INTERNATIONAL CENTRE FOR SETTLEMENT OF INVESTMENT DISPUTES
WASHINGTON, D.C.

IN THE PROCEEDING BETWEEN

PSEG Global Inc., The North American Coal Corporation, and Konya Ilgin Elektrik Üretim ve Ticaret Limited Sirketi
(CLAIMANTS)

and

Republic of Turkey
(RESPONDENT)

(ICSID Case No. ARB/02/5**)**

DECISION ON JURISDICTION

Members of the Tribunal
Professor Francisco Orrego Vicuña
Mr. L. Yves Fortier, CC, QC
Professor Gabrielle Kaufmann-Kohler

Secretary of the Tribunal
Mr. Ucheora Onwuamaegbu

Representing the Claimants
Ms. Carolyn B. Lamm,
Ms. Abby Cohen Smutny and
Mr. Lee A. Steven
White & Case LLP

Representing the Respondent
Judge Stephen M. Schwebel

Messrs Daniel M. Price,
Stanimir A Alexandrov,
Samuel Boxerman and
P. David Richardson
Sidley Austin Brown & Wood LLP

Mr. Serdar Paksoy, Paksoy & Co

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I Procedure

A. Registration of the Request for Arbitration

1. On March 22, 2002, the International Centre for Settlement of Investment Disputes ("ICSID" or "the Centre") received a request for arbitration against the Republic of Turkey ("Turkey" or the "Respondent") from PSEG Global Inc. (PSEG), a company incorporated under the laws of New Jersey in the United States of America (USA); the North American Coal Corporation ("North American Coal"), a company incorporated under the laws of the state of Delaware in the USA; and Konya Ilgin Elektrik Üretim ve Ticaret Limited Sirketi (the "Project Company"), described in the request for arbitration as a special purpose limited liability company incorporated under the laws of Turkey and wholly owned through several subsidiaries by PSEG (together referred to as the "Claimants").

2. The request invoked the ICSID arbitration provisions in the Treaty between the United States of America and the Government of the Republic of Turkey Concerning the Reciprocal Encouragement and Protection of Investments (the "Treaty"), which was signed on December 3, 1985 and entered into force on May 18, 1990.

3. The Centre, on March 25, 2002, 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 Turkey and to the Embassy of Turkey in Washington, D.C.

4. On April 12, 2002, the Centre requested further information from the Claimants, with regard to (i) the investment of each requesting party, for purposes of the ICSID Convention and the Treaty; (ii) the dispute of each requesting party, including further information as to the date on which the dispute arose; (iii) each claimed violation of the Treaty in respect of each requesting party; and (iv) the efforts on the part of each requesting party to settle the dispute through consultations and negotiations in good faith. The Claimants responded by a letter of April 18, 2002.

5. The request, as supplemented by the Claimants' letter of April 18, 2002, was registered by the Centre on May 2, 2002, pursuant to Article 36(3) of the ICSID Convention, and on the same day the 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.

B. Constitution of the Arbitral Tribunal and Commencement of Proceeding

6. Following the registration of the request for arbitration by the Centre and the invitation to the parties to proceed to constitute an Arbitral Tribunal, the Claimants reiterated the proposal in their request for arbitration that the Tribunal be composed of three arbitrators, one appointed by each party and the third, who shall be the President of the Tribunal, to be appointed by agreement of the parties. Pursuant to Rule 2(2) of the ICSID Rules of Procedure for Arbitration Proceedings (Arbitration Rules), the Centre communicated this proposal to the Republic of Turkey by letter of May 9, 2002 and by letter of May 24, 2002, the Republic of Turkey notified the Centre of its acceptance of the proposal.

7. The Claimants, by a letter of June 6, 2002, appointed Mr. L. Yves Fortier, C.C., Q.C., a national of Canada, as arbitrator and by letter of June 25, 2002, the Respondent appointed Professor Gabrielle Kaufmann-Kohler, a Swiss national, as arbitrator. By agreement, the parties in a joint letter of October 22, 2002 appointed Professor Francisco Orrego Vicuña, a national of Chile, as the presiding arbitrator.

8. All three arbitrators having accepted their appointments, the Centre by a letter of October 25, 2002, informed the parties of the constitution of the Tribunal, consisting of Professor Francisco Orrego Vicuña, Mr. L. Yves Fortier, C.C., Q.C., and Professor Gabrielle Kaufmann-Kohler, and that the proceeding was deemed to have commenced on that day, pursuant to ICSID Arbitration Rule 6(1).

C. Written and Oral Proceedings

9. After consulting with the parties and the Centre, the Tribunal scheduled a first session for January 8, 2003, and the parties, by a joint letter of December 23, 2002, communicated to the Tribunal their agreement on procedural matters identified in the provisional agenda for the first session, which had been sent to them by the Tribunal's Secretary. In that letter, the parties notified the Tribunal that the Respondent intended to raise objections to jurisdiction, which the

Tribunal would be required to rule on before proceeding to the merits of the case in accordance with Article 41 of the ICSID Arbitration Rules. They also notified the Tribunal of their agreed schedule for the submissions and hearing on jurisdiction. Further, the parties in the same letter informed the Tribunal that in the event that the Tribunal were to reach the merits of the dispute, the Respondent intended to submit a counterclaim and the Claimants reserved their rights to raise objections as to the Tribunal's jurisdiction over any such counterclaim, which objection would be heard at the same time as the merits of the claims and counterclaims.

10. The first session of the Tribunal was held as scheduled on January 8, 2003, at the seat of the Centre in Washington, D.C. The parties reiterated their agreement on the points communicated to the Tribunal in their joint letter of December 23, 2002, and the remainder of the procedural issues on the agenda for the session were discussed and agreed. All the conclusions were reflected in the written minutes of the session, signed by the President and Secretary of the Tribunal and provided to the parties, as well as all Members of the Tribunal.

11. In accordance with the agreed schedule, the Respondent on April 3, 2003, filed its Memorial on Jurisdiction, and on June 27, 2003, the Claimant filed its Counter-Memorial on Jurisdiction.

12. On July 11, 2003, the Respondent requested the Tribunal, in accordance with ICSID Arbitration Rule 26, to extend by 45 days the time for the Respondent to file its Reply on Jurisdiction. The Respondent cited as the reasons for this request, the volume of the Claimants' Counter-Memorial on Jurisdiction (121 pages) and the number of exhibits thereto (300); and the fact that "a substantial portion of the materials in [the] Claimants' Counter-Memorial … including 13 of the witness statements and expert opinions, [were] in English only" and needed to be translated into Turkish. The Claimants in a letter of July 15, 2003 objected to the Respondent's request, suggesting instead that if an extension of time was of critical importance, it should be for no more than 30 days to minimize the delay to the originally agreed schedule, and that, in such an event, a similar extension should also be allowed the Claimants for their Rejoinder.

13. Following a further letter of July 15, 2003 from the Respondent, the Tribunal by its Secretary's letter of July 17, 2003, communicated to the parties its decision to extend the deadline for the filing of the Reply on Jurisdiction by 30 days and to allow a similar extension to the Claimants for the submission of the Rejoinder on Jurisdiction. The Tribunal also decided to reschedule the hearing on jurisdiction, originally set for November 3 to 6, 2003, to take place no earlier than the second half of January 2004 on dates to be agreed by the Tribunal in consultation with the parties and the Secretariat.

14. In compliance with the new schedule, the Respondent's Reply on Jurisdiction was duly filed on September 10, 2003, and the Claimants' Rejoinder on Jurisdiction was duly filed on November 24, 2003.

15. Also, in accordance with a new schedule, agreed after several exchanges of correspondence between the Tribunal and the parties, and in consultation with the Centre, the hearing on jurisdiction was held at the seat of the Centre in Washington, D.C., from February 22 to 25, 2004. The parties were represented by their respective counsel who made presentations to the Tribunal and examined witnesses and experts from their side and the opposing side. Seven witnesses and experts testified on behalf of the Claimants and six testified on behalf of the Respondent. Present at the hearing were:

Members of the Tribunal: Professor Francisco Orrego Vicuña, President, Mr. L. Yves Fortier, CC, QC and Professor Gabrielle Kaufmann-Kohler.

ICSID Secretariat: Mr. Ucheora O. Onwuamaegbu, Secretary of the Tribunal.

Attending on behalf of the Claimant: Carolyn B. Lamm, Abby Cohen Smutny, Lee A. Steven, Lee M. Caplan, Noyan K. Goksu, Petr Polasek, Katherine F. Price, Matthew N. Drossos, Erica M. Preiss, and Darryl S. Lew of White & Case LLP; Mesut Çakmak and Tugba Bayman of Cakmak Ortak Avukat Bürosu; Matthew J. McGrath and Halil E. Sunar PSEG Global, Inc.; Clark A. Moseley of North America Coal Corporation; Sarah P. Voll and Carlos A. Pabón-Agudelo of National Economic Research Associates; as well as William VanHerwarde, Michael B. Rosenzweig, Metin Gunday, Sait Guran, and Ata Sakmar.

Attending on behalf of the Respondent: Selahattin Çimen, Sevim Argun, and Oguzhan Ertugrul, Representatives; Daniel M. Price, Stanimir A. Alexandrov, Stephen M. Schwebel, Samuel Boxerman, P. David Richardson, Marinn F. Carlson, Lesley Foxhall, Jennifer Haworth McCandless, Banu Demiralp, Serdar Paksoy, Duygu Limnili, Elvan Aziz, and John P. Wintrol, Counsel; Selda Bilgiç, Osman Emed, Ahmet Oktay Kavas, Carlos Lapuerta, Ergun Özsunay, Rutherford B. Poats, Robert Sansom, and Mumtaz Soysal.

16. Following the hearing, the Members of the Tribunal deliberated by various means of communication, including a meeting for deliberations in London on May 4, 2004.

17. The Tribunal considers it unnecessary to describe the numerous procedural issues that it was called upon to resolve, or to recount the parties' many submissions, requests and applications relating to these issues. Suffice it to say that throughout the written phase of this jurisdictional phase of the arbitration, the Tribunal was required to consider and determine a myriad of questions relating to the disclosure of documents and the availability of one witness.

II. Considerations.

A. The facts of the dispute.

The early start-up of the Project, the Feasibility Study and the Implementation Contract.

18. In the past two decades Turkey has undertaken an important expansion of its energy sector with a view to ensuring the overall development of its economy. In 1984, Parliament enacted Law No. 3096 authorizing private companies to build and operate generation facilities and to sell the generated electricity to TEAS, the Turkish state-owned electric entity. Under this Law a "Build-Operate-Transfer" ("BOT") model was established, allowing private investors to undertake the generation project with the requirement of transferring to the Government the ownership of the site and plant at the end of the authorization period. This legal framework was perfected in 1994 with the enactment of Law No. 3996, which in essence provided for the BOT contracts and agreements to operate subject to private law.

19. Foreign investment was expected to be a key feature in this energy expansion program. In April 1994, PSEG requested the Ministry of Energy to undertake the negotiation of a contract with a view to developing a lignite-fired electric power plant in the Turkish Province of Konya. The development of an adjacent lignite mine that would supply the plant's fuel was also envisaged in the proposal. After some initial negotiations and revisions, the Ministry in November 1995 approved the Feasibility Study of the project prepared by PSEG.

20. The Feasibility Study considered a plant with a generating capacity of 425 MW gross and 375 MW net. The average annual price per kilowatt-hour was US$0.0498 cents,[1] the operational period 38 years, the annual availability factor 85.08% and the total investment US$804. 8 millions. The net capacity, the price and the availability factor are the key commercial terms and are set out in a "tariff" which establishes the terms and conditions for the provision of and payment for power on a yearly basis.

21. In March 1996, the Turkish Constitutional Court ruled that BOT power projects could not be subject to private law and had to follow the traditional model of concession contracts subject to the approval of the Turkish Council of State (the "Danistay"). Upon approval of the project by the State Planning Organization, the parties in August 1996 initialed an Implementation Contract[2] based on the same factors as the Feasibility Study. This contract was then submitted to the Danistay for review and approval in the form of a Concession Contract.[3]

22. A few weeks before the Implementation Contract was initialed, PSEG advised the Ministry that an additional site exploration had to be conducted before preparing the final Mine Plan, a step that could have an influence in the operation plan and coal production costs. Article 5.1 of the Implementation Contract allowed the Claimants to conduct additional studies concerning the mine site and, if necessary, to prepare a Revised Mine Plan; it also allowed for the submission of a revised energy tariff reflecting such cost increases.

23. The Implementation Contract also provided for a Long Term Energy Sales Agreement to be entered into by the Claimants and TEAS and for a Fund Agreement with the Electrical Energy Fund, as well as for the project to benefit from a Treasury guarantee under Article 11 of Law 3996.[4] Discussions on the Energy and Fund agreements made progress but ultimately were not finalized. The Treasury guarantee experienced other problems as will be mentioned below.

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[1] All references to currencies made in this Decision are to dollars of the United States of America.
[2] Hereinafter the "Implementation Contract".
[3] Hereinafter the "Concession Contract" or the "Contract".
[4] Hereinafter the "Treasury guarantee".

The Revised Mine Plan and the corporate structure.

24. The Revised Mine Plan was submitted by the Claimants in December 1997, incorporating conditions for the mine that were different from those originally envisaged. As a result, it was estimated by the Claimants that a capital investment of US$361.6 million would have to be made in addition to the US$804.8 million investment envisaged in the Feasibility Study, thus totaling US$1.166 billion. Furthermore, the Revised Mine Plan called for an additional US$557 million that would be needed for the mine during the life of the Project and an additional US$20 million yearly operating and maintenance costs. It was also proposed that these increased costs could be met by increasing the generating capacity of the plant to 500 MW gross and 433.5 MW net with an average availability of 87%, the price per kilowatt hour remaining unchanged. Additional energy would have to be bought by TEAS under this proposal. The overall cost of the project would increase by approximately US$1 billion.

25. The negotiations between the parties that followed in 1998 were of an increasingly complex nature. Part of it was related to the implications of the Revised Mine Plan and part to the proposed corporate structure.

26. At first, a Turkish joint stock company was envisaged as the corporate vehicle, but as a result of amendments of the Turkish law and tax issues PSEG later proposed that it be changed to a Turkish branch Office of the foreign investor. The Ministry favored the first choice although there would be adverse tax implications for the project. In this context, the Ministry apparently requested the Claimant to prepare alternative proposals that would take into account variations in the plant capacity and other factors that could affect the tariff structure, including the question of the corporate structure. Consequently, the Project Company was first established as a Turkish branch Office of a Dutch corporation created to handle the investment and later incorporated as a limited liability company.

27. The North American Coal Company (NACC) began assisting with the mining aspects of the project in 1996 and in 1998 entered into a Memorandum of Understanding with PSEG so as to become an equity investor.

28. In so far as the settlement of disputes was concerned, the Implementation Contract had provided for ICSID arbitration. The relevant clause was, however, deleted from the

Concession Contract in the review process before the Danistay and as a result the Contract did not contain any specific provision on dispute settlement.

29. Three proposals were submitted by the Claimant to take account of the changed costs in February 1998. These proposals ranged from 433 MW gross/375 MW net to 500 MW gross/433.5 MW net; from an average availability factor of 85% to 87%; and all had in common an increase in price from the original US$0.0498 cents to: US$0.0571 cents/Kwh, US$0.0523 cents/Kwh and US$0.0634 cents/Kwh, respectively.

30. The parties have different views about what was agreed in this respect. The Respondent is of the view that the proposals were rejected because they would increase the cost to the Turkish Government and consumer, but that it was prepared to accommodate the 500/433.5 MW alternative provided the price remained unchanged and that a limited liability company was established. The Respondent also submits that this was agreed at a meeting held on February 13, 1998. The Claimants have a different view, believing that no agreement was reached at this time and that the Ministry would continue to examine the various proposals and to consider the Revised Mine Plan.

31. The discussions continued at another meeting held on February 19, 1998, where it was agreed that a draft amended Contract would be submitted to the Danistay, including the changes agreed. Exactly what changes and amendments would be submitted remained unclear in the light of the continuing discussions about the Revised Mine Plan and the plant capacity and other associated elements. The Revised Mine Plan was later approved by the Turkish Coal Enterprise in May 1998.

The Concession Contract.

32. The fact is, however, that the Danistay approved the Implementation Contract in the form of a Concession Contract on March 30, 1998. The economics of the project as envisaged in the Feasibility Study were not changed as no agreed amendment had been submitted. It follows that a plant capacity of 425 MW gross/375 MW net, on a 38-year term, an annual average availability factor of 85.08% and an average price of US$0.0498 cents/Kwh, were approved.

33. One of the amendments introduced by the Danistay concerned the revised tariff and its approval. Article 5.1 of the Implementation Contract had provided for the possibility of submitting a new tariff to the Ministry covering the increased fuel production costs. This resulted in the amended Article 8, paragraph 3, of the Contract, which provides:

> "If necessary, the Company will prepare a revised mine plan based on such additional research and exploration conducted in the mine site prior to the construction start date. If such revised mine plan increases the Company's estimated fuel production cost, the Company shall submit to the Ministry a revised tariff reflecting such cost increase, which the Ministry shall approve or disapprove in no later than sixty days after the submission by the Company. In the event the Ministry withholds its approval for the revised tariff on the basis of reasonable grounds and if the Company abandons the project prior to the construction start date, the Company and the Ministry shall have no claims against the other".

34. Additional meetings were allegedly held in May 1998, although the Respondent has explained that it has no official records of any such meetings and the officials allegedly participating do not recall attending such meetings. In the Claimants' version, at a meeting held on May 18, 1998 the Ministry orally accepted a proposal for a 500 MW gross/465 MW net plant capacity and an 87% availability factor so as to include the increased costs and the added tax burden resulting from the limited liability company corporate structure. Furthermore, a letter from the Claimant followed on the same date confirming the alleged understandings. The Respondent, however, does not believe that any such agreement was reached and that the letter remained unanswered as it was beyond the scope of the agreement allegedly reached in February. In any event, the Respondent argues, the Claimant itself believed that the May terms were only a proposal, as reflected in a letter of June 3, 1999.

35. Other crucial steps in the process of negotiation took place in June 1998, but again the views of the parties on such events are different. Following the approval of the Revised Mine Plan by the Turkish Coal Enterprise, the Ministry approved on June 19, 1998 the commercial terms of the project. The Respondent believes these are the terms agreed to in February 1998,

that is, a plant capacity of 500 MW gross/433.5 MW net, the availability factor and the tariff remaining unchanged. The Claimant, for its part, submits that as a result of the May meetings and another meeting held on June 16, 1998, the Ministry through its approval of June 19, 1998 accepted the 500 MW/gross and 465 MW net plant capacity as the means to cover the increased costs, although admittedly no reference was made to the net factor. The Respondent further argues that the 465 MW net capacity was not feasible and that in any event the Ministry alone could not approve new commercial terms. It also does not agree with the Claimants that a meeting was held in this context.

36. After further exchanges of correspondence between the Claimant and the Ministry concerning the Danistay approval of the Contract and the Claimant's reservations in respect of arbitration and other issues, PSEG executed the Concession Contract as issued by the Danistay on December 10, 1998. A ground breaking ceremony took place on December 17, 1998. In February 1999 the Claimant issued a performance bond for US$8.848 millions and on March 8, 1999 the Ministry signed the Concession Contract.

37. Whether the Contract included a final agreement on key commercial terms and what those terms were has also been a matter of controversy. The Respondent is of the view that the Contract did not include a final agreement on essential commercial terms as the original cost estimates turned to be inaccurate and no amendments were submitted to the Danistay. A reference to 425 MW was made in the Ministry's transmittal letter of the executed Contract and later a reference to 500 MW gross/465 MW net was included in a draft Protocol that the parties discussed in connection with the amendments that could be submitted to the Danistay.

38. Each party argues that this Protocol was drafted by the other. In Respondent's view the reference to 465 MW net is a mistake that originated in the draft being prepared by the Claimant; conversely, the Claimant argues that this was drafted by the Respondent and therefore constitutes further evidence of the revised commercial terms having been agreed to and that in any event the alleged mistake, even if such, was never corrected. New meetings were held and correspondence exchanged in March and April 1999 concerning the terms of the Protocol and again the parties dispute whether the 465 MW figure was accepted or even discussed at this other stage.

The aftermath of the execution of the Contract.

39. Various meetings that followed the execution of the Contract and the discussion of the draft amendment Protocol showed that the parties were entrenched in their views of the facts. The Ministry considered in particular that the final figures had been agreed to in February 1998 and that any increase in the net capacity above 433.5 MW would inevitably result in an unacceptable increase of the envisaged tariff of US$0.0498 cents. In addition, the Ministry's engineers believed that the increased tariff would not only cover the costs but would also result in a higher profit for the Company. The Claimants insisted that only by increasing the net capacity to 465 MW, as agreed in May 1998, could the tariff be kept at that level and at the same time offset the additional costs imposed by a limited liability company structure.

40. Additional proposals were made by the Claimants in June 1999 but none of them were acceptable to the Ministry if it resulted in a higher cost to the Government and, eventually, to the consumer. The alternative of a 545 MW gross/465 MW net was also considered at this stage. On February 10, 2000, the Claimants made what they considered their final offer: a 500 MW gross/433.5 MW net plant capacity with a higher availability factor for the first twelve years of the project, but this was not acceptable to the Ministry.

41. Several important steps were taken as from mid-1999 in respect of the corporate organization of the project and the governing legal framework. A Permission Certificate authorizing the Project Company to invest and do business in Turkey was issued on July 5, 1999. The Company was incorporated as Konya Ilgin Ltd. on August 19, 1999. Also in August 1999 the Turkish Constitution was amended to enable Parliament to authorize certain public services to be provided under private law contracts and to permit the Republic of Turkey to consent to international arbitration. Following the enactment of Law No. 4493 in December 1999, BOT contracts could be concluded as private law contracts.

42. Also with the enactment of Law No. 4501 on January 22, 2000, parties to existing concession contracts could convert these instruments to private law contracts or could agree to submit disputes to international or domestic arbitration. The Claimants applied to the Ministry within the deadline given to convert the Concession Contract to a private law contract or,

alternatively, to amend the Contract agreeing to submission of disputes to international arbitration.

43. This application led to a new round of disagreements between the parties as to the commercial terms of the Contract. According to the Claimants, the Ministry demanded six changes in the Contract before forwarding the application to the Council of Ministers. In the view of the Claimants the Ministry was seeking to obtain financial concessions which it did not have authority to demand under the law.

44. On December 22, 2000, the Claimants indicated that they would demand reimbursement of the expenses made and payment for its losses. It appears that no further negotiations took place thereafter. The performance bond expired on February 23, 2001 and was not extended.

45. An additional amendment of the legal framework took place in March 2001 with the enactment of Law No. 4628 on the Electricity Market. The Claimants believe that Article 8 (1) of this Law, by eliminating the possibility of obtaining a Treasury guarantee, effectively terminated the Concession Contract as this was one of its essential components. The Respondent believes that the law had no impact on the project as the Claimant had ended the negotiations before its adoption.

46. A decision of the Turkish Constitutional Court of February 13, 2002 invalidated the provision of Law No. 4628 eliminating the rights of a company to the Treasury guarantee, because this was a right created by the concession contract and hence had to be protected under the contract, the rule of law and the Turkish Constitution. The Claimants believe that their right to this guarantee has thus been revived, but no governmental action was taken in this respect.

47. As noted, the Claimants introduced a request for arbitration before ICSID on March 22, 2002, thus beginning this proceeding.

The parties' explanation of the dispute.

48. The parties also offer different explanations about the reasons for their disagreements and, ultimately, for submitting their dispute to arbitration. A number of the issues raised are

connected more to the merits than to jurisdiction in this case, but it is necessary to keep them in sight in order to better understand the nature and extent of the jurisdictional objections made by the Respondent and the views of the Claimants thereon.

The Claimants' views.

49. The Claimants have argued that the Respondent took action and engaged in deliberate inaction to destroy the Claimants' investment in the Republic of Turkey. After having authorized the investment and concluded a valid and binding Concession Contract, it is argued, the Respondent took steps to deprive the Claimants of the Treasury guarantee, the long-term power purchase agreement and the Fund Agreement that were essential to the success and feasibility of the project. In this context, the Claimants argue that various contractual undertakings were breached, in particular the revision of the tariff structure so as to accommodate increased costs. It is also claimed that other rights provided to investors by law were denied.

50. Given the fact that the project was organized along the lines of a BOT model, the actions and inactions were particularly detrimental to its feasibility. The Claimants explain that the significant level of investment required involves both equity and loan resources, including international debt financing, which is dependent on a tariff structure that is able to generate sufficient income to repay lenders, meet the operational expenses and offer sufficient returns on equity. Although regulations in force at the time provided that a BOT project's rate of return should be capped at 16%, most of the alternatives discussed with the Ministry ended up in lower figures that led, in the Claimants' view, to an inadequate and unreasonable rate of return.

51. In the Claimants' understanding these difficulties stemmed from the changing priorities of the Turkish Government and particularly from the pressure to reform the country's economy in the light of the negotiations for access to the European Community and World Bank policies. It is alleged that these policies were contrary to the BOT model as it was thought that the profitability of the project would be artificially ensured through government guarantees and other mechanisms, including a subsidized tariff structure resulting in uncompetitive generation costs. The Government was required to impose limits on the new projects included in the public investment program and to limit the issuance of new guarantees.

52. The end result was that the Government abandoned the large-scale BOT projects, with the exception of 29 small projects that did not include the Claimants' project. Treasury guarantees were effectively eliminated under the Electricity Market Law, noted above, and power purchase agreements could not exceed one year. These measures led to the effective termination of the project. Notwithstanding the fact that the Constitutional Court ruled that such restrictive provisions of the Electricity Market Law were unconstitutional, as explained above, no government action ensued to remedy the situation. Moreover, it is argued by the Claimants that both the Energy Sales Agreement and the Fund Agreement had been substantially completed with the technical bodies involved but the Ministry never extended the necessary authorization.

53. The Claimants also explain that all the major components of the project had been completed prior to financial closing. These components included the preparation of an Environmental Impact Assessment, the selection of the engineering, procurement and construction contractor, the conduct of hydrological studies, a mining license and operation permit for the mine, loan applications and appointment of financial agents, zoning changes and preparatory steps for the necessary expropriations.

The Respondent's views.

54. The Respondent rejects all of the above explanations and believes that the dispute arises from the project never having moved off the drawing board or the negotiating table. Since the Claimants had dramatically underestimated the costs of the project in the Feasibility Study, it is argued, there simply was no agreement on the commercial terms. It follows in the Respondent's view that all the activities undertaken were merely preparatory to the investment and did not involve any legal expectation or right.

55. Before any Concession Contract was approved by the Danistay, the Claimants knew that the original commercial terms were unfeasible as they had changed dramatically in the light of the Revised Mine Plan. The Respondent believes that the Claimants have constantly sought to pass on to the Turkish Government and consumer the higher costs involved by selling more electricity, resulting in a burden to the public of US$2 billion. The Ministry repeatedly advised the Claimants that the original commercial framework was not feasible as neither were many

additional proposals that differed substantially from the original. In particular it is asserted that the Ministry never agreed to and the Danistay never approved a 500 MW gross/465 MW net plant capacity.

56. Even after the Danistay approved the Concession Contract, both parties clearly understood that new commercial terms would have to be agreed to and submitted for the approval of this body. This was the reason for the many negotiations that took place and the draft amendment Protocol that was discussed after the approval of the Concession Contract.

57. In addition, the Respondent is of the view that the Claimants never completed the steps required to make an investment in Turkey. The initial framework setting was not followed up and as a result the Claimants did not obtain the necessary authorizations from the Treasury to proceed with the investment, did not obtain approval from the Turkish Coal Enterprises to mine certain needed reserves, never concluded the Energy Sales Agreement or the Plant Performance Report and never obtained a host of other permits nor took other steps required, including loan agreements, insurance, plant permission, construction license and others. The activities undertaken by the Claimants are all pre-investment steps and in a number of cases do not even fall in this category. The ground-breaking ceremony was merely symbolic.

58. As to the question of the Treasury guarantee, the Respondent explains that there was no obligation in this connection as the issuance of such guarantees is a discretionary power of the Treasury and there was no obligation to this effect under the Concession Contract. Neither did the restrictions introduced by the Electricity Market Law have any consequence for the project as the commercial terms had failed much earlier and the project had in fact been abandoned. In any event, it is argued, as the Constitutional Court held these restrictions unconstitutional, the Claimants could have pursued an agreement and applied for the guarantee at any time, but this was not done.

59. The Respondent also explains that the Ministry worked diligently at all times and that its responses to the various proposals were reasonable in the light of the need to protect the public interest. So was the requirement to organize the project company as a Turkish capital company as PSEG had obtained a windfall by changing the structure to a branch office of a foreign

company. At all times the Ministry instructed the various public services involved to cooperate in the obtaining of permits, agreements and elements required for the beginning of the project, but the Claimants were remiss in their own action to this effect while they waited for more favorable legislation to be enacted.

60. The Respondent opposes in particular any connection with World Bank policies, as these were discussed much later than the date when disagreements emerged as a result of the increased costs of the Revised Mine Plan. Neither did the Ministry interfere with the Claimants' rights to obtain the benefits of a private law regime under Law No. 4501 as it only asked for the introduction of standard conditions required to improve all projects.

III. Respondent's jurisdictional objections.

61. Based upon its views of the facts and the meaning of the dispute, the Respondent has made the following objections to jurisdiction:

a) There is no jurisdiction in this case because there is no investment or an investment dispute under the ICSID Convention or the Treaty.

b) Even if there was an investment, the Government of Turkey has not consented to jurisdiction.

c) The obligation under the Treaty to resort to any previously agreed dispute settlement procedure has not been met.

d) The North American Coal Corporation (NACC) and the Project Company do not have standing in this case.

62. The parties have raised as a preliminary point an aspect that the Tribunal wishes to dispose of at the very outset.

63. The Claimants have argued that the Tribunal needs only to be satisfied that if the facts alleged by Claimants are ultimately proven true, they would be capable of constituting a violation of the Treaty. The Claimants have invoked in support of this proposition the prima *facie* test

applied in *UPS v. Canada*[5] and the assumption relied upon in *Methanex v. United States*[6] that, for purposes of jurisdiction, the Claimants' factual contentions are deemed correct. In the Respondent's view, however, when the jurisdictional challenge involves disputed questions of fact, as in this case, the Tribunal has the duty to consider the facts alleged by both parties and make its own findings of fact for deciding the jurisdictional aspects.

64. The Tribunal is aware that the *prima facie* test has been applied in a number of cases, including ICSID cases such as *Maffezini*[7] and *CMS*[8], and that as a general approach to jurisdictional decisions it is a reasonable one. However, this is a test that is always case-specific. If, as in the present case, the parties have views which are so different about the facts and the meaning of the dispute, it would not be appropriate for the Tribunal to rely only on the assumption that the facts as presented by the Claimants are correct.

65. The Tribunal necessarily has to examine the facts in a broader perspective, including the views expressed by the Respondent, so as to reach a jurisdictional determination, keeping of course separate the need to prove the facts as a matter pertaining to the merits. This is what the Tribunal will do.

A. <u>Jurisdictional Objection concerning the existence of an investment.</u>

Respondent's arguments.

66. The Respondent argues first that the Treaty protection extends only to the investments defined therein and as neither the proposed project nor the Concession Contract are an investment the Tribunal lacks jurisdiction. Article I (1) (c) of the BIT defines "investment" as follows:

> "'Investment' means every kind of investment in the territory of one Party owned or controlled, directly or indirectly, by nationals or companies of the other Party,

[5]United Parcel Service of America v. Government of Canada, *available at* http://www.state.gov/s/l/c3749.htm

[6] Methanex Corp. v. United States of America, *available at* http://www.state.gov/s/l/c5818.htm

[7] Emilio Agustín Maffezini v. Kingdom of Spain (ICSID Case No. ARB/97/7), Decision on Request for Provisional Measures of October 28, 1999 and Decision on Objections to Jurisdiction of January 25, 2000, 16 *ICSID Rev.—FILJ* 212 (2001); Award of the Tribunal of November 13, 2000; 16 *ICSID Rev.—FILJ* 248 (2001). Rectification of the Award of January 31, 2001; 16 *ICSID Rev.—FILJ* 279 (2001).

[8] CMS Gas Transmission Company v. Argentine Republic (ICSID Case No. ARB/01/8), Decision on Jurisdiction of July 17, 2003, 42 ILM 788 (2003).

including assets, equity, debt, claims and service and investment contracts; and includes

(i) tangible and intangible property, including rights, such as mortgages, liens and pledges;

(ii) a company or shares of stock or other interests in a company or interests in the assets thereof;

(iii) a claim to money or a claim to performance having economic value and associated with an investment;

(iv) intellectual and industrial property rights, including rights with respect to copyrights, patents, trademark, trade names, industrial designs, trade secrets and know-how, and goodwill;

(v) any right conferred by law or contract, and any licenses and permits pursuant to law; and

(vi) reinvestment of returns, and of principal and interest payments arising under loan agreements."

67. As noted above, the Respondent believes that the project never moved beyond the drawing board and the lengthy negotiations undertaken did not mature into an investment. As the parties never agreed to the essential commercial terms of the project, such as gross and net plant capacity, availability factor and purchase price, there was simply no "meeting of the minds".[9] Even if there had been an agreement, the Respondent adds for the sake of argument, no amendments or revisions were submitted to the Danistay for approval, an essential step under Turkish law, nor were a number of other key agreements concluded, notably the Energy Sales Agreement.

[9] Legal Opinion of Professor Dr. Ergun Özsunay. September 10, 2003, at 14.

68. The Respondent further argues that the situation in this case is analogous to that in *Mihaly v. Sri Lanka,*[10] where a number of preliminary expenditures and steps undertaken by the Claimant were ruled not to be an investment as no binding and effective concession contract was concluded by the parties. It alleges that there is no investment in this case either; there are only some expenditures on a project that never materialized.

69. The Respondent argues next that, while it is not disputed that the Concession Contract was approved by the Danistay and executed by the parties, this Contract does not constitute an investment because it did not contain the essential agreed commercial terms. In the best of circumstances there was a framework for an agreement to negotiate further. The parties knew this before the Contract was submitted to the Danistay and this explains why the Contract contains provisions for a revised mine plan and a revised tariff. However, it is explained, the Danistay provided the Ministry with broad discretion to withhold its approval of the revised tariff and did not fix the commercial terms to be negotiated.

70. In the Respondent's view nothing prevented the Claimants from implementing the Contract in the terms that it contained reflecting the early agreement of the Feasibility Study, but, before submission to the Danistay, the Claimants advised that the Contract was not feasible in those terms and that it had to be renegotiated. The amendments requested by the Claimants were ultimately not acceptable to the Respondent.

71. The end result is that the Contract, the Respondent asserts, is not a valid and binding agreement to which both parties have expressed their consent to be bound. The original terms were repudiated by the Claimants and there are no new terms agreed to. In addition, under Turkish law a contract is null and void if its subject matter is impossible to carry out, this being the case here from a technological and economic point of view unless entirely new terms were introduced. Neither was the Contract financially feasible without the financial incentives that the Claimants never obtained nor sought. Such situation of uncertainty made it impossible for any tribunal to fill the gaps concerning the essential commercial terms, which are thus clearly unenforceable.

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[10] Mihaly International Corporation v. Democratic Socialist Republic of Sri Lanka (ICSID Case No. ARB/00/2), Award of March 15, 2002, 17 ICSID Rev.—FILJ 142 (2002).

72. Also the Respondent opposes in this context the characterization that the Claimants have made of the Branch Office and Konya Ilgin Ltd, the Project Company, as an investment within the meaning of the Treaty or that any of the claimed assets of this Company qualify as investments. First, because in the Respondent's argument the Branch Office established in January 1998 is not an investment under any definition and, in any event, this would not be an investment out of which the dispute arises. The dispute in this case concerns the proposed project and not the activities of a branch Office which did not even sign the Concession Contract submitted to the Danistay. The fact that a limited liability Company was incorporated in August 1999, long after the relevant events invoked by the Claimants in support of their argument, does not in Respondent's view alter the situation as this is still not an investment.

73. Relying on the criteria set out in *Mihaly*[11] and *Zhinvali* (R1907),[12] the Respondent argues in particular that the Feasibility Study, the Revised Mine Plan, the Transfer of Mining Rights Agreement and other permits and licenses claimed to be part of the assets of the Project Company are mere development activities undertaken in preparation of an investment that never came about.

The Claimants' argument.

74. In making their argument the Claimants rely on the accepted fact that the ICSID Convention deliberately omitted the definition of investment and left this definition to the parties.[13] Broad definitions were embodied in numerous treaties and agreements and a broad interpretation has also been upheld by ICSID tribunals, particularly *Fedax*[14] and *CSOB*.[15] The Treaty concerned in this case is no exception as the Parties thereto have agreed to a broad definition of investment. The Claimants assert that the Concession Contract clearly constitutes an investment which is listed in Article I (1)(c) to include service and investment contracts, claim to performance and intangible property.

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[11] Mihaly cit.

[12] Zhinvali Development Ltd. v. Republic of Georgia (ICSID Case No. ARB/00/1), Award of January 24, 2003, unpublished but introduced in the arbitration record.

[13] Expert Opinion of Prof. Dr. Dr. Rudolf Dolzer, June 27, 2003, at 2-5.

[14] Fedax N.V. v. Republic of Venezuela (ICSID Case No. ARB/96/3), Decision on Objections to Jurisdiction of July 11, 1997, 37 ILM 1378 (1998); Award of March 9, 1998, 37 ILM 1391 (1998).

[15] Ceskoslovenska obchodni banka, a.s. v. Slovak Republic (ICSID Case No. ARB/97/4), Decision on Objections to Jurisdiction (May 24, 1999), *available at*

75. The UNIDROIT Principles of International Commercial Contracts are invoked by the Claimants in support of their view that it is not always necessary to reach an agreement on all the essential terms of a contract as long as the parties have the intention of forming a contract[16] and the obligation to proceed to negotiate the pending terms in good faith. It is further invoked that civil law systems also allow the parties to leave open many terms of the contract to be determined later in good faith and that, particularly in long-term concession contracts, it is often the case that adjustment clauses will allow for change to basic terms in order to remain within the economic parameters of the contract. It is also stated that the validity of adjustment clauses and their enforceability have been upheld by arbitral tribunals.[17]

76. The Claimants also argue that the Contract is unequivocally a valid and binding legal agreement between the parties, as reflected in a precise legal language and the use of all the solemnities of a contract, all of it far from a mere statement of intention. In the Claimants' view there is no possible analogy with *Mihaly*, where no contract was signed and all preliminary documents of intention expressly contained disclaimers that no binding rights were being created. Moreover, the Concession Contract in the present case expresses its binding legal character and was executed by the parties, authorizing the completion of further contracts but not depending itself on these other contracts.

77. Expert opinions introduced by the Claimants also examine in detail the validity of contracts under Turkish law,[18] concluding in this respect that once a concession contract is approved by the Danistay and executed by the parties it constitutes a legally binding and valid instrument. It is also concluded that in this particular case the Contract includes more comprehensive terms than most contracts approved by the Danistay, even the essential commercial terms the Respondent argues to be missing. Adjustment clauses, such as Article 8 of the Contract, constitute an integral part of the agreement and are also binding under Turkish law. In any event, as explained in connection with the facts, the Claimants believe that an agreement on the new essential commercial terms was reached with the Ministry.

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http://www.worldbank.org/icsid/cases/csob_decision.pdf; Decision of the Tribunal on the Further and Partial Objection to Jurisdiction of December 1, 2000, 15 ICSID Rev.—FILJ 530 (2000).

[16] UNIDROIT Principles of International Commercial Contracts, 1994, Article 2.14.

[17] *Aminoil* Award, 21 ILM 976, (1982).

78. In the Claimants' argument the Project Company is in itself an investment that was duly incorporated under Turkish law and granted the necessary Permission Certificate to operate and do business in that country. In particular, it is further affirmed, all of its assets are investment in the meaning of the Treaty, including the Feasibility Study and the Revised Mine Plan as well as intangible property and industrial property rights, the Transfer of Mining Rights Agreement as both intangible property and licenses and permits, and the Environmental Impact Assessment Report and other permits and licenses. Even if it were correct to observe that the project does not constitute an investment, all the agreements, legal rights, licenses, authorizations, assets and property of the investor do qualify as investments under the Treaty.

The Tribunal's findings in respect of the existence of the investment.

79. The Tribunal must first note that the facts alleged by the parties are not always consistent with the very views in support of which they are invoked. A number of contradictions can be noted in this respect. This is not surprising in a highly complex operation and negotiation that on many occasions were handled by technical staff not familiar with the legal language.

80. The essential point that the Tribunal must establish, however, is a legal one. Does the Concession Contract exist? The answer to this question is not difficult as the parties do not dispute the fact that the Concession Contract does exist, was duly signed, submitted to the Danistay and approved by this body and later executed with all the legal formalities and requirements. It is not disputed either that both parties unequivocally believed that the Contract had become effective on the date of the signing by the Ministry. The Contract is couched in proper legal language.

81. Numerous documents in the record evidence this understanding of the parties. Letters from the Ministry of March 11, 1999, April 9, 1999 and July 20, 1999, for example, refer to the Contract having become effective. This in itself is a substantive difference with the facts in *Mihaly* where, as explained above, the parties never signed a concession contract and expressly disclaimed any legal obligations arising from the preparatory work undertaken. The same is true of *Zhinvaly* where the parties expressly acknowledged that the Claimant did not have an investment.

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[18] Rejoinder Opinion of Prof. Dr. Metin Günday, November 24, 2003, par. 13; Legal Opinion of Prof. Dr. Sait

82. The question that the Tribunal must answer next is a more difficult one. Is the Contract valid? Herein lies the fundamental dispute between the parties. The answer is related to the question of whether the Contract omitted essential terms and conditions that make it a nullity or a different kind of instrument.

83. The Tribunal must first note in this respect that the Contract did not ignore the essential commercial terms of the transaction as the terms originally agreed to in the Feasibility Study were incorporated in the Contract. Technical formulas to define the tariff structure and the price were thus included in Annex 2 of the Contract. To this extent there is not a blank or a vacuum in the Contract. Theoretically, on the basis of the Contract as signed and executed, the Claimants could still undertake the project on the commercial terms therein specified, which the Respondent has admitted was a possibility. The Claimants could also seek either to amend those terms, under both Articles 8 and 32 of the Contract or to ultimately abandon the project.

84. The parties to the Contract knew before its submission to the Danistay in draft form that costs would increase as a result of the Revised Mine Plan.[19] This Revision entailed significant changes to the earlier economic estimates and to the work envisaged in the mine site. Letters pointing to the need for accommodation and tariff restructuring were abundant. This is precisely why the Implementation Contract included a rebalancing mechanism in Article 5.1, which later led to Article 8 of the Concession Contract. This is also why the Claimants repeatedly made reservations of their rights under the Implementation Contract and stated that amendments included in the draft submitted to the Danistay did not constitute a waiver of such rights.

85. The fact that economically the project might be difficult to execute or even become unfeasible does not render the Contract invalid. Neither does the fact that the project could become impossible to perform. As Professor Güran stated in his Legal Opinion, "…economic hardship does not constitute a valid excuse to escape a party's contractual obligations, whether under the doctrine of impossibility of performance or any other principle of Turkish law".[20]

Güran, November 24, 2003, par. 6.

[19] Witness Statement of Halil L. Sunar, June 27, 2003, par. 59.

[20] Legal Opinion of Prof. Dr. Sait Güran, November 24, 2003, par. 23.

Professor Günday offered a similar opinion. He said that "…economic hardship is not recognized as impossibility as that concept is understood by Turkish law".[21]

86. Moreover, the repudiation that the Claimants have allegedly made of the original terms stems from its economic and financial feasibility. It does not alter the legal validity of the Contract, particularly since both parties foresaw that there would be a need for an economic adjustment as a result of the Revised Mine Plan and other issues intervening in the negotiation. The need for an economic adjustment informs Article 8 of the Contract. Article 8 of the Contract allows the Claimants to seek an economic rebalancing of the Contract terms in case of significant change in that balance.

87. An additional consideration arises because the Contract contains a mechanism for renegotiating the commercial terms and the tariff as a result of the Revised Mine Plan. Again, this does not affect the validity of the Contract; it only means that the terms therein defined can be reopened in the light of certain events.

88. This is not an unusual feature in contracts dealing with highly complex concessions of services of long duration or other types of long-term transactions. Faced with the possibility of renegotiation of certain contract terms, the parties' intent is dispositive of the question whether the Contract nevertheless came into existence. In the present case, both the language of the Contract as well as the circumstances, as they are reviewed below, demonstrate an intent by the Parties to be bound in spite of the fact that certain terms still needed to be agreed upon at a later date.

89. The Tribunal also notes that several experts on Turkish administrative law have opined that the Concession Contract is binding on the Turkish State and meets all the conditions to become effective under Turkish administrative law.

90. The conclusions reached by the Tribunal on the existence and the validity of the Contract would suffice to affirm jurisdiction on this point. The issue whether the parties undertook the required negotiations on the amendment and rebalancing of the commercial terms of the Contract in good faith and its eventual legal consequences pertains to the merits.

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[21] Rejoinder Opinion of Prof. Dr. Metin Günday, November 24, 2003, par. 26.

91. The Tribunal cannot ignore, however, the related question whether the commercial terms were actually agreed as this question is also of the essence of the dispute between the parties. The documentary evidence offered by the parties in support of their respective arguments is not generally conclusive on this matter. Whether the terms were agreed to in February 1998, as the Respondent believes, or in May and June 1998, as the Claimants believe, and what those terms were, is not sufficiently documented. In fact, there are indications pointing both ways and again many contradictions. The same is true of the statements of fact witnesses.

92. The Respondent argues in particular that the Claimants in a letter of June 3, 1999,[22] characterized as a proposal what they now argue was an agreement referred to in an earlier letter of May 18, 1998,[23] thus acknowledging that an agreement was never reached. While grammatically that may be so, the Tribunal cannot draw from this fact a legal conclusion since it is perfectly possible that the Claimants were referring to the proposal on the basis of which the alleged agreement of May 18, 1998 was reached. The ongoing submission of cash flow tables and tariff alternatives up to the year 2000 suggests, however, that no firm agreement was in place but that it was being explored and negotiated.

93. The Respondent has also invoked minutes of the Claimants concerning, for example, meetings held on May 14, July 19, September 21 and October 13, 1999, suggesting that a number of issues were not considered sufficiently clarified, agreed to or settled. The Respondent also argued that the Claimants stated clearly that the project could not move forward without an agreement on the tariff, as reflected in minutes of meetings held on December 16, 1999, January 27, March 3 and April 10, 2000.

94. The Claimants have also bolstered their arguments with documentary evidence. The letters sent by the Claimants to the Ministry on May 18 and June 23, 1998 make specific reference to agreements on amendments discussed at meetings, as does the draft Protocol that was prepared but not actually sent to the Danistay. Furthermore, various notes of meetings appear to corroborate the Claimants' view that an agreement was in fact reached. On this

[22] Sunar to Ministry, June 3, 1999.
[23] Sunar to Ministry, May 18, 1998.

question, Claimants refer to notes of meetings held on May 15 and 18 and June 16, 1998, filed late in the proceedings. The Claimants also refer to documents allegedly evidencing that the Respondent's view that a different agreement was reached is not tenable. Some documents do indeed point to the specific figures of 500 MW gross/465 MGW net or to the 500 MW alone.[24]

95. Considering the conclusion on jurisdiction which the Tribunal reached on the basis of the intent of the Parties, there is no need at this stage for the Tribunal to elaborate on the fact that some of these documents were indeed filed very late in the proceedings. This may be a matter to be considered during the second phase of the arbitration.

96. There are, however, other documents which the Tribunal believes are particularly important in establishing the intent of the parties to conclude and be bound by the Contract. The most fundamental of these is evidently the Contract itself. There are many provisions in the Contract which evidence the intent of the parties to be bound. The main one is Article 8 which specifically allows for a rebalancing of the Contract where a Revised Mine Plan introduces substantial changes in the economics of the Contract, such as in the present case. The wording of Article 8 is very clear. The pertinent terms of this Article, reproduced above, are clearly indicative of the central role played by the economic rebalancing which is envisaged.

97. While much has been discussed about whether the 60-day period the Ministry had to approve or disapprove the Article 8 amendments on reasonable grounds entails a mandatory action, or the opposite conclusion that if no action is taken it simply means the rejection of the amendments under Turkish law, this does not alter the fact that the Claimants could avail themselves of this mechanism and indeed did so in order to seek to rebalance the Contract. The long negotiations between the parties with respect to a new tariff so indicates and the very terms of the draft Protocol discussed by the parties also show that commercial elements were being debated pursuant to the mechanism set out in Article 8 of the Contract.

98. In turn, this mechanism is related to Article 15 of the Contract which refers to a number of agreements or protocols to be concluded by the Company. The fact that this was seen as an

[24] Ministry to TEAS, 30 June 1998; Letter by Technical staff to Ministry, 19 June, 1998.

obligation is clearly expressed by the use of the term "shall". This very obligation also assumes that the Respondent's institutions will concur in these agreements which will supplement the Contract.

99. Article 35 of the Contract is also significant in this context. This Article provides that the Contract shall be effective on the date of execution upon review by the Danistay, all of which happened in fact. It provides next for the Company to complete other related steps concerning, in particular, financing, executing the Contracts envisaged in Article 15, obtaining required authorizations and permits and obtaining the final approval of projects by the Ministry. Paragraph 2 of Article 35 begins with the expression "However". This word does not condition the effectiveness of the Contract under paragraph 1 because termination only arises in case of "default" of the Company. Otherwise the Contract remains in force and is effective.

100. The Danistay Decision of 11 March 1998 approving the Contract refers to the fulfillment of a number of additional transactions by the Company as "an obligation arising from the contract", thus indicating that the obligations would be in effect as soon as the Contract was approved and executed. Clearly, these obligations were to be fulfilled once the Contract had become effective.

101. Although, as noted, the witness statements are contradictory, it is well established that there were meetings held by the Company officials with the Ministry's representatives in charge of negotiations, in particular Mr. Basli. The correspondence that followed these meetings indicates clearly that discussions were progressing on the commercial terms, including the plant capacity. Although witnesses for the Respondent have stated that they were not aware of any such meetings, that no official records were prepared and that, at the most, these should be considered simply as visits, the fact is that a certain number of meetings were held.

102. The Tribunal need not find during this phase of the arbitration whether or not the parties reached agreement on any amendment to some of the commercial terms of the Contract. However, in weighing the totality of the evidence submitted by the parties, the Tribunal does find that amendments to the Contract terms were pursued. This finding further confirms the existence, validity and binding nature of the Contract.

103. In reaching its conclusion on this matter the Tribunal is also persuaded by the argument that if the parties did not intend to bind themselves by means of a Contract, why would they then have signed, submitted for approval and executed a Contract? Letters of intention or other instruments would have sufficed to provide a general framework to continue negotiations until an agreement was reached or not without any legal consequence for either party, as the events in *Mihaly* show. The view of the Respondent that the Contract was signed as a mere courtesy or sign of good will is not tenable, nor is the view that this is nothing but a framework devoid of legal significance.

104. A contract is a contract. The Concession Contract exists, is valid and is legally binding. This conclusion is sufficient to establish that the Tribunal has jurisdiction on the basis of an investment having been made in the form of a Concession Contract. A different question, again pertaining to the merits, is whether all or some of the activities undertaken qualify as a part of the investment or are to be regarded as merely preparatory. The same holds true of whether the assets of the Project Company constitute an investment.

105. The objection to the Tribunal's jurisdiction on this count is therefore dismissed.

B. Jurisdictional objection concerning the question that the dispute does not arise directly out of an investment.

The Respondent's argument.

106. Intertwined with the arguments on the jurisdictional objection concerning the existence of an investment, the Respondent has also raised the question that if there is no investment, there cannot be an investment dispute under the Treaty and the ICSID Convention. But even if there is an investment, the argument follows, the dispute does not arise directly from such investment in terms of Article 25 (1) of the Convention.

Article VI (1) of the Treaty defines an investment dispute as

> "a dispute involving (a) the interpretation or application of an investment agreement between a Party and a national or company of the other Party; (b) the interpretation or application of any investment authorization granted by a Party's foreign investment authority to such national or company; or (c) an

alleged breach of any right conferred or created by this Treaty with respect to an investment."

107. The Respondent believes that none of these three situations arise in the present case. There is no investment agreement or authorization in this case, avers the Respondent, and there are no Treaty rights associated with an investment. If the activities undertaken do not qualify as investments under the Treaty the dispute cannot be said to arise directly out of an investment as required under Article 25 (1) of the Convention, particularly since the Convention left the definition of investment to the parties.

108. The *CSOB* decision invoked by the Claimants in connection with the definition of an investment is, according to the Respondent, to be distinguished from this case. The dispute and the investment in the *CSOB* case were held to be sufficiently connected since the specific transaction involved was an integral part of an overall operation qualifying as an investment, but in this case the proposed project does not qualify as an investment nor does the Contract.

109. The Respondent submits further that there can be no investment authorization because at the time the project was under discussion there were three foreign investment permissions required under Turkish law, the Claimants having obtained only one. These permissions were the "permission certificate" (or pink certificate) that the Claimants did obtain both for the branch office and later for the limited liability company; the "investment permission certificate" (or green certificate) and the "investment permission and incentive certificate" (or blue certificate - usually encompassing also the green certificate), which the Claimants failed to apply for. It follows, in the Respondent's view, that there is no proper investment authorization under Turkish law and Article VI (1) of the Treaty.

The Claimants' argument.

110. The Claimants are of the view that the dispute in this case involves in essence the interpretation or application of the Concession Contract and also the interpretation or application of the investment authorization granted, just as Treaty rights associated to the investment are also involved. As the dispute falls within the terms of Article VI of the Treaty, the jurisdictional requirement of Article 25 (1) of the Convention has been met as the dispute arises directly from the investment.

111. In this connection, the Claimants rely in particular on the decision in *CSOB* and its precedents to the extent that an investment is frequently a complex operation the elements of which ought not to be examined in isolation but cumulatively,[25] and the *Holiday Inns* approach emphasizing "the general unity of an investment operation".[26] *Lanco* is also invoked to the extent that a concession contract was characterized as such as an investment,[27] as also is *SGS v. Pakistan* in recognizing intangible property as an investment.[28]

112. The Claimants also argue that since the Concession Contract is a valid and binding instrument it is properly characterized as an investment agreement and can also be characterized as an investment authorization from the State to pursue the project defined. The Claimants also assert that even the authorization granted to conduct the Feasibility Study was a foreign investment authorization by the Turkish Government. The Claimants further submit that the discussion about obtaining a green and a blue certificate is not relevant. The blue certificate refers to non-mandatory economic incentives for which the investor may or may not apply, and the green certificate is not a part of the requirements for foreign investment authorization in Turkey.

113. The Claimants conclude that the dispute arises directly from the investment made and that both the Treaty and the Convention requirements are met.

The Tribunal's findings on the dispute arising directly out of the investment.

114. The Tribunal has held above that the Concession Contract is valid and binding. By its very nature and specific terms the Contract embodies an investment agreement under which the investor is authorized to undertake the power generation activities therein specified. The Contract refers repeatedly to the investment, its amount, financing, period of implementation and a host of other investment connected questions. Article 4 of the Contract provides in particular for a detailed investment schedule.

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[25] *CSOB* cit., par. 72.
[26] Holiday Inns S.A. and others v. Morocco (ICSID Case No. ARB/72/1), **Yes,** Lalive's article, p. 84.
[27] Lanco International, Inc. v. Argentine Republic (ICSID Case No. ARB/97/6), Decision of the Tribunal of December 8, 1998 (English text), 40 ILM 457 (2001).
[28] SGS Société Générale de Surveillance S.A. v. Islamic Republic of Pakistan (ICSID Case No. ARB/01/13), Decision on Objections to Jurisdiction of August 6, 2003; 18 ICSID Rev.—FILJ 301 (2003).

115. The foreign investor is a party to the Contract in its own right. The investor was specifically encouraged to undertake the project and assurances were apparently given at the time of signing of the Contract that any pending problems would be accommodated. The investment operation as a whole was related to the activities to follow the delivery of the site as is evident from both Articles 4 and 35 of the Contract, which refer to such step among many others to be undertaken by the Company.

116. The Tribunal also concludes that, in addition, the proper authorization has been granted by the foreign investment authority to the company, first in the form of a branch office and later as a limited liability company. The Turkish law governing foreign investments does not require a string of authorizations[29] nor does the Foreign Capital Framework Decree of 1995.[30] More specifically, the Communiqué explaining this last decree only requires one authorization issued in the form of a permit by the Foreign Investment General Directorate, Undersecretary of the Treasury.[31]

117. The terms of the authorizations given in this case are also self-contained, in that a permit is granted for the Company to "conduct its activities by having equal rights and responsibilities with local institutions acting in the same field…".[32] The field of activity permitted is broad as it allows the Company to "…plan, construct and operate energy power plants, to exploit mining reservoirs, to trade electric energy and conduct all types of electricity, mining and other activities in accordance with the current related legislation".

118. It is quite common that countries, host to an investment, will require a number of other authorizations to permit the investment to operate a number of specific activities, but in so far as the authorization to invest is concerned only one decision by the pertinent government service suffices. This authorization has been duly given by the Foreign Investment General Directorate, as noted.

119. The so called green and blue certificates may be necessary to undertake given activities or acquire certain rights, but these elements are not an essential part of the investment

[29] Law Concerning the Encouragement of Foreign Capital, No. 6224 Jan 18, 1954.
[30] Decree No. 95/6990, June 7, 1995.
[31] Communiqué No. 95/2, August 24, 1995.

authorization. The Tribunal notes that the information required by both the green and blue certificates is in essence the same, this probably being the reason why in practice both are combined. Moreover, as the Claimants have argued, the blue certificate relates to a non-mandatory incentive the investor may or may not apply for. The very Communiqué noted above requires the activity to be undertaken to be listed in "permits and/or incentive certificates granted by the General Directorate of Foreign Investment…"; the incentive is evidently not compulsory.

120. There is yet another aspect that convinces the Tribunal that an authorization was duly given by the Respondent. The Concession Contract could not have been approved by the Danistay if the foreign investment had not been authorized. Neither could it have been submitted to this body by the Ministry or even signed. Moreover, the very Contract provides in connection with the transfer of authorization in Article 27 that shareholders shall be free to transfer, assign, pledge or sell the Company shares in whole or in part subject to the Ministry's approval and in cases required by the legislation, "the permit to be issued by the Undersecretariat of Treasury, Foreign Investment General Directorate". If other authorizations would have been required in connection with the original investment, there is every reason to conclude that they would have been required for subsequent activities.

121. The dispute that has been described above, in the view of both parties, involves questions of interpretation or application of both the investment agreement and the investment authorization. This is also the case in respect of the Respondent's argument that there is no investment, agreement or authorization as these very claims involve the interpretation of the Contract and the authorization. The dispute therefore arises unequivocally directly out of the investment subject, of course, to the same proviso made above that the issue of what constitutes precisely an investment as opposed to mere preparatory activities pertains to the merits.

122. There is yet another element in Article VI (1) concerning a dispute involving an alleged breach of any right conferred or created by the Treaty with respect to an investment. The Claimants have argued in the Request for Arbitration that, in addition to having failed to fulfill its obligations under the Contract and the authorizations given, the Respondent has also violated

[32] Permission Certificate No. 6014, 5 July 1999, replacing certificate No. 4492 of 5 May 1997.

the Treaty. In particular, Claimants submit that there haven been breaches of Article II of the Treaty, concerning treatment of the investment, and Article III, concerning expropriation.

123. Although it is not possible at this jurisdictional stage to decide whether breaches have been committed, the history and terms of the dispute described are indicative that the investment is in principle subject to protection under the Treaty and that the Claimants are entitled to have their complaint examined.

124. The Tribunal accordingly finds that it has jurisdiction under this heading as the dispute concerned arises directly out of an investment in terms of the interpretation and application of the Contract and the investment authorization, as well as in terms of Treaty rights connected to this investment that could have been compromised.

C. Jurisdictional Objection Concerning Respondent's Notification under Article 25 (4) of the Convention.

Respondent's arguments.

125. Article 25 (4) of the Convention allows any Contracting State to "…notify the Centre of the class or classes of disputes which it would or would not consider submitting to the jurisdiction of the Centre…". On the basis of this provision, the Republic of Turkey notified the Secretary-General of ICSID on February 23, 1989 that "only the disputes arising directly out of investment activities which have obtained necessary permission, in conformity with the relevant legislation of the Republic of Turkey on foreign capital, and that have effectively started shall be subject to the jurisdiction of the Centre".

126. The Respondent argues in this connection that the notification made qualifies the consent to arbitration contained in the Treaty, admittedly not as a reservation to the Convention but with the effect of informing the limits and scope of its subsequent consent to arbitration under the Treaty. As in the Respondent's view the project never "effectively started", the consent to arbitration is absent. Effective start is generally identified by the Respondent with the beginning of construction of either the mine or the power plant. As discussed above, the Respondent has also argued that the Claimants lacked the necessary investment permits.

127. In support of its objection, the Respondent first notes that unilateral declarations of States can have legal effects in spite of not technically being reservations. Internal documents of the Turkish Government describe the notification as a "condition" to becoming signatory to the Convention.

128. *CSOB* and *Fedax* are relied upon in support of the Respondent's understanding of the effects of a notification under Article 25 (4) of the Convention. The first case refers to the declarations made under this Article as limiting the scope of the Centre's jurisdiction, while the second, in the Respondent's view, puts investors on notice as to the disputes envisaged and that in the context of that case it was recognized that such notification would have qualified the State's consent under the pertinent treaty. The Respondent further alleges that *Aguas del Aconquija* accepted a similar exclusion effect of notifications.

129. The Respondent also argues in this context that the terms of the notification are more specific than those of the Treaty and, therefore, in the event of a conflict the more specific terms would prevail.

130. As to the timing of the various instruments concerned, the Respondent argues that although the Treaty was signed on December 3, 1985 and the notification made on March 3, 1989 upon ratification of the Convention, the entry into force of the Treaty only took place on May 18, 1990. It follows in the Respondent's arguments that the notification preceded the consent and that the terms of the notification are presumed to be incorporated into the meeting of the minds when the consent is later given. As the United States was fully aware of the notification made by Turkey and did not object to it before making the Treaty effective, the Respondent believes that the United States accepted those qualifications to Turkey's consent as notified.

The Claimants' approach.

131. The Claimants have argued in respect of this objection that notifications under Article 25 (4) of the Convention do not have a binding legal effect. That very Article explicitly provides that "Such notification shall not constitute the consent required by paragraph (1)". In the light of the drafting history of the Article, the World Bank Executive Director's Report on the

Convention and scholarly writings,[33] the Claimants conclude that this notification only serves information purposes in terms of letting prospective investors or their respective governments know that the terms of the notification will be relied upon or called up at the time of expressing the consent to arbitration. As the Convention does not deal with the question of consent neither can it deal with a qualification or condition to consent, a matter to be taken up in agreements or treaties. Both parties agree that the notification is not a reservation to the Convention.

132. The Claimants are also of the view that the consent expressed in the Treaty is far more specific than the general qualifications contained in the notification and that, as the Treaty entered into force after the notification, both the United States and Turkey could have qualified their consent as expressed in the Treaty, just as they did in a Protocol to the Treaty in respect of other matters, but kept silent in connection with the terms of the notification.

133. In any event, the Claimants are of the view that the investment activities had all effectively started and that there is no reasonable basis to equate this requirement with the start of construction. A long list of activities that had effectively started is referred to by the Claimants, who further submit that if activities did not go beyond a certain stage it was because the Respondent prevented the project from proceeding further.

134. The Claimants also submit a different interpretation of ICSID cases in this respect, particularly of *Fedax* which clearly stated that Article 25 (4) allows Contracting States "to put investors on notice" as to the disputes they would or would not consider consenting to.

The Tribunal's findings in respect of consent qualified by notification under the Convention.

135. The Tribunal has examined the important question raised by the Respondent in respect of the legal extent of notifications under Article 25 (4) of the Convention, with particular attention to the most thorough and learned discussion of the subject by Judge Schwebel in his presentation on the matter at the hearing held in this case.[34]

136. It must first be noted that Article 25 (4) in itself does not assign any particular legal effect to notifications as it refers to the disputes that the Contracting State "would or would not

[33] Christoph H. Schreuer: The ICSID Convention. A Commentary, 2001, at 342.
[34] Hearing, February 22, 2004, at 37-57.

consider submitting to the jurisdiction of the Centre". This is quite natural as the whole issue of consent was left to instruments other than the Convention, for example investment agreements and bilateral investment treaties. This is also the reason why that very Article clearly separates notification from consent by providing that "Such notification shall not constitute the consent required by paragraph (1)".

137. The Claimants have invoked the *travaux préparatoires* of this provision, noting in particular that Mr. Broches, the architect of the Convention, conceived the notification system as one allowing Contracting Parties to "make declarations under the Convention in which they could define in advance, if they so desired, the scope within which they would be willing to consider, always subject to the specific consent on their part in any specific case, making use of the Center".[35] The Report on the Convention by the Bank's Executive Directors also clarified that notifications would "serve for purposes of information only" and not constitute reservations to the Convention.[36] Scholarly opinions have also supported this interpretation.[37]

138. Most pertinently, following a question from the Tribunal, Judge Schwebel emphasized that notifications must necessarily have a purpose as otherwise they would be a meaningless exercise. There is no doubt that this is true. In fact, at the time the Convention was negotiated it was envisaged that the Contracting States would normally express their consent in investment agreements concluded with the private investors, which were later supplemented by the massive network of bilateral investment treaties in force today. Notifications were a useful means to inform beforehand the kind of disputes to which consent for arbitration might or might not be expected by the prospective investor or its State of nationality. To this extent the notification has a specific purpose.

139. In this connection the Tribunal does not share the Respondent's interpretation of the *CSOB* and *Fedax* cases. Although the language in *CSOB* appears to support the interpretation that notifications can limit the scope of the Centre's jurisdiction, that Tribunal concluded that by not making such a declaration the Contracting Party has "submitted itself broadly to the full

[35] ICSID, History of the Convention, Vol. II, at 567.
[36] Report of the Executive Directors on the Convention, 1 ICSID Reports 29.
[37] Legal Opinion of Professor W. Michael Reisman, June 27, 2003, at 25; Expert Opinion of Prof. Dr. Dr. Rudolf Dolzer, June 27, 2003, par. 39; Schreuer, at 342.

scope of the subject matter jurisdiction governed by the Convention".[38] Yet it remains that the "subject matter" jurisdiction is determined by the consent of the Contracting State expressed in a separate instrument and by the definition of investment included in that expression of consent. True, it is governed by the Convention but it is not defined by it. It follows that notifications under Article 25 (4) do not have a life of their own and are wholly dependent on the consent mechanism.

140. Similarly, *Fedax* was also explicit in referring to notifications as putting "investors on notice", but it does not follow that the Tribunal accepted a qualification of consent by means of a notification under Article 25 (4). Evidently, in case of doubt, the notification will help the interpretation of the parties' consent but it does not have an autonomous legal operation.

141. The discussion above still does not answer the key question concerning the legal nature or effect of notifications. Both parties have agreed that notifications are not reservations. This is also the view of the Tribunal. An autonomous legal effect of notifications has been ruled out for the reasons explained above.

142. The view that unilateral acts of States have legal effects under international law is accurate as evidenced by the decisions of the Permanent Court of International Justice in the *Eastern Greenland* case[39] and of the International Court of Justice in the *Nuclear Tests* case.[40] There is no doubt that notifications qualify as unilateral acts under international law[41], although in the present case it is not an autonomous act as it depends on the Convention. However, in the cases mentioned above the essence of the legal effects admitted has been that the unilateral acts in question create obligations for the State concerned on which other States can rely.

143. In the instant case, the notification does not create an obligation for the Contracting State, but rather it is associated with the claim to a right. In fact, States making notifications will always wish to remain free to either follow or not follow the terms of the notification when expressing their consent. No State would believe that by making a notification it has become

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[38] *CSOB* cit., par. 65.
[39] Permanent Court of International Justice, *Eastern Greenland* case, 1933, PCIJ, Ser. A/B, No. 53, at 52.
[40] International Court of Justice, *Nuclear Tests* case, ICJ Reports 1974, at 253.

bound by its terms as in that case there would be no difference between notification and consent, thus contradicting specific provisions of the Convention. In this context, the Contracting State is in fact claiming a right to later exclude certain disputes from consent, if it so wishes, and it is always free not to adhere to the terms of its notification.

144. It has become increasingly common for treaties to exclude reservations and allow for declarations instead. These declarations do not alter the legal rights and obligations under the treaty nor do they amend any of its provisions. They are simply an instrument that allows States to express questions of policy to which they are not bound and that do not create rights for the other parties. It is a matter of information, normally resorted to for domestic needs. This is also the legal nature of the declarations made by States in the form of notifications under Article 25 (4) of the Convention. Interestingly Mr. Broches, quoted above, referred to these notifications as "declarations".

145. It follows that to be effective the contents of a notification will always have to be embodied in the consent that the Contracting Party will later give in its agreements or treaties. If, as in this case, consent was given in the Treaty before the notification, that treaty could have been supplemented by means of a Protocol to include the limitations of the notification into the State's consent. Otherwise the consent given in the Treaty stands unqualified by the notification.

146. Although the practice of the Contracting Parties in this connection under Article 25 (4) of the ICSID Convention is not easy to establish in view of the fact that few notifications have been made, it must be noted, for example, that the terms of the notification made by the People's Republic of China are reproduced in various bilateral investment treaties entered into with other countries.[42] It follows that the legal effects of those terms arise from the treaties and not from the notification as such.

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[41] Patrick Daillier et Alain Pellet: Droit International Public, 2002, 359-366.

[42] See, for example, the Agreement between the Government of Australia and the Government of the People's Republic of China, 11 July 1988, Article XII, 2, b; Agreement between the Government of Lithuania and the Government of the People's Republic of China, 8 November 1993, Article 8, 2, b; Agreement between the People's Republic of China and the Government of the Republic of Korea, 30 September 1992, Article 9. 10. The text of the notification of the People's Republic of China is found in www. Worldbank.org/icsid/pubs/icsid-8-d.htm

147. The Tribunal accordingly holds that the objection to jurisdiction on this count is also dismissed.

D. Objection to Jurisdiction on the basis of the Claimants not having resorted to previously agreed dispute settlement procedures.

The Respondent's argument.

148. The Respondent has invoked in the alternative the lack of jurisdiction of this Tribunal in view of the fact that under the Treaty the parties are required to exhaust any previously agreed upon dispute settlement procedures before they may resort to international arbitration. The Respondent refers to the question as one requiring the parties to resort to those procedures but not necessarily to exhaust them.

149. In this connection, the Respondent relies on Article VI (2) and its relationship with Article VI (3) (a) of the Treaty. The first clause provides that if the dispute cannot be solved by consultations and negotiations, "the dispute shall be submitted for settlement in accordance with any previously agreed, applicable dispute settlement procedures". The second clause provides that after one year a party may resort to ICSID arbitration if "the dispute has not, for any reason, been submitted by the national or company for resolution in accordance with any applicable dispute settlement procedure previously agreed to by the parties to the dispute".

150. The Respondent is of the view that the Claimant has the obligation to resort to the agreed procedure before arbitration since Article VI (2) so mandates by using the verb "shall". If this was not so, the second clause would result in the cancellation of the first. It follows that only if the Claimant had a compelling reason, not just "any reason", for not submitting the dispute to the previously agreed procedure could it resort to the ICSID arbitration.

151. The Respondent further believes that the parties in this case have agreed to a dispute settlement procedure. Although the draft Contract submitted to the Danistay had an ICSID arbitration clause, this clause was expressly deleted by that body on the understanding that the Danistay had exclusive jurisdiction over disputes concerning Concession Contracts under Turkish law. This was in particular the result of the Constitutional Court's decision that concession contracts were administrative contracts. As the Claimants failed to submit the

dispute to the Danistay and did not offer any reason for it, they are precluded under the Treaty from resorting to ICSID arbitration.

152. It is further argued by the Respondent that if Turkey had envisaged giving an option to the Claimants it would have included in the Treaty the typical "fork-in-the-road" clause that it has used in many other treaties. Neither could any most favored nation clause argument affect this conclusion as the requirement of Article VI (2) embodies a fundamental policy consideration not subject to the operation of the clause, as established by the Tribunal in *Maffezini*, a case also relied on by the Claimants. In any event, it is asserted, the Treaty in this case contains a more restricted most favored nation clause than the one in the treaty concerned in *Maffezini* and does not allow for the application of the clause to dispute settlement mechanisms.

153. The Respondent also argues for distinguishing this case from that of *Lanco*, invoked by the Claimants, because in that case the Claimants had a typical choice of procedures that is absent in the present case.

The Claimants' view.

154. The Claimants argue that Article VI of the Treaty does not require that a dispute be referred first to a previously agreed, applicable dispute settlement procedure as a condition for submitting the dispute to ICSID. In the light of Article VI (3)(a)(i), the investor may choose to submit the dispute to ICSID if it has not otherwise been submitted for resolution in accordance with a previously agreed procedure. This means in Claimants' view that the investor may submit the dispute to the previously agreed mechanism if it so wishes, but that it would by so doing lose its right to resort to ICSID. This would be the equivalent of a "fork-in-the-road" provision.

155. The most favored nation clause is also invoked by the Claimants in support of their view and they argue that a number of bilateral investment treaties to which Turkey is a party do not include a mechanism for resorting to a previously agreed mechanism and investors are free to choose. In the light of *Maffezini* the Claimants argue they are entitled to benefit from a more favorable treatment included in those treaties.

156. The Claimants are also of the view that, in any event, there was no previously agreed procedure in this case because they never accepted that the Contract was subject to the

exclusive jurisdiction of the Danistay and an express reservation was made to safeguard their right to resort to ICSID when that body deleted the ICSID clause from the draft Contract. Moreover, the ICSID clause was not replaced by another clause with the result that the Contract does not contain a dispute settlement mechanism. As in *Lanco*, there was no choice freely available to the investor and therefore there can be no agreement to submit disputes to domestic jurisdiction.

157. It is further argued that not even under Turkish law does the Danistay have exclusive jurisdiction, among other reasons because international law is part of the domestic legal order and prevails over municipal law. Therefore, the rights of the investors under treaties have to be observed, including the right to resort to ICSID.

158. Even if there had been an agreement to submit disputes to the Danistay, this would not have prevented ICSID arbitration since, as in *Aguas del Aconquija*,[43] the *Vivendi* annulment,[44] *Salini v. Morocco*,[45] *SGS v. Pakistan*[46] and other recent cases, contract based disputes are different from treaty based disputes and arise out of separate causes of action. Treaty based disputes can always be submitted to international arbitration from this point of view.

The Tribunal's findings in respect of the previously agreed dispute settlement procedure.

159. Following the detailed examination of the issues discussed above, the Tribunal concludes that there is no incompatibility between the provisions of Article VI (2) and Article VI (3) (a) and that they respond to a step by step search for a dispute resolution mechanism. First, consultations and negotiations are envisaged as an initial step. If this fails, third party non-binding procedures can be attempted if agreed between the parties. If these procedures fail, then the dispute shall be submitted to the previously agreed mechanism.

160. If no submission had been made pursuant to the previously agreed mechanism, then, after one year, the investor can apply to ICSID. This sequence of dispute settlement

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[43] Compañia de Aguas del Aconquija S.A. v. Argentine Republic (ICSID Case No. ARB/97/3), Award of November 21, 2000, 16 ICSID Rev.—FILJ 641 (2001)

[44] Compañía de Aguas del Aconquija S.A. and Vivendi Universal v. Argentine Republic (Case No. ARB/97/3), Decision on Application for Annulment of July 3, 2002, 41 ILM 1135 (2002).

[45] Salini Construttori S.p.A. and Italstrade S.p.A. v. Kingdom of Morocco (ICSID Case No. ARB/00/4), Decision of July 23, 2001, [French original] 129 Journal du droit international 196 (2002); English translation in 42 ILM 609 (2003).

[46] *SGS v. Pakistan* cit.

procedures is quite typical of dispute settlement arrangements under international law, beginning with political alternatives, followed by third party non-binding intervention and ultimately by binding procedures, which can include a method agreed to or lead to binding international arbitration.

161. The fact that Article VI (2) provides that the dispute "shall" be submitted to the previously agreed mechanism does not entail an obligation on the part of the investor. The investor may well choose to live with the dispute and never attempt a settlement. This is always a choice of the claimant party. If the investor chooses to resort to the previously agreed mechanism, the dispute must then be submitted to that procedure. It is obligatory and the other party has no further option. It is in this context that the "shall" becomes mandatory for the other party.

162. This is the reason why Article VI (3) (a) expressly provides that the ICSID alternative will not be available if the "national or company" has submitted the dispute to the previously agreed procedure, thereby clearly indicating that the choice belongs to the investor. Any other interpretation would mean that the principal feature of the Treaty, which is to make ICSID arbitration available to the investor, would be nullified and impaired by Article VI (2).

163. In the light of this finding, based on the interpretation of the Treaty, the Tribunal does not consider it necessary to discuss the issue in terms of the operation of the most favored nation clause. If the right to resort to ICSID arbitration in the terms discussed is embodied in the Treaty itself, there is no need to look for it under other treaties.

164. The Tribunal is not convinced either that in the light of the facts of the case there was a procedure previously agreed to. This is not because of the rather elliptic *Lanco* argument that a party cannot select a jurisdiction which by law is not subject to agreement or waiver, such as an administrative court, but because of an entirely different reason. The decision of the Danistay to delete the ICSID clause contained in the draft Contract certainly does not have the effect of precluding ICSID jurisdiction provided by consent in treaties. Otherwise treaties would be subject to unilateral derogation by one party. The Respondent has argued in this connection that the Danistay has exclusive jurisdiction over contract disputes as a consequence of the

Constitutional Court ruling of 1996 not allowing private law contracts for BOT power projects and requiring instead concession contracts approved by the Danistay. This view, however, cannot be imposed upon the investor who seeks to rely on an arbitration established by treaty.

165. The Claimants' argument to the effect that the Danistay's deletion of the ICSID arbitration clause did not really mean that the clause was rejected is not tenable. As expressed in paragraph 10 of the Danistay's approval decision of March 11, 1998

> "the Council of State has jurisdiction on disputes between parties arising from concession contracts. Therefore, Article 28 regarding arbitration and pre-arbitration, which is a private law tool, has been removed from the text".

166. The submission of the Respondent that such deletion was accepted by the Claimants on signing the Contract and that, in any event, the Danistay also has jurisdiction to hear treaty-based claims does not convince the Tribunal. On the contrary, this discussion evidences that there was no agreement on an exclusive dispute settlement mechanism.

167. But even assuming for the sake of argument that the Danistay jurisdiction could be exclusive under Turkish legislation, there are two additional considerations to be had. The first is that the Turkish legislature came later to the conclusion that concession agreements could be submitted to international arbitration and that investors could request their conversion to private law contracts, as noted above. This new approach entailed recognition that international arbitration was not to be regarded as incompatible with Turkish legislation. Claimants believe this to be the case since the very outset.

168. The second consideration is the place of treaties under Article 90 of the Turkish Constitution. The last paragraph of this Article provides that "International agreements duly put into effect carry the force of law…". In the Turkish Constitutional system this means that at the very least treaties rank equally with the law. A number of opinions are of the view that treaties even prevail over the law. In this context, whatever jurisdiction the Danistay might have had or still has in respect of administrative acts and concession contracts yields to treaty provisions which, in the instant case is the investment protection Treaty and associated arbitration.

169. The discussion about a forum selection clause is also associated to the question of contract-based and treaty-based rights that have haunted many ICSID tribunals, which if applicable to the present case would mean that some disputes are capable of being submitted to Danistay or Turkish jurisdiction and some other kind of disputes could be submitted to international arbitration.

170. The difference between contract-based claims and treaty-based claims has been discussed by various international arbitral tribunals as evidenced by the decisions in *Lauder*,[47] *Genin*,[48] *Aguas del Aconquija*,[49] *CMS*[50] and *Azurix*[51] and by those of the Annulment Committees in *Vivendi*[52] and *Wena*.[53] The Tribunal held in *CMS*, referring to this series of decisions, that "as contractual claims are different from treaty claims, even if there had been or there currently was a recourse to the local courts for breach of contract, this would not have prevented submission of the treaty claim to arbitration".[54]

171. Where to draw the line, however, is not easy in practice as has been evidenced by the discussion of these various cases. The *Vivendi* Annulment Committee explained that "[i]n a case where the essential basis of a claim brought before an international tribunal is a breach of contract, the tribunal will give effect to any valid choice of forum clause in the contract".[55] However, to the extent that the basis for the claim is a treaty violation, the existence of an exclusive jurisdiction clause in a contract between the claimant and the respondent state "cannot operate as a bar to the application of the treaty standard".[56] To the extent that there are valid concurrent alternatives, the choice will then depend on the nature of the dispute submitted.

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[47] Ronald S. Lauder v. Czech Republic, UNCITRAL Final Award (Sept. 3, 2001).
[48] Alex Genin and others v. Republic of Estonia (ICSID Case No. ARB/99/2), Award of the Tribunal (June 25, 2001); Decision on Claimants' Request for Supplementary Decisions and Rectification (April 4, 2002), *available at*: http://www.worldbank.org/icsid/cases/conclude.htm
[49] *Aguas* cit.
[50] *CMS* cit.
[51] Azurix Corp. v. Argentine Republic (ICSID Case No. ARB/01/12), Decision on Jurisdiction of December 8, 2003, International Law in Brief *available at*: http://www.asil.org/ilib/azurix.pdf.
[52] *Vivendi annulment* cit.
[53] Wena Hotels Ltd. v. Egypt (ICSID Case No. ARB/98/4), Decision on Application for Annulment rendered on February 5, 2002, 41 ILM 933 (2002).
[54] *CMS* cit., par. 80; *Azurix* cit., par. 89.
[55] *Vivendi Annulment* cit., par. 98.
[56] *Vivendi Annulment* cit., par. 101.

172. In the recent case of *SGS* v. *Pakistan*, the Tribunal concluded in this respect that it did not have jurisdiction over contract claims "which do not also constitute or amount to breaches of the substantive standards of the BIT".[57]

173. In the instant case, however, it is not evident that there was such an alternative or an agreed forum selection clause. The existence of a previously agreed procedure is questionable and disputed. In any event, the dispute that has arisen in this case rather qualifies as a treaty-based dispute as it is related both to the issue of interpretation and implementation of the Contract as an investment agreement and to the allegation that the Government, through various measures, impeded and ultimately destroyed the investment. The nature of the dispute is therefore not that of a typical contractual dispute.

174. The Tribunal accordingly affirms its jurisdiction and the objection based on the lack of resort to a previously agreed dispute settlement mechanism is dismissed.

E. <u>Objection to jurisdiction on the basis of lack of standing.</u>

Respondent's objection.

175. The Respondent also objects to the jurisdiction of the Tribunal in respect of the North American Coal Corporation (NACC) and the Project Company on the ground that these entities lack standing. It is argued that NACC has no investment in Turkey nor any rights under the Danistay approved Contract, which was not even signed by NACC. Moreover, the Respondent believes that NACC owns no equity in the Project Company and owns none of the assets that have been claimed as investments. The only link it has to the case is a Memorandum of Understanding signed on August 1, 1998 between NACC and PSEG, conferring the option to acquire ownership interest in the Project Company by means of a Shareholders Agreement to be negotiated later.

176. In Respondent's view, the Memorandum in question is not valid because it is a preliminary agreement which is not binding until the parties' intention to be bound materializes, a situation that never happened. The instrument was conceived as the expression of a desire to "explore an arrangement", the terms of which were never formalized or even agreed to.

[57] *SGS v. Pakistan* cit., par. 162.

However broad the definition of "investment" might be, it does not include mere options and, therefore, this Memorandum does not qualify either as an investment under the Treaty or in any other way. Even if some expenses were made by NACC in connection with the Revised Mine Plan, these are not an investment subject to recovery.

177. In respect of the Project Company, the Respondent argues that it is not a company of the United States as required by the Treaty. Under Article VI (6) a company incorporated in Turkey must have existed before the events giving rise to the dispute for it to be considered a national of the United States. In this case, the Project Company was incorporated in August 1999, two years after the disputed events. Moreover, the Respondent believes that the Project Company cannot simply be considered the successor to the earlier Branch Office opened in January 1998, as this was not a company of the United States; it was merely a component of a foreign company not recognized in Turkey as a separate legal entity and, unlike other treaties concluded by the United States, not included in the Treaty governing this case.

The Claimants' view.

178. The Claimants' view is that NACC owns a 25% interest in the Project Company and 25% of all its assets, including the Contract. Under the Treaty definition of investment it is not necessary to own shares of stock as "other interests" are also included. In its view, the Memorandum is valid and binding and currently in force, providing a clear intention of the parties and establishing all the essential terms of the transaction, a situation that the legal opinion of Mr. David Rivkin explains is sufficient under the law of New York to uphold the validity of such an agreement.[58] If there was an intent not to be bound, this would have to be expressed clearly, as in *Mihaly*.

179. The Claimants also argue that the NACC investments in the Project are clearly covered by the Treaty and even if it were correct to characterize them as an option, this is also covered by the Treaty definition as encompassing a present interest to acquire that property in the terms of the option.

180. As to the Project Company, Claimants argue that it was established following long negotiations with the Ministry as to the terms of the project and the corporate structure required

and that, in any event, the vast majority of the events giving rise to the dispute occurred after the date of incorporation, such as the question of the Treasury guarantee and the application under Law No. 4501. But even in respect of events that took place before 1999 Claimants are of the view that, as held in *Mondev*,[59] events or conduct prior to the entry into force of an obligation may be relevant in determining whether the Respondent has subsequently committed a breach of an obligation.

181. In the Claimants view, the branch office of a foreign investor controlled by PSEG is governed by the Treaty because under its Article I (1) (a) any kind of juridical entity qualifies as a company, including any business association or other organization. The branch office under Turkish law is distinct from the head office and a Permission Certificate was issued specifically to such branch for the purpose of the investment.

The Tribunal's findings on the question of standing.

182. The standing of PSEG to bring this arbitration is not disputed. The objection made concerns only the standing as Claimants of NACC and the Project Company. The Tribunal will now examine each of these objections, beginning with that relating to the Project Company.

183. It must first be noted that the establishment of a branch office of a foreign investor in Turkey is done in accordance with Turkish legislation. The foreign company of which the branch office was an integral part was owned and controlled by PSEG. This fact alone would provide a clear link between this branch and the investment. However, other facts also strengthen this link. The branch was known to the Turkish Government as the conduit for the proposed investment and its establishment for this purpose was discussed at various times. More importantly, the fact that the first Permission Certificate was issued to this branch is in itself evidence that it was regarded by the Turkish Government as the entity authorized to operate and do business in that country in the specific context of the mining and power project envisaged. The Tribunal notes that the legal status of the Project Company is persuasively explained in the Opinions of Professors Reisman and Dolzer.

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[58] Expert Opinion of David W. Rivkin, June 27, 2003.

[59] Mondev International Ltd. v. United States of America (ICSID Case No. ARB(AF)/99/2), Award of October 11, 2002, 42 ILM 85 (2003).

184. It was later that the question of a new corporate structure arose in the light of tax policies and other interests. This discussion resulted in long negotiations, including the impact of the change on the tariff, and ultimately led to the incorporation of Konya Ilgin Ltd. There can be no doubt that whatever rights or interests the branch office had were transferred to the new company as its successor in law and business. The objectives of the Project Company as stated in the act of incorporation are unequivocally linked to the investment.[60]

185. Because of this continuity, the fact that the Company as such only came into existence later is immaterial. Any right or dispute concerning the branch office was also the concern of the successor as both entities were the legal vehicles of the investment made. Even if the Tribunal were to accept a line separating events in time in connection with the date of incorporation, there are still events after that date which involve a dispute between the parties.

186. On many occasions the critical date for the purpose of jurisdiction is whether the dispute arose before or after the entry into force of the relevant treaty. This is the situation specifically considered in *Mondev*, where events or conduct prior to that date were considered only for the purpose of establishing breaches subsequent to the entry into force of the treaty. Similarly, in *Maffezini* the Tribunal held that events before the critical date might be factors leading to the legal dispute after that date. The critical date in this case is not the incorporation date of the Project Company but again that of the entry into force of the Treaty. Every dispute affecting the investment arose in this case after the Treaty had entered into force.

187. The jurisdiction of the Tribunal is therefore not affected either because of the change of corporate structure or because of the date of the events leading to the dispute.

188. The situation in respect of NACC is different. This company began participating in the Project in the summer of 1996 to assist in developing the mining aspects of the power project and later, in 1998, allegedly joined PSEG as an equity investor by means of the Memorandum discussed above. NACC at all times participated as an auxiliary to PSEG and even though it intervened actively in the preparation of the mining plans, the counterpart of the Turkish Government was at all times PSEG. This explains why NACC is not a signatory to the

[6060] Trade Registry Gazette, No. 4861, 27 August 1999.

Contract. Exhibit A to the Memorandum clearly outlines NACC functions as mainly those of a service provider to the Project Company under a Management Services Agreement.

189. Whether the Memorandum is valid and in force is immaterial for the purpose of the Tribunal's decision. The Tribunal considers that the Respondent's argument that the definition of investment does not include an option is persuasive as a general approach. Broad as many definitions of investment are in treaties of this kind, there is a limit to what they can reasonably encompass as an investment. Options such as this particular one can not, in the view of the Tribunal, be interpreted as an "investment". The Tribunal acknowledges that different circumstances from those which obtain in the present case may lead to a different conclusion.

190. Professor Dolzer's Rejoinder Opinion to the effect that the Treaty definition of investment refers to any right, even one that can be exercised at any time in the future, is not persuasive.[61] The Tribunal is not persuaded either by the explanation that a Shareholders' Agreement was not pursued by the parties to the Memorandum because it would not have been a prudent business decision and a waste of time.

191. In the opinion of the Tribunal NACC was at best only a technical operator for the investor in respect of the mining operations of the project and, later, an equity holder with a standing no different from any other equity holder. In fact at some point another entity had the same status as NACC since a similar Memorandum was signed between PSEG and Guris, a Turkish corporation. Given the corporate structure of the project, only PSEG as the investor and the Project Company as the conduit for this investment can be considered legally linked to the Turkish Government for the purpose of the Contract and the operation of the Treaty, including the consent given to arbitration. Other equity holders do not have an interest separate from these entities and consequently cannot claim on their own.

192. The case may be different when minority shareholders are accorded a right to claim independently from the project company because, for example, of questions of nationality or other reason as in *CMS*[62] or *Enron*.[63] In those cases the interest of the investor would be

[61] Additional Expert Opinion, Professor Dr. Dr. Rudolf Dolzer, November 24, 2003, at 11.
[62] *CMS* cit.

nugatory if they were not allowed to claim in their own right. The operation of the respective treaties would then be paralyzed. This is not the case here. Any interest, which the investor may eventually have, may accrue, in part, to NACC, if the latter still has an ongoing equity participation in the investor company. But this is a matter which concerns only intra-corporate arrangements that are separate and distinct from any Treaty connection between NACC and the Respondent. As such, while it may possibly result in a claim by NACC against PSEG, it does not give rise to a Treaty claim by NACC against the Respondent.

193. As held in *Enron*, the corporate linkages can be recognized for the purpose of the jurisdiction of an arbitral tribunal to the extent that the consent to arbitration is considered to extend to a given entity, but not beyond. NACC is beyond the reach of the consent to arbitration as far as the Respondent is concerned.

194. The Tribunal accordingly finds that it lacks jurisdiction in respect of claims by NACC in this case.

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[63] Enron Corporation and Ponderosa Assets, L.P. v. Argentine Republic (ICSID Case No. ARB/01/3), Decision on Jurisdiction of January 14, 2004, International Law in Brief, *available at:* http://www.asil.org/ilib/Enron.pdf

IV. Decision.

For the above reasons, the Tribunal decides that:

1. The dispute submitted by PSEG and Konya Ilgin Ltd. is within the jurisdiction of the Centre and the competence of the Tribunal.

2. The dispute submitted by NACC is not within the jurisdiction of the Centre and the competence of the Tribunal.

3. The costs of the jurisdictional phase of the arbitration are reserved.

So decided.

Date: June 4, 2004

Francisco Orrego Vicuña

President of the Tribunal

L. Yves Fortier Gabrielle

Arbitrator

Kaufmann-Kohler

Arbitrator