer in this short article to the issue of equality in a state of illegality. Leaving the lowlands of the actual case behind and putting the subject-matter of the article in more abstract terms, one can depict the area under discussion as follows: a band of investors, one foreign and the others domestic, in comparable circumstances[5] are all in violation of the same national rule. This state of affairs lasts for some time until the moment the host State decides suddenly to act. The host State, however, chooses to take steps only against one of the investors, which happens to be the foreign one, but turns a blind eye on *all* or *almost all* of the domestic investors or lacks the same energy in enforcing the given rule against the latter.[6] In consequence, the foreign investor suffers severe financial losses or even falls bankrupt.

In such a situation, local remedies may not have been readily available or meaningful, or were pursued without any success.[7] The foreign investor might be tempted to turn to international investment arbitration based on a bilateral investment treaty (BIT) or any other comparable legal instrument. But how promising will such an undertaking be—recalling the fact that the foreign investor finds itself in breach of national regulations and, at first sight, the host State merely seeks to re-establish a state of lawfulness? Blanking out all the uncertainties generally involved in an investment arbitration, this article wants to narrow the focus on the interaction and collision of two legal principles which might, if one is prepared to follow the solution suggested in this article, essentially decide the investor's fate in such a situation. On the one hand, there is the *principle of non-discrimination*, to be found, *inter alia*, in national,[8] most-favoured-

[4] *Thunderbird v. Mexico* (Separate Opinion), paras. 107 *et seq.* A question different from the one considered here is the issue of whether a bilateral investment treaty (BIT) is meant to help parties which are legally unskilful in local court proceedings to receive an additional chance in an international investment arbitration just because they are foreign.

[5] See, for the ongoing debate in international investment law on how to determine "likeness", e.g. Thomas Wälde, *Comments on the Discipline of "National Treatment" in International Investment Law: Boosting Good Governance versus Intruding into Domestic Regulatory Space?* (unpublished manuscript, envisaged for publication in TDM); Jürgen Kurtz, *National Treatment, Foreign Investment and Regulatory Autonomy: The Search for Protectionism or Something More?* in: Hague Academy of International Law (ed.), *Report of the 2004 Research Seminar on International Investment Law*, (The Hague: forthcoming 2006). For an account of "likeness" in the WTO legal order, see, e.g. Jonell B. Goco, *Non-Discrimination, "Likeness", and Market Definition in World Trade Organisation Jurisprudence*, 40 Journal of World Trade (2006), 315 *et seq.*; Claus-Dieter Ehlermann and Lothar Ehring, *WTO Dispute Settlement and Competition Law: Views from the Perspective of the Appellate Body's Experience*, 26 Fordham Int'l L. J. (2002-2003), 1505 *et seq.*

[6] This article, due to its scope, considers only those rules which entitle the administration of the host State to interfere with existing rights of an investor but not those rules which entitle it to distribute additional rights or benefits.

[7] For an account of how national legal orders of transition countries, the Russian legal order serves as a point of reference, dealing—or better, failing to deal—with the issue of discrimination; see Max Gutbrod and Steffen Hindelang, *The Missing Bits–To Be Substituted by BITs? The Inadequacy of Russian Law in regard to the Effective Protection of Foreign Investors, The Role of BITs and the Need for Reform Coming from within the State*, 1 SIAR (2006:2), forthcoming.

[8] *Cf* e.g. M. Sornarajah, *The International Law on Foreign Investment*, 2nd ed. (Cambridge: Cambridge Univ. Press, 2004), 233 *et seq.*; United Nations Conference on Trade and Development (UNCTAD), *National Treatment*, UNCTAD Series on Issues in International Investment Agreements (New York and Geneva: UNCTAD, 1999).