

**TOWARDS LIMITING TREATY SHOPPING IN INTERNATIONAL INVESTMENT
LAW AND ARBITRATION: A *CRITICAL ANALYSIS OF THE EFFECTIVENESS
OF THE DENIAL OF BENEFITS CLAUSE.***

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ABSTRACT

The question of who qualifies as an investor stands as one of the foundational issues of international investment law. However, it has been argued that the notions of nationality and the origin of capital are increasingly irrelevant within structure of international investment law. According to this view, practices such as treaty shopping have been submitted as being a true reflection of the multilateralized nature of investment law and a manifestation of its purpose.

However, the response of other stakeholders in the regime particularly host states, suggests that this view lacks consensus. One of the manifestations of this differing position is the increasing incorporation of the denial of benefits (DOB) clause as an in-treaty mechanism for limiting the practice of treaty shopping in international investment agreements and treaties. The DOB clause has been argued to be an effective remedy possessing the potential of limiting treaty shopping, and serving as a vehicle for birthing stability and predictability in international investment law and arbitration. It is the veracity of this position that this work seeks to test. At the heart of this research is the determination of the question of the effectiveness of the DOB clause as a mechanism for limiting treaty shopping.

DEDICATION

To proof of that which is possible, in appreciation of all those who helped make it possible,
and Him to whom nothing is impossible.

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Chapter One

Introduction:

The Question of Globalisation, International Investment Law, State Sovereignty and the Denial of Benefits Clause

1. Background

Over the last three decades the political and socio – economic landscape of the world has witnessed the introduction, adoption and propagation of market liberalism.¹ Central to this idea is the proposition and view that the markets have the potential to effectively and efficiently manage both national and world economies. This is in turn to lead to the creation of prosperity for a larger number of people and result in the development and growth of third world nations; ultimately resulting in world peace and security.²

While not without its challenges and shortcomings as a medium for the efficient and equitable distribution of resources, this ideology and its policies have over the years arguably succeeded in the attainment of these objectives. As such, market liberalism enjoys a predominant position as the economic theory of choice in international fora. This has led to increased growth in the creation and development of cross border production lines, the integration of global economies by multinational enterprises (MNEs), increase in financial flows, and the emergence of global markets for many erstwhile localised goods and services. These in turn have been made possible through the internationalisation of production, the promotion of worldwide transportation and

¹ Muthucumaraswamy Sornarajah, 'The Neo – Liberal Agenda In Investment Arbitration: Its Rise, Retreat and Impact on State Sovereignty' in Wenshua Shan, Penelope Simons and Dalvinder Singh (Eds) *Redefining Sovereignty in International Economic Law* (Hart Publishing 2008) 199.

² Rafael Leal – Arcas, 'A New Era in Global Economic Governance' (2009) *International Security Forum* 1.

communication infrastructures, trade liberalisation etc.³ Cumulatively, these systems, processes and results are generally known as globalisation.

With its leanings and preference for a market - led system of production and distribution, globalisation in its essence necessitates the dismantling of institutions of state through which governments control the flow of economic resources within their territories. In other words, the introduction of the market economic model conversely demands the withdrawal of the state and its institutional and regulatory machineries from the economic sphere, or the stripping of their influence to a minimum.⁴

However, growing alongside globalisation have been concerns with regard to its effect on the welfare of states. These concerns have been focused particularly on the regulatory and policy autonomy of governments within their territories. Over time, these perceptions and interests pertaining to the influence of globalisation and its mechanisms on state powers reached public consciousness. Notable among these are the popular uprisings and civil society demonstrations in opposition to the proposed Multilateral Agreement on Investment (MAI) within the auspices of the Organization for Economic Cooperation and Development (OECD) in 1998. They were further expressed against the World Trade Organization (WTO) at its 1999 ministerial meeting in Seattle, aimed at launching the new millennium round of trade negotiations.⁵

³ Christine Cote, 'A Chilling Effect? The Impact of International Investment Agreements on National Regulatory Autonomy in the Areas of Health, Safety and the Environment' (DPhil Thesis, The London School of Economics and Political Science 2014).

⁴ See generally, Milton and Rose Friedman, *Free to Choose; A Personal Statement* (Harcourt Brace 1980). Worthy of mention on this point is the work of Francis Fukuyama, who formerly held the belief in the free market ideology as a vehicle for economic and social freedom. See, Francis Fukuyama, *After the Neo – Cons: America at the Crossroads* (Profile Books 2006).

⁵ See, Peter Muchlinski, 'The Rise and Fall of the Multilateral Agreement on Investment: Where Now?' (1999) 34(3) *The International Lawyer* 1033.

These issues were also debated in the context of regional trade and investment negotiations under the Trans Pacific Partnership (TPP),⁶ as well as the US-EU Transatlantic Trade and Investment Partnership (TTIP).⁷ The particular questions these demonstrations and debates have raised, and which continue to challenge scholars are notably, whether globalisation is having a negative impact on the ability of governments to set domestic policy, and as a corollary, whether private actors are playing an ever increasing role in this equation.⁸

Necessary and central to the effectiveness of the liberal ideology of the globalisation 'movement' is the need for a legal and institutional framework which supports and promotes the market ideology. It is in this sense that international investment law has been believed to play an important role in promoting liberal agendas and policies.⁹ The vast and increasingly growing body of bilateral, multilateral and regional treaties and agreements provide a necessary structure upon which market ideology can be built.

⁶ Rick Rowden, '9 Ways the TTP is Bad for Developing Countries' *Foreign Policy* (Washington, 7th July, 2015) <http://foreignpolicy.com/2015/07/07/9-ways-the-tpp-is-bad-for-developing-countries/> > accessed 18 October 2017; Joy Firestone 'Fast/Track/TPP: The Death of National Sovereignty, State Sovereignty, Separation of Powers, and Democracy' (*New Economic Perspectives*, 1 May 2015). <http://neweconomicperspectives.org/2015/05/fasttracktpp-the-death-of-national-sovereignty-state-sovereignty-separation-of-powers-and-democracy.html> > accessed 18 October 2017; Luis Ferreira Alvarez, 'Free Trade Agreements and Sovereignty' (*Permaculture Research Institute*, 6 July 2015). <https://permaculturenews.org/2015/07/06/free-trade-agreements-and-sovereignty/> > accessed 18 October 2017.

⁷ Colin Crouch, 'Democracy at a TTIP'ing point: Seizing a slim chance to reassert democratic sovereignty in Europe' (2014) 21 (3) *IPPR Progressive Review*, 176; Lee Williams, 'What is TTIP? And Six Reasons Why the Answer should Scare You' *The Independent* (London, 12 October 2015).

⁸ Cote (n 6) 21.

⁹ Spurred by factors such as the increase in capital and investment flows, foreign investors have entertained concerns as to the capacity of domestic legal systems in host countries in ensuring the protection and enforcement of their property rights. With most host countries being developing countries, it is not unusual that they possess relatively weak financial and tax, labour laws and equally important, legal institutions. In respect of the latter, the emergence of international investment law as a platform which guarantees the protection and enforcement of foreign investor rights has held a certain allure for most investors. The appeal of international investment agreements (IIAs) as against the reliance on domestic legal systems of host states has received a further boost by the unique access private investors have had through these agreements to investor-state dispute settlement provisions and international arbitration proceedings. See Sornarajah (n 1) 199.

Not surprisingly, however, international investment law has been the subject of growing criticism and voiced concerns. Just as in the case of globalisation, scholars and other stakeholders have considered whether the guarantees and enforcement mechanisms under international investment law, which serves as a legal framework for globalisation, have constraining influences on national policies. These concerns range from the view that litigation against states through rights provided to private actors by IIAs will constrain the sovereignty and regulatory ability of the state, to the lopsided nature of obligations and rights under bilateral investment treaties (BITs) and International Investment Agreements (IIAs),¹⁰ parallel proceedings, lack of consistency and predictability of awards, huge monetary awards, forum and treaty shopping practices etc.¹¹

While some scholars have opined as to the absence, insignificance, or the supposed undue magnification of some of these issues in international investment law¹²; it is argued that these issues do exist and are pivotal to the dynamics of the operation of this area of law as well as its perception. Consequently, the identification, analysis and discussions held on the basis of these issues are wholesome for the development of this area of international law. Particularly in so far as they are designed to initiate, recommend or consolidate options for making this area of law better equipped to serve its purpose as a balanced and reliable framework for the protection and promotion of international investment and fostering economic development.

¹⁰ Peter Muchlinski, 'Corporations and the Uses of Law: International Investment Arbitration as a Multilateral Legal Order' (2011) 1(4) Onati Socio-Legal Series 1; Olivia Chung, 'The Lopsided International Investment Law Regime and Its Effect on the Future of Investor-State Arbitration' (2006-2007) 27 Va.J.Int'l L 953.

¹¹ Joachim Karl, 'International Investment Arbitration: A Threat to State Sovereignty?' in Wenshua Shan, Penelope Simons and Dalvinder Singh, *Redefining Sovereignty in International Economic Law* (Hart Publishing 2008) 225.

¹² See generally, Stephan Schill, *The Multilateralization of International Investment Law* (Cambridge University Press 2009). The work argues that some of the generally acclaimed issues of international investment law are in fact testimony of its multilateralised character through the vehicle of bilateralism.

Indeed these aforementioned issues are relevant when the motivations for entering into these agreements by state parties are considered. States under international law in exercising their sovereign rights can enter into treaties which limit their sovereignty. However, the salient question is the consideration of what purpose(s) and to what end are state parties willing to restrict their sovereign and regulatory powers? This broad thematic enquiry no doubt leaves room for the postulation of different legal and policy inspired hypotheses within the general auspices of international law, as well as the consideration of the particular motivations of individual state parties. However, in the context of international investment law, the generally accepted reason for the signing of these agreements is the protection and promotion of international investment.¹³

Taking this a step further, a fundamental reason for the signing of these agreements on the part of developed countries is the reduction of political risks which their nationals face when investing abroad. BITs and other IIAs became the principal mode of protecting the investment of nationals in foreign territories after the demise of the New International Economic Order (NIEO). The NIEO placed emphasis on the sovereign rights of the host state and the expression of this right in the regulation and control of foreign investors and their investments. It further sought to establish the recognition of the host state's permanent national sovereignty over the natural resources in its territory. However, this was replaced by a series of investment agreements concluded between countries and outside of the multinational ambit of the UN resolutions.¹⁴ It is to these that many developed nations have resorted in the protection of the investment of their nationals outside their home territories.

¹³ See generally, Rudolf Dolzer, Christoph Schreuer, *Principles of International Investment Law* (OUP 2012); Jeswald Salacuse, *The Law of Investment Treaties* (OUP 2010).

¹⁴ Thomas Walde, 'A Requiem for the "New International Economic Order: The Rise and Fall of Paradigms in International Economic Law' (2003) 1 OGEL 1; Peter Muchlinski, 'Corporations and the Uses of Law: International Investment Arbitration as a Multilateral Legal Order' (2011) 1(4) Onati Socio-Legal Series 1.

However, on the part of most developing countries, the signing of these treaties is closely tied to the underlying assumptions by these states that BITs would promote the inflow of much needed foreign direct investment into their territories. This expectation was in itself built on the premise that foreign direct investment through the platform of market liberalisation was fundamental to the realisation of their economic goals and overall development.¹⁵ Foreign investment was therefore to be promoted through the protection of properties and contractual rights of the foreign investor and its investment. This was in turn to be achieved by ensuring a stable investment climate, guaranteeing of standards such as national treatment, fair and equitable treatment, and the abstinence from arbitrary governmental interference in the sphere of the foreign investors' rights. Where such rights are infringed upon, the host state guarantees the investor the right to initiate arbitral proceedings under international fora.

However, these assumptions have proven to be costly for many states. First a number of empirical findings have shown that BITs and other IIAs are of little or no significance in increasing the inflow of foreign direct investments.¹⁶ While a careful analysis into the veracity of these findings is not the focus of this work, it does lead to the consideration

¹⁵ Chung (n 10) 953.

¹⁶ Gus Van Harten, 'Five Justifications for Investment Treaties: A Critical Discussion' (2010) 2 Trade, Law & Development 1; UNCTAD, 'The Role of International Investment Agreements in Attracting Foreign Direct Investment to Developing Countries' in UNCTAD, *Series on International Investment Policies for Development* (UNCTAD, 2009), 33–37, 54–58; Mary Hallward-Driemeier, 'Do Bilateral Investment Treaties Attract Foreign Direct Investment? A Bit...and They Could Bite', (2003) World Bank Working Paper No. 3121, 2003, <<http://elibrary.worldbank.org/content/workingpaper/10.1596/1813-9450-3121>> accessed 11 November 2016; Susan Rose-Ackerman and Jennifer Tobin, 'Foreign Direct Investment and the Business Environment in Developing Countries: The Impact of Bilateral Investment Treaties', (2005) Yale Law & Economics Research Paper No. 293, 2005 available at <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=557121> accessed 11 November 2016. See also, Eric Neumayer and Laura Spess, 'Do Bilateral Investment Treaties Increase Foreign Direct Investment to Developing Countries?' (2005) 33 World Development 1567; Jeswald Salacuse and Nicholas Sullivan, 'Do BITs Really Work: An Evaluation of Bilateral Investment Treaties and their Grand Bargain' (2005) 46 Harv. Int'l. L. J. 67; Petter Eggerr and Michael Pfaffermayr, 'The Impact of Bilateral Investment Treaties on Foreign Direct Investment' (2004) 32(4) J.Comp.Econ 788; Matthias Busse, Jens Koniger and Peter Nunnenkamp, 'FDI Promotion through Bilateral Investment Treaties: More Than a Bit?' (2010) 146 Review of World Economics 147.

of the question of whether or not states have struck a good bargain in entering into these treaties.¹⁷ This is further given impetus by the second point.

While a qualitative and or quantitative increase in the number of investments in developing countries remains a grey area, however, what stands clear is the number of investment claims brought on the basis of these agreements and the impact of same. Importantly, where decisions are in favour of the investor, state parties are required to pay monetary compensation to such investor. Very often this runs into hundreds millions and even billions of dollars per award. When this and other reasons are considered, the question of whether or not state parties have struck a good bargain becomes more crucial.

Thus, the question is whether the exchange of regulatory discretion for the prospect of investment inflows; the curtailing of the exercise of governmental power for developmental policies which might affect the profitability of the investor's property rights etc. is commensurate to the sacrifice of state sovereignty, regulatory restriction and heavy monetary compensation? Simply put, the question is, is the grand bargain of signing investment treaties in the hopes of foreign investment a good enough barter for the restriction of state sovereignty and the consequent expansion of alien property and contractual rights?

1.2. The Issue

Devolving from this general thematic background, the central question of this research is, first and primarily, *'whether and to what extent does the denial of benefits clause*

¹⁷ Jeswald Salacuse and Nicholas Sullivan, 'Do BITs really work: An Evaluation of Bilateral Investment Treaties and their Grand Bargain' (2005) 46 Harv. Int'l. L. J 67.

(DOB) as an in-treaty legal mechanism effectively set limits on treaty shopping in international investment law and arbitration'. Second and subsidiarily, 'where the clause is perceived to have the potential of limiting treaty shopping in the present context of international investment law; what factors if any, impede this clause as a mechanism for limiting treaty shopping and its serving as a mechanism for balancing of rights and obligations in international investment law?'

Central with regards to the rising disenchantment with international investment law as a legal framework underpinning globalisation is the issue of the proliferation of investment treaty shopping. This involves practices where investors particularly multinationals structure their investments in such ways as to take advantage of more favourable investment protection. These structurings and restructurings by investors are often sought where the levels of protection subsisting between a host country and the home state of the investor are non-existent or considered insufficient to adequately protect the particular interests of the investor.

However, while investors through these practices have access to better investment protection, these inevitably often result in a number of consequent eventualities. Particularly relevant to this work is that, this practice allows for the bringing of claims from multinational corporations over and beyond what many state parties expected when they signed these investment agreements. These 'unexpected claims' include notably those initiated by third party nationals whom the contracting parties to the agreements did not intend to extend treaty protection.

Second and equally important are claims brought by nationals of the host state against their home country on the basis of these agreements and through the instrumentality of the practice of treaty shopping. Consequently and not surprising, many states have

expressed increasing discontent with the current system of international investment law and the practice of treaty shopping in particular.¹⁸

In this context, a number of countries have started to look for ways out of these agreements or, at least, to tame some of the most constraining elements they contain.¹⁹

Developed countries such as the US, themselves increasingly becoming recipients of foreign investment flows from developing countries and consequently, investment arbitration respondents, have progressively amended their model BITs so as to exclude or limit the most expansive effects of some of their provisions.²⁰ Alternatively, others as in the case of Australia have decided to discontinue the practice of including investor-state dispute resolution procedures in their agreements.²¹

Some developing countries, however, have adopted a more radical stance by withdrawing from the ICSID Convention or putting an end to some or all of their BITs.²² For instance, in 2007, Bolivia became the first country to ever denounce the ICSID Convention.²³ This was followed by Ecuador in 2009²⁴ and most recently by Venezuela

¹⁸ Frederico Lavopa, Lucas Barreiros and Victoria Bruno, 'How to Kill a BIT and Not Die Trying: Legal and Political Challenges of Denouncing or Renegotiating Bilateral Investment Treaties' (2013) 16(4) *Journal of International Economic Law* 869.

¹⁹ *Ibid.*

²⁰ *Ibid.*; See also, Peter Muchlinski, 'Trends in International Investment Agreements 2008/2009: Review of the Model Bilateral Investment treaties of Norway, South Africa, and the United States' in Karl Sauvant (Ed) *Yearbook on International Investment Law & Policy 2009 – 2010* (OUP 2010) 41.

²¹ See, Australian Government, Department of Foreign Affairs and Trade, 'Gillard Government Trade Policy Statement: Trading our way to more Jobs and Prosperity' (2011) <<http://www.acci.asn.au/getattachment/b9d3cfae-fc0c-4c2a-a3df-3f58228daf6d/Gillard-Government-Trade-Policy-Statement.aspx>> accessed 19 November 2016.

²² Lavopa *et al* (n 18) 869.

²³ See generally, Christoph Schreuer, 'Denunciation of the ICSID Convention and Consent to Arbitration' in Michael Waibel, Asha Kaushal, Kyo-Hwa Liz Chung, and Claire Balchin, (Eds) *The Backlash against Investment Arbitration: Perceptions and Reality* (Kluwer Law International 2010) 353, 368.

²⁴ *Ibid.*

in January 2012. Similarly, South Africa has also terminated its BIT programme.²⁵ Similar withdrawals and terminations are believed to be witnessed in coming years.

In the light of these events, scholars over the last few years have asked probing questions as to the way forward for international investment law. Among solutions proffered to these questions, are recommendations believed to have the capacity to give balance to the international investment regime. With regard to the issue of treaty shopping, a recommended antidote has been the DOB clause, which has been described as having the potential of limiting the practice of treaty shopping in international investment law and birthing balance in the system.²⁶

With the DOB clause touted to play a crucial role in the limiting of treaty shopping, research on the clause is relatively recent.²⁷ This is particularly evident when compared to issues such as substantive standards of treatment in investment treaties, direct and indirect expropriation, arbitrator bias etc. However, over the course of the past few years, there has been a growing interest in DOB clauses. This development is largely the result of the analysis of the tribunal in the case of *Plama v. Bulgaria*²⁸, which was brought under the auspices of the Energy Charter Treaty (ECT). Included among the issues considered under the case was the application of DOB clause as contained under Article 17(2) of the ECT. The interpretation of the tribunal on points relating to the clause initiated renewed interest in the DOB clause.

²⁵ Kathryn Gordon and Joachim Pohl, 'Investment Treaties over Time - Treaty Practice and Interpretation in a Changing World' OECD, OECD Working Papers on International Investment 2015/02, <<http://dx.doi.org/10.1787/5js7rhd8sq7h-en>> accessed 19 November 2016; see also, Peter Muchlinski, 'Trends in International Investment Agreements 2008/2009: Review of the Model Bilateral Investment treaties of Norway, South Africa, and the United States' in Karl Sauvant (Ed) Yearbook on International Investment Law & Policy 2009 – 2010 (OUP 2010) 41.

²⁶ Mark Feldman, 'Setting Limits on Corporate Nationality Planning in Investment Treaty Arbitration' (2012) 22(2) ICSID Review 281.

²⁷ The denial of benefits clause is not a recent concept. However, attention has only once again turned to it in recent times.

²⁸ *Plama v Bulgaria*, ICSID Case No. ARB/03/24, Decision on Jurisdiction, 8 February 2005.

Legal academic quests have in the past few years looked into different aspects of the DOB clause. Ranging from commentaries on cases where issues bothering on the clause have been considered²⁹ to references to the DOB clause as a means of limiting treaty shopping. Concretely, the limited but current research on the clause has traversed the history, evolution and purpose of the clause,³⁰ to the more common focus of the procedural requirement for its exercise. However, these literatures have tended to evolve in a rather compartmentalised way with little or no cross – fertilisation between them. This represents a gap which this work seeks to fill.

Particularly, the focus of research on the DOB clause has spanned the consideration of its origins as a mechanism of the US treaty programme. With scholars such Henry Walker Jr as well as Pamela Gann in their chronicling of the US BIT and commercial treaty programmes indicating the motivation for the inclusion of the clause. This motivation has been noted to be inspired by the need to reduce the possibility of free riding by third country investors. However, besides statements and indications as to the purpose of the clause, there is little insight into the nuances of how it is designed to function.³¹

Similarly, the working of the clause particularly within the context of its operation through the use of the control criterion has also been explored. In his consideration of the impact of the *Barcelona Traction Case*³², Panayotis Protopsaltis, looks into the

²⁹ See generally, James Chalker, 'Making the Energy Charter Treaty Too Investor Friendly: Plama Consortium v The Republic of Bulgaria, (2006) 3(5) Transnational Dispute Management 1; Holger Essig, 'Balancing Investors' Interests and State Sovereignty: The ICSID – Decision on Jurisdiction Plama Consortium Ltd v Republic of Bulgaria (2007) 5(2) OGEL 1.

³⁰ Loukas Mistelis and Crina Baltag, 'Denial of Benefits and Article 17 of the Energy Charter Treaty' (2009) 113(4) Penn St.L.Rev. 1301.

³¹ Pamela Gann, 'The US Bilateral Investment Treaty Program' (1985) 21 Stan.J.Int'l L 373, 379-80; Herman Walker Jr, 'Provisions on Companies in United States Commercial Treaties' (1956) 50 Am.J.Int'l. L 373, 388.

³² *Barcelona Traction, Light and Power Company, Limited (Belgium v. Spain); Second Phase*, International Court of Justice (ICJ), 5 February 1970.

evolution and forms of the DOB clause. He draws a distinction between the early forms of the clause which impose a blanket denial of benefits on third party nationals and the recent versions of the clause which are largely conditional in nature and possess an arguably more flexible construction.³³ Notable also, are the works of Rachel Thorn, Jennifer Doucleff³⁴ as well as Lindsay Gastrell and Paul - Jean le Cannu³⁵, with their focus being primarily on the procedural requirements for the exercise of the clause as well as its effect. This was achieved through a consideration and review of the decisions of arbitral tribunals on the issues relating to the clause.

A major proponent of the DOB clause and its potential role in international investment law and arbitration has been Mark Feldman.³⁶ He argues that central to the balance and stability of the international investment regime is the need for the establishment of predictable limits in the regime generally, but particularly on the practice of treaty shopping. In his argument, Feldman explores the increasing reliance by state parties on the principle of abuse of rights and takes the position that the very absence of unpredictable decisions impact on the effectiveness of the principle in limiting treaty shopping. He posits that the DOB clause sits in the best position to establish clear, predictable limits on corporate nationality planning.³⁷

In support of his claim, Feldman's principal argument centres on the idea that the incorporation of the DOB clause into BITs and IIAs plainly expresses the views of the relevant state parties in limiting treaty shopping by investors and claimants. However,

³³ Panayotis Protosaltis, 'The Challenge of the Barcelona Traction Hypothesis: Barcelona Traction Clauses and the Denial of Benefits clauses in BITs and IIAs' (2010) 11 J. World investments and Trade 561.

³⁴ Rachel Thorn and Jennifer Doucleff, 'Disregarding the Corporate Veil and Denial of Benefits Clauses: Testing Treaty language and the Concept of investor' in Michael Waibel and Aisha Kaushal et al (Eds) *The Backlash against Investment Arbitration* (Kluwer Law International 2010) 3.

³⁵ Lindsay Gastrell and Paul-Jean Le Cannu, 'Procedural Requirements of Denial-of-Benefits Clauses in Investment Treaties: A Review of Arbitral Decisions' (2015) 30(1) ICSID Review 78.

³⁶ Mark Feldman, 'Setting Limits on Corporate Nationality Planning in Investment Treaty Arbitration' (2012) 27 (2) ICSID Review 281.

³⁷ *Ibid*, 293.

he goes no further in his argument. Rather, he resorts to a restatement of the evolution and origin of the clause and how investment tribunals have sought to interpret it in recent times.

Another proponent of the clause has been Xiao – Jing Zhang,³⁸ who in his consideration of the role of interpretation of the concept of nationality in limiting treaty shopping touches on the DOB clause. Taking a similar position to Feldman, Zhang argues that the DOB clause where properly interpreted and drafted can play a role in limiting treaty shopping. However, he also attempts to make his point by focusing largely on how arbitral tribunals have looked into and interpreted the procedural requirements of the clause.

A number of scholars who have ventured into the consideration, research and analysis of the concepts of nationality and treaty shopping in international investment law also more often than not make a passing statement about the DOB clause. While they seldom express an in-depth analysis of the clause, the generally accepted idea seems to be that the DOB has the potential to limit treaty shopping. What that means and how and to what extent it is possible is rarely the subject of review.

For example, professors Rudolf Dolzer and Christoph Schreuer in their classic text on international investment law, refers to “the insertion of the so - called denial of benefits clause by states as a counteractive strategy adopted by states to limit nationality planning”.³⁹ A similar reference was made by professor Sonarajah, where he noted that the clause “gets over the problem that mere satisfaction of the formalities involved

³⁸ Xiao – Jing Zhang, ‘Proper interpretation of Corporate Nationality under International Investment law to prevent Treaty Shopping’ (2013) 6 Contemp. Asia. Arb. J 49.

³⁹ Rudolf Dolzer and Christop Scheurer, *Principles of International Investment Law* (OUP 2nd edn, 2012) 55 -56.

does not satisfy corporate nationality”.⁴⁰ For Stephan Schill, DOB clauses are generally used to deny investment protection to investors that have opted into the treaty regime through shell box companies. He argues (in line with the central theme of his work), that the DOB clause illustrates that state parties are aware of the multilateralised nature of their BITs and IIAs.⁴¹

As such, while there is some reference to the DOB clause within the context of concepts such as nationality, treaty shopping and other general issues of international investment law and arbitration. An exhaustive engagement of the clause is at the moment near non - existent. In instances where research on the clause does exist, these are often largely centred on the procedural questions it raises, as well as the presentation and touting of the clause as having the potential of limiting treaty shopping in the regime. Such presentations, descriptions and arguments, however, are generally short of any analysis of its effectiveness in fulfilling the task.

Therefore, first and broadly, what this research seeks do is to consolidate the different aspects of the research on the DOB clause, with the intent to provide a holistic treatise on the DOB clause in the present context of the international investment regime. Second and in particular, the research focuses on an analysis of the potential of the DOB clause as an effective mechanism in limiting treaty shopping and as a mechanism capable of bringing a balance in the international investment law and arbitration.

In other words, the research will consider the DOB clause in the context of its being a tool for limiting treaty shopping. The focus is on whether DOB clauses as they are presently drafted have the capacity to limit treaty shopping in all its present and

⁴⁰ Muthucumaraswamy Sonarajah, *The International Law on Foreign Investment* (Cambridge University Press 3rd edn, 2010) 329.

⁴¹ Stephan Schill, *The Multilateralization of International Investment Law* (Cambridge University Press 2009) 329.

evolving forms. Implicitly, the thesis also considers the potential of the clause as an in-treaty mechanism capable of allowing host states to exercise their sovereignty and accord them a platform for possessing a right in a regime which is considered largely one-sided in this regard.

Once again, the central question of this research is, first and primarily, *‘whether and to what extent does the DOB clause as an in-treaty legal mechanism effectively sets limits on treaty shopping in international investment law and arbitration ?’*. Second and subsidiarily, *‘where the clause is perceived to have the potential of limiting treaty shopping in the present context of international investment law; what factors if any, impede this clause as a mechanism for limiting treaty shopping and its serving as a mechanism for balancing of rights and obligations in international investment law?’*.

In attempting to answer these principal questions, the thesis will draw on material concerning issues such as:

- 1) The concept of nationality in international investment law.
- 2) The practice of treaty shopping in international investment law.
- 3) The forms of treaty shopping within the present context of international investment law.
- 4) Legal and policy implications of the treaty shopping practice.
- 5) The evolution, purpose and role of the DOB clause within the present context of International investment law.
- 6) The internal structure of the DOB clause and its impact on the potential of the clause as a mechanism for limiting treaty shopping.
- 7) External influences or factor(s) which impact the potential of the clause as a mechanism for limiting treaty shopping.

1.3. Relevance of Research

This thesis is built on three foundational premises. First, it is believed that the increased inclusion of the DOB clause in BITs and other IIAs by states, as well as the reliance on the clause in their defence before investment tribunals, is a sign that states consider the issue of their sovereignty important within the context of the international investment law and arbitration system. As such, though the system itself precludes the restriction of state sovereignty and regulatory action where foreign investors and investments are concerned. However, the increased use of the DOB clause reveals that states are taking steps to ensure that such constraints on their sovereignty and regulatory power are not limited by investors where the states had no intention of acceding to such sovereign limitations.

Second and devolving from the first, the weight of the issues of state sovereignty, investor rights and the protection of such rights in international investment law makes an in depth analysis of the effectiveness of the DOB clause a germane subject of legal scholastic pursuit in the area. If states perceive the DOB clause as a principal means of clawing back some aspects of their sovereignty, particularly in the context of investors outside the scope of their legal and policy intent at the signing of investment agreements, then an analysis as to the effectiveness of the clause is trite.

Third, that though the recent introduction and reliance on the clause is a response to the actual or perceived 'lopsided' nature of the regime, that this should be distinguished from other forms of responses engaged by states. The central point here is that the use of the clause by states is an 'in-regime' response. That is a response which bellies a belief that though not presently having the most balanced of structures, the investment law and arbitration regime still has the potential to balance the rights and duties of

actors. This is as against 'ex-regime' responses which express a total loss of confidence in the system such as withdrawal from the regime or cancellation of investment agreement programmes, or 'anti-regime' responses which sabotage the system itself.⁴²

This work is approached with an appreciation of the historical and socio – political context of international investment law and arbitration. It is a widely known historical fact that the international rules on the protection of foreign-owned property originated in the reciprocal arrangements of European nations.⁴³ Notably, these states possessed relatively equal bargaining power and sought to secure minimum standards of treatment for their citizens engaging in investment activity within the region.⁴⁴ However, the transformation into international investment law, changed the character of these rules fundamentally. It was this process of applying these standards to non-European, capital importing developing states that became inextricably linked with colonialism, oppressive protection of commercial interests, and military intervention.⁴⁵ And as a result of this shift in practice, foreign investment protection law moved from a system of reciprocity among countries of equal bargaining power, to one of imposition between unequals.

Non-European inter-nation legal regimes and trading and investment arrangements were ultimately replaced with a universal system of international law based on European conceptions of property – and it is clear that power struggles, military force,

⁴² Christoph Schreuer, 'Denunciation of the ICSID Convention and Consent to Arbitration' in Michael Waibel, Asha Kaushal, Kyo-Hwa Liz Chung, and Claire Balchin, (Eds) *The Backlash against Investment Arbitration: Perceptions and Reality* (Kluwer Law International 2010) 353, 368; James Chalker, 'Making the Energy Charter Treaty Too Investor Friendly: Plama Consortium v The Republic of Bulgaria, (2006) 3(5) Transnational Dispute Management 1.

⁴³ Charles Lipson, *Standing Guard : Protecting Foreign Capital in the Nineteenth and Twentieth Century* (University of California Press 1985)

⁴⁴ Ibid

⁴⁵ Frank Dawson and Ivan Head, *International Law, National Tribunals, and the Rights of Aliens* (Syracuse University Press, 1971).

and the use of legal doctrine were deeply involved in that process of replacement. The development of international rules on the protection of foreign investment was also closely tied to the methods of commercial expansion adopted by European and North American powers in the eighteenth and nineteenth centuries.⁴⁶ The strategies included the securing of 'friendship, commerce and navigation' treaties, the acquiring of concessions, diplomatic pressure, capitulation treaties, extraterritorial jurisdiction, military intervention, and colonial annexation of territory.⁴⁷ Significantly, this process of Western commercial and political expansionism was facilitated by international law.

What is particularly interesting is that capital-exporting states asserted the legitimacy of these strategies within international law and that the impact of their reiterated assertions was so profound. By sharing a political and economic base in liberalism, powerful nations of the West had a common understanding of the principles of international law pertaining to foreign investment.⁴⁸ It is not surprising that this understanding reflected their interests, and accentuated the obligations of nations to facilitate trade and investment.

These were evident in unequal treaties and concessions for the exploitation of natural resources which were erstwhile within the province of the regulatory powers of the conceding host states. The translation of European trading and investment principles into universal rules of international law on foreign investment protection is bound up with this history of colonialism, the calculated, often brutal, use of force, and the manipulation of legal doctrines to acquire commercial benefits.⁴⁹ These historical

⁴⁶ Sonarajah, (n1).

⁴⁷ Ibid.

⁴⁸ Lipson (n43).

⁴⁹ Antony Anghie, *Imperialism, Sovereignty and the Making of International Law* (2004, Cambridge University Press).

circumstances later on drove the establishment, development and construction of international investment law.

Legal principles were developed and used by capital-exporting states to legitimise their often repressive actions in acquiring commercial advantages and protecting property.⁵⁰ These were facilitated through the signing of BIT and IIA with capital importing developing countries. This historical background of international investment law and the agendas it sought to achieve, has led to the backlash against international investment law in its present state. International investment law has been expressed to be a 'lopsided regime' with burdensome restrictions on sovereignty, inequitable and excessive arbitral awards.⁵¹

However, while this is the background of international investment law, the position held here and which informs the motivation for this work, is that there is room for redemption. Hence a rebalancing of the international investment law regime as to reflect the interest of not just capital exporting nations and the business interests of investors, but also the interests of capital importing, developing host states is necessary. It is also believed that this rebalancing is achievable. In particular, one of the mechanisms which have been professed to have the potential to bring much needed balance in the regime is the DOB clause.

Consequently, a critical analysis of the effectiveness of the DOB clause in limiting treaty shopping will contribute in no small measure in understanding the expectation of state parties who seek to apply the clause. Such analysis will further assist in providing an informed conception of the capacity of the clause to meet these expectations. Equally,

⁵⁰ Lipson (n 43).

⁵¹ Olivia Chung, 'The Lopsided International Investment Law of Regime and Its Effects on the Future of Investor - State Arbitration' (2006 – 2007) 47 Va.J. Int'L. 953.

it allows for the testing of the clause to determine its strengths and weaknesses in the light of its purpose for inclusion and reliance by states and in the investment regime. Lastly, it serves as a springboard for further research on the bolstering of this clause or the formulation of similar mechanisms which might come to play a crucial role in the balancing of the investment law regime.

1.4. Methodology of Research

The thesis adopts an analytical and not merely descriptive approach to the issues discussed. It critically examines the research topic and the issues raised there in. This it does by principally analysing arbitral case laws, BITs, IIAs and other legal instruments related to the issues under consideration. It also makes an extensive use of other secondary literature related to the topic; that is the evaluation of the effectiveness of the DOB clause.

For the purposes of this research, the term 'effectiveness' is used in reference to the determination and or evaluation of how close the results of the application of DOB clauses are to the expectations of contracting parties when incorporating them into their BITs and IIAs. In other words, to what extent do DOB clauses fulfil the purpose and objective behind their inclusion in investment treaties and agreements?

Broadly speaking, it is argued that the intention of contracting parties in including these clauses is the limitation and perhaps prevention of treaty shopping, and the consequent restraint it imposes on state sovereignty. The measure of the effectiveness of DOB clauses will therefore be the extent to which these results are achieved or not as the case may be. Put in another way, the question of the effectiveness of these clauses is,

how well do DOB clauses limit treaty shopping in the international investment law and arbitration regime?

The argument presented in the thesis is primarily doctrinal. However, this approach is not a rejection of normative considerations in the determination of the central question and issues of the thesis. In fact, the very premise of the argument of the work finds its roots in normative elements such as the exercise of the sovereign powers of state parties in international investment law. The limitation of its sovereign powers by entering into a BIT or IIA is in itself a sovereign act by a state. In committing to the obligations contained in these agreements, a state party is bound by the content of the agreement including definitions of who is an investor and what is an investment. In other words, state parties sovereignly contract to be bound by open and expansive definitions of these concepts in their agreements. By extension where a DOB clause is incorporated into a BIT or IIA, the parties have agreed to incorporate same as a sovereign act.

However, as the core research question involves a determination of the effectiveness of the DOB clause in terms of its “strengths” and “weaknesses” as a legal mechanism for preventing treaty shopping. As well as its viability as a means of ensuring state sovereignty is not restricted for the purposes of persons outside of the contemplation of the parties. As a result the argument made in the work is not solely normative but incorporates doctrinal analysis. The doctrinal analysis assesses such strength, based on a consideration of the construction of the clause.

The thesis, for the purposes of ensuring that the issues analysed are clear and thoroughly addressed, adopts a method that analyses the effectiveness of the DOB clause not just against the concept of treaty shopping in general; but it makes particular

analytical in-roads into the determination of the question of the effectiveness of the clause with regards to definite forms of the practice. In answering this question, the thesis endeavours to look not just to the common form of treaty shopping in the context of third parties nationals and mailbox companies, but also looks into the practice as engaged by nationals of the host state. Similarly, it also considers the effectiveness of the clause with regard to the practice of treaty shopping through the assignment of treaty claims.

This approach seeks to guarantee an in-depth and comprehensive analysis of the effectiveness of the DOB clause. This is as against the general analysis adopted by most of the few available scholastic inquiries into treaty shopping and the potential of the DOB clause. The adoption of this strategy infuses the research, along with other aforementioned factors, with a distinct and original approach in the consideration of the DOB clause.

This work is not focused on any specific DOB clause as contained in any particular BIT or IIA. However, what the thesis seeks to achieve is to give as much particularity and analytical thrust as can be achievable in analysing the general effectiveness of these clauses in limiting treaty shopping in international investment law. In the same spirit, arbitral cases from which the analyses of these clauses are largely drawn are considered with an understanding of the unique and distinct nature of each arbitral tribunal.

As each DOB clause contained in each individual BIT or IIA is distinct from the next, not merely in terms of their structural constitution, but even where such constitutions are similar, the particular purposes and political intentions of the parties gives each clause a distinct legal and political colouration which influences how such should be perceived.

Similarly, the independent nature of arbitral tribunals particularly evidenced in the non-binding nature of arbitral awards firmly inputs in the interpretation of each clause by a tribunal a unique and different perspective. This in turn is further strengthened by the dynamic nature of the particular set of facts under which the clause has been sought to apply and consequently interpreted.

Notwithstanding these distinct features, however, the thesis rests on the supposition that though possessing unique individuality of form and context, DOB clauses by consideration of their evolution and the general intendment of the parties which incorporate them into their agreements, possess a central thematic nature. It is this theme that is believed to run through the foundational character and embodied in the legal form, content and expression of these clauses.

As such the direction of this thesis, while not ignoring the peculiarity and individuality of each DOB clause, treaty contexts, factual dynamics and arbitral tribunal independence, emphasises at its core the central thematic underpinning of the DOB clause. It is the effectiveness of this general character of the DOB clause that constitutes the focal point of this research.

1.5. Thesis Outline

The work is grouped into eight chapters with each chapter focusing on a set of issues under the study. However, though separate, these are all interdependent and coalesce into a critical analysis of the overarching theme of the research. Chapter one gives a contextual background to what the study entails and seeks to achieve. It sets the tone of the research through the consideration of the concepts of globalisation, state

sovereignty, international investment law and arbitration as well as the DOB clause. By painting a broad stroke on how these concepts intersect, it creates the conceptual structure upon which the central issues of the thesis are drawn.

The chapter also frames the central question of the research, highlighting the motivation, purpose and relevance of the research. It further delimits the scope and focus of the work and gives an insight into the research methods to be employed in fulfilling the set objectives. Finally it gives an outline of what is to be expected in other chapters of the work. Showcasing and mapping out the parts of the work, as well as indicating how each chapter though addressing separate or unique issues in their own right constitute important junctures on the journey to consolidate the findings to the central question of the research.

Chapter two puts the discourse in gear as it consolidates the setting of the scene through the introduction of some of the foundational concepts underlying the study. It particularly focuses on the concept of nationality in international investment law and draws on relevant issues of this concept. The chapter especially looks into the significance of the notion of nationality as a requirement for access to investment treaty protection among others. Devolving from this, this part of the work introduces the concept of treaty shopping, also known as nationality planning. It endeavours to look into the drivers behind this practice as well as an overview of its forms. The chapter concludes with a consideration of the positions of relevant actors on the issue of treaty shopping, particularly, investors, states and arbitral tribunals.

Building on the foundational character of the preceding chapters, chapter three zeroes in on the question of treaty shopping. With its initial focus on the reaction of state parties to this practice, this chapter explores the different mechanisms employed by

states in an attempt to limit the practice of treaty shopping by investors. This focus evolves into a consideration of the abuse of rights and process principle as an ex-treaty mechanism capable of limiting treaty shopping. It further looks into the purported strengths and weaknesses of this principle as an effective measure for limiting treaty shopping.

The chapter moves on to introduce the DOB clause as an in-treaty provision increasingly used by states to achieve the objective of limiting treaty shopping and argued to have the potential and capacity to limit the practice of treaty shopping in international investment law and arbitration. It looks into the evolution of the clause with an aim of understanding its purpose. This is done with the intent of in turn determining the effectiveness of the clause in fulfilling its purpose. The chapter concludes on proffering the argument that the potential of the DOB clause must be tested by weighing the effectiveness of the clause as it is presently drafted and interpreted in three nationality planning models, namely; free-riding/mailbox companies, round tripping and the assignment of claims.

Taking its cue from the third chapter, chapter four leads the charge in undertaking an in-depth analysis of the 'free-riding/mailbox' nationality planning model. Upon the consideration of the nature and character of this treaty shopping route, the chapter weighs the effectiveness of the DOB clause in curbing this form of treaty shopping. In achieving its aim, the chapter looks into the design, structure and construction of the DOB clause. Subjecting these to analyses, this part of the work attempts to determine whether or not the DOB clause is indeed effectively equipped with respects to its construction in fulfilling its purpose of limiting treaty shopping, and the free riding route in particular. The chapter then attempts to consider how the nature and structure of the DOB clause in practical terms works in limiting this form of treaty shopping. This it does

by engaging the interpretations, expressions and considerations of arbitral tribunals and parties on the application of this clause to this form of treaty shopping in arriving at its conclusion.

Picking up from chapter four, the fifth chapter moves on to the second form of nationality planning to be considered in the study. The chapter examines the practice of treaty shopping in the form of 'round tripping'. In marshalling its points, the chapter emphasises the importance and role of the ideas of the 'foreignness' of international investment law, the principle of reciprocity and state sovereignty among others. It further goes on to consider the legal and policy impacts of the round tripping route of treaty shopping and highlighting the response of state parties to this form of the treaty shopping practice. As part of these responses, the chapter looks into the increased inclusion of DOB clauses in BITs and IIAs, arguing that these are indicators of the position of state parties to the practice as well as the exercise of political will in the limiting of same.

However, not unlike the preceding chapter, the chapter endeavours to answer the question of whether or not the DOB clause indeed has the potential to limit this form of treaty shopping. Building on the arguments of the chapter four, the chapter focuses on the peculiarity of the round tripping treaty shopping route and considers whether DOB clauses are equipped to address the issues it presents. Consequently, the chapter looks into the design, structure and construction of the DOB clause in international investment treaties and how these have been tailored towards limiting this form of treaty shopping.

Chapter six is dedicated to the last model of treaty shopping; that is the 'assignment of claims' route. Arguably a recent evolution of the treaty shopping practice, this form of

treaty shopping presents a unique set of questions. Being unlike the other forms of treaty shopping, it pushes the question of the effectiveness of the DOB clause to the limit. At the heart of this chapter is the engagement of the question of whether or not the DOB clause is fit to address 'untraditional' treaty shopping routes. The distinct nature of this form of treaty shopping makes it all the more pertinent that the effectiveness of the DOB clause as a mechanism capable of limiting treaty shopping be considered.

The chapter analyses this form of treaty shopping, exploring its nature and motivations. In a manner similar to chapters four and five, it goes on to weigh how effective the drafting and structure of DOB clauses are in containing this form of treaty shopping. In its analysis the chapter critically considers the position and interpretative approaches of arbitral tribunals to this particular form of treaty shopping. The chapter particularly argues that in the light of the dynamic nature of this form of treaty shopping, the DOB clause as it is presently constructed does not seem to address the issues presented by this treaty shopping route. Thus, it suggests a revisiting of the DOB clause as to catch up with the evolving character of treaty shopping generally.

The seventh chapter of the work takes a different approach in its determination of the effectiveness of the DOB clause. Quite apart from chapters four, five and six, which have attempted to address the central question of the thesis through a consideration of the design, structure and construction of the clause. This chapter ventures to engage the focal point of this work by exploring external factors which possess the capacity to impact on the effectiveness of the clause. Particularly, the chapter looks into how the procedural requirements for the exercise of the DOB clause impacts on its effectiveness.

Drawing on the notions of the legitimacy of international investment law, the issues of interpretation, the consolidation of public international law and international commercial law in the international investment regime and the impact of same among others, the chapter critically analyses the interpretations of arbitral tribunals on the procedural requirements and effects of the DOB clause. This approach as engaged in the chapter is built on the premise that while the drafting and structure of the substantive provisions of the clause undoubtedly impacts the effectiveness of the clause, the procedural requirements for the exercise of the clause are of equal or arguably of more importance with regard to the 'effectiveness' of the clause as a tool for limiting the practice of treaty shopping.

The eighth chapter of the work, which also serves as its conclusion draws on the findings of the research and puts these in the perspective of the objectives set out in chapter one. It goes over the summary of the conclusions of the core research with an aim of giving robust and objective analyses of the effectiveness of the DOB clause. It proffers arguments based on the findings of the research on the strengths and perceived weaknesses of the DOB clause as it is presently drafted and interpreted vis-a-vis its nature as a tool for limiting treaty shopping and as a tool for birthing balance in international investment law and arbitration.

Chapter Two

Reconciling the Notions of Nationality and Nationality Planning in International Investment Law and Arbitration

2. Introduction

The notion of nationality arguably stands as one of the most definitive and decisive of notions in public international law, broadly, and international investment law especially. Notably, with respect to the latter, the definition of nationality is one of the key elements in determining the scope of rights and obligations of parties and beneficiaries under international investment agreements (IIAs).¹ These agreements, largely comprising of bilateral investment treaties (BITs), multilateral investment treaties (MITs) and investment chapters in free trade agreements (FTAs), although interstate in nature are designed to be of direct benefit to investors who are private individuals as well as corporate entities who are not signatories to the agreements.²

However, accessing the rights enshrined in these agreements³ is premised on the investor fulfilling the nationality criteria prescribed by the particular treaty under which a claim is brought. In a positive sense, this means that only the investors who hold the nationality of a contracting state to an investment agreement have the right to make a

¹ Xia-Jing Zhang, 'Proper Interpretation of Corporate Nationality under International Investment Law to Prevent Treaty Shopping' (2013) 6 *Contemp. Asia Arb.J* 49.

² Suzy Nikiema, *Best Practices Definition of Investor* (International Institute for Sustainable Development 2012) 1.

³ To achieve their objective of promoting investment flows across national borders, these agreements contain both substantive and procedural rights which are purposed to instil investor confidence in committing capital to the host state. These rights guarantee the protection of the investor and its investment as well as providing for compensation in cases of a breach of treaty obligations by the host state. Of particular importance is the right conferred by the majority of these treaties in allowing the investor to bring a claim against the host state before an international investment tribunal. This procedural right has been referred to as giving 'teeth' to IIAs. See, Anthony Sinclair 'The Substance of Nationality Requirements in Investment Treaty Arbitration' (2005) 20 *ICSID Review* 357.

claim against the other contracting state which hosts their investments.⁴ Conversely, however, it also implies that investors who are nationals of states who are not contracting parties to the investment agreement, as well as investors who are nationals of the host state itself do not have recourse to the substantive rights enshrined in the treaty. These set of investors cannot (or should not) in turn be able to institute a claim against the host state before an investment tribunal. In this sense, the nationality requirements of investment agreements serve as gatekeepers manning access to the protection provided by these agreements.

However, being instruments for advancing economic liberalisation and facilitating the free movement of assets and investments in a globalized world,⁵ these agreements contain broad and liberal definitions of nationality and investment. That is, definitions and terms which allow for a diffuse application and scope with regards to investors and investments.⁶ With respect to investments, these definitions are not limited to investments directly owned or controlled by the foreign investor in the host state, but also extend to investments owned or controlled indirectly. Effectively including shares held in companies as investment, license agreements, management contracts, joint ventures, service and production sharing agreements, loans etc.⁷

⁴ Nikiema (n 2) 1.

⁵ See, Muthucumaraswamy Sornarajah, 'The Neo-Liberal Agenda in Investment Arbitration: Its Rise, Retreat and Impact on State Sovereignty' in Wenshua Shan, Penelope Simons and Dalvinder Singh (Eds), *Redefining Sovereignty in International Economic Law* (Hart Publishing 2008) 199; stating that investment treaties and investment treaty arbitration are the legal mechanisms designed to enforce the neo-liberal agenda in an increasingly globalised world.

⁶ Gus Van Harten, 'Five Justifications of Investment Treaties: A Critical Discussion' (2010) Vol 2(1) Trade, Law and Development 19; Olivia Chung, 'The Lopsided International Investment Law Regime and its Effect on the Future of Investor – State Arbitration' (2006-2007) 47 Va. J. Int'l L. 952; Omar Garcia - Bolivar, 'The Teleology of International Investment Law: The Role of Purpose in the Interpretation of International Investment Agreements' (2005) 6. J. World Investment & Trade 751.

⁷ A point which is a direct reaction to the outcome of the *Barcelona Traction, Light and Power Company Limited (New Application, 1962)*, *Belgium v Spain*, *Belgium v. Spain*, (1970) ICJ Rep 3; on the protection of shareholder interests in a company. This issue will be discussed later in the chapter.

Furthermore, these definitions protect not only investments by natural persons, but also that of corporate investors. This width of scope effectively allows investors especially corporate multinationals to structure their investments in ways to ensure that an investment benefits from the protection of an investment treaty should a dispute arise.⁸ It is the structuring and restructuring of investments by an investor in ways which allow it to be covered by an investment treaty where it otherwise would not have been covered that is generally referred to as treaty shopping.⁹

A fundamental reason why contracting parties sign investment treaties, is in part to secure protection for the investments of their nationals in the other contracting party. In other words, state parties agree to these agreements, which effectively restrict the exercise of their sovereign and regulatory powers in respect to the investor and investment, in exchange for a similar treatment of their investors and investments in the territory of the other contracting party.

As such, the entering into investment protection agreements by state parties among other things keeps states on a short leash, resulting in what is oftentimes referred to as the 'regulatory chill'. These are instances where the state cognisant of its obligations under its treaties does not undertake policies which might affect its treaty obligations, even where these might be to the benefit of its citizens.¹⁰ Therefore, a principal conditionality upon which these agreements are entered into by parties is

⁸ Sinclair (n 3) 357.

⁹ Julien Chiassé, 'The Treaty Shopping Practice: Corporate Structuring and Restructuring to Gain Access to Investment Treaties and Arbitration' (2015) 11 Hasting Bus.L.J 225; Rimantas Daujotas, 'Jurisdiction Ratione Personae And Corporate Nationality In International Investment Arbitration – Legitimate Corporate Planning Or Abuse Of Right?' (2011) available at <<http://www.researchgate.net/publication/228120727>> accessed 22 November 2016.

¹⁰ Regulatory chill has been defined as situations where host states fail to take certain social, political, environmental action for national benefit in the furtherance of national economic development or other agenda for fear of breaching international investment obligations. See, Christine Cote, 'A Chilling Effect? The Impact of International Investment Agreements on National Regulatory Autonomy in the Areas of Health, Safety and the Environment' (DPhil Thesis, The London School of Economics and Political Science 2014).

reciprocity. With the obligations state parties assume under these agreements being burdensome, it is undoubted that the accessing of treaty rights by investors, who the state parties did not intend to protect when negotiating the treaty introduces a new twist into the dynamics of investment treaty protection, and one which undoubtedly elicits reactions from stakeholders.

This chapter will consider the concept of nationality (particularly corporate nationality) under international investment law and arbitration. Emphasising on the effectiveness of the definition of nationality in international investment agreements, the chapter argues that the very essence of international investment law demands that the most plausible definitions and interpretations of nationality within the regime are those which require the substance of a genuine link between the corporate investor and the home state.

It reviews the argument made by some scholars that in view of the purpose of investment treaties, that is, 'the protection and promotion of foreign investments', the nationality of an investor and the origin of capital should matter little to the host state.¹¹ Finally, the chapter will also engage the issue of treaty shopping – a resultant effect of broad and far reaching definitions of investor and investment as well as formal interpretations of same by investment tribunals - looking at its drivers, forms and the position of stakeholders.

¹¹ See Stephan Schill, *The Multilateralization of International Investment Law*, (Cambridge University Press 2009) 228, 239. According to Schill, " the possibility of corporate structuring shows that nationality as a criterion to restrict the benefits of an investment treaty to specific nationals is becoming increasingly ineffective in regulating access to, and exclusion from, the protection of bilateral investment treaties.." Furthermore, he argues that " In view of the object and purpose of investment treaties to promote foreign investments, it should thus matter little for the host state where the capital for such investments comes from and what relations a corporate investor has to the State of its incorporation".

2.1. The Concept of Nationality under International Investment Law

Nationality under international law defines the status of persons in relation to countries.¹² It has been defined as the membership of an individual in a territorial community for the purposes both of obtaining external protection against other territorial communities and of securing richer participation in the value processes of his chosen community and the world community.¹³

Individuals are said to be the "nationals" of a state when that state asserts, and the larger world community honours, claims to protect and control such individuals for all the comprehensive purposes of states.¹⁴ With the recognition of corporate entities as distinct legal personalities under municipal laws, the juristic person also enjoys similar rights to the individual on the national scene. Nationality, therefore, is a legal status embracing a set of mutual rights and obligations towards a political entity fulfilling certain requirements necessary for the existence of a sovereign state.¹⁵

Within the context of international investment law, the investor's nationality is important for several purposes.¹⁶ First, the substantive standards of treatment guaranteed in a treaty will only apply to privileged investors who possess the nationality of the other contracting party to a BIT or IIA.¹⁷ Second, where the treaty contains an investor-state dispute settlement (ISDS) mechanism, the host state's consent to jurisdiction will only apply to nationals of a state that is a party to the

¹² James Brown Scott, 'Nationality: Jus Soli or Jus Sanguinis' (1930) 24 Am. J. Int'l L 58.

¹³ Myres McDougal, Harold Lasswell, and Lung-chu Chen, 'Nationality and Human Rights: The Protection of the Individual in the External Arena' (1973-1974) 83 Yale L.J 900.

¹⁴ Ibid.

¹⁵ Kay Hailbronner, 'Nationality in Public International Law and European Law' in Rainer Baubock *et al* (Eds), *Acquisition and Loss of Nationality: Policies and Trends in 15 European Countries*, (Amsterdam University Press 2006) 35.

¹⁶ Christoph Schreuer, 'Nationality of Investors vs Business Interests' (2009) 24 (2) ICSID Review 521.

¹⁷ Ibid.

treaty.¹⁸ For example, for an ICSID tribunal to assume jurisdiction over a claim, the claimant must among other things not be a national of the disputing party.¹⁹

Where a BIT subsists between the host state and the home state of the investor, the investor has to show that it is a national of the other contracting party as defined under the treaty.²⁰ However, due to the peculiar nature of issues in relation to the nationality of the individual and the corporate person, the consideration of the issues relating to each will be considered separately.

2.1.1. Nationality of the Individual under Customary International Law

Being a matter relating to the legal position of a person to a country, the issue of nationality is largely a domestic matter.²¹ An individual's nationality is determined

¹⁸ Ibid.

¹⁹ Article 25 of the ICSID Convention provides;

(1) The jurisdiction of the Centre shall extend to any legal dispute arising directly out of an investment, between a Contracting State...and a national of another Contracting State, which the parties to the dispute consent in writing to submit to the Centre. When the parties have given their consent, no party may withdraw its consent unilaterally.

(2) "National of another Contracting State" means:

(a) any natural person who had the nationality of a Contracting State other than the State party to the dispute on the date on which the parties consented to submit such dispute to conciliation or arbitration as well as on the date on which the request was registered pursuant to paragraph (3) of Article 28 or paragraph (3) of Article 36, but does not include any person who on either date also had the nationality of the Contracting State party to the dispute; and

(b) any juridical person which had the nationality of a Contracting State other than the State party to the dispute on the date on which the parties consented to submit such dispute to conciliation or arbitration and any juridical person which had the nationality of the Contracting State party to the dispute on that date and which, because of foreign control, the parties have agreed should be treated as a national of another Contracting State for the purposes of this Convention. (Emphasis added)

²⁰ For Example, Article 1(7)(a) of the Energy Charter Treaty provides;

"Investor" means:

(a) With respect to a Contracting Party:

(i) A natural person having the citizenship or nationality of or who is permanently residing in that Contracting Party in accordance with its applicable law;

(ii) A company or other organisation organized in accordance with the law applicable in that Contracting party

²¹ In *Nationality Decrees Issued in Tunis and Morocco* (1923) PCIJ Ser B No 4, 24, the Permanent Court of International Justice, noted that: 'The question whether a certain matter is or is not solely within the jurisdiction of a State is an essentially relative question; it depends upon the development of international

primarily by the country whose nationality is at issue.²² On the international scene, the customary international law rules for determining the nationality of natural persons were developed in the context of diplomatic protection,²³ which a state can only provide to individuals who qualify as its nationals.²⁴ Thus allowing states to espouse the claims of their nationals under international law in instances where such nationals have suffered injury from the acts or omissions of another state.²⁵

The nationality of a natural person, however, raises certain questions where the person claims the nationality of two or more states. Under customary international law, particularly for the purposes of espousing claims on behalf of a national by a state, the issue is determined by the application of the effective nationality rule, as established in the *Nottebohm Case*.²⁶

2.1.1. A. The Effective Nationality Rule

In the *Nottebohm case*, Liechtenstein espoused the claims of Nottebohm against Guatemala before the International Court of Justice (ICJ) in relation to his arrest,

relations. Thus, in the present state of international law, questions of nationality are, in the opinion of this Court, in principle within this reserved domain'.

²² Rudolf Dolzer and Christoph Schreuer, *Principles of International Investment Law*, (2nd edn, OUP 2012) 45; Christoph Schreuer, 'Nationality of Investors vs. Business Interests' (2009) 24 (2) ICSID Review 521.

²³ Christopher Dugan, Don Wallace, Jr, Noah Rubins and Borzu Sabahi, *Investor-State Arbitration* (OUP 2008) 292.

²⁴ The significance of nationality in international law relates among other things to, first, a state whose national has suffered an injury caused by an internationally wrongful act of another state may exercise diplomatic protection. Second, numerous duties of states in relation to war and neutrality, resting on the most part on customary law are framed in terms of the acts or omissions by nationals which states should prevent and, in some cases punish. Third, the foreign nationality of aliens in the territory of another state give rise to a number of complex relations, principal of which is the question of international responsibility when acts of the state of residence affect aliens and their property. Fourth, nationality provides a regular basis for the exercise of civil and criminal jurisdiction and this even in respect of acts committed abroad. It is the third aspect that international investment law seeks to regulate within the sphere of a *lex specialis* regime among states. See, James Crawford, *Brownlie's Principles of Public International Law*, (8th edn, OUP 2012) 510.

²⁵ Gus Van Harten, *Investment Treaty Arbitration and Public Law*, (OUP 2007) 112.

²⁶ *Nottebohm (Liechtenstein v Guatemala)*, ICJ Reports 1955.

detention, and expulsion from Guatemala as well as the expropriation of his property. Prior to the claim, Nottebohm, a German citizen had acquired Liechtenstein citizenship through naturalisation. He had also spent a number of years in Guatemala and made it the centre of his business activities. Guatemala on its part argued that 'Liechtenstein had failed to prove that Nottebohm...properly acquired Liechtenstein nationality in accordance with the law of that Principality'.²⁷

On the doctrine of real and effective nationality, the court stated that:

*'International arbitrators have ...given their preference to the real and effective nationality, that which accorded with the facts, that based on stronger factual ties between the person concerned and one of the States whose nationality is involved. Different factors are taken into consideration, and their importance will vary from one case to the next; habitual residence of the individual concerned...centre of his interests, his family ties, his participation in public life, attachment shown by him for a given country and inculcated in his children etc.'*²⁸

In concluding,²⁹ the ICJ held that Liechtenstein's claim on behalf of Nottebohm was inadmissible because Nottebohm had no real ties to Liechtenstein since he did not reside there, conducted business in Guatemala, and appeared to only have become a citizen of Liechtenstein so that he could be listed as a citizen of a neutral country

²⁷ Ibid.

²⁸ Ibid, 22.

²⁹ Furthermore, in applying this rule to the facts of the case of Mr Nottebohm, the Court observed: *'He had been settled in Guatemala for 34 years. He had carried on his activities there. It was the main seat of his interests...and business activities...In contrast, his actual connections with Liechtenstein were extremely tenuous. No settled abode, no prolonged residence...No intention of settling there was shown...there is no allegation of any economic interests or of any activities exercised or to be exercised in Liechtenstein, and no manifestation of any intention whatsoever to transfer all or some of his interests and business activities to Liechtenstein...These facts clearly establish, on the one hand, the absence of any bond of attachment between Nottebohm and Liechtenstein and, on the other hand, the existence of a long-standing and close connection between him and Guatemala, a link which his naturalization in no way weakened'*. Ibid, 25.

during the War. Other international adjudicating bodies, including the Iran –U.S. Claims Tribunal³⁰ and the United Nations Compensation Commission³¹, have also applied the principle of effective nationality in order to determine the standing of the claimants to obtain relief.

2.1.2. Nationality of the Natural Individual under International Investment Treaties and Arbitral Jurisprudence

In keeping with the general position of international law, the definition of who a national of a contracting state is under BITs and other IIAs is determined by the relevant national laws of the state parties. For example, Article 1(c) of the US – Argentina BIT (in a definition similar to other BITs especially with the US as a contracting party) provides that "national" of a party means a natural person who is a national of a party under its applicable law.³²

In some instances, the threshold of who qualifies as an investor is reduced to accommodate requirements of domicile, permanent residence etc. This is often peculiar to multilateral treaties such as the North American Free Trade Agreement (NAFTA), which defines a national as a natural person who is a citizen or permanent resident of a party'.³³ The Energy Charter Treaty (ECT) also has similar wording.³⁴ The presentation of a certificate of nationality, issued by the relevant authorities of a state, is usually considered *prima facie* evidence for the existence of the nationality

³⁰ *Iran v U.S.* Case No. A/18, Decision No. DEC 32-A18-FT, 6 April 6 1984.

³¹ See United Nations Compensation Commission Governing Council, Report and Recommendations Made by panel of Commissioners Concerning the Sixth Instalment for Claims Departure from Iraq or Kuwait (Category "A" Claims), U.N. Doc.S/AC.26/1996/3 (Oct.16, 1996) 27-33. See generally, Dugan (n 23) 294.

³² Treaty with Argentina Concerning the Reciprocal Encouragement and Protection of Investment; signed November 14, 1991; entered into Force October 20, 1994.

³³ See NAFTA, art 201(1).

³⁴ See, ECT art 7(n 20).

of that state.³⁵ However, most investment tribunals undertake an independent analysis of the claimant's nationality under the national law of the state whose nationality is claimed.

In the case of *Soufraki v United Arab Emirates*³⁶ the claimant Mr Soufraki instituted the claim on the BIT between Italy and the United Arab Emirates (UAE). In support of his standing as an Italian national, the claimant presented several Italian certificates of nationality. However, according to the tribunal, 'the first contentious question to be decided' was whether or not 'the Certificates of Nationality issued by Italian authorities characterizing Mr Soufraki as an Italian national...constitute conclusive proof that Mr Soufraki'³⁷ was a national of Italy. The tribunal found that the claimant had lost his Italian nationality after obtaining Canadian nationality and as such could not rely of the BIT between Italy and the UAE.³⁸

While the issue of the nationality of an individual for the securing protection under a BIT is relatively straightforward in instances where the claimant is in possession of a single nationality, complications arise where the claimant is a dual national. Where a BIT makes no reference to dual nationality, several tribunals have concluded that the dual nationality of the claimant did not represent an obstacle to their jurisdiction

³⁵ *Micula v Romania*, Decision on Jurisdiction, 24 September 2008, paras 70-106.

³⁶ *Soufraki v United Arab Emirates* (UAE), Award, 7 July 2004.

³⁷ *Ibid*, para 53.

³⁸ In asserting the power of the tribunal to consider the issue of determining the nationality of Mr Soufraki, the tribunal stated: " it is accepted in international law that nationality is within the domestic jurisdiction of the State, which settles, by its own legislation, the rules relating to the acquisition and loss of its nationality...But it is no less accepted that when, in international arbitral or judicial proceedings, the nationality of a person is challenged, the international tribunal is competent to pass upon that challenge...Where, as in the instant case, the jurisdiction of an international tribunal turns on an issue of nationality, the international tribunal is empowered, indeed bound, to decide that issue." See, *Ibid* para 55.

under the treaty.³⁹ This was the position held in the case of *Micula v Romania*⁴⁰ ; according to the tribunal:

*'it is ...doubtful whether the genuine link test would apply pursuant to the BIT. The Contracting Parties to the BIT are free to agree whether any additional standards must be applied to the determination of nationality. Sweden and Romania... included no additional requirements for the determination of Swedish nationality'*⁴¹

In *Olguin v Paraguay*⁴², the claimant relied on the BIT between Paraguay and Peru. In objection, Paraguay asserted that the claimant was also a US national. The tribunal, however, found that the claimant held dual nationality and that both nationalities were effective. The tribunal concluded that the subsistence of the claimant's Peruvian nationality allowed him access to protection under the BIT.

From the foregoing, the position seems to be that as long as the claimant has the nationality of one of the contracting parties to a BIT, even where he holds the nationality of a third country; investment tribunals consider such an investor as being covered by the BIT. Generally, tribunals have not favoured the 'effective nationality' rule in such instances. However, in instances where one of the nationalities of the claimant is that of the host state, the position seems to be different.

³⁹ Nikiema (n 2) 13.

⁴⁰ *Ioan Micula, Viorel Micula, S.C. European Food S.A, S.C. Starmill S.R.L. and S.C. Multipack S.R.L. v. Romania*, ICSID Case No. ARB/05/20 Decision on Jurisdiction, 24 September 2008, paras 70-106. (*Micula v Romania*).

⁴¹ *Ibid*, para 101.

⁴² *Eudoro Armando Olguín v Republic of Paraguay*, ICSID Case No. ARB/98/5, Award, 26 July 2001.

For example, in the case of *Champion Trading v Egypt*⁴³ the tribunal denied jurisdiction to entertain the claim of three of the claimants who were both American and Egyptian nationals.⁴⁴ Similarly, in the case of *Siag & Vecchi v Egypt*⁴⁵, the claimants claimed as Italian nationals. In objection to the jurisdiction of the tribunal, Egypt argued that the claimants were also Egyptian nationals. Both claimants, however, countered that they had lost their Egyptian nationality before filing the claim. The majority of the tribunal accepted the claimants' argument and assumed jurisdiction.⁴⁶

It is posited that the germane question is not whether state parties in entering into BITs and other IIAs, contracted to waive their sovereign immunity. What is pertinent to enquire is whether state parties conceded to be brought before investment tribunals by their own nationals or nationals of countries not signatories to the treaty, or dual nationals. While in principle, the response is negative,⁴⁷ however, the definition of investor and investment⁴⁸ and the rules governing the jurisdiction of established arbitral tribunals play an important role in determining what the answer to the question is in particular instances.

Article 25 (2)(a) of the ICSID Convention, for example, bars nationals of a host state from instituting claims against their country, with the exception of instances where a company incorporated under local law and which is controlled by foreign investors is

⁴³ *Champion Trading Company, Ameritrade International, Inc. v Arab Republic of Egypt*, ICSID Case No. ARB/02/9 (formerly *Champion Trading Company, Ameritrade International, Inc., James T. Wahba, John B. Wahba, Timothy T. Wahba v. Arab Republic of Egypt*), Decision on Jurisdiction, 21 October 2003.

⁴⁴ The tribunal, however, confirmed its jurisdiction for the other claimants who were American companies.

⁴⁵ *Waguih Elie George Siag and Clorinda Vecchi v. The Arab Republic of Egypt*, ICSID Case No. ARB/05/15, Decision on Jurisdiction, 28 May, 2007.

⁴⁶ One of the arbitrators, Orrego Vicuna, disagreed with the position of the majority. He argued that the position of the tribunal, particularly on the consideration of the effective nationality of the claimant was inconsistent with the intentions of the Washington Convention drafters.

⁴⁷ Nikiema (n 2) 1.

⁴⁸ This point shall be considered later in this work.

considered to be a foreign company, subject to the express agreement of the parties.⁴⁹ As such, one reason why questions arise as to the protection of investors who are dual nationals is because most BITs and IIAs do not contain provisions on dual nationality.⁵⁰ One exception, however, is the Dominican Republic- Central American Free Trade Agreement (CAFTA-DR) which provides:

*'Investor of a Party means...a national...of a Party, that attempts to make, is making, or has made an investment in the territory of another Party; provided, however, that a natural person who is a dual national shall be deemed to be exclusively a national of the State of his or her dominant or effective nationality'*⁵¹

Therefore, where states refuse to expressly provide for their position in regard to dual nationals in investment treaties, tribunals are free to decide on such points. Arguably, where contracting parties do not incorporate provisions on dual nationality in their agreements, it can be assumed that such states forgo such possibility. State parties who object to the conclusions of tribunals in according dual nationals access to treaty benefits will do well to incorporate provisions similar to that of the CAFTA-DR.

With the number of challenges accompanying the determination of the nationality of the investor-claimant when claiming under a BIT, investing in a host state through the incorporation of a company or the holding of shares in a corporate investor has

⁴⁹ Article 25 (2) (b) ICISD Convention.

⁵⁰ UNCTAD, *Scope and Definition: 2nd UNCTAD Series on Issues in International Investment Agreements* (United Nations 1999) 36.

⁵¹ Article 10.28, Dominican Republic- Central America Free Trade Agreement (2004); See also Article 1 of the United States – Uruguay BIT (2005) which provides: 'investor of a Party means...a national...of a Party,...; provided, however, that a natural person who is a dual national shall be deemed exclusively a citizen of the State of his or her dominant and effective citizenship'. Such provisions as this will undoubtedly resolve many of the issues that arise before investment tribunals on the protection of dual nationals under a BIT.

become an effective means of bypassing the possible difficulties a natural investor might encounter. While these vehicles of making an investment through a corporate entity do have their strong points, they are, however, not without challenges of their own.

2.1.3. Nationality of the Corporate Person under International Investment Law

In delimiting the scope of who qualifies as a corporate investor, investment treaties under their nationality provisions use definitions which effectively embrace a variety of legal entities. Terms commonly used often include among others, company,⁵² juridical person⁵³ and legal person.⁵⁴ As nationality normally presupposes legal personality,⁵⁵ therefore, unincorporated entities and groupings will not, in general, enjoy legal protection.⁵⁶ However, a number of investment treaties extend the scope of their definition of investor to include non-legal personalities. The Benin – UK BIT provides such an instance, covering ‘corporations, firms and associations’.⁵⁷

In determining the nationality of juridical persons who qualify as investors under investment treaties, contracting state parties employ three different criteria or a combination of a number of them. First is the place of incorporation, second, the seat

⁵²Belgium – Philippines BIT, signed 14th January 1998 entered into force 19th December 2003, art 1(b); Philippines-Thailand BIT, signed 30th September 1995, entered into force 6th September 1996, art 1.

⁵³ Belgium – Thailand BIT, signed 12th June 2002, entered into force 19th September 2004, art 1(1) (b); South Korea-Panama BIT, signed 10th September 2001, entered into force 8th February 2002, art 1(3).

⁵⁴ Ethiopia – Sudan BIT, signed 7th March 2000, entered into force 15th May 2001, art1(b)(ii); Hungary – Yemen BIT, signed 18th January 2004, entered into force 9th April 2006, art 2.

⁵⁵Dolzer and Schreuer (n 22) 47.

⁵⁶ *Consorzio Groupment LESI – Dipenta v Republique Algerienne*, Award, 10 January 2005, paras 37-41; *Impregilo v Pakistan*, Decision on Jurisdiction, 22 April 2005, paras 131 – 139.

⁵⁷ Benin – UK BIT signed and entered into force 27th November 1987, art 1(d). See also the US – Ecuador BIT, signed 27th August 1993, entered into force 11th May 1997, art 1(b) as well as the ECT and the NAFTA where the definition of investor cover both organizations established for profit as well as non-profit, trusts, partnerships, sole proprietorship, joint venture or other association etc.

of management also known as '*siege sociale*' and third, the control criterion. Unlike the natural person, there is no single appropriate link between a company or other juridical person asserting a right to protection under an investment treaty and the contracting state under whose treaty of protection an investor seeks to benefit.⁵⁸

Consequently, cultural, economic and political factors influence which test a particular state will prefer to apply.⁵⁹ The place of incorporation and the seat of management are the most commonly employed by states in investment treaties, with an increasing number of states introducing the control criterion as an alternative.⁶⁰ However, an analysis of these notions of nationality under international investment law can only be effectively made within the appreciation of the position of customary international law on the nationality of corporations and shareholder standing. In this light, the *Barcelona Traction*⁶¹ case and its implications on international investment law is noteworthy.

2.1.3. A. Customary International Law on Nationality of Corporations – *The Barcelona Traction Case*.

Barcelona Traction was a Canadian company with its shares owned mostly by Belgian nationals. Though incorporated in Canada, it had no activities in Canada but carried out operations solely in Spain. The matter was based on claims that actions of the government of Spain led up to the bankruptcy of the company. Instituting the claim on behalf of its nationals who owned 88 percent of the shares in the

⁵⁸ Anthony Sinclair, 'The Substance of Nationality Requirements in Investment Treaty Arbitration' (2005)20(2) ICSID Review 357.

⁵⁹ Ibid.

⁶⁰ See, Nikiema (n 2); Dolzer and Schreuer (n 22); Christoph Schreuer, 'Nationality of Investors vs. Business Interests' (2009) 24 (2) ICSID Review 521; Robert Wisner and Nick Gallus, 'Nationality Requirements in Investor-State Arbitration' (2004) 5 J. World Investment & Trade 927.

⁶¹ *Barcelona Traction, Light and Power Company Limited (Belgium v Spain)* (1970) ICJ Rep 3.

company⁶², the government of Belgium on behalf of Belgian shareholders in the company sought to exercise the right of diplomatic protection.

Belgium's decision might not have been unconnected with the genuine link rule stated by the ICJ in the *Nottenbohm* case. Thus, were this rule to be considered 'absolute' in the determination of the *Barcelona* case, the company would have been found to have genuine links with Belgium through its shareholders. Consequently, allowing Belgium to exercise its right of diplomatic protection on behalf of the shareholders.

However, the ICJ ruled that Belgium had no standing, as only the country in which the company was incorporated can sue. In its analysis, the court held that international law held no single genuine link test for corporate nationality⁶³. Noting that some states employ the use of the '*siege sociale*' while others use the 'economic control'⁶⁴ test for determining the genuine link of a corporation to a state. The position of the court was that no absolute test of genuine link held general acceptance.⁶⁵

In deciding *Barcelona Traction*, the ICJ faced two tasks. First, the court had to clarify the customary rule on corporate nationality and, therefore, provide a rule of standing for claim espousal. Second, in order to resolve the specific case, it had to decide how to apply this rule of standing to a state that represented a supermajority of shareholders but was not the state of incorporation.⁶⁶

⁶² Ibid at 24-25.

⁶³ Ibid at 42.

⁶⁴ Ibid at 184 (separate opinion of Judge Jessup).

⁶⁵ Ibid at 42.

⁶⁶ Ibid at 32-33; See, Lawrence Jahn Lee, '*Barcelona Traction* in the 21st Century: Revisiting its Customary and Policy Underpinnings 35 years Later' (2006) 42 *Stan.J.Int'l.L* 237.

In answering these questions, however, the ICJ analysed general principles of law as commonly found under municipal laws on corporations and based its reasoning on the following points. First, the concept of the corporation as an entity with legal personality exists as a matter of widespread practice.⁶⁷ Second, municipal law created the corporation expressly to have a legal personality distinct from that of its shareholders, in order to shield them from liability beyond their shareholdings, but also to prevent these shareholders from having access to the assets of the corporation.⁶⁸ Third, a corporation's creditors may not generally pierce the corporate veil, except under special circumstances (e.g., malfeasance, fraud);⁶⁹ and fourth, shareholders may not pierce the corporate veil to recover for damages to the corporation in international claims, except under special circumstances⁷⁰, which were not applicable in the *Barcelona Traction* case.⁷¹ The ICJ thus concluded that the "traditional rule attributes the right of diplomatic protection of a corporate entity to the State under the laws of which it is incorporated and in whose territory it has its registered office".⁷²

Although the judgment of the ICJ in the *Barcelona Traction* case is of primary relevance within the context of diplomatic protection, however, BITs and IIAS, concluded to offer special privileges including protection against measures of the host country to investors who are nationals of the contracting parties, also present the challenge of *Barcelona Traction*.⁷³ Furthermore, understanding the context and policy considerations which form the background against which the ICJ reached its

⁶⁷ *Barcelona Traction* (n 61) 34-39.

⁶⁸ *Ibid* at 34-35.

⁶⁹ *Ibid* at 39.

⁷⁰ *Ibid*.

⁷¹ *Ibid* at 40-45.

⁷² *Ibid* at 42.

⁷³ Panayotis Protopsaltis, 'The Challenge of the *Barcelona Traction* Hypothesis: *Barcelona Traction* Clauses and Denial of Benefits Clauses in BITs and IIAS' (2010) 11 J. World Investment & Trade 561.

decision allows for a better understanding of the definition of nationality adopted by most BITs and IIAs.

A noteworthy point in understanding the position of the court is that the *Barcelona Traction* case was decided against the backdrop of the then New International Economic Order (NIEO). Which though did not evolve to constitute positive international law, nevertheless influenced international policy and relations.⁷⁴ This order emerged from the growing dissatisfaction of developing countries with the dynamics of the international economic system in general.⁷⁵ While the NIEO addressed many issues, a principal issue was the concern developing countries had about the operations of multinational corporations in their states.⁷⁶

To curb the practices of multinational corporations, developing countries advocated the regulation of these entities. As such, defining which company qualifies for the espousal of diplomatic protection by a state in the prevalent economic and political atmosphere was undoubtedly an important issue.⁷⁷ The conventional wisdom seemed to be, on the one hand, that a wider rule (e.g. "a company is a national of any state with which it has a connection") favours developed states by making it

⁷⁴ John King Gamble and Maria Frankowska, 'International Law's Response to the New International Economic Order' (1986) 9(2) Boston College International and Comparative Law Review 257; Karen Hudes 'Towards a New International Economic Order' (1975) 2(1) Yale Studies in World Order, 88.

⁷⁵ Kamal Hossain, *Legal Aspects of the New International Economic Order* (Nichols Publishing Company 1980) 2; See generally, Thomas Walde, 'A Requiem for the New International Economic Order: The Rise and Fall of Paradigms in International Economic Law' (2003) 1 OGEL 1.

⁷⁶ Thomas Walde, 'A Requiem for the New International Economic Order: The Rise and Fall of Paradigms in International Economic Law' (2003) 1 Special Archive Oil, Gas & Energy Intelligence (OGEL) 1. . According to Walde: "*The major feature of NIEO, though, was the image of international companies... as prime malfeasors... multinational companies were seen as the prime vehicle of maintaining developing countries in a subordinate stage of underdevelopment. Their prime characteristics were seen as exploitation of non-renewable natural resources, sold at inequitable, perennially low and declining prices against ever more expensive industrial products; opposing independent-minded governments and in association with profiteering Third World collaborators, multinationals were seen as continuously involved in exploiting unequal bargaining power, manipulating host state tax returns through affiliate transactions, as exhausting national foreign exchange reserves by excessive repatriation of capital, as denying economic development, training and acquisition of technology to host states by enclave-structured, foreign-run investment projects.*"

⁷⁷ Lawrence Jahoon Lee, '*Barcelona Traction* in the 21st Century: Revisiting its Customary and Policy Underpinnings 35 years Later', (2006) 42 Stan.J.Int'L 237.

more likely that a state will have standing to espouse a claim on its behalf if it is injured. On the other hand, a narrower rule (e.g. "a company is a national of a state only if it is incorporated and headquartered in that state and all its shareholders live in that state") ostensibly protects developing states from the vexatious claims brought on behalf of corporations by powerful, capital-exporting states.⁷⁸

In articulating its policy considerations for its decision, the court's main concern seemed to be that if any state with shareholders of an injured corporation had standing, a mass of states would bring claims on behalf of shareholders, thus "creat[ing] an atmosphere of confusion and insecurity in international economic relations."⁷⁹In his separate opinion, Judge Padilla Nervo stated:

*"it is not the shareholders in those huge corporations who are in need of diplomatic protection; it is rather the poorer or weaker States, where the investments take place, who need to be protected against encroachment by powerful financial groups, or against unwarranted diplomatic pressure from government."*⁸⁰

The judgement of the ICJ was met by criticism, with arguments being proffered that states did not use the incorporation test of nationality in practice,⁸¹ but instead used a wide variety of tests,⁸² and that the ICJ had not conducted a proper analysis of

⁷⁸ Ibid at 240.

⁷⁹ *Barcelona Traction* (n 61) 49.

⁸⁰ Ibid, 248, He also criticizes the use of arbitral tribunal decisions as state practice because agreements establishing such tribunals were "on many occasions concluded under pressure, by political, economic or military threats."

⁸¹ Stanley Metzger, 'Nationality of Corporate Investment under Investment Guaranty Schemes - The Relevance of *Barcelona Traction*', (1971) 65 AM. J. Int'l. L 532, 534-37.

⁸² Ian Brownlie, *Principles of Public International Law* (5th edn, OUP 1998) 482-92.

state practice.⁸³ Consequently, from the decision of the ICJ, save the case where participation in a company constitutes an investment, the place of constitution or incorporation and or the seat tests leave unprotected the rights of the parent company or of the shareholders.⁸⁴ As will be seen, this is a position most countries, particularly developed countries addressed in their signing of investment treaties with developing states, where they formulated definitions of investor to suit their particular needs⁸⁵.

2.1.4. The Incorporation Criterion under International Investment Law

Whether or not the decision of the ICJ in *Barcelona Traction* was a true reflection of customary international law at the time, the place of incorporation criterion was and is still widely used in BITs and other IIAs for defining the set of corporate investors covered by a BIT.⁸⁶ By simply assigning to the company the nationality of the state of incorporation, it has the advantage of being easily identifiable and fixed in as much as it is unaffected by the changes to the head office or the place of the company's principal activities.⁸⁷

For example in the United Kingdom (UK) – Mozambique BIT, 'Companies' mean:

⁸³ See Richard Lillich, 'The Rigidity of Barcelona', (1971) 65 Am. J. Int'l. L 522; see generally, Lawrence Jahoon Lee, '*Barcelona Traction* in the 21st Century: Revisiting its Customary and Policy Underpinnings 35 years Later', (2006) 42 Stan.J.Int'l L 237.

⁸⁴ *Protosaltis* (n 73) 561.

⁸⁵ *Ibid*; see also, Jahoon - Lee (n 77) 237.

⁸⁶ Commenting on this position, the tribunal in the case of *Autopista v Venezuela* stated that " according to international law and practice, there are different possible criteria to determine a juridical person's nationality. The most widely used is the place of incorporation or registered office..." See *Autopista v Venezuela*, Decision on Jurisdiction, 27 September 2001, para 107.

⁸⁷ *Nikiema* (n 2) 8.

‘in respect of the United Kingdom: corporations, firms and associations incorporated or constituted under the law in force in any part of the United Kingdom...in respect of Mozambique: corporations firms and associations incorporated or constituted under the laws in force in any part of Mozambique...’⁸⁸

Generally, states adopt this criterion when they wish to encourage the establishment of companies in their territories⁸⁹ without concerning themselves with the fact that those companies conduct their activities beyond that country’s borders.⁹⁰

Investment tribunals where faced with a determination of the nationality of a company where the definition espoused by the relevant BIT or IIA is the incorporation criterion, have considered the issue largely according to the ordinary wording of the treaty in question. The case of *Tokios Tokeles*⁹¹ represents one of the instances a tribunal had to rule on whether or not to pierce the corporate veil by looking at the true owners of the company or decide the nationality of the claimant solely on the incorporation criterion contained in the treaty.

⁸⁸ Article 1(d) of The Agreement between the Government of the United Kingdom of Britain and Northern Ireland and the Government of the Republic of Mozambique for the Promotion and Protection of Investments, signed 18 March 2004 and entered into force on 27 February 2007.

⁸⁹ A similar provision with a slight variation is contained in the Article 2(b) of the Netherlands – China BIT, which defines “economic entities”:

“as including companies, corporations, associations, partnerships and other organizations, incorporated and constituted under the laws and regulations of either contracting party and have their seats in that contracting party, irrespective of whether or not for profit and whether their liabilities are limited or not.” This provision also goes further by requiring the seat of business to be in either of the contracting states.

⁹⁰ See generally, Roos van Os & Roeline Knottnerus, *Dutch Bilateral Investment Treaties: A Gateway to ‘Treaty Shopping’ by Multinational Companies* (Stichting Onderzoek Multinationale Ondernemingen Centre for Research on Multinational Corporations 2011), (Os n.d.) pointing out how The Netherlands has established itself as a safe haven for multinationals and other corporations seeking to gain access to treaty coverage by exploiting the vast network of BITs signed by the country with other states and with the investor friendly definitions of ‘investor’ contained in such agreements, the establishment of shell companies in The Netherlands is largely considered a ‘normal’ business strategy by corporate investors.

⁹¹ *Tokios Tokeles v Ukraine*, ICSID Case No Arb/02/18, Decision on Jurisdiction, 29 April 2004. Hereafter *Tokios Tokeles*.

In the case, Tokios Tokeles, a company established under Lithuanian law had formed a wholly owned subsidiary (Taki Spravy) under the laws of Ukraine.⁹²In 2002, Tokios brought a claim before the ICSID alleging Ukraine had breached the BIT between Lithuania and Ukraine by engaging in a series of actions that adversely affected its investments in Ukraine.⁹³ The respondent argued that the claimant was not a “genuine entity” of Lithuania as it was owned and controlled by Ukrainian nationals, the respondent also argued that the company had no substantial business activities in Lithuania.

However, interpreting Article 1(2) of the Ukraine – Lithuania BIT which defines investor as “any entity established in the territory of the Republic of Lithuania in conformity with its laws and regulations”, the tribunal refused to pierce the veil of the company to determine who the real controllers of the company were. According to the tribunal:

“The Respondent’s request to restrict the scope of covered investors through a control-test would be inconsistent with the object and purpose of the treaty, which is to provide broad protection of investors and their investments...In addition, a number of investment treaties of other states enable the parties to deny the benefits of the treaty to entities of the other party that are controlled by the nationals of the denying party...”⁹⁴

⁹² Ibid para 3.

⁹³ Ibid para 1, 2.

⁹⁴ Ibid.

The tribunal regarded the absence of such a clause or other limitation as a deliberate choice of the parties and considered that “it is not for tribunals to impose limits on the scope of BITs not found in the text”.⁹⁵

It is argued, however, that being a criterion which is easily satisfied through mere registration of a company in a state, this mode of conferring protection on corporate investors gives room for treaty shopping. Thus, allowing nationals of the host state and or nationals of a third country to incorporate a company in the territory of a contracting state solely for the purpose of gaining access to treaty protection where it otherwise would be an unprotected investor. In many instances, such a company has little to no substantive connection to the state of incorporation.

The case of *Saluka v Czech Republic*⁹⁶ evidences an instance of the tenuous nature of the relationship that can subsist between a contracting state and a company registered under its laws. The arbitration arose out of events consequent upon the reorganisation and privatisation of the Czech banking sector.⁹⁷ The Nomura Group, a major Japanese merchant banking and financial services group of companies, which typically operates through subsidiaries set up in various countries, bought the shares in Investiční a Poštovní banka a.s. (later known as IP banka a.s., or “IPB”),⁹⁸ transferred them to another Nomura subsidiary, Saluka Investments BV (“Saluka”), a legal person constituted under the laws of The Netherlands.

Subsequently, following a forced administration of its assets and eventual sale, Saluka sought to be compensated. Objecting to the claim, the respondents argued that the Saluka did not have *bona fide*, real and continuous links to The Netherlands

⁹⁵ Ibid para.

⁹⁶ *Saluka Investments BV (The Netherlands) v Czech Republic*, Partial Award, 17 March 2006. Hereafter, *Saluka v Czech*.

⁹⁷ Ibid, para 1.

⁹⁸ Ibid, para 33.

and for that reason did not satisfy the requirements which are necessary to qualify as an investor able to benefit from the provisions of the treaty and was merely a shell company controlled by its Japanese owners.⁹⁹ The tribunal, however, stated that:

“The Tribunal has some sympathy for the argument that a company which has no real connection with a State party to a BIT, and which is in reality a mere shell company controlled by another company which is not constituted under the laws of that State, should not be entitled to invoke the provisions of that treaty. Such a possibility lends itself to abuses of the arbitral procedure, and to practices of “treaty shopping” which can share many of the disadvantages of the widely criticised practice of “forum shopping.”^{100, 101}

This expression of the tribunal brings to fore the far reaching effects of the drafting of BITs and IIAs in how they are interpreted and applied. While it is arguable that the contracting parties, or at least in this instance Czech Republic did not intend for advantages of the BIT to be extended to an investor who is considered to have no real connection to the Netherlands. Notwithstanding, it is evident that the expression of the BIT when applied *strictu sensu* effectively prevents the interpretation of the definition of investor from a more teleological perspective. It is this limitation of the

⁹⁹ Ibid, para 239.

¹⁰⁰ Ibid, para 240.

¹⁰¹ However, notwithstanding the tribunal’s sympathy for the respondent’s argument and the potential for treaty shopping, the tribunal pointed out that:

“...the predominant factor which must guide the Tribunal’s exercise of its functions is the terms in which the parties to the Treaty now in question have agreed to establish the Tribunal’s jurisdiction. In the present context, that means the terms in which they have agreed upon who is an investor who may become a claimant entitled to invoke the Treaty’s arbitration procedures. The parties had complete freedom of choice in this matter, and they chose to limit entitled “investors” to those satisfying the definition set out in Article 1 of the Treaty. The Tribunal cannot in effect impose upon the parties a definition of “investor” other than that which they themselves agreed. That agreed definition required only that the claimant-investor should be constituted under the laws of (in the present case) The Netherlands, and it is not open to the Tribunal to add other requirements which the parties could themselves have added but which they omitted to add.” See Ibid, para 241.

incorporation criterion which has led other states to define the term investor under their BITs and IIAs using other criteria such as the *siege sociale*.

2.1.5. The *Siege Sociale* Criterion

The head office or *siege sociale* criterion next to the incorporation criterion is one of the most commonly used tests in the determination of corporate nationality.¹⁰² This standard which links the nationality of the corporate national to the state of the place or centre, from which the corporation is controlled, is followed in many civil legal systems.¹⁰³ In the Germany – Egypt BIT, the article on nationality provides for the seat criterion as well as the incorporation test disjunctively. According to the BIT, the term investor covers:

*'legal entities, including companies, corporations, business associations, partnerships and other organizations with Or without legal personality which have their registered office Or seat in the territory of that Contracting State, irrespective of whether or not their activities are directed at profit'*¹⁰⁴

The France – Mexico BIT also uses a similar language, extending protection to 'any legal person constituted in the territory of one contracting party...having its head office in the territory of that party'.¹⁰⁵

¹⁰² Protosaltis (n 73) 561.

¹⁰³ Muthucumaraswamy Sornarajah, *The International Law on Foreign Investment* (3rd edn, Cambridge 2010) 198.

¹⁰⁴ See, Germany – Egypt BIT, signed 16 June, 2005, entered into force 22 November, 2009, art 2(b); see also Germany – Bangladesh BIT, entered into force 6th May 1981, entered into force 14th September 1986, art 8(4)(a), which provides " any juridical person as well as any commercial or other company or association with or without legal personality having its seat in the German area of application of the present Agreement and lawfully existing consistent with legal provisions, irrespective of whether the liability of its partners, associates or members is limited or unlimited and whether or not its activities are directed at profit".

¹⁰⁵ France – Mexico BIT, signed 12 November, 1998, entered into force 12 October, 2010, art 2(b).

The seat of a company may not be as easy to determine as the country of incorporation, but it reflects a more significant economic relationship between the company and the country of nationality.¹⁰⁶ Compared with the incorporation criterion this nationality standard does more in limiting the incidence of “treaty shopping” through the acquisition or establishment of a shell company in a jurisdiction where a relevant BIT applies. Thus some states require that in order to qualify as an investor a legal person should not only be constituted or incorporated in the host country but also have its seat and/or effective management there.¹⁰⁷

In the case of *Yuang Chi Oo Trading v Government of the Union of Myanmar (Yuang Chi Oo)*¹⁰⁸ brought under the Association of Southeast Asian Nations (ASEAN) Investment Guarantee Agreement (AIGA)¹⁰⁹ the tribunal in considering the reason why the effective management criterion was included by contracting parties to the agreement observed:

“ It appears that the requirement of effective management of the investing company in the place of incorporation was primarily included in the 1987 ASEAN Agreement to avoid what has been referred to as "protection (or treaty) shopping"; i.e., the adoption of a local corporate form without any real

¹⁰⁶ UNCTAD, *Series on Issues in International Investment Agreements: Scope and Definitions* (United Nations 1999) 38-39.

¹⁰⁷ Catherine Yannaca - Small, ‘Definition of Investor and Investment in International Investment Agreements in OECD, *International Investment Law: Understanding Concepts and Tracking Innovations* (OECD 2008) 22 <<https://www.oecd.org/investment/internationalinvestmentagreements/40471468.pdf>> accessed 21 November 2016.

¹⁰⁸ *Yuang Chi Oo Trading v Government of the Union of Myanmar* ASEAN ID Case ARB/01/1, Award, 31 March, 2003. Hereafter, *Yaung v Myanmar*.

¹⁰⁹ Article 1(2) ASEAN Investment Guarantee Agreement defines the term “company” of a Contracting Party to mean a corporation, partnership or other business association, incorporated or constituted under the laws in force in the territory of any Contracting Party wherein the place of effective management is situated.

*economic connection in order to bring a foreign entity or investment within the scope of treaty protection.*¹¹⁰

However, while this test may on the face encourage a more genuine link; by demanding that business or managerial activities of some sort be the determining factor for identifying the nationality nexus between the company and the home country. Nonetheless it does not answer the question of having third party nationals, and indeed nationals of the host state, who are ideally not covered by the treaty between contracting parties, to have access to protection afforded by contracting parties in such agreements. In other words, this standard also possesses a similar weakness as the incorporation test.

As noted earlier, the *Barcelona Traction* case illustrates the limitation(s) of these two tests.¹¹¹ On the one hand, these tests cover only a company of the home country but not a foreign one - a company of a third country or a Calvo corporation – that is, a company controlled by nationals of the home country.¹¹² Consequently, save the case where participation in a company constitutes an investment,¹¹³ the place of constitution or incorporation and/or the seat tests leave unprotected the rights of the parent company or of the shareholders.¹¹⁴

On the other hand, and as a consequence of the first point, these tests while not covering a foreign company, allow for treaty shopping practices by third party

¹¹⁰ *Yaung v Myanmar*, para 52.

¹¹¹ *Protopsaltis* (n 73) 561.

¹¹² *Ibid.*

¹¹³ In turn, many BIT and IIAs in response to this provide for definitions of “investment” which are broad and open ended, covering not only properties movable and immovable, but also rights and interests including shares, intellectual property, business concessions among many others. Consequently, the term investment not only refers to assets which in theory could amount to an investment, but also underlying transactions in which those assets are involved. See generally, UNCTAD Series on issues in international investment agreements: Scope and Definitions (United Nations 1999).

¹¹⁴ See *Barcelona Traction*, (n 61).

nationals and host country nationals. These limitations of incorporation and head office criteria have led an increasing number of states to the use of the control test as an alternative criterion in determining the nationality of corporate investors.¹¹⁵

2.1.6. The Control Criterion

Generally, the control criterion is often used in combination with the incorporation and head office tests. It has been considered as the 'alternative criterion'.¹¹⁶ While determining the country-of-ownership or control may be the most difficult to ascertain and the least permanent of the tests¹¹⁷, particularly in the case of companies whose stock is traded on major stock exchanges. However, its principal benefit is that it 'links coverage by an agreement with a genuine economic link'.¹¹⁸

The introduction of this test by contracting parties has been described as matching the current reality of foreign direct investment (FDI)¹¹⁹ which is more of a shift in control rather than a movement of capital.¹²⁰ This point is underscored by the fact that the nature of international investment law demands a genuine and effective link between the home state and the investor. Succinctly, the obligations undertaken by state parties, the effects of such obligations on their sovereign and regulatory powers - prominent of which is the power accorded to a private investor to claim against the host state - suggests that before such powers can be exercised by a foreign investor,

¹¹⁵ Nikiema (n 2) 9.

¹¹⁶ Ibid.

¹¹⁷ OECD, 'Definition of Investor and Investment in International Investment Agreements' in *International Investment Law: Understanding Concepts and Tracking Innovations* (OECD 2008) 24; see also UNCTAD, *Series on Issues in International Investment Agreements: Scope and Definitions* (United Nations 1999) 39.

¹¹⁸ Ibid.

¹¹⁹ Protopsaltis (n 73) 561, 566.

¹²⁰ Kenneth Vandeveld, 'Economics of Bilateral Investment Treaties' (2000) 41 Harv. Int'l. L.J. 469.

the link between the investor and the home country with which the host state contracted should be genuine and effective.

As has been said by a commentator, *'it is all very well to offer rights and guarantees to the greatest number of investors in the hope of attracting foreign capital, regardless of its provenance. However, allowing any investor recourse to an international arbitration against the host state is another matter'*.¹²¹ The position espoused is that the definitions of who qualifies as an investor in investment treaties should be based on a genuine economic link. That is, definitions not cloaked in superficiality or tenuous links to allow the investor to exercise the power to bring the host state before an international tribunal.

It is argued that the high cost borne by states in undertaking obligations under BITs should be matched by a nationality requirement which demands an equally high threshold of determining nationality. The use of the word 'high' here, however, is not to imply 'difficulty' but rather suggests the placing of content and genuineness of the relationship between the investor and the home state over form. Particularly, if and where the goal of the regime and investment treaties is one hinged on 'balance' and 'reciprocal treatment' between the contracting parties.

The very appeal of the control test is its preference of substance of nationality over form.¹²² Generally, the test is given expression through two major clauses. On the one hand, the test is used in what has been termed '*Barcelona Traction Clauses*'. The term is used to describe provisions inspired by the judgement of the ICJ in the

¹²¹ Nikiema (n 2) 1.

¹²² This is however, to the extent that the very essence of the test is not limited by the insertion of qualifying words which stretch the scope of the test's applicability as to encompass legal persons hiding behind the 'form' of corporate entities. This issue is pointed out below.

case of *Barcelona Traction*,¹²³ to the end that the control test is used positively to extend the scope of application *ratione personae* in BITs and IIAs.¹²⁴ On the other hand the control test is used negatively through the inclusion of the denial of benefits clause in investment treaties, to the end that it restricts the scope of application *ratione personae* in investment treaties and agreements.^{125, 126}

In extending treaty coverage to investors, *Barcelona Traction* clauses cover investments not only directly owned or controlled by the investor, but also indirect investments through shareholding arrangements in the company or through intermediary companies who hold such assets on behalf of the investor.¹²⁷ In article 1 of the Netherlands – Venezuela BIT, nationals include legal persons ‘*not constituted under the law of*’ a Contracting Party *but controlled, directly or indirectly, by natural persons...or by legal persons*’¹²⁸

Unlike the formal criteria of incorporation and the seat, the control criterion allows for the piercing of the corporate veil to reveal the real controllers behind the corporate

¹²³ Paul Peters, ‘Some Serendipitous Findings in BITS: the *Barcelona Traction* Case and the Reach of Bilateral Investment Treaties’ in Eric Denters and Nico Schirijver (Eds), *Reflections on International Law from the Low Countries In Honour of Paul de Waart* (Martinus Nijhoff Publishers 1998) 42 ,43.

¹²⁴ Protosaltis (n 73) 561, 567.

¹²⁵ According to Professor Acconci:

“control – defined either as the ownership of the majority of the company’s shares or as the power to decide the company’s conduct – represents the criterion used to determine the internationally relevant link, although it is used cumulatively or negatively in all respects, but never exclusively.” See, Pia Acconci, ‘Determining the International Relevant Link between a State and a Corporate Investor: Recent Trends Concerning the Application of the “Genuine Link” Test’ (2004) 5 J. World Investment and Trade 139.

¹²⁶ Touching on the dual use of the control test, she further noted:

“using the control criterion cumulatively means that the international relevance is given to the nationality of a company determined by using one of the formal criteria-i.e. the place of incorporation and/or siege social – only when it matches the nationality of those in control of the company whereas using the control criterion negatively usually implies that the international relevance of a company’s nationality determined by using one of the formal criteria is excluded if this company is controlled by nationals of the host state or a third state”. Ibid.

¹²⁷ This as mentioned earlier is further by the broad definition of “investment” used in these agreements and treaties. Definition of ‘investment’ in these treaties often read ‘any kind of asset owned or controlled either directly, or indirectly, through an investor in a third state or shares, stocks and all other forms of participation directly or indirectly in the capital of companies in the territory of one of the contracting parties.

¹²⁸ Netherlands – Venezuela BIT, signed 22nd October 1991, entered into force 1st November 1993, art 19b) (iii); See also, French Model BIT, art 1(2).

entity. As in the cases of *Tokios Tokeles* and *Saluka* discussed above, many tribunals refrain from going beyond the nationality of the claimant corporation to examine whether it is foreign-controlled. In *Rumeli Telecom A.S. and Telsim Mobil Telekomikasyon Hizmetleri A.S. v. Kazakhstan*¹²⁹, the tribunal noted that "nowhere in the ICSID Convention is there a basis for piercing the corporate veil of a designated claimant."¹³⁰ The arbitrators rejected the application of the effective nationality test to pierce the corporate veil and reach the real controllers of the corporate group.¹³¹

However, few ICSID tribunals underscore the importance of identifying the real controllers behind a corporate investor. In *Vacuum Salt Products Ltd. v. Republic of Ghana*,¹³² the issue was whether the company was under foreign control, or under the control of Ghana nationals, and as such, fell outside of the scope of the tribunal's personal jurisdiction.¹³³ Interpreting article 25 of the ICSID the tribunal stated:

*"Nevertheless the words "because of foreign control" have to be given some meaning and effect. These words are clearly intended to qualify an agreement to arbitrate and the parties are not at liberty to agree to treat any company of the host State as a foreign national: They may only do so "because of foreign control" "*¹³⁴

In the words of the tribunal, the reference in Article 25(2)(b) to "foreign control" necessarily sets an objective limit beyond which ICSID jurisdiction cannot exist and

¹²⁹ *Rumeli Telecom A.S. and Telsim Mobil Telekomikasyon Hizmetleri A.S. v Kazakhstan*, ICSID Case No. ARB/05/16, award, 29 July, 2008. Hereafter *Rumeli v Kazakhstan*.

¹³⁰ *Ibid*, Para 186.

¹³¹ The tribunal justified its position by appealing to the decisions in the cases of '*Saluka*' and '*Agua del Tunari, S.A. v. Republic of Bolivia*', ICSID Case No. ARB/02/3.

¹³² See generally *Vacuum Salt Products Ltd v Ghana (Vacuum Salt)* ICSID Case No. ARB/92/1, Award, 16 February, 1994.

¹³³ *Ibid*, para 38.

¹³⁴ *Ibid*.

parties therefore lack power to invoke same no matter how devoutly they may have desired to do so¹³⁵.

Notwithstanding the advantage of the control criterion, qualification of the criterion with the term 'directly or indirectly' in many investment treaties leaves room for the encouragement of treaty shopping by investors. As most BITs which employ this criterion do not specify the level of indirect control at which the investor might be protected and conversely at which protection ceases. As such, while the control test allows for the determination of the real investors in a company and consequently the determination of the company's nationality based on the nationality of its owners or controllers, the insertion of qualifying terms detracts from the efficacy of the criterion, particularly under *Barcelona Traction* Clauses in stemming treaty shopping.¹³⁶

From the foregoing, it is clear that corporate nationality tests couched in broad, open and generous definitions of investor in BITs and IIAs engender access to treaty protection by investors through different treaty shopping routes and practices. In the words of Valerie Pironon "all roads leads to nationality"¹³⁷ Accordingly, nationality as a gateway that determines the applicability of an investment treaty has been argued to have become increasingly irrelevant in determining the active level of investment

¹³⁵ Ibid, para 36; see generally, *TSA Spectrum de Argentina S.A. v. Argentine Republic* ICSID Case No. ARB/05/5, Award, 19 December, 2008.

¹³⁶ Nonetheless, the use of the criterion negatively through the denial of benefits clause can be used to achieve a balancing effect in this regard, however, this can only be done through the insertion of the clause either as a part of investor definition in investment treaties, or as a separate clause.

¹³⁷ Valerie Pironon, 'L'arbitrage des differends entr une joint-venture et l'Ectact d'accueil de l'investissement: a la recherche de la nationalite de l'investisseur,'(Arbitration in Dispute between a joint venture and the investment host State: In Search of the Investor Nationality) (2010) 2 *Revue de L'arbitrage* 247.

protection due to a specific investor, its investment and access to the right to initiate investment arbitration against the host state.¹³⁸

This position finds an advocate in Barton Legum, who argues that where a host state has entered into BITs that cover indirectly controlled investments, there could be between one and twenty layers of intermediate holding companies that separate the company which is covered under the treaty, with the ultimate company controlled by third country nationals.¹³⁹ Consequently, according to him, “although each investment treaty is drafted as a bilateral set of obligations, to comply with those obligations the host state must treat them as obligations *erga omnes*;¹⁴⁰ obligations owed to every state and every company”^{141 142}

The principle underlying this argument¹⁴³ is that state parties through their definitions of ‘investor’, ‘national’ and ‘investment’ support and encourage the practice of corporate structuring and treaty shopping, or in the least that states do not mind their lack of knowledge of the extent of protection that investors may claim since they

¹³⁸ See Schill, (n 11), 221, 237; he further opined, that the protection of shareholders and corporate structuring passively multilateralises investment treaty protection by de facto extending the effect *rationale personae* to investors who are not directly protected.

¹³⁹ Barton Legum, ‘Defining Investment and Investor: Who is entitled to Claim?’ (2006) 22 Arbitration International 521.

¹⁴⁰ See, Institute of International Law, Resolution of the Fifth Commission, Krakov Session (2005), Art 1‘An obligation *erga omnes* is(a) an obligation under general international law that a state owes in any given case to the international community, in view of its common values and its concerns for compliance, so that a breach of that obligation enables all states to take action; or (b) an obligation under a multilateral treaty that a state party to the treaty owes in any given case to all other state parties to the same treaty, in view of their common values and concern for compliance, so that breach of that obligation enables all these states to take action’< www.idid-iil.org/idiE/resolutionsE/2005_kra_01_en.pdf.> accessed 22 November 2016.

¹⁴¹ Ibid. This view was also reiterated in the case of *Aguas del Tunari S.A v. Republic of Bolivia*.

¹⁴² *Aguas del Tunari S.A v Republic of Bolivia*, ICSID Case No ARB/02/3, Decision on Respondent’s Objection to Jurisdiction, October 21, 2005. Hereafter, *ADT v Bolivia*. Where the tribunal stated that its decision: “...reflects the growing uses of treaty based referrals to arbitration of certain investment disputes. Although titled ‘bilateral’ investment treaties, this case makes clear that which has been clear to negotiating states for some time, namely, that through the definition of ‘national’ or ‘investor’, such treaties are in many cases more broadly as portals through which investments are structured, organized, and most importantly, encouraged through the availability of a neutral forum. The language of the definition of national in many BITs evidenced that such national routing of investment is entirely in keeping with the purpose of the instruments and motivations of the parties”

¹⁴³ Ibid, para 332.

assume that all investors are covered by the highest standards of any BIT in force for the state.¹⁴⁴ To undertake an analysis of this argument, the concept of treaty shopping in international investment law will first be considered.

2.2. The Concept of Treaty Shopping in International Investment Law

States sign investment treaties among other reasons to secure protections for their nationals investing abroad.¹⁴⁵ However, as noted earlier, the definitions of 'investor' and 'investment' in most BITs and other IIAs allow instances where the investor, arguably consisting of no more than the incorporation of a shell company in the territory of the home state,¹⁴⁶ to take advantage of such open and broadly couched definitions, to organize their investment in ways that afford maximum protection under existing treaties.¹⁴⁷

It is this structuring of investments to gain access to treaty protection that is referred to as treaty shopping. Also referred to as 'nationality planning'¹⁴⁸ the practice has been defined as *'the conduct of foreign investors who deliberately seek to acquire the benefits of a BIT by making foreign investments or bringing claims from third countries that have more favourable treaty terms with the target host state'*¹⁴⁹

Taking a comprehensive approach, Jorun Baumgartner defines the practice as:

¹⁴⁴ Legum (n 139) 521.

¹⁴⁵ Mark Feldman, 'Setting Limits on Corporate Nationality Planning in Investment Treaty Arbitration' (2012) 27 ICSID Review 281.

¹⁴⁶ Ibid.

¹⁴⁷ Christoph Schreuer, 'Nationality of Investors: Legitimate Restrictions vs Business Interests' ICSID Review (2009) 24(2) 521.

¹⁴⁸ Dolzer and Schreuer (n 22) 52.

¹⁴⁹ Matthew Skinner, Cameron Miles and Sam Luttrell 'Access and Advantage in Investor State Arbitration: The Law and Practice of Treaty Shopping' (2010) 3 Journal of World Energy and Business Law 260.

“All legal operations aimed at invoking or creating qualifying nationality and or a qualifying investment ... by structuring or restructuring an investment or by otherwise conferring an entitlement or property right to an investment, with a view to benefitting from a particular international investment agreement.”¹⁵⁰

Within the context of international investment law, the practice of treaty shopping is not considered as illegal or unethical as such, by some commentators.¹⁵¹ However, this position when the nature of the practice is reviewed might be considered as a narrow or imbalanced perception of the issue. While the practice of treaty shopping might not be considered illegal in the present framework of international investment regime, one might, however, argue as to the ethicality of the practice and its impact on the international investment regime.

As such, the positions of stakeholders and scholars on the nature, validity and effect of the practice differ. While multinational corporate investors backed by international legal firms which represent and advise them, as well as some scholars in the field perceive treaty shopping as a phenomenon in furtherance of the purpose of investment treaty law and arbitration on the one hand. Countries particularly host states alongside some scholars do not share this view¹⁵². More importantly, the position of international tribunals on this practice differs. This part of the chapter will

¹⁵⁰ Jorun Baumgartner, *Treaty Shopping in International Investment Law* (OUP 2016). For the purposes of this work, this definition will be adopted as it effectively reflects the position held in this work as to the concept of treaty shopping in international investment law.

¹⁵¹ Dolzer and Schreuer (n 22) 52; Indeed corporate structuring is considered a common practice rather than the exception in international business, particularly to take advantage of tax and other regulatory advantages. In the same light, international legal practices now customarily advise their clients that strategic structuring can ensure that an investment benefits from the protection of an effective investment treaty should a dispute arise. See generally, Protopsaltis (n 73) 561; Anthony Sinclair ‘The Substance of Nationality in Investment Treaty Arbitration’ (2005)20(2) ICSID Review 357.

¹⁵² The positions and argument of countries such as Venezuela, Egypt, Bolivia, Ecuador, Russia, Myanmar, etc. who have been respondents in cases where tribunals had to decide on the legality of the practice or otherwise is particularly instructive.

highlight some of the salient issues on treaty shopping, particularly¹⁵³, the drivers behind investor decisions to treaty shop, the position of the different parties and stakeholders. Finally, the chapter will engage an analysis of the concept as it ties in with the relevance of nationality requirements in the regime.

2.2.1. Investor Motivations for Treaty Shopping in International Investment Law

There are generally three principal reasons corporate investors structure their investments as to benefit from treaty protection. In the first scenario, the investor's home state does not have an investment treaty with the state of its investment. To remedy this, the investor in seeking to take advantage of treaty protection, structures its investment in a way as to acquire the nationality of a third country which has an investment treaty with the host state of its investment.

In the second scenario, the investor's home state has an investment treaty with the host state of the investment. However, the host state has another treaty with a third country, which for the investor's purposes has more beneficial or advantageous treaty provisions. To gain access into the more advantageous treaty, the investor structures his investment to acquire the nationality of the third country.¹⁵⁴

In the final case, the investor holds the nationality of the host state where the investment is situated and is therefore a local investor. However, to gain access to protection under an investment treaty subsisting between the investor's state and another contracting party, the local investor structures its investment to acquire the

¹⁵³ This point is already discussed in the preceding paragraph as well as this.

¹⁵⁴ Another alternative is for the investor to bring his claim under the subsisting treaty between its home country and the host country and invoke the application of the Most Favoured Nation clause (MFN) if the treaty has one, to allow the application of an advantageous clause in the treaty between the host state and the third country.

nationality of the other contracting party, thereby, elevating a local investment to an international status.

2.2.2. Treaty Shopping Routes in International Investment Law

In accessing treaty benefits, there are three principal avenues through which investments can be structured to benefit from treaty protection. Depending on the position of the company and or its motivations for treaty shopping, the investor can engage in either the routes of; assignment of claims, round tripping, or free riding.

The assignment of claims method as the name implies involves the sale of the investment or investment claim by an investor to another investor who has the required nationality of the contracting party to the BIT with the host state of the investment. This latter investor who is covered by the treaty with the host state then brings a claim before an international tribunal against the host state.¹⁵⁵ This option is generally used where a dispute already exists with the host state and the initial investor feels that it has not benefited from the best legal protection in terms of its nationality.¹⁵⁶

The second treaty shopping route is the round tripping method. The major peculiarity of this method is the nationality of the investor which is the nationality of the host state. In these cases, the investor is a local investor making a local investment in the host state's economy. However, as mentioned above, with the desire to gain access to treaty protection which is usually beyond the reach of the nationals of the host state, the investor incorporates a company in the territory of the other contracting

¹⁵⁵ See, Matthew Skinner (n 149) 260, 269; See generally, Nikiema (n 2) 4.

¹⁵⁶ Matthew Skinner (n 149) 269. Pointing out there is a growing market for BIT claims with an increasing number of sophisticated investors dedicated to 'trafficking in BIT claims'.

party to the BIT. This company with the nationality of the other contracting party (though owned and controlled by the host state's national) then brings a claim against the host state in the event of a breach of the provisions of the BIT.

The third route is the 'free riding' route. In this instance, the investor who does not hold the required nationality under the particular BIT sought to be accessed creates a subsidiary in the territory of the other contracting party to the BIT. Usually, the newly incorporated subsidiary is nothing more than an empty shell without any independent business activity or staff¹⁵⁷, these are popularly known as 'mailbox companies'. This intermediary shell company then holds the investment in the host state and initiates a claim against the host state in case of a dispute.

2.2.3. Stakeholders' Reactions to Treaty Shopping In International Investment Law

The perspective of stakeholders, that is, states, investors, scholars, lawyers, non-governmental organizations etc. to the practice of treaty shopping is far from consensual.¹⁵⁸ The practice is considered an integral part of international investment law by multinationals and international legal practices that represent and advise them. This view is also upheld by a number of scholars in the field¹⁵⁹. Conversely, many state parties under the investment regime as well as scholars do not perceive the practice as a welcome development. While these two sides are at extreme ends,

¹⁵⁷ Ibid.

¹⁵⁸ See Schill, (n 11) 221 – 240, arguing that corporate structuring and treaty shopping, are sources not only of the multilateralization, but of the universalization of international investment law. See also, Peter Muchlinski 'Corporations and the Uses of Law: International Investment Arbitration as a Multilateral Legal Order' (2011) 1(4) Onati Socio-Legal Series, in rebuttal of the position adopted by Schill.

¹⁵⁹ Some of the views expressed by these scholars have been mentioned above. See, Legum (n 139) 521 and Schill (n 11) 221 – 240 above. These points shall be restated as they are relevant under the concept of treaty shopping as under nationality.

the position of international investment tribunals has been both for and against the practice.

2.2.3. A. Treating Shopping in International Investment Law: Its Proponents and Discontents.

The arguments in support of the practice of nationality planning have the same fundamental premises as the arguments on the ineffectiveness of nationality requirements in BITs and IIAs. This is not surprising, as treaty shopping being as it were a capitalisation on the broad and porous nationality requirements of investment treaties, will have arguments on the efficacy of nationality requirements extend to it.

The thrust of arguments on the ineffectiveness of nationality requirements (or treaty shopping as in the present point in our discourse), is that the concept of the nationality of the investor is increasingly an irrelevant phenomenon in the international investment law regime. Underlying this argument are two sub arguments. First, that the primary purpose of international investment law is the protection and promotion of foreign investment. Second and related to the first, that, if the purpose of investment treaties is the promotion and protection of foreign investments, then from a policy perspective, the nationality of the source of investment should not matter to the host state.¹⁶⁰

The first pillar in the argument is that the purpose of international investment law is the protection and promotion of foreign investment. It is worthy of note, however, that to follow this line of reasoning, it would ensue that the underlying reason why developing countries signed investment treaties is solely for the protection and

¹⁶⁰ Legum (n 139) 521.

promotion of foreign investment. Furthermore, contracting parties, particularly developing states limited their sovereign rights and curtailed their regulatory powers only to allow the protection and promotion of foreign investments by agreeing to wide substantive guarantees in investment treaties, as well as the empowering of foreign investors to bring claims against the host state before an international tribunal.

This view has also been adopted by some investment tribunals. In the case of *Azurix Corp (USA) v Argentina*¹⁶¹, the tribunal in considering the object and purpose of the BIT stated that the agreement between the state parties was to “encourage and protect investment”¹⁶². Also, in the case of *SGS Société Générale de Surveillance S.A. v. Republic of the Philippines*,¹⁶³ the tribunal was of the view that the purpose of the BIT between Switzerland and Philippines is a treaty for the promotion and reciprocal protection of investments. Accordingly, the tribunal found it “legitimate to resolve uncertainties in its interpretation so as to [favour] the protection of covered investments.”¹⁶⁴

However, the challenge with this position is, being a largely bilateral system of promoting and protecting foreign investments between a particular party and another, the liberal approach many investment treaties take to corporate restructuring does not lend credence to the protection of ‘foreign’ investment. Notably, an investment that was originally domestic, in that it was owned by nationals of the host state in question, can be made ‘foreign’ merely by a paper

¹⁶¹ *Azurix Corp v The Argentine State*, ICSID Case No. ARB/01/12, Award, 14 July, 2006. Hereafter, *Azurix v Argentina*.

¹⁶² *Ibid*, para 307.

¹⁶³ *Société Générale de Surveillance S.A. v Republic of the Philippines*, ICSID Case No ARB/02/6, Decision on Objections to Jurisdiction. Hereafter, *SGS v. Philippines*.

¹⁶⁴ *Ibid*, para 116.

transfer of ownership to a foreign entity¹⁶⁵. As such local investments are internationalised under the cloak of corporate nationality as seen in the case of *Tokios Tokeles*.

However, a counter argument to this point is that contracting parties implicitly encourage the practice of treaty shopping with the wide and broad definitions of 'national' or 'investor' and 'investment' in their treaties. While this point may finger states as being responsible for including and accepting broad definitions in their agreements. It still begs the issue that if the aim of investment treaties is to encourage foreign investments between the state parties to the treaties and not to expand special rights and privileges broadly to an international class of corporate owners of assets, then the expansive approach to treaty shopping that is enabled by broad language in many of the treaties and by the permissive interpretations of some arbitrators is unfounded.¹⁶⁶

Furthermore, the claim that the purpose of international investment treaties is the merely for the protection and promotion of foreign investment is akin to attempting to 'describe an elephant by a single body part'. While the promotion and protection of investments between contracting parties is indeed a reason for entering into BITs and IIAs. However, it must be correctly perceived as being alongside other motivations why contracting parties, particularly developing countries enter into these agreements.

Holding unto the perception of the protection and promotion of foreign investment as being the sole purpose of international investment law, neglects the big picture

¹⁶⁵ See generally, *Fedax N.V. v The Republic of Venezuela*, ICSID Case No. ARB/96/35, Decision of the Tribunal on Objections to Jurisdiction, 11 July 1997.

See also, Gus Van Harten 'Five Justifications for Investment Treaties: A Critical Discussion' (2010) 2 Trade, Law and Development 19.

¹⁶⁶ *Ibid.*

behind the reasons why countries sign such treaties. It is argued that a primary reason why investment treaties were signed by developing states at the initiation of the new investment regime rests on the promise of economic development and an avenue to further create, encourage and develop mutually beneficial economic relations among states¹⁶⁷ thought to be accompanied by the signing of such agreements.

While a point frequently raised on this discourse is that the historical aim of BITs has been to strengthen the protection of foreign investors, especially in developing and transitional markets.¹⁶⁸ The bilateral nature of these agreements suggests that while the expression of the wills of the parties may be evidenced through the treaties, it merely signifies the convergence or the agreements of the parties on how to achieve their individual objectives for signing the agreement. These treaties it is submitted are designed to facilitate the promotion and protection of 'foreign' investment as a means to an end and not an end in and by itself.

This fact is evident when the parties to these treaties are considered. Most investment treaties are concluded between a developed 'capital – exporting' country on the one hand, and a developing (or transition) 'capital - importing' country on the other. Although the treaty terms bind both parties, the capital flows largely in one direction.¹⁶⁹ As such, while developed countries benefit from the expanded market

¹⁶⁷ See Rafael Leal –Arcas, 'A New Era in Global Economic Governance' (2009) International Security Forum 1. He argues that the objective of nations engaging with each other on trade and economic matters, (including entering into BITs) is to the end of establishing peace, security and prosperity in the 21st century.

¹⁶⁸ Peter Muchlinski 'Holistic Approaches to Development and International Investment Law: The Role of International Investment Agreements' in Julio Faundez and Celine Tan (Eds), *International Economic Law, Globalisation and Developing Countries* (Edward Elgar Publishing 2010) 186; see also Jeswald Salacuse, Nicholas P. Sullivan 'Do BITS Really Work?: An Evaluation of Bilateral Investment Treaties and Their Grand Bargain' (2005) 46 Harv Int'l L.J. 68.

¹⁶⁹ Olivia Chung, 'The Lopsided International Investment Law and Its Effect on the Future of Investor – State Arbitration' (2006-2007) 47 Va.J.Int'l.L. 953.

and production networks made available by developing countries, developing countries in turn benefit from the much needed capital for economic development.¹⁷⁰

A proper conception of the purpose of investment treaties, therefore, is the protection and promotion of investment for economic development. Arguing that the sole purpose of investment treaties is for the promotion and protection of foreign properties is elevating the means of achieving a purpose above the purpose itself. This position was also endorsed in the case of *Saluka Investments v. Czech Republic*¹⁷¹ where the tribunal stated that the purpose of investment treaties:

*"...is a more subtle and balanced statement of the Treaty's aims than is sometimes appreciated. The protection of foreign investments is not the sole aim of the Treaty, but rather a necessary element alongside the overall aim of encouraging foreign investment and extending and intensifying the parties' economic relations. That in turn calls for a balanced approach to the interpretation of the Treaty's substantive provisions for the protection of investments, since an interpretation which exaggerates the protection to be accorded to foreign investments may serve to dissuade host States from admitting foreign investments and so undermine the overall aim of extending and intensifying the parties' mutual economic relations."*¹⁷²

Therefore, this initial footing of the argument that nationality requirements are irrelevant in international investment law, as the protection and promotion of foreign investment is the reason why states sign investment treaties is not entirely correct and can be misleading.

¹⁷⁰ Ibid.

¹⁷¹ *Saluka v Czech* (n 96).

¹⁷² Ibid, para 300.

The second leg of the argument is; 'If the purpose of investment treaties is the promotion and protection of foreign investments. Then from a policy perspective, the nationality of the source of investment should not matter to the host state.' First, this argument fails to take cognisance of the largely bilateral system of the international investment law regime. By signing BITs, state parties seek protections for their nationals investing abroad, at the cost of doing same for the nationals of the other contracting party in their territory. Therefore, the set of obligations owed between the parties is solely to the other contracting party.

This is evidenced by the titles of these agreements which are stated to be 'a reciprocal agreement' between 'State A and State B'. As such a state can enter in to an agreement with another state and assume another set of obligations under the other treaty, on the same subject matter. Consequently, the entering into a BIT by a state party on a bilateral basis suggests a specificity of intention to enter into a binding set of obligations in respect to the nationals and investments of the other contracting party and none other.¹⁷³

On this point, state parties, particularly developing states have reacted to the arguments advocating treaty shopping and by extension the irrelevance of nationality requirement by advancing the principle of reciprocity the bilateral relations the investments treaties create. States parties have argued that treaty shopping violates the principle of reciprocity, as BITs and other IIAs establish reciprocal rights and

¹⁷³ This point is further reinforced by the failure of state parties to conclude a multilateral investment treaty. Prominent of which is the failure of the Multilateral Investment Agreement (MAI). It is worthy of note that the failure of the MAI is 'attributed to the concerns of developed countries over excessive in roads into state sovereignty when dealing with the presence of foreign investors in their territory' See, Peter Muchlinski, 'The Rise and fall of the Multilateral Investment Agreement on Investment: Where Now?' (2000) 34 International Lawyer 1033; Sol Picciotto, 'Linkages in International Investment Regulation: The Antimonies of the Draft Multilateral Agreement on Investment' (1998) 19 The University of Pennsylvania Journal of International Law 731.

obligations between the contracting states.¹⁷⁴ Allowing third party nationals and indeed nationals of the host country of the investment to have access to the protection of IIAs effectively denies the contracting parties the benefit of securing the same protections for their nationals in the territory of the third country while bearing the burden of shouldering the obligations contained in the treaty to the investor of the third party.

In the same vein, the extension of the benefits of an international investment treaty to a national of the host state amounts to the guaranteeing of more onerous obligations by the host state to the local investor for and in respect to an investment already covered by local investment laws. With no extra set of obligations or duties assumed by the investor, it is evident that the condoning of such a practice will result in an undoubtedly uneven outcome.

Focusing on uneven outcomes, the accessing of international investment treaty protection by a local investor in the host state suggests the introduction of an imbalanced legal regime in the protection of property and assets for economic development in the host state. The availability of BIT protection to a set of local investors, who can afford to hire international law firms in the structuring of their investments to acquire the nationality of the other contracting party as against other investors who cannot, creates a distortion in the degree of legal protection available to different investors essentially resulting in a 'economic power makes right' scenario.

Furthermore, in the instance where a claim made by a 'local investor' is made against the host state and succeeds, the payment of damages totalling huge sums of

¹⁷⁴ Muthucumaraswamy Sornarajah, *The International Law on Foreign Investment* (Cambridge University Press 2004) 8.

money to a single investor at the expense of the welfare of other citizens at large raises a question of whether or not the rights of the other citizens of the state, are not being sacrificed on the altar of an individual investor. In other words, where respondent states pay huge sums in awards to claimants, there is the possibility that this impacts on the financial capacity of such states to effectively discharge their responsibilities in protecting the environment, provision of infrastructure and other matters of public welfare.

These views are unlike those pointed out to the end that the availability of BIT protection to various elements in a corporate group structure, and the opportunity for treaty shopping widen the protective power of individual treaties and ultimately add to the process of the multilateralisation of international investment law.¹⁷⁵ Nevertheless, the landscape of international investment law regime covered with thousands of BITs emphasise the process of specific reciprocity, coupled with “a simultaneous balancing of specific quid-pro-quo by each party with every other at all times”¹⁷⁶. Therefore, the specificity of the parties, and the obligations they assume under these agreements, casts a doubt on the claim that the nationality requirements as contained in investment treaties are irrelevant in the scheme of international investment law. As such, it fails as a point in support of treaty shopping as an acceptable practice under the regime.

A second point in rebuttal of this argument is that the notion that states do not or ought not to care about the source or origin of investment capital is one which fails to consider the complex relations between countries that might create conditions for

¹⁷⁵ See Schill (n 11).

¹⁷⁶ John Ruggie, ‘Multilateralism: The Anatomy of an Institution’ in John Ruggie (Ed), *Multilateralism Matters: The Theory and Praxis of an Institutional Form* (Columbia University Press 1993) 11; See Generally, Peter Muchlinski, ‘Corporations and Uses of Law: International Investment Arbitration as a “Multilateral” Legal Order’ (2011) 1 *Onati Socio –Legal Series*, 1.

foreign investment flows.¹⁷⁷ Some of these factors arise out of webs of influence, historical ties and cultural values that make communities highly sensitive to the origins of investors and investments¹⁷⁸.

The omission to take cognisance of the nationality based rules on who can actually own a business in a host country and the periodic concerns about particular investors from particular countries¹⁷⁹ is to neglect the importance states attach to the nationality of investment capital. Prominent among others were the concerns in the United States (U.S) over the decision by the Committee on Foreign Investment in the United States (CFIUS) to approve the takeover of UK company P&O's port operations in the United States by Dubai Ports World, subject to certain assurances in security matters.¹⁸⁰ Similarly, the takeover of Cadburys by Kraft in the UK in 2009 created a groundswell of opinion that some kind of review process for foreign takeovers was necessary.¹⁸¹ This is coupled with failure of the investors to honour assurances made with respect to jobs.

Furthermore, the inclusion of the denial of benefits (DOB) clause by an increasing number of state parties in the regime is another pointer as to the position of state parties to the practice of treaty shopping. The clause which seeks to prevent nationals of third countries and the host state from accessing treaty benefits and claiming against the host state before an investment tribunal also evidences the fact

¹⁷⁷ Muchlinski (n 168).

¹⁷⁸ John Dunning and Sarianna Lundan, *Multinational Enterprises and the Global Economy* (2nd edn Edward Elgar 2008).

¹⁷⁹ Muchlinski (n 168).

¹⁸⁰ See Edward Graham and David Marchick, *US National Security and Foreign Direct Investment* (Institute for International Economics 2006).

¹⁸¹ Business, Innovation and Skills Committee, *Mergers, Acquisitions and Takeovers: the Takeover of Cadbury by Kraft*, (HC 2009-2010); See generally; Peter Muchlinski, 'Trends in International Investment Agreements : Balancing Investor Rights and the Right to Regulate - The Issue of National Security' in Karl Sauvant (Ed) *Yearbook of International Investment Law and Policy 2008 – 2009* (OUP 2009) 35, 50, defining the concept on national security in international investment law and citing examples of increasing regulatory and policy changes and restrictions connected with the nationality of foreign investment ; Muchlinski (n 168).

that state parties consider the nationality of investments as an important factor. This is a testimony to the effect that not all state parties consider treaty shopping practice as beneficial to their welfare and position under investment treaties they have signed.

2.2.4. Arbitral Jurisprudence on Treaty Shopping in International Investment Law

As mentioned earlier, treaty shopping as the deliberate engagement of legal operations for the purpose of accessing certain legal and regulatory environments provided by states, including the availability and access to a BIT or IIA is not in itself considered illegal. Lending its voice to this fact, the tribunal in *HICEE v Slovakia*¹⁸² stated that the practice of structuring investment is:

*"...not unusual, nor is there anything in the least reprehensible about it, structured investments are commonplace. The purpose is to secure advantages from incorporation or operation in a particular jurisdiction...the advantage anticipated often include the protection of particular bilateral (or other) investment treaties covering foreign investment."*¹⁸³

As considered above, stakeholders in the investment law regime do not share the same perspective on the issue. International investment tribunals that have had the opportunity to consider the practice have also reached seemingly divergent positions on the practice.

In a number of cases, investment tribunals have accepted the investor's corporate nationality based on the definition of investor contained in the particular BIT,

¹⁸² *HICEE v Slovakia*, Permanent Court of Arbitration (PCA) Case No 2009 -11, Partial Award, 23 May, 2011.

¹⁸³ *Ibid*, para 103.

regardless of the tribunal's awareness that such corporate nationality was a medium through which third country nationals or host country nationals veil their original national identity. Examples include the cases of *Tokios Tokeles v Ukraine*¹⁸⁴ and *Saluka v Czech*¹⁸⁵ mentioned earlier.

In both instances, the tribunals refused to go beyond the definition of corporate national as expressed by the parties in the BIT. Even where the tribunal expressed its sympathy for the respondent party in its admission that where a corporate investor "is in reality a mere shell company controlled by another company which is not constituted under the laws of that State" such an investor "should not be entitled to invoke the provisions of that treaty. Such a possibility lends itself to abuses of the arbitral procedure, and to practices of "treaty shopping" which can share many of the disadvantages of the widely criticised practice of "forum shopping."¹⁸⁶

In the case of *ADT v. Bolivia*¹⁸⁷ the claimant was incorporated under Bolivian law. Relying on the definition of national in the Bolivia – Netherlands BIT¹⁸⁸, ADT argued that it was a national of Netherlands. In response, Bolivia argued that the company was in fact ultimately controlled by a US company. However, the tribunal reached a finding that the companies were more than mere shell companies set up to obtain the jurisdiction of the tribunal.¹⁸⁹ Commenting on the practice of treaty shopping, the tribunal stated:

"It is not uncommon in practice, and –absent a particular limitation – not illegal to locate one's operations in a jurisdiction perceived to provide a beneficial

¹⁸⁴ *Tokios Tokeles v Ukraine* (n 91).

¹⁸⁵ *Saluka v. Czech*, (n 96).

¹⁸⁶ *Saluka v Czech* (n 96) para 240.

¹⁸⁷ *ADT V Bolivia* (n 137).

¹⁸⁸ Bolivia – Netherlands BIT, art 1(b) defines a 'national' as including legal persons incorporated in the host state but controlled by nationals of the other state.

¹⁸⁹ *ADT v Bolivia* (n 137) para 206 – 323.

*regulatory and legal environment in terms, for example of taxation or the substantive law of the jurisdiction, including the availability of a BIT*¹⁹⁰

However, not all tribunals take this perspective. In the case of *Tokios Tokeles*¹⁹¹ while the majority of the arbitrators accepted the corporate nationality of the investor owned by ‘home state nationals’ the President of the tribunal Professor Prosper Weil strongly dissented from the majority. While the majority held that ‘the ICSID Convention contains no inchoate requirement that the investment at issue in a dispute have an international character in which the origin of the capital is decisive’¹⁹², and as such the ‘Convention had not been used for purposes for which it was clearly not intended’.¹⁹³ Professor Weil emphasized that the purpose of the ICSID Convention was to govern ‘international’ investments, that is, investments characterised by a trans-border movement of capital rather than investment disputes between a country and its citizens¹⁹⁴

In *Phoenix Action Ltd v. Czech Republic*¹⁹⁵, the original dispute was between the Czech State and a local investor. While the dispute was ongoing, the Czech investor tried to acquire Israeli nationality by selling the investment to an Israeli company, Phoenix, which had been established for that purpose. The ‘new’ investor shortly after the transfer commenced ICSID arbitration relying on the BIT between Israel and the Czech Republic. The tribunal found that it had no jurisdiction *ratione temporis* to

¹⁹⁰ Ibid, para 330(d).

¹⁹¹ *Tokios Tokeles v Ukraine* (n 91).

¹⁹² Ibid, para 82.

¹⁹³ Ibid, para 39.

¹⁹⁴ See Dissenting Opinion of Professor Prosper Weil, 29 April, 2004, para 19.

¹⁹⁵ *Phoenix Action Ltd v Czech Republic*, ICSID Case No. ARB/06/5, Award, 15 April, 2009. Hereafter, *Phoneix v Czech*.

consider claims that had arisen prior to the alleged investment by the Israeli company.¹⁹⁶

Similarly in the case of *Banro American Resources, Inc. and Société Aurifère du Kivu et du Maniema S.A.R.L. v. Democratic Republic of the Congo*¹⁹⁷, the claim arose from an investment agreement between The Democratic Republic of Congo and Banro Resource a Canadian company and contained an ICSID clause. Subsequently, a dispute arose between the parties and Banro Resource transferred its assets to Banro American, as Canada was not a party to the ICSID Convention. The tribunal found that the investor was not a national of the contracting party to the ICSID at the time the agreement was entered into by the parties. Applying the principle of *nemo plus iuris transferre ipse habet*, the tribunal held that Banro could not effectively assign its claim to a US subsidiary that had not entered in to an arbitration agreement with the respondent state¹⁹⁸ in order to bypass the effect of jurisdiction.¹⁹⁹

¹⁹⁶ Ibid, para 142. According to the tribunal:

“ The evidence indeed shows that the Claimant made an “investment” not for the purpose of engaging in economic activity, but for the sole purpose of bringing international litigation against the Czech Republic. This alleged investment was not made in order to engage in national economic activity, it was made solely for the purpose of getting involved with international legal activity. The unique goal of the “investment” was to transform a pre-existing domestic dispute into an international dispute subject to ICSID arbitration under a bilateral investment treaty. This kind of transaction is not a bona fide transaction and cannot be a protected investment under the ICSID system”. Expressing strong sentiments against the action of the investor, the tribunal further added:

“ The conclusion of the Tribunal is therefore that the Claimant's initiation and pursuit of this arbitration is an abuse of the system of international ICSID investment arbitration... It is indeed the Tribunal's view that to accept jurisdiction in this case would go against the basic objectives underlying the ICSID Convention as well as those of bilateral investment treaties. The Tribunal has to ensure that the ICSID mechanism does not protect investments that it was not designed for to protect, because they are in essence domestic investments disguised as international investments for the sole purpose of access to this mechanism”. See para 143 and 144.

¹⁹⁷ *Banro American Resources, Inc. and Société Aurifère du Kivu et du Maniema S.A.R.L. v. Democratic Republic of the Congo*, ICSID Case No. ARB/98/7, Award of the Tribunal of September 1, 2000. Hereafter *Banro v Congo*.

¹⁹⁸ Ibid, see para 6.

¹⁹⁹ See, Christoph Schreuer, ‘Nationality Planning Under International Investment Law’ in Arthur W Rovine (Ed) *Contemporary Issues in International Arbitration and Mediation: The Fordham Papers 2012* (Martinus Nijhoff Publishers 2013) 1.

In the case of *Cementownia "Nowa Huta" S.A v Republic of Turkey*²⁰⁰ the claimant was a Polish company that claimed to have acquired two Turkish companies. However, the alleged transfers took place only twelve days before Turkey terminated concession agreements. The claimants argued that Turkey had breached its obligations under the ECT. The tribunal found that the share transfer purported to have taken place between the Turkish companies and the Polish company were fabricated and never actually took place.^{201 202}

The position in this regard seems to be that while investment tribunals consider nationality planning as a common practice in international business, the timing and motive of such structuring or restructuring of investment is a determinant factor. As such, tribunals have expressed their approval for "upstream" structuring of investments in a manner that best fits their need for international protection, however, tribunals usually do not seem to condone attempts by investors to modify "downstream" the protection once the acts damaging to the investment have already been committed.²⁰³

²⁰⁰*Cementownia "Nowa Huta" S.A v Republic of Turkey*, ICSID Case No. ARB(AF)/06/2, Award, 17 September, 2009, hereafter *Cementownia v Turkey*.

²⁰¹ *Ibid*, para 156.

²⁰² Commenting on the attempt of the claimant to gain access to the benefits of the ECT, the tribunal noted: *"This...is unabashedly treaty shopping. As other tribunals have found, treaty shopping per se is not in principle to be disapproved of, but in some instances it has been found to be a mere artifice employed to manufacture an international dispute out of a purely domestic dispute. Given the dispute's history and the temporal aspects of the case (a mere twelve days elapsed between the claimed acquisition of shares in companies already on notice of potential termination of the concessions and the actual termination measures themselves), had the Tribunal found that the share transfers actually did occur on May 30, 2003, it would have held that this case fell within the category of an artifice. Even if they did occur, the share transfers would not have been bona fide transactions, but rather attempts (in the face of government measures dating back some years about to culminate in the concessions' termination) to fabricate international jurisdiction where none should exist."* *Ibid*, para 117.

²⁰³ *Phoenix v Czech* (n 195) para 94, 95. These expressions are used to delineate the timing of investment structuring and restructuring. The term 'upstream' is used in reference to investment structurings before the relevant dispute arose, while the term 'downstream' refers to restructurings made close to, during or after the relevant dispute.

This position was clearly expressed in the case of *Mobil Corporation Holdings B.V et al v Venezuela*²⁰⁴ in the case, Exxon Mobil had made investments in Venezuela through Delaware and Bahamian holding companies. After disagreements on royalties and income tax, Exxon Mobil restructured its investments in two oil production projects by interposing a holding company incorporated under the law of the Netherlands, which in turn owned 100% of the Delaware and Bahamian companies. Subsequently, Venezuela took nationalisation measures, upon which Exxon Mobil initiated a claim under the ICSID relying on the BIT between the Netherlands and Venezuela. Commenting on the restructuring, the tribunal observed that while the restructuring could be legitimate, it depends on the circumstances in which it happened.²⁰⁵

The tribunal in making its decision found the timing of the restructuring by Mobil to be a decisive factor. In reaching its conclusion, the tribunal distinguished the royalty payment and income tax dispute, which arose before the restructuring from the nationalization dispute which arose after the restructuring. Commenting on this distinction and its effect on the tribunal's view on corporate structuring, it opined:

“ the aim of the restructuring of their investments in Venezuela through a Dutch holding was to protect those investments against breaches of their rights by the Venezuelan authorities by gaining access to ICSID arbitration

²⁰⁴ *Mobil Corporation Holdings B.V et al v Bolivarian Republic of Venezuela*, Decision on Jurisdiction, ICSID Case No. ARB/07/27, 10 June 2010. Hereafter, *Mobil v Venezuela*.

²⁰⁵ The tribunal stated:

“it appears to the Tribunal that the main, if not the sole purpose of the restructuring was to protect Mobil investment from the adverse Venezuelan measures in getting access to ICSID arbitration through the Dutch – Venezuelan BIT. Such restructuring could be ‘legitimate corporate planning’ as contended by the Claimants or an ‘abuse of right’ as submitted by the Respondents. It depends upon the circumstances in which it happened.” Ibid, paras 190,191.

*through the BIT. The Tribunal considers that this was a perfectly legitimate goal as far as it concerned future disputes.*²⁰⁶ (Emphasis added)

Conversely, the tribunal held with regard to disputes which existed before the restructuring:

*“ With respect to pre-existing disputes, the situation is different and the Tribunal considers that to restructure investments only in order to gain jurisdiction under a BIT for such disputes would constitute, to take the words of the Phoenix Tribunal, “an abusive manipulation of the system of international investment protection under the ICSID Convention and the BITs.”*²⁰⁷

Applying the principle of abuse of right, the tribunal dismissed Mobil’s claim to the extent that it concerned ‘any dispute born before’ the restructuring.²⁰⁸ This position of the tribunal is trite. In preventing the use of corporate nationality as a tool merely for accessing BIT protection after the fact, the tribunal effectively delimited the use of international investment law and arbitration in a way that is unrepresentative the essence of this area of law.²⁰⁹

2.3. Conclusion

Most investment treaties under the international investment law regime contain broad notions of “investor” and “investment”. With definitions of investment which

²⁰⁶ Ibid, para 204.

²⁰⁷ Ibid, para 205.

²⁰⁸ Ibid, para 206.

²⁰⁹ The question of the potential role and effectiveness of the doctrine of abuse of right and procedure in limiting treaty shopping in international investment law and arbitration is further explored in the next chapter.

go beyond foreign direct investment to include 'every kind of asset', effectively widening the scope of these treaties. In the same manner investment treaties through their definitions of investor, particularly through the covering of not just natural persons, but also corporate persons, who own or control investments directly and more importantly "indirectly" has provided avenues through which intermediary companies, with or without tenuous links with their home states, owned or controlled by nationals of third countries or nationals of the host state itself are able to hide under the corporate veil and gain access to investment treaty protection.

With the relative ease of fulfilling nationality requirements particularly the incorporation and seat of control criteria; coupled with the largely strict and formalistic interpretative stance taken by most international investment tribunals, nationality as a gatekeeper in prescribing a limitation on the accessibility of investment treaty protection has been described as having become increasingly irrelevant.

However, the purpose of international investment law – the protection and promotion of 'foreign' investment for economic development – and the relative cost borne by states in the limitation of their sovereignty and regulatory powers. Evident in the elevation of the property rights of the 'foreign' investor over and above the welfare of its citizens and in the conflict between the investor's rights and the host state's health, environmental, technological and other public policies. The bypassing of the host state's regulatory system regardless of whether or not they are capable of delivering justice; the elevation of contractual agreements to international contracts covered by investment treaty disputes resolution mechanisms even where such contracts do not contain such dispute resolution clauses; and the latitude given to investors to structure their investments and bring their claims through convenient

forums²¹⁰ among others; demands at least a genuine and effective link between the investor and the home state.

The embrace of the control criterion by more state parties and their reactions to the issue of treaty shopping in international investment law casts a doubt on the claim that the origin of capital in international investment law is of no relevance. While a number of state parties particularly developing capital-importing states may have signed investment treaties which allow for the extension of treaty coverage to investors such states did not have in mind when concluding such treaties - the refusal by states to accept the practice as an avenue for the 'multilateralisation of investment law through a bilateral regime' suggests that reaching conclusions as to the (in)effectiveness of nationality provisions in the regime might be denying the existence of indices to the contrary. Without conceding, however, assuming such is the case, the picture painted is one lacking consensus among contracting parties in the regime, casting a doubt on the nature of the emerging 'multilateral' structure through the vehicle of treaty shopping among others.

The question to be considered, therefore, has shifted from the analysis of the effectiveness of nationality requirements in international investment treaties to a study and analysis of the reaction of state parties to the laxity of the presently prevalent requirements. This requires an identification of the arguments presented by states and other stakeholders on the practice and their underlying justifications, an objective consideration of the measures employed in remedying the laxity, and most importantly (within the sphere of this work) the effectiveness of the measures and mechanisms employed.

²¹⁰ See Gus Van Harten, 'Five Justifications for Investment Treaties: A Critical Discussion', (2010) 2(1) Trade, Law and Development, 1.

This is more crucial when weighing the position that treaty shopping practice in international investment law and arbitration is not considered illegal as such. This, however, can be considered as a stance that is held largely due to the implied acceptance or encouragement of the practice as a product of the silence of most investment treaties on the practice. Consequently, therefore, where state parties expressly deny such a practice in their treaties on investment, a different perspective on the relevance of nationality and by extension the place of treaty shopping in international investment law and arbitration is imperative.

Chapter Three

Towards Limiting Treaty Shopping in International Investment Law and Arbitration

3. Introduction

The particular purposes and contexts which inspire and within which bilateral investment treaties (BITs) and other International Investment Agreements (IIAs) are signed are arguably peculiar and distinct to the contracting parties involved. Reasons for the signing of these agreements can range from being part of the ceremonial activities of a state visit, to the desire to follow in the policy footsteps of other nations¹ among others. In other words, the prevailing conditions and motivations for which many of these agreements have been entered into are as multifarious as the agreements themselves.

However, regardless of these subjective peculiarities, the primary purpose of these agreements is generally accepted to be the protection and promotion of foreign investments between or among the parties.² Specifically and as argued in chapter two, this should be understood to culminate in the ultimate purpose and objective of global economic development, peace and security.³ That is, from a 'teleological' and holistic perspective, the proposition is held that international investment law, through the vehicle of BITs and IIAs is in its truest sense a means to an end and not an end in itself.

¹ Srividya Jandhyala, Witold Henisz and Edward Mansfield, 'Three Waves of BITs: The Global Diffusion of Foreign Investment Policy' (2011) 55(6) *Journal of Conflict Resolution* 1047; Andrew Guzman, 'Why LDCs Sign Treaties That Hurt Them: Explaining the Popularity of Bilateral Investment Treaties' (1998) 38 *Va.J Int'l L* 639.

² See generally, Rudolf Dolzer and Christoph Schreuer, *Principles of International Investment Law* (2nd edn, OUP 2012).

³ Rafael Leal – Arcas, 'A New Era in Global Economic Governance' (2009) 1 *International Security Forum* 1.

In other words, the promotion and protection of foreign investments in the territory of the host state is not a self-serving objective. Rather, it is to be perceived as a 'feeder' strategy of sorts designed to climax in global economic prosperity, peace and development. This position it is argued, effectively captures the economic, political and legal motivations for state parties, particularly developing, capital importing states to shoulder the obligations imposed by these agreements and the attendant restraint on the exercise of their sovereignty and regulatory autonomy.⁴

Being legal frameworks operating specifically between or among an identifiable number of contracting states, BITs and other IIAs necessarily possess a nature of legal exclusivity. That is, the rights, obligations and benefits which subsist and accrue under these agreements are intended by the parties to be only applicable to persons or entities whom they agree to grant these benefits. As such, state parties assume obligations under these agreements on the strength of the belief that the investments of their nationals will be protected to an equal extent under the framework of the relevant IIA in the territory of the other contracting party.

This in turn creates a mutual and corresponding equality of the 'sovereignty cost'⁵, between the parties. That is, the restrictions on the sovereign and regulatory powers of the host state in ensuring the protection of foreign investments in its territory shouldered by the contracting parties. With this uniformity of sovereignty cost, states are able to share and preserve the reciprocity inherent in nature of these

⁴ See Peter Muchlinski 'Holistic Approaches to Development and International Investment Law : The Role of International Investment Agreements' in Julio Faundez and Celine Tan (Eds) *International Economic Law, Globalisation and Developing Countries* (Edward Elgar Publishing Limited 2010) 180.

⁵ This term is coined to represent the limitations in the exercise of sovereign and regulatory powers by state parties in keeping to the terms of BITs and IIAs they have entered into. Not least of these are the issues of restrictions on expropriation and submission to investment arbitration by investors under relevant investment state dispute mechanisms (ISDM) under such agreements as well as the attendant implications, which state parties have to forego or technically give up in exchange of the promise or potential attraction of foreign investment.

agreements. However, where third party nationals or nationals of the host state (where originally disallowed) through the practice of treaty shopping gain access to the benefits of these agreements outside of the contemplation of the parties, this increases the 'sovereignty cost' incurred by the parties without any commensurate cost or sacrifice on the part of the country of such third party investor(s).

In responding to the issue of treaty shopping in international investment law, contracting parties have therefore resorted to the use of a couple of measures in preventing the practice. This chapter focuses on a consideration of these measures, notably, the abuse of right doctrine and the denial of benefits (DOB) clause. The chapter will engage a review and analyses of these measures and their potential in effectively limiting treaty shopping in international investment law and arbitration.

3.1. The Abuse of Right / Process and the Limitation of Treaty Shopping in international Investment Law and Arbitration.

Respondent state parties have increasingly resorted to the use of the abuse of right or process doctrine in contesting the validity and legality of the structuring or restructuring of investments by investors to access the benefits of a BIT or IIA.⁶ Consequently, investment tribunals have had to consider in what instances corporate structuring or restructuring constitute an abuse of right or process. As will be shown, central to the decision of investment tribunals on whether or not a corporate structuring was done *mala fide* is the question of when the structuring or restructuring was done, the intent of the purpose of the restructuring as well as

⁶ Jorun Baumgartner, *Treaty Shopping in International Investment Law* (OUP 2016) 203; Mark Feldman, 'Setting Limits on Corporate Nationality Planning in Investment Treaty Arbitration' (2012) 27 (2) ICSID Rev 281.

actuality or foreseeability of an investment claim by the investor.⁷ However, these lines of inquiry as to whether or not an investment restructuring or nationality change was done in good faith or not are fraught with difficulties which in turn impact on the desirability of the abuse of right doctrine as a choice mechanism for the limitation of treaty shopping in international investment law and arbitration.

3.2. The Doctrine of Abuse of Right/Process.

The doctrine of abuse of right/process is a principal expression of the principle of good faith; one widely accepted as a general principle of law and as part of customary international law.⁸ Regardless, the nature and character of the doctrine is one which has been considered by scholars through the lens of different perspectives with respect to what constitutes and abuse of rights.

First, one of such notions is that which holds, that on the premise of a "right being the protection of a legitimate interest, an attempt to engage such legal protection in a manner which is malicious, arbitrary or fictitious or one designed to the intent of bringing injury to another or for the purpose of escaping a contractual obligation or rendering a rule of law ineffectual, even where such an exercise does not expressly constitute the violation of the right of another is prohibited as an abuse of right".⁹

⁷ Ibid.

⁸ Marion Panizzon, *Good Faith in the Jurisprudence of the WTO* (Hart Publishing 2006) 30; Robert Kolb, *La Bonne Foi en Droit International Publique* (Presses Universitaires de France 2000) 463; Bin Cheng, *General Principles of Law as Applied by International Courts and Tribunals* (Stevens and Sons 1953) 121; Hersch Lauterpatcht, *The Function of Law in the International Community* (Clarendon Press 1933) 298; Michael Byers 'Abuse of Rights: An Old Principle, A New Age' (2002) 47 McGill. L. J 391 397.

⁹ Bin Cheng, *General Principles of Law as Applied by International Courts and Tribunals* (Stevens and Sons 1953) 122 – 123.

Second, another approach to the doctrine of abuse of rights is one which holds, that on the basis of the interdependent nature of the relationship between rights and obligations, “where the exercise of a right would impinge on an obligation assumed, that right must be exercised reasonably and in good faith”.¹⁰ As such, the doctrine of abuse of right, ‘while protecting the legitimate interests of the owner of the right, imposes such limitations upon the right as will render its exercise compatible with that party’s treaty obligations, or, in other words, the legitimate interests of the other contracting party’.¹¹

Third, and equally worthy of note, is the perception of the abuse of rights doctrine in the light of procedural aspects. According to Robert Kolb, abuse of process:

*“consists of the use of the procedural instruments or rights by one or more parties for purposes that are alien to those for which the procedural rights were established, especially for a fraudulent, procrastinatory or frivolous purpose, for the purpose of causing harm or of obtaining an illegitimate advantage of some other available process or for the purpose of reducing or removing the effectiveness of some other available process or for the purposes of pure propaganda. To these situations, action with a malevolent intent or with bad faith can be added.”*¹²

¹⁰ Baumgartner (n 6) 205.

¹¹ Cheng (n 9) 124.

¹² Robert Kolb, ‘General Principles of Procedural law’ in Andreas Zimmermann, Christian Tomuschat and Karin Oellers – Frahm (Eds), *The Statute of the International Court of Justice : A Commentary* (2nd edn, OUP 2012) 904; see also John Gaffney, ‘Abuse of Process in Investment Treaty Arbitration’ (2010) 11JWIT 515, 518.

It is evident from the above, that the operation of the doctrine of abuse of rights is one which is engaged in instances where the exercise of a legal interest is found to go 'against certain social or legal conventions'¹³

It is against the backdrop of these that contracting parties as respondents have resorted to the use of the abuse of right doctrine in contesting the validity of corporate structuring and restructuring which culminates in giving the claimant access to bring a claim under a BIT or IIA. Consequently, investment tribunals are saddled with the responsibility of analysing the factual aspects of each case in seeking to determine whether or not the legal interest of the claimant is barred by the doctrine of abuse of right/process.

In the quest to determine whether or not an investment restructuring constitutes an abuse of right, investment tribunals have developed three tests as a means of deciphering the validity or otherwise of the corporate restructuring. These are; the consideration of the motive behind the action of the investor; second, the timing of the transaction or restructuring in question; and third, whether or not a dispute was foreseeable at such a time.

3.2.1. The Abuse of Right/Process Principle by Investment Tribunals

In the case of *Cementownia v Turkey*¹⁴, the investment tribunal was saddled with the consideration of determining whether the purported corporate restructuring

¹³ Baumgartner (n 6)) 205.

¹⁴ *Cementonia "Nowa Huta" SA v Republic of Turkey*, ICSID Case No ARB(AF)/06/2, Award, 17 September 2009.

amounted to an abusive form of treaty shopping. In its analysis of the case, the tribunal considered the issue of the timing of the restructuring.^{15 16}

Similarly, in the case of *Phoenix Action v Czech Republic*¹⁷ the tribunal also considered the issue of timing in its deliberations. In its view, the tribunal noted:

*“ According to ICSID case law, a corporation cannot modify the structure of its investment for the sole purpose of gaining access to ICSID jurisdiction, after damages have occurred. To change the structure of a company complaining of measures adopted by a State for the sole purpose of acquiring an ICSID claim that did not exist before such change cannot give birth to a protected investment”*¹⁸

Highlighting what it considered to be its responsibilities, the tribunal further stated:

“ The Tribunal is concerned here with the international principle of good faith as applied to the international arbitration mechanism of ICSID. The Tribunal has to prevent an abuse of the system of international investment protection under the ICSID Convention, in ensuring that only investments that are made

¹⁵ According to the tribunal: *“The date of 12 June 2003 assumes importance in the tribunal’s consideration of the claimed transaction, because that is the date on which the measures complained of culminated with the termination of the concession...The timing of the claimed transaction is important because for any share transfers, the purchaser would be deemed to be aware of the reduction in value in shareholdings resulting from the acts of termination.”* Ibid, para 122.

¹⁶ Pointing out that the intention behind the restructuring on the part of the claimant was for the protection of its interests, the tribunal further observed: *“ This, if true, is unabashedly treaty shopping...treaty shopping per se is not in principle to be disapproved of, but in some instances it has been found to be a mere artifice employed to manufacture an international dispute out of a purely domestic dispute. Given the disputes history and the temporal aspects of the case (a mere twelve days elapsed between the claimed acquisition of shares in companies already on notice of potential termination of the concessions and the actual termination treasures themselves).”* Ibid, para 117.

¹⁷ *Phoenix Action Ltd v Czech Republic*, ICSID Case No ARB/06/5, Award, 15 April 2009.

¹⁸ Ibid, para 92.

in compliance with the international principle of good faith and do not attempt to misuse the system are protected.”¹⁹ (Emphasis in original text)

In its conclusion, the tribunal found that on its examination and analysis of all the elements of timing of the investment and claim, the nature of the transaction,²⁰ the actions of the claimant were motivated by the desire to ‘transfer’ a national dispute ‘from the domestic arena to the international scene’.²¹ According to the tribunal, ‘to accept jurisdiction...would go against the basic objectives underlying the ICSID Convention as well as those of bilateral investment treaties’²²

Also noteworthy on the issue is the case of *Mobil v Venezuela*²³. Set against the backdrop of resource nationalism in Venezuela, particularly the introduction of laws and measures aimed at a stricter regulation of the hydrocarbons sector, the case centred on the lawfulness of the claimant’s insertion of a new corporate entity under the laws of the Netherlands, into its investment ownership structure, which then became the new indirect owner of the investments in the host state.²⁴

Looking in to the question of abuse of rights raised by the respondents, the tribunal considered the issue of motive. The tribunal observed:

“The main if not the sole purpose of the restructuring was to protect Mobil Investment from adverse Venezuelan measures in getting to ICSID arbitration through the Dutch – Venezuela BIT. Such restructuring could be ‘legitimate corporate planning’ as contended by the Claimants or an ‘abuse of rights’ as

¹⁹ Ibid, para 113.

²⁰ Ibid, 143.

²¹ Ibid, 144.

²² Ibid.

²³ *Mobil Corporation, Venezuela Holdings BV, Mobil Cerro Negro Holding Ltd, Mobil Venezolana de Ptroleos Holdings Inc, Mobil Cerro Negro, Ltd, and Mobil Venezolana de Petroleos, Inc v Bolivarian Republic of Venezuela*, ICSID Case No ARB/07/27, Decision on Jurisdiction, 11 June 2010.

²⁴ Ibid, paras 19, 23, 24.

submitted by the Respondents. It depends upon the circumstances in which it happened”²⁵

In its consideration of the circumstances, the tribunal concluded that the restructuring undertaken by the claimant was to protect its investment against breaches of their rights by Venezuelan authorities by gaining access to ICSID arbitration through the BIT. In the tribunals view:

“This was a perfectly legitimate goal as far as it concerned future disputes. With respect to pre – existing disputes, the situation is different and the Tribunal considers that to restructure investments only in order to gain jurisdiction under a BIT for such disputes would constitute, to take the words of the Phoenix Tribunal, ‘an abusive manipulation of the system of international investment protection under the ICSID Convention and the BITs’²⁶

In the case of *Tidewater v Venezuela*²⁷ a case also bordering on resource nationalism in Venezuela, the claimant restructured its investment by its incorporation of a new entity under the laws of Barbados, which then became the indirect owner of the locally incorporated investment. Making reference to Article 8(1) of the Barbados – Venezuela BIT under which the dispute was brought, which provides that a dispute ‘between a Contracting Party and a national or company of the other Contracting Party’, the tribunal noted that the claimant could not expect to obtain protection for pre-existing disputes. Having established this, the tribunal turned to the question of the foreseeability of the dispute.

²⁵ Ibid, para 190 ,191.

²⁶ Ibid, para 204 ,205.

²⁷ *Tidewater Inc, Tidewater Investment SRL, Tidewater Caribe, C A, Twenty Grand Offshore. LLC, Jackson Marine LLC and Zapata Gulf Marine Operators, LLC v Bolivarian Republic of Venezuela*, ICSID Case No ARB/10/5, Decision on Jurisdiction, 5 February, 2013.

After a review of the facts, the tribunal observed that a nationalization of the investment was not ‘imminent’ and as such not foreseeable.²⁸ Central to the tribunal’s position on this point is the fact that the claimants had been in business in Venezuela for the past fifty years, that they continued to invest in the host country and that the Reserve Law had been enacted without any warning in just over three days.²⁹ It is worthy of note, that this conclusion was reached by the tribunal in the face of the fact that assets of another company was seized earlier in the year and there were possible signs of nationalization of the company’s assets.³⁰ With this, the tribunal dismissed the objections raised by the respondent and assumed jurisdiction over the claims.

In the case of *Philip Morris v Australia*³¹ the tribunal considered the issue of abuse of rights. Particularly, the tribunal looked into the issue of the foreseeability of an investment dispute and whether it was of significance in the decision of the claimant to restructure its investment. According to the tribunal:

“The initiation of a treaty based investor-State arbitration constitutes an abuse of rights (or abuse of process, the rights abused being procedural in nature) when an investor has changed its corporate structure to gain the protection of an investment treaty at a point in time when a specific dispute was foreseeable, ... a dispute is foreseeable when there is reasonable prospect, as stated by the Tidewater Tribunal that a measure which may give rise to a treaty claim will materialize”³²

²⁸ Ibid, para 194.

²⁹ Ibid, para 194 , 196.

³⁰ Ibid, para 195.

³¹ *Philip Morris Asia Ltd v Commonwealth of Australia*, UNCITRAL, PCA Case No 2012 – 12, Award on Jurisdiction and Admissibility, 17 December, 2015.

³² Applying this test to the facts before it, the tribunal noted that the claimant:

In its conclusion, the tribunal stated that it was ‘not persuaded that tax or other business reasons were determinative factors³³...the main and determinative, if not sole, reason for the restructuring was the intention to bring a claim under the treaty using an entity from Hong Kong’³⁴

When critically observed, it is evident that a thread that runs through these tests is the question and nature of subjectivity they possess. Taking the test of the investors’ motive for example, this test inherently falls within a subjective sphere. Determining the reason why the investor restructured its investment is one which arguably falls largely within the purview of the investor. As such, “making them – in particular in absence of a clear admission of the (real) reasons for the transaction – difficult to establish in an objective, respectively objectifiable manner”.³⁵

Similarly the determination of the claimant’s knowledge of the existence or foreseeability of a dispute and the understanding of what constitutes a dispute are elements of these tests which have been described as placing “too much emphasis on the investor horizon and lacks an objective element that may be needed as a corrective to avoid abuse”³⁶

Added to the issue of subjectivity, is the question of the disparity in the analysis and application of these tests by investment tribunals. Where these tests have been

“As early as 2009, it had informed the Australian Government that plain packaging would interfere with its property rights and its internal memoranda made it clear that it was considering the matter in legal terms. On 29 April 2010, Australia’s Prime Minister Rudd and Health Minister Roxon unequivocally announced the Government’s intention to introduce Plain Packaging Measures. In the Tribunal’s view, there was no uncertainty about the Government’s intention to introduce plain packaging as of that point. Accordingly, there was at least a reasonable prospect that legislation equivalent to the Plain Packaging Measures would eventually be enacted, which would trigger a dispute. The Tribunal is not convinced that political developments after 29 April 2010 were such that the Claimant could reasonably conclude that the enactment of the Plain Packaging measures and the ensuing dispute were no longer foreseeable.” Ibid, para 554.

³³ Ibid, para 582.

³⁴ Ibid, para 584.

³⁵ Baumgartner (n 6) 206.

³⁶ Ibid, 226.

engaged as seen in the above mentioned cases, there still remains a manifest disparity in the perspectives and application of these tests by investment tribunals. Thus making the doctrine of abuse of rights / process and its application as a tool for determining and limiting treaty shopping, not just being subjective in essence, but also unpredictable in its engagement. This in turn places the abuse of right / process doctrine in the least desirable of positions as an objective and predictable mechanism for limiting treaty shopping.

Accordingly, commentators have argued that the DOB clause has the capacity and potential to offer a more predictable and comprehensive protection against treaty shopping than the “nebulous” good faith principles and its strains of abuse of right and process.³⁷ This preference is largely the result of the view that the basis of the DOB clause in treaty text accords it a better standing to operate in a more objective, predictable and uniform way than the abuse of right and process doctrine.

Consequently, therefore, the question turns on whether or not the DOB clause is indeed an effective measure in limiting treaty shopping in international investment law and arbitration. However, before attempting to answer this question, it is important to understand and appreciate the origin, evolution and purpose of the DOB clause in our attempt to measure its effectiveness. It is to this preliminary analysis that the rest of this chapter turns to.

³⁷ See generally John Lee, ‘Resolving Concerns of Treaty Shopping in International Investment Arbitration’ (2015) 6 *Journal of International Dispute Settlement* 355; Xiao – Jing Zhang, ‘Proper Interpretation of Corporate Nationality under International Investment Law to Prevent Treaty Shopping’ (2013) 6(1) *Contemp. Asia. Arb. J* 49; Mark Feldman, ‘Setting Limits on Corporate Nationality Planning in Investment Treaty Arbitration’ (2012) 27(2) *ICSID Rev* 281, 302.

3.3. The Denial of Benefits Clause in Perspective

In response to the growing use of treaty shopping by corporate investors, particularly multinational companies to gain access to treaty benefits, states have recently employed the use of the DOB clause as a counteracting measure.³⁸ The insertion of the clause into an increasing number of investment agreements is an attempt by states to create a balance against the broad definition of ‘investor’ many of their investment agreements contain. Functionally, the DOB provisions give host states ‘the authority to effectively carve out from the definition of “investor” shell companies owned by nationals of a third country or the host state and companies owned by enemy aliens’³⁹.

3.3.1. Evolution of the Clause

While the DOB clause has recently become a subject of interest in legal and other circles, the existence of the clause dates farther back. Early versions of the DOB clause appear in the modern Friendship, Commerce and Navigation (FCN) treaties signed by the United States following World War II.⁴⁰ Under these treaties, contracting parties could deny the benefits of the treaty to companies which were owned or controlled by nationals of third countries.

³⁸ Dolzer and Schreuer described the clause as one of the methods states have devised to counteract strategies that seek the protection of particular treaties by acquiring a favourable nationality. See Dolzer and Schreuer, (n 2) 55.

³⁹ Barton Legum, ‘Defining Investment and Investor: Who is Entitled to Claim?’ (2006) 22 *Arb Intl* 521,524 - 525.

⁴⁰ Kenneth Vandeveld, ‘The Bilateral Investment Treaty Program of the United States’ (1981) 21 *Cornell Intl L J* 202, 206.

For example, under the US – Republic of China FCN⁴¹, article XXVI(5) provides that each party reserved the right ‘to deny any of the rights and privileges accorded by this Treaty’ to any ‘corporation or association’ that was ‘directly or indirectly owned or controlled by...nationals, corporations, or associations of any third country or countries’. In a similar language, The US – Japan FCN⁴² provides in article XXI (1)(e) :

(1) The present Treaty shall not preclude the application of measures...

(e) denying to any company in the ownership or direction of which nationals of any third country or countries have directly or indirectly the controlling interest, the advantages of the present Treaty.

The success of European countries in signing BITs saw the US stripping its FCN agreements to the core investment provisions.⁴³ This development led to the inclusion of the DOB clause in the first set of BITs negotiated by US with other states from 1989 to 1992.⁴⁴ Each of these contained a DOB clause. Generally, these clauses give a reserved right to both countries to deny the benefits of the treaty to ‘any company of either party,’ or ‘or any of its own companies or companies of the other party’, ‘if nationals of any third country control such a company’. This establishes a single criterion across board, that is, the control of a company by the

⁴¹ Treaty of Friendship, Commerce and Navigation between the United States of America and the Republic of China. Signed 4 November 1946, entered into force 30 November, 1948.

⁴² Treaty of Friendship, Commerce and Navigation between the United States of America and Japan. Signed on April 2, 1953, entered into force 30 October, 1953. Similar provisions are contained in the Thailand – U.S Treaty of Amity and Economic Relations, signed on May 29, 1966, art XII(1)(f). See also, Treaty of Amity and Economic Relations between the United States of America and the Togolese Republic, signed February 8, 1966.

⁴³ About the time the US ‘FCN’ programme was winding down, several European countries were beginning to negotiate new bilateral investment agreements with a large number of developing and developed countries. While the US FCN treaties covered a range of issues besides investment, these bilateral investment treaties were solely concerned with investment protection. It did not take long for the US business community and Congress to agitate for an investment treaty programme similar to that of the Europeans. See, Vandeveld, (n 40) 202, 210.

⁴⁴ These are BITs concluded by the US with Egypt, Senegal, Grenada, Morocco, Turkey, Cameroun and Bangladesh.

national(s) of a third state. The only exception is the BIT with Grenada which in addition to the first leg provides that:

*'...and, in the case of a company of the other Party, that company has no substantial business activities in the territory of the other Party or is controlled by nationals of a third country with which the denying Party does not maintain normal economic relations.'*⁴⁵(Emphasis added)

This use of the word 'and' before the second leg, establishes that both the first and second leg in the case of a company of the other contracting party be taken conjunctively.

However, the second leg provides a disjunctive set of circumstances in itself, as it creates two scenarios, exclusive of each other, under which advantages of the treaty can be denied. Therefore, first, such a company of the other contracting party is controlled by the nationals of a third country 'and' does not conduct 'substantial business activities in the territory of the other party'⁴⁶. Alternatively, and relating in particular to the third country in question, that such a company is 'controlled by nationals of a third country with which the denying Party does not maintain normal economic relations'

While the other DOB clauses in the other BITs do not contain this requirement, they contain a notification requirement. Taking the US – Senegal BIT⁴⁷ as a sample, where a party decides to deny benefits to a company on the basis of its control by the national of a third State, the denying party is required to 'promptly consult with

⁴⁵ See, The Treaty between the United States of America and Grenada concerning the reciprocal encouragement and protection of investment. Signed May 2, 1986; entered into force March 3, 1989, art 1(2).

⁴⁶ A term which was left undefined in the text of the treaty (and still undefined in more recent treaties).

⁴⁷ See, The Treaty between The United States of America and The Republic of Senegal Concerning the Reciprocal Encouragement and Protection of Investment. Signed December 6, 1983, entered into for October 25, 1990, art 1(b) (ii).

the other party to seek a mutually satisfactory resolution of the matter'. What is meant by the term 'mutually satisfactory resolution' and the mechanism through which such is to be achieved is not stated in the text of the treaties.

A view that can be adopted is that such a mutually satisfying resolution will touch upon deciding on the questions whether or not such a company conducts substantial business activities in the home state and as such has a relevant link with it, and or the third country nationals in control of the company are from such a third state with which the denying party has no economic relations. Therefore unlike the US – Grenada BIT where such questions are left to the discretion of the denying party, the other treaties do not allow for such discretion.

The 1994, 2004 and the more recent 2012 US Model BITs and the treaties modelled on them see the DOB clause taking a more obvious position. In place of a single provision (usually under the article containing definition of terms, particularly the definition of a company), the clause evolved into a full article, which in turn clearly distinguishes the two instances when the advantages of the treaty may be denied to an investor. Using the 2012 Model representatively in this regard, Article 17 of the Treaty provides:

1. *A Party may deny the benefits of this Treaty to an investor of the other Party that is an enterprise of such other Party and to investments of that investor if persons of a non-Party own or control the enterprise and the denying Party:*
 - (a) does not maintain diplomatic relations with the non-Party; or*
 - (b) adopts or maintains measures with respect to the non-Party or a person of the non-Party that prohibit transactions with the enterprise or that would be*

violated or circumvented if the benefits of this Treaty were accorded to the enterprise or to its investments.

a. A Party may deny the benefits of this Treaty to an investor of the other Party that is an enterprise of such other Party and to investments of that investor if the enterprise has no substantial business activities in the territory of the other Party and persons of a non-Party, or of the denying Party, own or control the enterprise.

When considered, it is evident that while the first requirement of this clause relates more to the effect of the existence or otherwise of a political relationship, the second is more of an economic criterion.

Over the years, a growing number of states have also introduced the DOB clause into their treaty agreements. Countries such as Austria,⁴⁸ Canada,⁴⁹ China,⁵⁰ Lebanon,⁵¹ Australia,⁵² New Zealand,⁵³ Korea,⁵⁴ Japan⁵⁵ and Mexico⁵⁶ have bilateral

⁴⁸ See Agreement between the Government of Australia and the Government of the United Mexican States on the Promotion and Reciprocal Protection of Investments Article 2(2). Signed August 23, 2005, entered into force 21 July, 2007.

⁴⁹ See, Agreement between the Government of Canada and the Government of The Republic of Costa Rica for the Protection and promotion of Investments. Signed 18 March 1998, entered into force 29 September, 1999, annex I, s III (7).

⁵⁰ See, Agreement on Investment of the Framework Agreement on the Comprehensive Economic Cooperation between the Association of Southeast Asian nations and the People's Republic of China. Signed 15 August, 2009, entered in to force 1 January, 2010, art 15.

⁵¹ See, Agreement between the Lebanese Republic and the Republic and the Republic of Austria on the Reciprocal Promotion and Protection of Investments. Signed 26 May, 2001, entered into force 30 September, 2002, art 10.

⁵² See, Agreement between the Government of Australia and the Government of the United Mexican States on the Promotion and Reciprocal Protection of Investments. Signed 23 August, 2005, entered into force 21 July, 2007, art 2(2).

⁵³ See, Agreement Establishing the ASEAN-Australia-New Zealand Free Trade Area. Signed 27 February, 2009, entered into force 1 January, 2010, Ch 11 art 11.

⁵⁴ See, Agreement among the Government of Japan, the Government of the Republic of Korea, and the Government of the People's Republic of China for the Promotion, Facilitation, and Protection of Investment art 22 Signed 13 May, 2012.

⁵⁵ See, Agreement between the Government of the Republic of Korea and the Government of Japan for the Liberalisation, Promotion, and Protection of Investment. Signed 22 March, 2002, entered in to force 1 January, 2003, art 22.

and other investment treaties which contain such clauses.⁵⁷ The influence of the U.S in the negotiation and conclusion of regional and multilateral treaties such as the NAFTA⁵⁸, Energy Charter Treaty⁵⁹, and CAFTA - DR⁶⁰ also strongly suggests the inclusion of the DOB clause in these agreements.

A noteworthy point at this stage is the use of the phrase ‘...deny the advantages of this *part*...’⁶¹ or ‘...deny the benefits of this *chapter*...’⁶² in DOB clauses found in multilateral treaties and FTAs. This is as against the use of the phrase ‘...deny the advantages/benefits of this *Treaty*...’ commonly found in BITs which contain the clause. It is suggested that the reason for this difference in wording is as a result of the structural differences between BITS and other agreements with the latter covering non-investment related areas of relation between and among state parties⁶³. BITs on their part, however, deal exclusively with investment provisions. This difference is arguably the reason why the FTAs and other treaties limit the applicability of the clause only to the section or chapter regulating the investment related issues.⁶⁴

⁵⁶ See, Agreement between the Government of the United Mexican States and the Government of the People’s Republic of China on Promotion and Reciprocal Protection of Investments. Signed 11 July, 2008, entered into force 6 June, 2009, art 31.

⁵⁷ This is not much of a surprise as some of these countries are contracting states with the US in a number of FCN and Free Trade Agreements (FTAs). Canada, Mexico, Korea, Australia and Peru all have FTAs with the US which contain denial of benefits clause.

⁵⁸ North American Free trade Agreement. Entered into force January 1, 1994 (hereafter referred to as NAFTA).

⁵⁹ The Energy Charter Treaty. Signed on December 17, 1991 (hereafter referred to as the ECT).

⁶⁰ The Dominican Republic – Central America Free Trade Agreement. Signed 28 May 2004, entered into force 1 January 2009.

⁶¹ See, The ECT, art 17.

⁶² See, CAFTA – DR, art 10:12(2), also NAFTA 1113(2).

⁶³ Taking the Energy Charter Treaty as an example, it not only regulates energy investment, but also trade, transit, competition, environment and dispute settlement.

⁶⁴ Loukas Mistelis and Crina Baltag, ‘Denial of Benefits and Article 17 of the Energy Charter Treaty’ (2009) 113 Penn State Law Review 1306.

This issue was raised in the case of *Plama v Bulgaria*⁶⁵. In considering the effect of articles 17(1) and 26 of the ECT, the tribunal observed that the express terms of Article 17 refer to a denial of the advantages "of this Part", thereby referring to the substantive advantages conferred on the investor under Part III of the ECT. According to the tribunal *"the language is unambiguous; but it is confirmed by the title to Article 17: "Non-Application of Part III in Certain Circumstances"*. Refusing to give effect to the exercise of the DOB clause by the respondent in that case, the tribunal stated that it would "require a gross manipulation of language" for the application of the clause to refer to article 26 in Part V of the ECT.

Similar to the early United States BITs,⁶⁶ the DOB clause as contained in the NAFTA and the CAFTA –DR contains a notification requirement.⁶⁷ Citing Article 1113 of the NAFTA, it provides:

'Subject to prior notification and consultation in accordance with Articles 1803 (Notification and Provision of Information) and 2006 of (Consultations), a party may deny the benefits of this chapter...'

As mentioned earlier, the exercise of the clause in such instances is not left to the sole discretion of the denying state, but prior notice must be given to the other contracting party of which the investor in question asserts to be a national. In a commentary on the NAFTA, it has been suggested that this requirement is 'a safeguard preventing a too hasty decision on the real nationality of an enterprise by

⁶⁵ *Plama Consortium Limited v Republic of Bulgaria*, Decision on Jurisdiction ICSID Case No ARB/03/24, February 8, 2005.

⁶⁶ With the exception of the US-Grenada BIT.

⁶⁷ This approach has also been adopted by Canada. For example, Article 18 of the 2004 Canadian model BIT refers to notification and consultation in accordance with Article 19 of the treaty.

permitting the other Party to provide information about the alleged “sham” corporation...⁶⁸

A provision of similar essence as the DOB clause was also incorporated in the Draft Articles on Diplomatic Protection⁶⁹. Article 9 which deals with the state nationality of a corporation provided for the incorporation test for the determination of the nationality of a company. However, under certain circumstances, regardless of the state of incorporation of a company, a company shall be considered the national of another state where:

‘...the corporation is controlled by nationals of another State or States and has no substantial business activities in the State of incorporation, and the seat of management and the financial control of the corporation are both located in another State, that State shall be regarded as the State of nationality.’⁷⁰

Recently, the ongoing deliberations on the Transatlantic Trade and Investment Partnership Agreement,⁷¹ have raised concerns over the potential impact the agreement is to have in relation to the wide area of trade and other issues it is to cover. One issue arising from such concerns is the scope and definition of an investor under the agreement, particularly the corporate investor. Whilst the views range from the adoption of a broad definition of investor on the one hand, and a restrictive approach on the other, a point which has received affirmation across the

⁶⁸ Meg Kinnear, Andrea Bjorklund and John Hannaford, *Investment Disputes Under NAFTA: An Annotated Guide to NAFTA Chapter 11* (Kluwer Law 2006) 1113-16.

⁶⁹ Draft Articles on Diplomatic Protection, adopted in 2006 by the International Law Commission, available at <http://legal.un.org/ilc/texts/instruments/english/commentaries/9_8_2006.pdf> accessed 16 November 2016.

⁷⁰ *Ibid*, art 9.

⁷¹ The Transatlantic Trade and Investment Partnership (hereafter referred to as TTIP) is an ongoing series of negotiations between the US and the EU on trade, investment etc.

spectrum is the inclusion of a DOB clause by the negotiating parties in the text of the agreement.⁷²

3.3.2. Denial and Limitation of Benefits Clause in International Tax Treaties

Similar BITs and IIAs, tax treaties and are agreements entered into by state parties with the intent of avoiding double taxation and thus allowing for free flow of capital, investments and the promotion of trade between or among parties. Generally, they tend to reduce taxes of one treaty country for residents of the other treaty country in order to reduce double taxation of the same income.⁷³

As is with BITs, ⁷⁴ tax treaties have also been subject to treaty abuse/shopping by beneficiaries outside of the intent of state parties when concluding such treaties. In attempts to curb the practice, state parties employ general over-arching provisions which 'delimit the benefits of the treaty in question to an identifiable set of

⁷² See, European Commission , 'Online public consultation on investment protection and investor-to-state dispute settlement (ISDS) in the Transatlantic Trade and Investment Partnership Agreement (TTIP)' (TTIP Report) COM SWD (2015) 3 final, <http://trade.ec.europa.eu/doclib/docs/2015/january/tradoc_153044.pdf>; Transatlantic Business Council Response to EU consultation on ISDS, page 1, available at <<http://www.transatlanticbusiness.org/wp-content/uploads/2014/05/TABC-Response-to-EU-Consultation-re-ISDS-July-4-2014.pdf>>; Christian Tietje, Trent Buatte, Freya Baetens, Theodora Valkanou and Ecorys Rotterdam , 'The Impact of Investor-State-Dispute Settlement (ISDS) in the Transatlantic Trade and Investment Partnership: Study prepared for: Minister for Foreign Trade and Development Cooperation, Ministry of Foreign Affairs, The Netherlands', (2014) para 210.

⁷³ Arpith Prakash Jain 'Abuse of Tax Treaties and Steps to Curtail such Practices: A brief Analysis of Limitations of Benefits Provision in Tax Treaties', available at http://www.fitindia.org/downloads/Arpith_P_Jain_2012.pdf, accessed on 11th April 2018.

⁷⁴According to a commentator: "Tax treaties also provide other features that are vital to the competitive position of global businesses. For example, by prescribing internationally agreed thresholds for the imposition of taxation by foreign countries on inbound investment, and by requiring tax laws to be applied in a non-discriminatory manner to non-resident enterprises, treaties offer a significant measure of certainty to potential investors. Another extremely important benefit that is available exclusively under tax treaties is the mutual agreement procedure, to resolve disputes in particular cases or reach bilateral agreement on issues of interpretation or application. This bilateral administrative mechanism avoids double taxation on cross-border transactions" Ibid.

beneficiaries'.⁷⁵ In addition to these general provisions, provisions with a certain level of specificity are also used in these treaties. A popular type of this latter set of provisions is the Limitation-of-Benefits clause or the LOB clause.

Usually, the LOB clause adds a further requirement before treaty benefits will be conferred to beneficiaries. It is not sufficient that the relevant taxpayer is a 'resident' of the other contracting state. In addition, the taxpayer will have to meet one of two (or perhaps three) other tests.⁷⁶ The Commentary on the Draft OECD Tax Convention in paragraph 20 on Article 1 gives a sample of the LOB clause.

'Except as otherwise provided in this Article, a resident of a Contracting State who derives income from the other Contracting State shall be entitled to all the benefits of this Convention otherwise accorded to residents of a Contracting State only if such resident is a "qualified person" as defined in paragraph 2 and meets the other conditions of this Convention for the obtaining of such benefits.'

Just as is the case with the investor under BIT, 'a qualified person' under tax treaties is on the face of it entitled to the benefits of the treaty. However, to prevent the abuse, the clause states that being 'a qualified person' does not conclusively confer the benefits of the treaty. Therefore in conjunction with being a qualified person, a treaty beneficiary must meet the other conditions for the obtaining of such benefits.

The LOB clause thus effectively exempts persons who meet the definition of a 'qualified person' under the treaty but does not meet the further requirements from accessing the benefits of the treaty. The LOB clause thus achieves a similar

⁷⁵ These are often referred to as General Anti Abuse Rules (GAAR).

⁷⁶ Graeme Cooper, 'Preventing Tax Treaty Abuse' (2nd United Nations Workshop on "Tax Base Protection for Developing Countries, Paris, 2014).

objective under the international tax system as the DOB clause seeks to achieve under the international investment law regime.

3.4. The Purpose and Scope of the Denial of Benefits Clause in International Investment Law.

In a commentary on the United States treaty programme, it was suggested that the DOB clause was inserted into US treaties as a safeguard of sorts to prevent the 'abuse of the place of incorporation criterion'⁷⁷. Such an abuse was envisaged to occur where a company controlled by nationals from a third country gains access to treaty benefits solely by its incorporation under the laws of one of the treaty partners. To prevent this, the DOB clause was inserted to deny such companies the benefits of the treaty.⁷⁸

Speaking further on the subject, Walker Jr stated that the BIT making countries shared a '...hesitancy toward undertaking extensive treaty commitments in favour of alien corporations...'⁷⁹ According to him, this hesitancy has:

"... been in part attributable to a fear lest such commitments could become a cloak under cover of which rights would be gained by interests of third countries-in a situation in which the party to the treaty would not wish to be obligated to accord them, whether because such third countries were not

⁷⁷ Pamela Gann, 'The US Bilateral Investment Treaty Program' (1985) 21 Stan.J.Int'l L 373, 379-80.

⁷⁸ Ibid.

⁷⁹ Herman Walker Jr, 'Provisions on Companies in United States Commercial Treaties' (1956) 50 Am.J.Int'l. L 373, 388.

*party to the reciprocal arrangements embodied in the treaty or for other reasons.”*⁸⁰

It was in the attempt to prevent this undesirable situation that led to the reservation of the right to take measures denying the benefits of the treaty signed by the US, to be exercised when state parties desire to.⁸¹

According to Dolzer and Schreuer,⁸² the DOB clause is one of the methods used by states to ‘counteract strategies that seek the protection of particular treaties by acquiring a favourable nationality’. According to these scholars, the clause is designed to prevent a company with no economic connection to its state of incorporation from benefitting from the treaty.⁸³ In a similar language, Sonarajah posits that the DOB clause ‘gets over the problem that mere satisfaction of the formalities involved in incorporation does not satisfy corporate nationality’⁸⁴

In the case of *Petrobart v Kyrgyzstan*⁸⁵ the tribunal while considering the DOB clause contained in Article 17 of the ECT⁸⁶ opined that the test the clause proffers for the determination of whether or not a company is controlled by nationals of a third

⁸⁰ Ibid.

⁸¹ Ibid.

⁸² Dolzer and Scheurer (n 2).

⁸³ Ibid, 55, 56.

⁸⁴ Muthucumaraswami Sonarajah, *The International Law on Foreign Investment* (Cambridge 2010) 329. How well the clause does get over this problem is the question at the heart of this work.

⁸⁵ *Petrobart Limited v The Kyrgyz Republic* SCC Arb No. 126/2003 (hereinafter referred to as *Petrobart*).

⁸⁶ Article 17 of the ECT provides:

‘Each Contracting party reserves the right to deny the advantages of this Part to:

- (1) A legal entity if the citizens or nationals of a third state own or control such entity and if that entity has no substantial business activities in the Area of the Contracting Party in which it is organized; or
- (2) An Investment, if the denying Contracting Party establishes that such Investment is an Investment of an Investor of a third State with or as to which the denying Contracting Party:
 - (a) does not maintain a diplomatic relationship; or
 - (b) adopts or maintains measures that:
 - (i) prohibit transactions with Investors of that state; or
 - (ii) would be violated or circumvented if the benefits of this Part were accorded to Investors of that state or to their Investments

country may be 'expected to be handled quite strictly; otherwise, non – contracting states which do not accept the obligations of the treaty would enjoy the benefits and free loading is unlikely to be encouraged'⁸⁷

Also, in the case of *AMTO V Ukraine*⁸⁸ and with regards to Article 17 of the ECT as well, the tribunal stated the following;

*“ As the purpose of the ECT is to establish a legal framework in order to promote long term cooperation in the energy field, based on complementarities and mutual benefits...then the potential exclusion of foreign owned entities from ECT investment protection under Article 17 is readily comprehensible.”*⁸⁹

Furthermore, in the tribunal's view, the objectives of the ECT are 'unlikely to materialise for the host state with a state that serves as a nationality of convenience devoid of economic substance for an investment vehicle'⁹⁰

In the case of *GAI v Bolivia*⁹¹, the tribunal in its consideration of the alleged exercise of the right to deny the benefits of the US – Bolivia BIT by Bolivia, reasoned that the access of an investor to arbitration is limited where a BIT contains a denial of benefits clause. In the words of the tribunal, 'whenever a BIT includes a DOB clause, the consent of the host state to arbitration is conditional and thus may be denied by it'.⁹²

⁸⁷ *Petrobart*, para 42.

⁸⁸ *Limited Liability Company Amto v. Ukraine*, SCC Arb No. 080/2005 (hereafter referred to as *Amto v Ukraine*).

⁸⁹ *Ibid*, para 61.

⁹⁰ *Ibid*.

⁹¹ *Guaracachi America Inc, Rurelec Plc v Plurinational State of Bolivia*, PCA Case No. 2011-17, Award, 31st January, 2014 (hereafter referred to as *GAI v Bolivia*).

⁹² *Ibid*, para 372.

Commenting on the DOB clause, the tribunal in *Tokios Tokeles v Ukraine*⁹³ observed that the presence of the clause in treaties confirm that state parties are capable of excluding from the ambit of investment treaties, juridical investors of the other party that are controlled by nationals of a third country or by nationals of the host country.⁹⁴ The tribunal further noted that the absence of the clause in the Ukraine-Lithuania BIT is to be viewed as a 'deliberate choice of the contracting parties'.⁹⁵

3.5. The Denial of Benefits Clause and Host State Sovereignty in International Investment Law

There are a number of arguments against the practice of treaty shopping under the international investment law regime. A close look at these arguments, however, reveals that a principal issue many states have against the practice is its incompatibility with the concept of state sovereignty. While seeking to gain the best of advantages contained in BITs is an increasingly pivotal issue for investors, particularly multinational companies, however, the perception of many host states is different.

With views ranging from the consideration of the practice as inconsistent with the concept of reciprocity in international law to its consideration as free riding on treaty benefits which have not been conferred on certain class of investors, the practice of treaty shopping is one which many host states find as worthy of being put in check.⁹⁶

⁹³ *Tokios Tokeles v Ukraine*, ICSID Case No ARB/02/18, Decision on Jurisdiction (hereafter referred to as *Tokios Tokeles*).

⁹⁴ *Ibid*, para 36.

⁹⁵ *Ibid*.

⁹⁶ See generally, the submissions of the United States of America as well as Costa – Rica in their capacity as Non-Disputing Parties in the case of *Pacific Rim Cayman v The Republic of El Salvador*,

This response of host states does not come as a surprise in a regime that has become perceived by many as biased, and in many ways structured to favour the investor's interests as against that of the host state. Legitimacy issues have become a central theme with regards to the international investment law regime, with some opining that the regime is at the very precipice of losing the confidence it enjoys from states and other stakeholders.⁹⁷ With the practice of treaty shopping considered in many respects as a pro – investor's interest practice, the re-emergence of the DOB clause and its incorporation by a growing number of states in their BITs evidence a reaction by host states to what is considered by them as a further onslaught on their sovereignty.

The DOB clause from this point of view can then be considered as a one of the attempts states have devised to tilt the balance of international investment law in favour of a more state friendly structure. Therefore, allowing for an even consideration of investor and host state rights and interests, and not the predominance of the former over the latter as it is largely represented in the regime. Although a treaty clause which dates back in time, the relevance of the DOB clause in the quest to achieve and maintain balance and predictability in the regime is evident.

ICSID Case No. ARB/09/12, Decision on Respondent's Jurisdictional Objections. The position on state parties to the practice of treaty shopping can be gleaned from the arguments made before tribunals where the issue is in question. These views of states parties to the practice will be further considered in later chapters.

⁹⁷ This point further reinforces the importance of taking a critical look at the effectiveness or otherwise of the denial of benefits clause in international investment law, particularly, the role the effectiveness or otherwise of the clause plays in reinforcing or eroding the legitimacy of international investment law. See generally, Gus Van Harten, *Investment treaty Arbitration and Public Law* (OUP 2007); Olivia Chung, 'The Lopsided International Investment Law Regime and its Effect on the Future of Investor-State Arbitration' (2007) 47 Va.J Int'l L 953, arguing that the underlying hope countries have for turning to BITs is the opportunity it presents for economic benefits, and where the benefits do not materialize or are accessed at costs greater than anticipated or bargained by contracting states, there is danger of a potent backlash.

While the entering into an investment treaty on the part of a state is an exercise of its sovereignty and a conscious limitation of its sovereign power for the purpose of achieving a particular economic or developmental objective; it is worthy of note, that even where the state party understands (or is expected to understand) the implications of entering into such treaties, this however, does not preclude the host country from experiencing what has been termed as 'regulatory chill'. This has been generally described as the fear of breaching investment treaty obligations or the legitimate expectation of investors and the resultant 'handicap' of the host state from exercising its regulatory power in certain instances.

Therefore under what can be termed 'normal circumstances' where the state parties enter into a set of obligations with a specific country or countries and where such obligations devolve to the national(s) of such other party, the dynamics of the balancing of investor rights with the right of the host country to regulate in the pursuit of legitimate regulatory goals is at play⁹⁸. With the 'normal' obligations a host state owes to the investors who are nationals of the other contracting party to an investment treaty resulting in such an intricate web of restrictions and power shift, the addition of nationals of other countries (under the guise of being nationals of the other contracting party) benefitting from the limitation of the sovereign powers and restriction of the exercise of regulatory discretion of the host states makes the issue more complicated.

Thus, whilst still labouring under the pressures of meeting up with the demands of 'legitimate' investors who are nationals of the other contracting party. The according of rights to investors outside of the intent of contracting parties to the treaty is a

⁹⁸ Peter Muchlinski, 'Trends in International Investment Agreements Balancing Investor Rights and the Right to Regulate: The Issue of National Security' in Karl Sauvant (Ed) *Yearbook on International Investment Law and Policy* (OUP 2009) 35, 50.

burden many host states might be unwilling and in some instances unable to bear. Were host states to allow the practice of treating shopping by nationals of third countries, then such is tantamount to allowing such investors to reap where they (and their countries) have not sown.

While the argument can be made that such investors contribute to the economic development of the host country by committing resources to the host state through their investments. The point remains that in such instances, the investor whose country has no investment treaty with the host state is subject to the national laws on investment of the host country. It is suggested that it is the desire to access benefits over and above those available under the investment laws of the host state, or in some instances over and above that which is available under the treaty between the host state and the home state of the investor that births the engagement of third country investors in the practice.

Similar to the above (and particularly frowned at by host states) is the mode of treating shopping where nationals of the host states seek to take advantage of the benefit of investment treaties entered into by their home country with other states. This has the resultant effect, among others, of elevating local investments within the territory of the host state to that of an international investment, and of local investors to the position of international investors. This consequently and effectively results in the bypassing of the investment laws of the home state by its own nationals. By entering into a BIT with another country, the unambiguous intention set out to be

achieved by the home country is to guarantee and give protection to foreign funds that flow from external sources not funds that originate from the host state.⁹⁹

The right to international commerce has been recognised as one of the rights inherent to the sovereignty of a state.¹⁰⁰ In principle, a state has the right to enter or refuse to enter into economic relations with another country or its nationals. Technically, it is the right of a state to open or close its borders as regards trade or other economic ties with another country. The use of the DOB clause, therefore, seeks to strengthen this state right against its weakening through the practice of treaty shopping.

3.6. Conclusion

The notion and dynamics of the 'sovereignty cost',¹⁰¹ between or among parties to a BIT or IIA, seats as one of the central pillars upholding the workings of international investment law. As noted earlier, this can be qualified as the restrictions on the sovereign and regulatory powers of the host state in ensuring the protection of foreign investments in its territory shouldered by the contracting parties. With the presumption of equality and balance on the scale of sovereignty costs shouldered respectively, states are able to share and preserve the reciprocity inherent in the nature of these agreements.

However, when third parties (or nationals of the host state as the case may be) through the practice of treaty shopping gain access to the benefits of these

⁹⁹ See, Muthucumaraswamy Sornarajah, *Resistance and Change in the International Law on Foreign Investment* (Cambridge University Press 2015) 83.

¹⁰⁰ Marek St Korowicz, *Introduction to International Law: Present Conceptions of International Law in Theory and Practice*, (Springer 1959) 228.

¹⁰¹ See (n 5) on the concept of sovereignty cost.

agreements outside of the contemplation of the parties, the balance of the sovereignty cost borne by state parties increases without any corresponding burden on the part of the third party investor's home country. It is in response to this, that state parties have engaged the use of the principle of good faith, particularly the doctrine of abuse of rights and process, as well as the in-treaty mechanism, the DOB clause.

In fulfilling its purpose as part of the foundational construct of this work, this chapter has set the stage for the consideration of the central question this thesis. That is, the determination of the effectiveness of the DOB clause as an in-treaty mechanism capable of limiting treaty shopping in international investment law and arbitration. To do this, the chapter has engaged in an overview and analysis of the abuse of right and process doctrine as used by investment tribunals in discerning and limiting the practice of treaty shopping.

As noted in the chapter, the subjective theme which runs through the tests adopted by investment tribunals in determining whether an investment restructuring amounts to an abuse of rights and or process, as well as the disparity in the analysis and application of these tests make the abuse of rights and process doctrine an unpredictable tool in the quest to limit the practice of treaty shopping.

The focus of this work now turns to the DOB clause, which on the face of it as an in-treaty mechanism is designed and purposed to limit the practice of treaty shopping. Consequently, therefore, the question is whether or not the DOB clause is indeed an effective measure in the determination and limitation of treaty shopping in international investment law and arbitration. Thus, the next chapter will be looking in

to the effectiveness of the clause with respect to the practice of treaty shopping using the mail box/ shell company route.

Chapter Four

The Effectiveness of the Denial of Benefits Clause in Limiting Treaty Shopping: The Shell/Mail Box Company Route

4. Introduction

A central theme of this work is that states in response to the practice of treaty shopping¹ have had recourse² to DOB clauses among other mechanisms³ in attempts to nip the practice in the bud. In other instances, the clause has been used as an active mechanism in defence of claims brought through actual or purported treaty shopping arrangements by the claimant. Indeed, the DOB clause has been posited to have the potential of establishing predictable limits in the practice of treaty shopping in international investment law.⁴

¹ Mathew Skinner, Cameron Miles and Sam Luttrell, 'Access and Advantage in Investor- State Arbitration: The Law and Practice of Treaty Shopping' (2010) 3(3) *Journal of World Energy Law and Business* 260. Arguably, at the heart of the issue of treaty shopping as a practice in the international investment and arbitration regime is the determination of its legal, policy and business implications. Upon scrutiny, it is evident, that it is the evaluation of the impact of the practice of treaty shopping along these lines that have influenced the response of investors, investment tribunals and importantly state parties as to its desirability or otherwise in international investment law. For investors, the opportunity of accessing investment protection guarantees under bilateral investment treaties (BITs) or other international investment agreements (IIAs) where such would have been inapplicable on the basis of the original nationality of the investor makes the practice an appealing business, legal and in some instances political strategy. This is more so, where huge political risks are common place in the regulatory framework of the country of investment.

² Jorun Baumgartner, 'Treaty Shopping in International Investment Law (OUP Press 2016) 39 – 65; John Lee, 'Resolving Concerns of Treaty Shopping in International Investment Arbitration' (2015) 6 *Journal of International Dispute Management* 355. On the part of state parties, the practice is not one largely perceived as worthy of being received with wide open arms. With the issues of reciprocity, lack of consent, restriction of sovereign and regulatory powers; the possibility of huge awards in favour of claimants among others, the reluctance of governments in allowing the continued engagement of the practice can be appreciated. The question of treaty shopping thus arises within the broad context of business interests in a globalized world and the recognition of states as the primary components of administration and custodians of sovereign power.

³ See generally Chapter 3 where the mechanisms state parties have adopted in limiting and responding to claims brought through treaty shopping have been discussed.

⁴ Mark Feldman, 'Setting Limits on Corporate Nationality Planning in Investment Treaty Arbitration' (2012) 27 (2) *ICSID Rev* 281. Importantly, the issues as to the unpredictability and lack of consensus among arbitral

However, the evolving arbitral jurisprudence on the application of the clause in cases where the practice of treaty shopping is considered by investment tribunals calls for an evaluation of its effectiveness as a legal mechanism designed for the limiting of treaty shopping in international investment law and arbitration. Simply put, the question is whether or not DOB clauses in the different forms in which they are presently drafted (and interpreted) effectively fulfil the purpose for their introduction and use in BITs and IIAs.

The argument, therefore, as it has been established in preceding chapters, is not whether state parties (particularly developing host states) perceive the practice of treaty shopping as an acceptable integral part of the investment law regime, or an analysis of the intent of parties who employ the clause in their agreements as regards treaty shopping. Rather, what is pertinent is a consideration of the construction of the clause to determine (or at least measure) the sufficiency of the conditions established by the clause in fulfilling its purpose and achieving the aim for its inclusion in investment agreements.

To achieve this, the effectiveness of DOB clauses is sought to be measured against the three principal forms of treaty shopping. That is, treaty shopping through the use of mailbox and shell companies, treaty shopping through round tripping and finally treaty shopping through the assignment of investment claims. It is believed, that the consideration of the effectiveness of the DOB clause against these present and evolving forms of treaty shopping will cumulate in a recognition, understanding and appreciation of the extent to which this in-treaty mechanism limits the practice of treaty shopping in international investment law and arbitration.

tribunals as to the application of the abuse of rights and abuse of process principles makes these less effective and reliable with regards to engaging the legality or otherwise of the practice.

As part of its strategy to fulfil its purpose of excluding mailbox and shell companies owned by nationals of third countries, the DOB clause is structured on two principal pillars. These are aimed at inquiring into the investor's structure to define, determine and evaluate the nature of the link between the investor and the home state of which it claims to be a national. The first is the requirement of 'substantial business activities' in the home state of the investor. This seeks to address the veracity of the economic link between the investor and the host state in question. Second is the requirement of control. This is targeted at the identification of the nationality of the persons behind the company for the purpose of determining the real nationality of the investor beyond the corporate form it assumes.⁵

These requirements, particularly the requirement of control, allow the DOB clause regardless of the definitions of nationals found in BITs, to pierce through different layers of companies and jurisdictions through which the investment has been routed. In the absence of the DOB, arbitral tribunals have usually declined to pierce the corporate veil in order to deny a corporate investor standing and protection under an investment treaty because of the diverging nationality of its controlling shareholder.⁶

The presence of a DOB clause, therefore, empowers and requires investment tribunals to look beyond the corporate façade and make a determination on the existence of a 'genuine link' between the investor and the host state. The clause thus becomes preliminarily a mechanism to determine, through a process of inquiring into the substantiality of the activities of the investor and the nationality of its owners or

⁵ See generally, Panayotis Protopsaltis, 'The Challenge of the Barcelona Traction Hypothesis: Barcelona Traction Clauses and Denial of Benefits Clauses in BITs and IIAs' (2010) 11 J. World Investment and Trade 561; Loukas Mistelis and Crina Baltag 'Denial of benefits and Article 17 of the Energy Charter Treaty (2009) 113 Penn St.L.Rev 1301.

⁶ However, the tribunal in the case of *TSA v Argentina*, Award, 19 December, 2008, took a different approach and pierced the corporate veil in seeking to determine foreign control under Article 25(2) (b), ICSID Convention. See generally, Stephan Schill, *The Multilateralization of International Investment Law* (Cambridge University Press 2009) 224.

controllers, the effective and substantive connection between the host state and the investor.⁷ To the end that it prevents treaty shopping as it relates to the stakeholders in respect to a BIT or IIA containing the clause.

To illustrate whether or not the DOB is effective as a mechanism for the control and prevention of treaty shopping, particularly as regards the mailbox and treaty shopping route, this chapter analyses the potency of the clause by looking into the two core requirements and tests the DOB clause prescribes for the exclusion of investors from the advantages of a BIT. The first part of the chapter sets the tone by highlighting the context in which the DOB clause has emerged as a tool favoured by state parties in limiting the activities of mailbox and shell companies. The second part of the chapter looks into the questions raised by the requirements of the DOB clause and how these relate to the efficacy of the clause in limiting treaty shopping through mail box companies and shell companies in international investment law.

4.1. Rationale for the Inclusion of Denial of Benefits Clause in International Investment Agreements: A reaction to the abuse of corporate structuring and mailbox companies?

Historically, the purpose for the insertion of the DOB clause into treaties was to guard against the ‘possibility of a “free ride” by third country interests’ where a treaty party did not wish to accord protections to those interests ‘whether because such third countries were not party to the reciprocal arrangements embodied in the treaty or for other reasons’⁸. The DOB clause was also inserted to ‘allow either party to determine whether to extend treaty benefits when involvement by nationals of either

⁷ Pia Acconci, ‘Determining the Internationally Relevant Link between a State and a Corporate Investor: Recent Trends Concerning the Application of the Genuine Link Test’ (2004) *J. World Investment and Trade* 139.

⁸ Herman Walker Jr, ‘Provisions on Companies in United States Commercial Treaties’ (1956) 50 *AJIL* 373, 388.

party is relatively minor'.⁹To achieve this aim, the early forms of the DOB clause were structured in ways to allow the exclusion of any third (or denying) country investment or investor. For example, the US – Japan Treaty of Friendship, Commerce and Navigation (FCN) provides:

(1) The present treaty shall not preclude the application of measures...

(e) denying to any company in the ownership or direction of which nationals of any third country or countries have directly or indirectly the controlling interest, the advantages of the present Treaty¹⁰

Similarly, the FCN between the US and China also provides:

'...each High Contracting Party reserves the right to deny any of the rights and privileges accorded by this Treaty to any corporation or association created or organised under the laws and regulations of the other High Contracting Party which is directly or indirectly owned or controlled, through the majority stock ownership or otherwise, by nationals, corporations or associations of any third country or countries.¹¹

These early versions of the DOB clause, therefore, had the possession of the nationality of a third state as the 'sole' determining factor for the exercise of the DOB clause by either contracting party.

⁹ Pamela Gann, 'The U.S Bilateral Investment Treaty Program' (1985) 21 Stan.J.Int'l.L 373.

¹⁰ Treaty of Friendship and Commerce and Navigation between the United States of America and Japan. Signed on 2 April, 1953, entered into force 30 October, 1953, art XXI (1) (e).

¹¹ Treaty of Friendship, Commerce and Navigation between the United States of America and the Republic of China. Signed on 4 November, 1946 and entered into force on 30 November, 1948, art XXVI (13) (5).

As such while the meeting of the nationality criteria under the agreement and as established by the national laws of each contracting party identified the company or national in question as covered by the treaty. However, this was further subject to whether or not such a company was owned or controlled by nationals of a third state not party to the treaty. The *phrase 'directly or indirectly owned or controlled, through the majority stock ownership or otherwise'* as contained in the second example above, suggests that the DOB clause necessarily involves piercing the corporate veil to identify the persons behind the veil and to determine the nationalities of such persons for the purpose of denying (or permitting) access to the rights and privileges of the agreement.

The effect of this is that the nationality of a company under a treaty is determined by not the mere use of one of the formal criteria, that is, place of incorporation and siege social. But that this while acknowledged in form, become effective 'only' when it matches the nationality of those in control of the company.¹² Conversely, the formal criteria are excluded if the company is controlled by the national of a third State or of the host or denying State.¹³

However, recent versions of the clause, while maintaining the 'reciprocity effect'¹⁴ the first versions were designed to have, have been modified in ways to allow them streamline the class of investors sought to be excluded through the use of the clause. Taking the drafting of the US versions of the clause as an example, the DOB clause evolved from a blanket provision excluding third party owned or controlled

¹² Acconci (n 7) 139.

¹³ Ibid.

¹⁴ 'Reciprocity effect' is used here to represent the argument behind the introduction and use of the clause as a mechanism for maintaining reciprocity between or among contracting parties, and which excludes third countries and their nationals who have not entered into similar obligations and duties from benefitting from the advantages and privileges of the agreement.

companies by simply and solely using the control requirement restrictively¹⁵. Quite different from the earlier versions, the more recent clauses have limited their scope of application to cover only mail-box companies. Effectively allowing third country controlled companies who meet the required threshold of business activity to be covered under the relevant BIT or IIA.

A search through the timeline from the 1990s, reveal that the US BITs introduced for the first time, the exclusion of companies not only owned or controlled by nationals of a third state or the denying party¹⁶, but additionally, companies which do not have substantial business activities in the party of the purported home state. Another standard which was introduced was that a company can be excluded where it is owned or controlled by nationals of a third country with which the denying party does not maintain normal economic relations. For example, the 1992 US Model BIT provides:

“each party reserves the right to deny to any company of the other Party the advantages of this Treaty if (a) nationals of any third country, or nationals of such Party, control such company and the company has no substantial business activities in the territory of the other Party or (b) the company is controlled by nationals of a third country with which the denying Party does not maintain normal economic relations”¹⁷

A more elaborate version is found in the 2012 U.S Model BIT rendition of the clause, which is also similar to the 2004 version, and which provides:

¹⁵ See, Walker (n 8) 388; Gann (n 9) 373.

¹⁶ The treaty shopping route where nationals of the denying party/ host state, popularly referred to as ‘round tipping’ will be discussed in the next chapter.

¹⁷ U.S Model Agreement Concerning the Encouragement and Reciprocal Protection of Investment, 1992, art 1(2).

1. *A Party may deny the benefits of their treaty to an investor of the other Party that is an enterprise of such other Party and to investment of that investor of the other Party if persons of a non-party own or control the enterprise and the denying Party:*

(a) Does not maintain diplomatic relations with the non-Party; or

(b) Adopts or maintains measures with respect to the non-Party or a person of the non-party that prohibit transactions with the enterprise or that would be violated or circumvented if the benefits of this Treaty were accorded to hr enterprise or to its investments.

2. *A party may deny the benefits of this Treaty to an investor of the other Party that is an enterprise of such other Party and to investment s of that investor if the enterprise has no substantial business activities in the territory of the other Party and persons of a non-party, own or control the enterprise.¹⁸*

At this point in the discourse, it is trite that a consideration of the motivation behind the inclusion of the DOB clause in BITs and other IIAs by state parties in recent times is of importance. This is necessary to allow for both an appreciation of the expectation of state parties with respect to the clause, and as a platform for measuring its effectiveness.

It is argued that the recent inclusion of the DOB clause in more investment treaties by state parties is both a reflection of and reaction to the persistent debate of international investment law. The seemingly 'ever present' question of international investment law has been and is the question of how to effectively balance the rights and obligations of the relevant stakeholders, particularly, investors, home states and

¹⁸ U.S Model Treaty for the Encouragement and Promotion of Investment, 2012, art 17(1),(2).

host states.¹⁹ While some scholars argue that the regime is skewed in favour of investors (who are majorly multinational enterprises) by their home states, usually developed countries, through the conclusion of largely one sided investment treaties to the disadvantage of host states²⁰, majorly developing countries; others believe the regime as it is evidences no such disparity.²¹

Taking a close look the emergence of the present regime of international investment law, however, it is submitted that the regime is the result of an intersection of interests and intentions of state parties and not a complete fusion of such interests. On the one hand there is the desire of capital exporting countries for the protection of the properties of their nationals in host countries considered to have unstable investment climates. Specifically, these countries seek to protect their citizens and their investments in legal systems which do not provide adequate protections and course for redress against the possible unilateral acts of the government in the exercise of its sovereign powers to the detriment of the foreign investor.

On the other hand is the desire of developing countries (often the destination centres of the former's foreign investments) for capital necessary for economic development. The convergence and intersection of these interests, though different and aimed at achieving different ends resulted in the advent of the present international investment law regime. While the question as to the lopsided nature of the regime is subject to debate, the position is that the ultimate interest countries have in

¹⁹ See generally, Gus Van Harten, 'Five Justifications for Investment Treaties' (2010) Vol 2(1) Trade, Law and Development 19; Gus Van Harten, *Investment Treaty Arbitration and Public Law* (OUP 2007).

²⁰ See generally, Olivia Chung, 'The Lopsided International Investment Law Regime and Its Effect on the Future of Investor-State Arbitration' 2006-2007 47 Va.J.Int'l 973, arguing that the present regime of international investment law rests on "tenuous legitimacy" and unless changes are made, instances of backlash will continue and increase as host states try to ease the burden of complying with lopsided investment agreements.

²¹ See Jeswald Salacuse and Nicholas Sullivan, 'Do BITs Really Work? An Evaluation of Bilateral Investment Treaties and their Grand Bargain (2005) 46 Harv Int'l.L.J 67.

protecting foreign investment (and a great incentive on the part of developing countries to sign these agreements) is the promise of economic development and prosperity.²²

However, the empirical evidence on the relationship between the signing of investment treaties and the in-flow of foreign investments (and consequently, the nexus between investment treaties and economic development) remains indecisive and unsettled. While some studies find a positive correlation between the conclusion of BITs and increases in investment flows²³ others do not.²⁴

This status ²⁵ of the investment law²⁶ regime was noted by the International Law Association (ILA) in the Final Report of the International Law Association Committee on International Law on Foreign Investment. ²⁷ ²⁸ In its view:

²² See Omar Garcia –Bolivar, 'The Teleology of International Investment Law: The Role of Purpose in the Interpretation of International Investment Agreements' 2005 6 J. World Investment and Trade 751.

²³ See Jeswald Salacuse and Nicholas Sullivan, 'Do BITs Really Work? An Evaluation of Bilateral Investment Treaties and their Grand Bargain (2005) 46 Harv Int'l.L.J. 67; Eric Neumayer and Laura Spess, 'Do Bilateral Investment Treaties Increase Foreign Direct Investment to Developing Countries' (2005) 33(10) World Development 1567.

²⁴ See UNCTAD, 'The Role of Investment Agreements in Attracting Foreign Direct Investment to Developing Countries' (2009 United Nations, New York, Geneva); Mary Hallward-Driemeier, 'Do Bilateral Investment Treaties Attract Foreign Direct Investment? A Bit...and They Could Bite', (2003) World Bank Working Paper No. 3121, 2003, < <http://elibrary.worldbank.org/content/workingpaper/10.1596/1813-9450-3121>> accessed 11 November 2016.

²⁵ However, regardless of whether or not there is a direct relationship between the signing of investment treaties and foreign investment flows to developing countries, what is clear is that the unequal obligations (or the perception of such inequality) and floods of litigation have put developing countries in a dilemma. BIT arbitration is hurting host countries in a number of forms, such as restrictions on the ability to regulate within their territories, huge monetary awards that strain or in some instances drain financial resources, among others. See Olivia Chung (n 20).

²⁶ For example, research shows that the average award against developing countries relative to their annual government expenditure is 0.53% or 99 cents per capita. See, Kevin Gallagher and Elen Shrestha, Investment Treaty Arbitration and Developing Countries: A Re-Appraisal (2011) GDAE Working Paper No. 11-01 < <https://ase.tufts.edu/gdae/Pubs/wp/11-01TreatyArbitrationReappraisal.pdf>> accessed 22 November 2016.

²⁷ However, with respect to Canada, the percentage of investment awards it is liable for is 0.003% of its annual government spending and translates to 12 cents per capita. In other words, when compared to a developed country, awards have a higher impact on the economy of developing countries. Ibid.

²⁸ Yet, there are very few mechanisms within the system to resist these inequitable consequences See, Olivia Chung (n 20).

“The rise in investment arbitration in the opening decade of the 21st century has pushed international investment law towards a more litigious character. While this may be a welcome development for international lawyers, it has to be asked whether this field should take on such a character. Given that the main aim of the parties to foreign investment contracts is to offer economic development for the host country in return for a reasonable rate of profit for the investor, disputes should not form the ‘leitmotif’ of this subject. Rather, co-operation and long term collaboration should play this role.”²⁹

The Committee’s Report also notes that a balancing of the rights and obligations between the main actors could be required, given that the aim of international investment law is ‘to allow host countries to attract and to benefit from foreign investment and for investors to enjoy a transparent, secure and predictable investment environment’³⁰. The Committee further expressed its views on international investment law as:

“a field that combines both commercial and public law concerns and requires a balancing of rights and obligations to ensure that these complementary aims are achieved. This may require the highlighting of social and economic consequences of investment activity upon countries, as through increased awareness of the need to ensure that corporate social responsibility standards are respected by investors, through the possible introduction of new investor and home country obligations in new generations of agreements, and through

²⁹ International Law Association Committee on International Law on Foreign Investment, ‘Final Report’ (International Law Association Report of the Seventy-Third Conference Rio de Janeiro 2008) 788 - 89; Peter Muchlinski, ‘Holistic Approaches to Development and International Investment Law: The Role of International Investment Agreements’ in Julio Faundez and Celine Tan (Eds), *International Economic Law, Globalisation and Developing Countries* (Edward Elgar Publishing Limited 2010) 180.

³⁰ Ibid.

*the clarification of the scope of the host country's right to regulate alongside the existing rights of investors for protection of their assets . Equally a more development oriented approach may be needed.*³¹

The point sought to be made here is to the effect that the introduction of the DOB clause into investment treaties by more states in the international investment law regime is an attempt among others to balance the rights and obligations of stakeholders in the regime. In other words, the consequent reliance on the clause by state parties in their position as respondents to investment claims before international arbitration tribunals is a measure adopted by states to achieve balance in the regime by reserving the right to deny advantages of a treaty.

Therefore, states which use the clause do so to limit the persons who benefit from the limitation of their sovereign powers and the restriction of the exercise of their regulatory functions and other demands the signing of investment treaties place on them. The DOB clause from this perspective is an important tool in the drive for the recalibration of international investment treaties.³² It is a mechanism for minimizing exposure to investment arbitration and its various costs, that is, politically, socially, economically and otherwise. Particularly where such costs are borne or arise as a result of the activities of investors in the regime who use the cover of corporate structuring to gain access to the benefits of an investment treaty through the back door.³³

³¹ Ibid.

³² See, Peter Muchlinski, 'Holistic Approaches to Development and International Investment Law: The Role of International Investment Agreements' in Julio Faundez and Celine Tan (Eds), *International Economic Law, Globalisation and Developing Countries* (Edward Elgar Publishing Limited 2010) 190, arguing that the 'recalibration' of International Investment Agreements will achieve a greater balance between the rights and obligations of the main stakeholders in the investment process.

³³ Chung (n 20) 973.

This point was mirrored by the tribunal in the case of *AMTO V Ukraine*³⁴ brought under the Energy Charter Treaty (ECT), the tribunal commenting on the rationale behind the inclusion of the ECT's DOB clause (contained in article 17 of the treaty) and how it fits in to the purpose of the ECT, stated:

“...as the purpose of the ECT is to establish a legal framework “in order to promote long term cooperation in the energy field, based on complementarities and mutual benefits...” then the potential exclusion of foreign owned entities from ECT investment protection under Article 17 is readily comprehensible. Long term economic cooperation”, “complementarities” or “mutual benefits” are unlikely to materialise for the host State with a State that serves as a nationality of convenience devoid of economic substance for an investment vehicle.”³⁵ (Emphasis added)

While the observation of the tribunal is limited in particular to the legal framework of the ECT, this view can also be adopted to reflect the broader role of the DOB clause in the international investment regime as a whole. However, the application of the DOB clause is subject to certain conditions, which are designed to determine how it functions in the fulfilment of its purpose.

4.2. Conditions for the Application of Denial of Benefits Clauses.

Being a clause designed to use the control test to deny the application of a BIT to mail box companies controlled by nationals of third states,³⁶ the nationality of the persons controlling an investor and the ‘substantiality’ of the business undertaken by

³⁴ *Limited Liability Company Amto v Ukraine*, SCC Case No 080/2005, Final Award, 26 March, 2008.

³⁵ *Ibid*, 40.

³⁶ Panayotis Protosaltis, ‘The Challenge of the Barcelona Traction Hypothesis: Barcelona Traction Clauses and Denial of Benefits Clauses in BITs and IIAs’ (2010) 11 J. World Investment and Trade 561.

the investor are two principal conditions upon which the application of the clause rest. Both conditions are designed, first to determine the real nationality of the company. This, the clause seeks to achieve by conferring on the corporate entity the nationality of its controllers, thus, preserving the mutual and reciprocal nature of the agreement signed by the contracting parties. The second aim, and related to the first, is to measure the tenuousness or otherwise of the relationship between a contracting state and a corporate investor claiming its nationality under a formal criteria. Thus allowing a host state to prevent the said company from accessing and benefitting from the advantages of the treaty where its substantive nationality is not that of the other contracting party. On the whole, it is argued that the cumulative objective of these requirements is to demand a 'substantiation' of sorts from the legal person with regards to the relationship it professes to have with the other contracting party, through an evaluation of its real national and economic ties with the home state.

It is worthy of note, however, that the expression and wording of DOB clauses can differ considerably among treaties. These differences in wording have the capacity to effectively influence the scope of application of the clause.³⁷ These are of course expected, as these agreements are concluded by different states at different times; bargaining strengths, diplomatic relations, motivations, the investment climate, experience levels and predecessor instruments are not uniform and all can and do

³⁷ See for example, art 17 of the ECT (titled- NON APPLICATION OF PART 3 IN CERTAIN CIRCUMSTANCES), which restricts the application of the clause to Part 3 of the treaty; as such most investment tribunals have applied the clause under the ECT as having its scope of application limited only to this part of the treaty, though the dispute settlement mechanism, which also constitutes an advantage of the treaty is located under Part 5.provides:

'Each Contracting Party reserves the right to deny the advantages of this **Part** to...'
(Emphasis added).

influence a treaty's scope and coverage.³⁸ Notwithstanding these differences in the forms of DOB clauses, however, the conditions of 'control' and 'substantial business activities' form the fundamental requirements in most recent DOB clauses and constitute the fulcrum of their application.

4.2.1. The Control Requirement

The DOB clause in practice does not apply to natural persons. However, in principle, while the clause does not apply to natural persons *stricto sensu*. Its application is one which in part rests on the attribution of the nationality of natural persons to that of a corporate legal entity. The train of thought followed is one which is of the view that in considering the structure of most DOB clauses, where the conditions of 'control' and 'substantial business activities' are considered conjunctively, the investor can still be covered under the BIT where it meets the requirement of substantial business activity, but owned and controlled by third party nationals. In other words, where the investor satisfies the condition of substantial business activities under the DOB clause, its nationality as a third country national becomes irrelevant, and it can be covered under the BIT or IIA in question.

Taking this a step further, one can explore the idea of the emergence of a discriminatory system where the satisfaction of a condition permits a corporate entity to gain access to cover under a BIT despite its third country nationality. Conversely, a natural person is denied access on the singular condition of not being the national of either contracting party even where he or she has substantial business activities.

³⁸ Jennifer Doucleff and Rachel Thorn, 'Disregarding the Corporate Veil and Denial of Benefits Clause : Testing Treaty language and the Concept of Investor' in Michael Waibel, Asha Kaushal et al (Eds), *The Backlash against Investor Investment Arbitration* (Kluwer Law International 2010) 3.

This position can also be explored in advancing the argument that state parties should not (or do not) care about the source of foreign investment, but rather on the economic and developmental impact of an investment in the host country. At least, the construction of recent DOB clauses tend to suggest the case

However, the point of the incorporation of the DOB clauses into investment treaties is in part to ensure that third country 'natural' nationals who have been excluded by nationality requirements under a particular BIT or IIA but who use the vehicle of corporate entities to gain access to the benefits of the treaty, thus 'slipping through the fingers of the contracting parties' are excluded through the piercing of the veil of such corporate entities to determine the nationality of the owners or controllers. Arguably, therefore, although the DOB clause in principle does not apply to natural persons, the application of the clause is determined by natural persons and in fact ultimately aimed at natural persons. The extent to which this is effective remains a question subject to evaluation.

With regard to the determination of the nationality of the investment through its owners and or controllers, the principal questions the condition of control raises in the exercise of DOB clauses are; first, what does the concept of control (or ownership) mean? And second, how far up the corporate holding structure of the investor should the investment tribunal look when attempting to evaluate whether an entity is controlled by the national of a contracting party or a third party? These issues are considered in the following parts of this chapter.

4.2.1. A. Defining the Concept of Control under the DOB Clause.

Compared to other forms of corporate nationality requirement, the control requirement is considered to be ‘the most factually and analytically complex’.³⁹ The relative difficulty in determining the nationality of an investor through this criterion is better appreciated when the complex and intricate nature of investment structures and multiple layers of holding vehicles employed by corporate investors, particularly multinational companies are considered.⁴⁰

Therefore, seeking to identify which of the potentially numerous shareholders or layer exercises control for the purpose of determining the nationality of the investor for the application of the DOB clause may be akin to a herculean task.⁴¹ Recognising the complexity involved in identifying the role of the control criteria as substantive criteria with an effect of a ‘genuine link’ in international investment law, Professor Acconci observes:

“According to the scholars approving the use of the effectivity principle to determine the internationally relevant link in respect of corporate investors, the fact that for such investors the determination of the “genuine link” raises some major difficulties - especially when the lifting of the corporate veil is considered essential to determine the effectivity of the link – is not in itself a valid reason to reject its use”⁴²

She further points out that the nature of an effective genuine link, expressed through the control criteria, allows for ‘more chances of protecting ‘foreign’ investment from

³⁹ Ibid.

⁴⁰ Suzy Nikiema, *Best Practices Series: Best Practices Definition of Investor* (The Institute for Sustainable Development 2012).

⁴¹ Doucleff and Thorn (n 38) 7.

⁴² Acconci (n 7) 139.

every point of view, and thus, this final result ‘...justifies the difficulties met during its determination process.’⁴³

As such, the first challenge in identifying the nationality of a corporate entity based on the control criterion is defining the concept of control itself. Pinning down what the concept of ‘control’ means within the context of international investment law has been a mixed bag of perspectives. More so, this is largely because few BITs contain the control criterion, and fewer still, go further to detail what control means. Consequently and unsurprisingly, the task of arriving at plausible explanations as to what contracting parties mean by the term control has been a task investment tribunals have been saddled with on a number of occasions.

It is argued, that the vagueness of the notion of control in international investment law plays a major role in the effectiveness of DOB clauses as effective mechanisms for the limiting of treaty shopping. With control being a one of the criteria upon which the clauses are to be exercised, a clear interpretation of the concept will in no small measure ensure an effective application and exercise of the clause. However, where the notion of what constitutes control is largely undefined, indeterminate and unfixed, this leaves room for subjective interpretations by tribunals as to what the notion should entail, consequently influencing the exercise and potency of the clause.

Over time, the notion of control in international investment law has been interpreted along two major lines. On the one hand is what is often designated as the ‘quantitative approach’ and on the other hand is the ‘qualitative approach’. Considering the first approach, for example, The Draft 4th Edition of the OECD Benchmark Definition of Foreign Investment, emphasises the percentage of

⁴³ Ibid.

ownership or voting power in a company as the measure for determining control. In its recommendation as to what constitutes the quantitative approach, it provides:

“To classify an enterprise within a country on the basis of the presence or absence of effective foreign control, the criterion recommended for use is whether or not a majority of ordinary shares or voting power (more than 50% of the capital) is held by a single foreign direct investor or by a group of associated investors acting in concert...”⁴⁴

Similarly, The Convention Establishing the Multilateral Investment Guarantee Agency (MIGA) combining both the formal tests of the place of incorporation with the company seat but also allowing the use of the control criteria as an alternative, provides that a legal entity is an eligible investor under the Agency’s insurance programme provided that:

*“...such juridical person is incorporated and has its principal place of business in a member or the majority of its capital is owned by a member or members or nationals thereof, provided that such member is not the host country in any of the above cases”.*⁴⁵ (Emphasis added)

However, the case of *Thunderbird v. Mexico*⁴⁶ brought under the North American Free Trade Agreement (NAFTA); the tribunal interpreted the concept of control by adopting the qualitative approach. According to the tribunal:

“Control can also be achieved by the power to effectively decide and implement the key decisions of the business activity of an enterprise and,

⁴⁴ OECD, *The Draft OECD Benchmark Definition of Foreign Investment* (4th edn, OECD 2006).

⁴⁵ Convention Establishing the Multilateral Investment Guarantee Agency, submitted 11 October, 1985, effective 12 April, 1988, art 13(a) (ii).

⁴⁶ *International Thunderbird Gaming Corporation v United Mexican States*, Award, 26 January 2006.

under certain circumstances, control can be achieved by the existence of one or more factors such as technology, access to supplies, access to markets, access to capital, knowhow and authoritative reputation”⁴⁷

Also adopting the qualitative approach, The Protocol to the Egypt – US BIT defines control as “having a substantial share of ownership rights and the ability to exercise decisive influence”⁴⁸. The Draft United Nations Code of Conduct on Transnational Corporations also makes reference to the term “significant influence” in reference to a qualitative view of the concept of control.⁴⁹

However, it is worthy of note, that definitions of ownership or control in qualitative terms generally do not require majority or any specific quantum of ownership.⁵⁰ This approach reflects the fact that effective control of a company often is exercised by shareholders who own less than half of the stock.⁵¹ By lowering the requirement to less than majority ownership, a treaty makes it easier for an investor to have the necessary relationship with an investment to bring the investment within the coverage of the treaty and thus broadens the scope of the treaty. ⁵²Similarly, with regard to the DOB clause, an interpretation of control or ownership along qualitative terms creates an easily attainable threshold for the investor.

⁴⁷ Ibid, para 180; however, the use of the words ‘can also’ by the tribunal suggests it does not view the qualitative approach to defining ‘control’ as an exclusive definition.

⁴⁸ See, UNCTAD, *UNCTAD Series on Issues in International Investment Agreements: Scope and Definition* (United Nations 1999).

⁴⁹ Ibid.

⁵⁰ Ibid.

⁵¹ Ibid.

⁵² Ibid.

The case of *ADT v Bolivia*⁵³, the tribunal dealt at length on the concept of control. In defining control, the tribunal observed:

*“ ...the legal definition of the verb “control” provides several meanings for control. The first definition for control is to ‘exercise power or influence over...The second definition is ‘to regulate or govern’...The final definition is ‘to have a controlling interest in’. The first definition of control suggests the actual exercise of control with emphasis on the right to exercise control over an object but does not suggest ownership of the subject. The second definition similarly points to a right to control but not to ownership of that which is controlled. The third definition of control ties control to ownership interest providing that a controlling interest is understood as a legal share in something...sufficient ownership of stock in a company to control policy and management; especially a greater-than-50% ownership interest in an enterprise”*⁵⁴

Considering the third definition stated by the tribunal, the idea seems to be that the ‘qualitative’ form of control in terms of day to day running of an enterprise, policy making and management is a derivative or the result of the ‘quantitative form’ of control, through the ownership of the majority of shares in a company.

In the case of *Plama v Bulgaria*⁵⁵, the tribunal commenting on the requirement of ‘ownership or control’ contained in the ECT DOB clause stated:

⁵³ *Aguas del Tunari S.A v Republic of Bolivia*, ICSID Case NO ARB/02/03, Decision on Respondent’s Objections to Jurisdiction.

⁵⁴ *Ibid*, para 231.

⁵⁵ *Plama Consortium Limited v Republic of Bulgaria*, ICSID Case No. ARB/03/24, Decision on Jurisdiction, 27, August, 2008, para 54-68.

“...control includes control in fact, including an ability to exercise substantial influence over the legal entity’s management, operation and the selection of members of its board of directors or any other managing body.” (Emphasis added)

Also, the case of *Amto v Ukraine*⁵⁶ brought under the ECT, the tribunal made reference to Understandings 2 and 3 adopted by representatives of the contracting states, including Ukraine in relation to Articles 1(5) and 1(6). With regard to Article 1(6) which defines an investment under the ECT as ‘every kind of asset, owned or controlled directly or indirectly by an Investor...’ the Understanding adopted by the representatives of the contracting states provides:

With respect to Article 1(6)

For greater clarity as to whether an Investment made in the Area of one Contracting Party is controlled, directly or indirectly, by an Investor of any other Contracting Party, control of an Investment means control in fact, determined after an examination of the actual circumstances in each situation. In any such examination, all relevant factors should be considered, including the Investor's.

(a) financial interest, including equity interest, in the Investment;

(b) ability to exercise substantial influence over the management and operation of the Investment; and

⁵⁶ *Limited Liability AMTO v Ukraine*, Stockholm Chamber of Commerce, Arbitration No. 080/2005, Award, 26th March, 2008.

(c) ability to exercise substantial influence over the selection of members of the board of directors or any other managing body.⁵⁷

This provision unequivocally gives a clear indication of the ECT's contracting parties' conception of control in the treaty. The non-exhaustive list of factors it is believed, sufficiently covers both the quantitative and qualitative aspects of control.

However, unlike the ECT, most BITs and IIAs do not contain provisions which seek to define and clarify the boundaries and the meaning of the term control, giving investment tribunals room to define the concept and consequently creating an avenue for the adoption of the interpretation of the concept of control considered most suitable by the tribunal to the case at hand. In other words, while it is evident that the determination of the meaning of the concept of control plays an important role in the exercise of the DOB, a definitive idea of what the concept means and how it should be applied remains elusive.

With the purpose of DOB clauses in mind, that is, the denial of the advantages of a BIT or IIA to mail-box companies controlled by nationals of a third state, it is argued, that the formulation and adoption of a concept of control which incorporates both the quantitative and qualitative approaches of control by contracting parties in their DOB clauses will be most effective. In other words, with mailbox and shell companies at the centre of attention of DOB clauses, a notion of control which arguably is most suitable for preventing shell companies from treaty shopping would be one which focuses not just on the percentage of ownership interest in an enterprise, but equally focuses on the running of the day to day activities of the corporation.

⁵⁷ Ibid, para 38.

Such a cumulative control requirement it is believed will prevent third party nationals who own a controlling percentage of the shares in a company but are not involved in its day to day running and other administrative functions from being excluded by the definition of control where the qualitative definition is used by a DOB clause. Similarly, the incorporation of a definition which requires both the 'qualitative' and 'quantitative' elements of control will ensure that third party nationals who control the day to day activities of a company but do not own a controlling interest in it will not be excluded in the case of a definition which favours the use of a qualitative measure in determining control. This approach to defining control under DOB clauses it is argued gives the clause a better chance at being effective.

4.2.1. B. Determining the Number of Corporate Structure Layers to Pierce in Determining who Controls an Investment.

Having considered the issue of the delineation and scope of what constitutes the concept of control under the DOB clause, the second question that arises from the concept of control with respect to the DOB clause is the extent to which a tribunal is to look up the corporate structure to determine whether a third country national owns or controls the corporate entity. With the exercise of DOB clauses resting in part on the notion of control, investment tribunals have used this as an opening to look beyond the corporate form of the investor or investment and to embark on a closer examination as to the structure of the investor in question.

In these cases, the treaty language has been interpreted to permit and require a more searching enquiry into the nationality of the entities or natural person(s) with

the ultimate control or ownership interest in the investment.⁵⁸ However, there is no consensus among tribunals as to the number of tiers in the investment structure to be pierced in arriving at the determination of who constitutes the ultimate investor. While some tribunals have continued to pierce through the veil of successive layers to find control, others have stopped at the first tier above the entity incorporated.⁵⁹

In the case of *AMCO v. Indonesia*⁶⁰ the tribunal pierced the veil of one corporate layer beyond the local entity to find foreign control under Article 25(2) (b) of the ICSID Convention. The tribunal determined that it had jurisdiction after piercing the veil past an Indonesian investor to its US parent. The tribunal declined looking further up the corporate structure to determine the controllers of the US investor. In justifying its position, the tribunal opined that the proper inquiry should focus on the nationality of the foreign legal personality directly controlling the corporate entity rather than the nationality of those entities controlling the foreign legal entity itself.⁶¹

In the case of *AUCOVEN v Venezuela*⁶², the tribunal also pierced the veil and stopped at a single layer in determining the controllers of the corporate entity. The respondent state, Venezuela, argued for the piercing of the second layer in the corporate structure, stating that the ultimate controllers of the investment are Mexican nationals, and therefore nationals of a country not a contracting party to the ICSID Convention. The tribunal, however, in rejecting the argument observed:

“ Like the other objective requirements of Article 25 of the ICSID Convention, foreign control is not defined. Article 25(2)(b) does not specify the nature,

⁵⁸ Doucleff and Thorn (n 38) 14.

⁵⁹ Ibid.

⁶⁰ *AMCO and others v Republic of Indonesia*, ICSID Case No ARB/81/1, Decision on Jurisdiction, 25 September 1983.

⁶¹ Ibid.

⁶² *Autopista Concesionada de Venezuela, C.A v Bolivarian Republic of Venezuela*, ICSID Case No ARB/00/5, Decision on Jurisdiction, 27 September, 2001.

direct, indirect, ultimate or effective, of the foreign control. In different decisions on jurisdiction, arbitral tribunals have discussed how far a tribunal should go in searching for foreign control. In Amco the tribunal considered that it should go one step behind the nationality of the host State..."⁶³

The tribunal on the strength of this argument assumed jurisdiction over the matter.

However, in the case of *SOABI v Senegal*⁶⁴, the tribunal pierced two layers in the corporate structure. The first layer revealed the company to be controlled and wholly owned by a Panamanian company, however, as Panama was not a contracting party to the ICSID Convention; the tribunal pierced the second layer in the corporate structure to reveal the controllers of the Panamanian company, who were themselves nationals of an ICSID contracting party. In support of the tribunal's decision to pierce an additional layer in the corporate structure, the tribunal noted that:

*"investors may be led for the reasons of their own interests to invest their funds through intermediaries, while retaining the same degree of control over the national company as they would have been able to exercise as direct shareholders of the latter"*⁶⁵

In another instance, the tribunal in *ADT v. Bolivia*⁶⁶ pierced through to the third and fourth tiers. From its findings, the tribunal discovered that the 55% of the Bolivian company was held by a Luxembourg company, which in turn was 100% owned and controlled by a Dutch company, which in turn was also 100% owned by another

⁶³ Ibid, paras 110 -111.

⁶⁴ *Société Ouest-Africaine des Bétons Industriels (SOABI) v Senegal*, ICSID Case No ARB82/1, Decision on Jurisdiction, 1 August, 1984.

⁶⁵ Ibid, para 37.

⁶⁶ *Aguas Del Tunari S.A v Republic of Bolivia*, ICSID Case No ARB/02/3, Decision on Respondent's Objection to Jurisdiction, 21st October, 2005.

Dutch company. The tribunal concluded that the local company was controlled, directly or indirectly, by Dutch nationals and therefore that it had jurisdiction under the Netherlands-Bolivia BIT. The tribunal after piercing the fourth layer rejected Bolivia's calls that it should lift additional layers because the relevant entity behind the structure were not the Dutch companies, who were according to Bolivia mere shells through which a US corporation as the ultimate controller made its investments.

However, the tribunal in the case of *TSA Spectrum de Argentina S.A. v. the Argentine Republic*⁶⁷ took a different position and pierced multiple corporate layers to reach what the majority determined to be the “real source of control” or the “true controller” of the locally incorporated vehicle. In explaining its position, the tribunal observed that:

“It would not be consistent with the text, if the tribunal, when establishing whether there is foreign control, would be directed to pierce the veil of the corporate entity national of the host State and to stop short at the second corporate layer it meets, rather than pursuing its objective identification of foreign control up to its real source, using the same criterion with which it started”⁶⁸

The tribunal also aligning itself with the position of Professor Schreuer considered that the question of determining the nationality of the ultimate controlling entity in a corporate structure is underscored by whether or not it is:

⁶⁷ *TSA Spectrum de Argentina S.A v Argentine Republic*, ICSID Case No. ARB/05/5, Award, 19 December, 2008.

⁶⁸ *Ibid*, para 147.

“...sufficient for nationals of non-Contracting States or even of the host State to set up a company of convenience in a Contracting State to create the semblance of appropriate foreign control?...the better approach would appear to be a realistic look at the true controller thereby blocking access to the Centre for juridical persons that are controlled directly or indirectly by nationals of non-Contracting States or nationals of the host State”⁶⁹

While the positions of these tribunals as regards how far the tribunal is to pierce in determining in control might differ; they are particularly instructive in the consideration of the same question as regards the DOB clause. A closer look at the aforementioned cases reveals that the extent to which most investment tribunals are willing to pierce the layers of corporate entities behind an investment is often determinative of whether a controlling entity in the holding structure of the claimant meets the definition of investor as contained in the relevant BIT. Thus, once the ‘foreignness’ of the investment is determined (under the control criterion), investment tribunals often consider that part of their work done. More so, there is generally little discussion in these decisions on the principles that caused the tribunal to stop at one layer as against another.⁷⁰

Notwithstanding that most investment tribunals approach the issue of the number of layers to pierce differently, the nature of the control criteria in determining who constitutes an investor under a BIT, suggests that contracting parties desire to only confer the benefits of the investment to an investor only when the ‘real controllers’ are nationals of the other contracting party. It is argued that the true intentions of the parties in opting for a control criteria demands that the ‘ultimate controller’ of the

⁶⁹ Ibid, para 153.

⁷⁰ Ibid.

investment be determined. To stop the piercing of a corporate structure in the determination of an investment on the basis of the fact that the investment tribunal has happened to pierce through a tier with an investor who has the nationality of the other contracting party begs an appreciation of the very purpose for which the control criteria is preferred to the formal nationality criteria and its inclusion in the structure of the DOB clause.

It is therefore difficult to argue with the reasoning of the tribunal in the case of *TSA Spectrum v Argentina*⁷¹, where the tribunal noted that stopping short at the second layer in determining foreign control is inconsistent with the purpose of finding the controller of an investment. But rather, a tribunal should pursue the “*objective identification of foreign control up to its real source, using the same criterion with which it started*”.⁷² This position of the tribunal is trite. The central idea, therefore, is that the question of ‘who controls the investment’ should be asked at every layer of the investment structure adopted by the investor, till the ultimate controller of the investment is reached. It is at that point that the true determination of the nationality of the investor can be made.

While taking this position with regard to the issue is important in achieving the objective of who constitutes an investor under the control criterion, it takes a more crucial status with regard to the DOB clause. This is principally because the control requirement under the clause, though designed to operate similarly under the control criterion, in looking behind the corporate form to determine the real controllers behind an investment, goes a step further in its objective to determine whether the nationality of the controller of an investment is that of the other contracting party to a

⁷¹*TSA Spectrum de Argentina S.A v Argentine Republic*, ICSID Case No. ARB/05/5, Award, 19 December, 2008.

⁷² *Ibid*, para 147.

BIT or IIA or that of a third party. This is regardless of the fact that such an investor on the surface qualifies as a protected investor under the BIT or IIA by meeting the nationality criteria.

Furthermore, considering the fact that most BITS or IIAs which contain a DOB clause make use of formal nationality criteria in determining who constitutes an investor, thus leaving room for treaty shopping through the incorporation of shell or mailbox companies who in turn control the investment. The introduction and incorporation of a DOB clause to the treaty text suggests the intent of the relevant contracting parties to deny investors who use companies to meet the requirement of the formal criteria but have no real links with the home state from accessing the benefits of the treaty.

However, where investment tribunals stop their quest in determining who controls a legal entity at the second tier (or any other tier) before the ultimate and final controller is reached, the purpose for the inclusion of the DOB clause in BITS and IIAs will be hardly realised, if at all achieved. By assuming jurisdiction at any layer where a company with the nationality of the other contracting party is found, the tribunal would be indirectly instrumental in affording third country investors who are the ultimate controllers of the investment and who have structured their investments in ways that present them as nationals of the other contracting parties to have access to the BIT.

Consequently, the very purpose of the DOB clause in seeking to weed out investors of third party countries and denying them the advantages of the treaty will be defeated. Again, the question of Professor Schreuer in relation to investors of non-contracting States to the ICSID gaining access to the Centre lends credence to this position. Framing his observation, he noted whether or not it is "...sufficient for

*nationals of non-Contracting States or even of the host State to set up a company of convenience in a Contracting State to create the semblance of appropriate foreign control?*⁷³

One can argue that this is the very question the DOB clause seeks to answer, albeit with regard to investors of non-contracting states accessing the benefits under a BIT. In answering this question, which can also be adopted to suit the DOB clause, he observed:

*“...the better approach would appear to be a realistic look at the true controller thereby blocking access to the Centre for juridical persons that are controlled directly or indirectly by nationals of non-Contracting States or nationals of the host State”*⁷⁴

However, as BITs and IIAs do not indicate the number of tiers investment tribunals are expected to pierce in determining the controller of an investment, investment tribunals have the latitude to make this decision. However, as seen in the cases above, this freedom has not resulted in a convergence of approach to the issue as most investment tribunals do not pursue the question of who controls the investment to the last tier in the investment chain.

From the foregoing, putting the control criterion of the DOB clause within the context of the effectiveness of the clause in limiting the practice of treaty shopping, the clear position is that the inclusion of the control requirement as a tool for the determination of the ‘real nationality’ of the controllers of an investment is on the face an effective device. Particularly, when the purpose of the DOB clause is considered, the use of

⁷³ Christoph Schreuer, *The ICSID Convention: A Commentary* (2nd edn, Cambridge University Press 2009).

⁷⁴ *Ibid.*

the control requirement as against the formal criteria of incorporation and *siege sociale*, seeks to mitigate the effect of the weaknesses of these other criteria. This approach seems most plausible when the requirement of control is perceived as a more effective way of determining the internationally relevant link in respect of corporate investors.⁷⁵

Notwithstanding the seeming advantages of the requirement of control in the DOB clause and its role in preventing third country nationals from gaining access to the advantages of the particular BIT, through the determination of the real controllers or owners of the investment, the control requirement as it is presently contained in DOB clauses poses a couple of challenges. First is the question of what constitutes control or ownership of an investment. Considering the importance of the notion of control in the structure of the DOB clause and its crucial status in ensuring its successful application and effectiveness, it is suggested that defining what constitutes control within context of the DOB clauses in BITs will not only give more clarity as to the intent of the contracting parties, but also ensure the effective interpretation and application of the clause.

Second, the absence of any express indication in DOB clauses as to the extent to which investment tribunals are expected to pierce through tiers of corporate structuring also leaves a grey area which can hamper the effectiveness of the clause. As mentioned earlier, the approach of most investment tribunals on the issue which more often than not favours the conclusion of the inquiry into who owns or controls the investment at any layer the national of a foreign country of the other contracting party is found will not suffice for achieving the purpose of the DOB clause.

⁷⁵ Acconci (n 7) 139.

Being a clause which seeks to factually determine the nationality of the real controllers behind companies with the purported nationality of the other contracting party, this requirement of the clause cannot be satisfied without an unveiling of all layers in the corporate structure with regard to an investment. As such the effectiveness of the DOB clause can also be mitigated by the absence of any indication as to the level of layers necessary to pierce for the determination of the real investor.

4.3. The 'Substantial Business Activity' Requirement.

Although frequently used as a touchstone for when a state may deny benefits, particularly in the context of DOB clauses, the term 'substantial business activities' like its counterpart requirement of control is not defined in BITs and IIAs; nor is it otherwise addressed in explanatory notes relating to these treaties.⁷⁶ The term is also not self-defining.⁷⁷ With the DOB clause being largely of US origins, available public materials as regards the purpose and intent of the language used in the structure of the DOB clause come from the US and reflect a US point of view.

The legislative history surrounding the ratification of US BITs, NAFTA, and the CAFTA-DR suggests that the purpose of the language adopted in the DOB clause including the use of the term 'substantial business activities' or other similar expressions is to enable states to bar shell or mailbox companies from benefitting from the treaties protection when controlled by nationals of third countries.⁷⁸ Also,

⁷⁶ Doucleff and Thorn (n 38) 14.

⁷⁷ Ibid.

⁷⁸ See the NAFTA Statement of Administrative Action delivered by the US President and Implementing Bill (H.R. Doc. No. 103-59, at 145, 593-94 (1993); the NAFTA Canadian Statement of Implementation (Canadian Dep't. of External Affairs, Statement of Implementation regarding the North American Free Trade Agreement, 1994

according to the US Executive office on the use of the term ‘substantial business activities’ , the relevant inquiry appears to be whether the company maintains its “central administration or principal place of business in the territory of, or has real and continuous links with”⁷⁹ the contracting party.⁸⁰

On defining the term ‘substantial business activities’, it was observed that there was some doubt as to whether a generic or a contextual definition of the term had any value, as the determination of whether or not a company had substantial business activities is largely dependent on the case under consideration.⁸¹ However, the concern of the US seemed to be that the adoption of a particular definition of the term could have restrictive effects on the routes through which nationals of the country can make their investments. The idea was that the drafting of a definition “could disadvantage US investors by constraining how they structure their investment activities”⁸²

As such, although an important factor in the exercise of the DOB clause, the requirement of the investor’s substantial business activity in the relevant country is seldom accompanied by an explanation of what confers substantiality on the

Canada Gazette 152); the CAFTA-DR Implementation hearings (Implementation of the Dominican Republic Central America Free Trade Agreement (DR-CAFTA), Hearing before the H. Comm. on Ways and Means, 109th Cong. 193 (2005) (CAFTA-DR Hearings)); see also the statement of Chairman of the MAI, OECD Negotiating Group on the Multilateral Agreement on Investment, Note by the Chairman: Definition of Investor and Investment, para. 3, DAFFE/MAI/DG2(66)1/REV1 (Apr. 9, 1996).

⁷⁹ Department of State, Kyrgyzstan Bilateral Investment Treaty Letter of Submittal, 7 September, 1993 (Kyrgyzstan BIT Letter of Submittal) on the definition of Company

<http://tcc.export.gov/Trade_Agreements/Bilateral_Investment_Treaties/index.asp> accessed 10 December 2016. Also worthy of mention is the U.S. Gen. Accounting Office, Assessment of Major Issues Delivered to the U.S. Congress 20 (1993), discussing a “residency” test in the context of the denial of benefits clause in NAFTA.

⁸⁰ Jennifer Doucleff and Rachel Thorn, ‘Disregarding the Corporate Veil and Denial of Benefits Clause : Testing Treaty language and the Concept of Investor’ in Michael Waibel, Asha Kaushal et al (Eds), *The Backlash against Investor Investment Arbitration* (Kluwer Law International 2010) 21, 22.

⁸¹ CAFTA-DR Hearings (statement by Ambassador Peter Allgeier that it would be “difficult, if not impossible, to come up with a generic definition suitable for all business arrangements in all sectors”).

⁸² Bilateral Treaties with Argentina, Armenia, Bulgaria, Ecuador, Kazakhstan, Moldova and Romania, United States Senate: Hearing before the S. Comm. on Foreign Relations, 103d Cong. 27 (1993) (response of US Department of State to questions of Senator Pell).

activities of the investor. Thus far, few tribunals have yet had the occasion to address this issue, and none have particularly delineated the threshold amount of economic activity required to satisfy this test.⁸³ However, an attempt will be made to identify some factors investment tribunals have considered as regards the interpretation of the term.

In the case of *Pac Rim Cayman v El Salvador*⁸⁴ the tribunal had cause to consider the issue of the substantiality of the activities of the investor as one of the requirements of the CAFTA-DR DOB clause. Article 10.12(2) of the CAFTA-DR provides:

*“Subject to Articles 18.3 (Notification and Provision of Information) and 20.4 (Consultations), a Party may deny the benefits of this Chapter to an investor of another Party that is an enterprise of such other Party and to investments of that investor if the enterprise has no substantial business activities in the territory of any Party, other than the denying Party, and persons of a non-Party, or of the denying Party, own or control the enterprise.”*⁸⁵

In reaching its conclusion, the tribunal made a distinction between the activities of the company in question and the activities of the group to which it belongs. In the tribunal’s view, the first condition under the DOB clause relates not to the collective activities of a group of companies, but to activities attributable to the “enterprise” itself.⁸⁶

⁸³ Doucleff and Thorn (n 38) 22.

⁸⁴ *Pac Rim Cayman LLC v The Republic of El Salvador*, ICSID Case No ARB/09/12, Decision of Respondent’s Jurisdictional Objections, 1 June, 2012.

⁸⁵ CAFTA-DR, art 10.12(2); headed ‘Denial of Benefits’.

⁸⁶ *Ibid*, para 4.66.

The tribunal further noted that where the enterprise's own activities do not reach the level stipulated by the DOB clause, it cannot aggregate to itself the separate activities of other natural or legal persons to increase the level of its own activities as those would not be the enterprise's activities for the purpose of applying the DOB clause.⁸⁷ The tribunal in evaluating the evidence before it referred to the claimant's lack of employees, office space and a physical existence as constituting a slender scale of activities.⁸⁸ The tribunal further distinguished a 'traditional holding company', 'which will usually have a board of directors, board minutes, a continuous physical presence and a bank account'⁸⁹, from a 'shell company', which normally will have 'no geographical location for its nominal, passive, limited, and insubstantial activities'⁹⁰

Also, in the case of *AMTO v Ukraine*⁹¹, the tribunal had the opportunity to consider the issue of substantial business activity. The respondent argued that AMTO's case was inadmissible because AMTO failed to prove that it had substantial business activities in the area of ECT member state Latvia, its place of incorporation.⁹² In the opinion of the *AMTO* tribunal, the central question in determining the substantiality of the claimant's business activities was the materiality of the activity, rather than its magnitude; according to the tribunal:

"The ECT does not contain a definition of 'substantial', nor does the Final Act of the European Energy Charter Conference that would serve as guidance for interpretation...the purpose of Article 17(1) is to exclude from ECT protection

⁸⁷ Ibid.

⁸⁸ Ibid, para 4.68.

⁸⁹ Ibid, para 4.72.

⁹⁰ Ibid, para 4.75.

⁹¹ *Limited Liability Company AMTO v Ukraine*, Arbitration Institute of Stockholm Chamber of Commerce, Arbitration No 080/2005, Award, 28 March, 2008.

⁹² The Respondent further argued that AMTO had not demonstrated it was not ultimately owned or controlled by nationals of a third country. However, as the tribunal found that AMTO had substantial business activities in the area of the contracting party, the tribunal did not touch upon the issue. See, Ibid, para 40.

investors which have adopted a nationality of convenience. Accordingly, 'substantial' in this context means 'of substance, and not merely of form'. It does not mean 'large', and the materiality not the magnitude of the business activity is the decisive question."⁹³

The tribunal went on to find that the claimant had met the requirement of substantial business activity, having showed that it had employed a small but permanent staff of two persons at its premises in the relevant territory.⁹⁴

In the case of *Petrobart v Kyrgyzstan*⁹⁵, the tribunal in reaching its conclusion on the requirement of substantial business activities of the claimant simply observed that:

*"Petrobart provides the following information about its status and activities. Petrobart is managed by Pemed Ltd, a company registered in England with its principal office in London, which is handling many of Petrobart's strategic and administrative matters. Petrobart therefore has substantial business activities in the Area of a Contracting Party, i.e. the United Kingdom, in the meaning of Article 17 of the Treaty"*⁹⁶

The extent of the strategic and administrative matters handled on behalf of Petrobart was not stated. Furthermore, the tribunal equated the provision of this information by the claimant as falling within the meaning of substantial business activities under Article 17 of the ECT containing the DOB clause. Not to mention, that the said

⁹³ *TSA v Argentina* (n72), para 69. The tribunal further reasoned that the ECT's objectives of establishing "long-term economic cooperation," "complementarities," and "mutual benefits" would be undermined where a contracting party served as a "nationality of convenience devoid of economic substance for an investment vehicle.

⁹⁴ *Ibid.*

⁹⁵ *Petrobart Ltd v The Kyrgyz Republic*, Award, Arbitration Institute of the Stockholm Chamber of Commerce, Arbitration No. 126/2003, 29 March, 2005.

⁹⁶ *Ibid.*, para 63.

activities attributed to Petrobart are in fact those of Pemed Ltd, which though manages the latter, is not the same company.

In the case of *GAI v Bolivia*⁹⁷, the claimant in its argument stated that the US – Bolivia BIT under which the claim was brought did not provide a definition of the term substantial. However, according to the claimant “*if the VCLT were to be applied, the term ‘substantial’ would not be a synonym of ‘large’*”⁹⁸. Predicating its position on the conclusion of the *Petrobart* and *AMTO* tribunals among others, the claimant argued that its maintenance of an office, holding shareholders meetings as well as board of directors meeting fulfils the conditions described under arbitral case law.⁹⁹ However, in agreeing with the position of the respondent, the tribunal concluded that the claimant had not engaged in substantive business activities, as most of the activities the claimant mentioned as relating to its activities were practically non-existent since 2003¹⁰⁰.

In the case of *Plama v Bulgaria*,¹⁰¹ the claimant conceded that it did not have substantial business activity in the territory in which it was organised; therefore the tribunal did not touch on the issue. A similar approach was taken in the case of *Yukos v Russia*¹⁰² where the claimant directly objected that it did not engage in

⁹⁷ *Gururachi America, Inc, Rurelec Plc v. The Plurinational State of Bolivia*, Award, PCA Case No. 2011-17, 31 January, 2014. Hereafter referred to as *GAI v Bolivia*.

⁹⁸ *Ibid*, para 217.

⁹⁹ *Ibid*.

¹⁰⁰ *GAI v Bolivia* (n 97) para 215. According to the tribunal:

“The Tribunal is also convinced that GAI is a company that, for the purposes of Article XII of the US-Bolivia BIT, *has no substantial business activities in the territory of the Party under whose laws it is constituted or organized.*” Insufficient evidence has been provided to prove that GAI carried on substantial business activities in the US at any point in time.”

¹⁰¹ *Plama Consortium Limited v. Republic of Bulgaria*, ICSID Case No. ARB/03/24, Decision on Jurisdiction, 27, August, 2008, para 54-68.

¹⁰² *Yukos Universal Ltd (Isle of Man) v. The Russian Federation*, PCA Case No. AA 227, Interim Award on Jurisdiction and Admissibility, 30 November, 2009, para 456; *Hulley Enterprises Ltd v. The Russian Federation*, interim Award on Jurisdiction and Admissibility, 30 November, 2009, para 460; *Veteran Petroleum Limited v. The Russian Federation*, Interim Award on Jurisdiction and Admissibility, 30 November, 2009, para 517.

substantial business activities, the tribunal however, made no further enquiries on the matter.

Also on the issue, the cases of *BP et al v Argentina*¹⁰³ and *Tokios Tokeles v Ukraine*¹⁰⁴ although outside the purview of the DOB clause are instructive. In the case of *BP v. Argentina*, the tribunal affirmed that the employment of 37,000 employees and the maintenance of offices in 50 states were substantial business activities. Similarly, in the case of *Tokios Tokeles v Ukraine*, the tribunal noted that financial statements, employment information, and a catalogue of materials produced during the period 1991-1994 constituted “substantial business activities” in Lithuania. The tribunal, however, did not specify reasons for reaching the conclusion.

The absence of definitions as to what constitutes substantial business activities by contracting parties who include the DOB clause in their treaties has left an obvious gap in the consistent and effective application of the clause. This has led investment tribunals considering the issue to give interpretations which they perceive best reflects the intention of the contracting parties. However, from the limited decisions addressing the issue of substantial business activities with respect to the DOB clause, the approach of most investment tribunals who have considered the issue does not seem to yield any definitive insight into what constitutes the substantiality of a business activity. The limited number of cases where this issue has been considered, and a fewer number where it has been analysed at a relative level of

¹⁰³ *Pan American Energy LLC, et al v. Argentine Republic*, ICSID Case No. ARB/03/13, Decision on Preliminary Objection, 27 July, 2006.

¹⁰⁴ *Tokios Tokeles v. Ukraine*, ICSID Case No. ARB/02/18. Award, 26, July, 2007.

depth have not resulted in any delineation of the threshold amount of economic activity required to satisfy this test.¹⁰⁵

Notwithstanding the paucity of arbitral jurisprudence on the definition of the term, the position of most tribunals seems to be that the formulation of what constitutes substantial business is not defined by the magnitude or size of the investor's activities in the required territories. From the cases considered, it is apparent that tribunals seem to favour a qualitative interpretation of the phrase. The emphasis, therefore, follows a qualitative rather than a quantitative line of inquiry. Thus, the fact that a company's footprint in the territory is small in quantitative terms does not mean that it will be unable to show that it has 'substantial business activities'.¹⁰⁶

The result of this approach, however, is that, first; the threshold of what amounts to substantial business activity is not high.¹⁰⁷ Thus investors in the host state can simply qualify as having substantial business activities in their home states by merely meeting the minimum legal requirements for companies in such jurisdictions;¹⁰⁸ such as having premises, filing tax returns etc. In other words, investors are not required to engage in large scale or in-depth business activities to be qualified as having engaged in substantial business activities.¹⁰⁹

Second, and consequent from the first, the interpretation of the term 'substantial business activities' in this manner creates an increase in the possibility of impeding the purpose of the DOB clause in the prevention of treaty shopping. If the intent of state parties in incorporating DOB clauses into their agreement is to prevent treaty

¹⁰⁵ Doucleff and Thorn (n 38).

¹⁰⁶ Ibid.

¹⁰⁷ Xiao-Jing Zhang, 'Proper Interpretation of Corporate Nationality under International Investment Law to prevent Treaty Shopping' (2013) 6 *Contemp.Asia Arb.J* 49.

¹⁰⁸ *GAI v Bolivia* (n 100) para 215.

¹⁰⁹ Xiao –Jing Zhang (n 107).

shopping, particularly through the use of shell companies and mailbox companies which are merely incorporated in the home state (having met the necessary requirements for the establishment of a company in the territory), then it goes without saying that the issue of the substantiality of the investors business activities is pivotal.

It is argued, that it is the determination of this criterion that reveals the economic nexus between the investor and the purported home state. The central theme of recent DOB clauses is the limitation of the activities of mailbox companies and not just companies owned by third country nationals. Therefore, the issue of the substantiality or otherwise of the activities of the company under inquiry should be one which reflects an appreciation of the mischief the clause seeks to address and its interpretation along that line. The inclusion of the substantial business activities test is to reveal the tenuousness or actuality of the economic activities of the investor in the home state, therefore, giving effect to an interpretation of the term which emphasises merely the 'qualitative' nature of certain business activities might not adequately reflect the motivation of state parties for including the term in DOB clauses.

However, if the condition of the substantiality of economic activities carried out by an investor is met by its having an existence only on paper, or even having a physical premises and employing one or two employees, keeping of tax records etc. its practical effect is contrary to the purpose of the DOB clause. In other words, the result which such an interpretation achieves deviates from the purpose of the DOB clause and the mischief the inclusion of the 'substantial business activity test' seeks to address. Putting it more succinctly, the phrase in itself is suggestive of the meeting of a threshold against which business activities of an investor must be

measured and compared. It is indicative of a standard. As such, it calls for a distinction between not just the engagement of the investor in business activities, but also the substantiality of the activities in question.

To approach this issue, one must first consider what sort of activity constitutes business activity. Starting with a basic ordinary meaning of the term, according to Merriam Webster Dictionary, the word 'business' is defined as 'commercial or mercantile activity engaged in as a means of livelihood'¹¹⁰ the same word is defined by the Black's Law Dictionary as a word embracing 'everything about which a person can be employed. That which occupies the time, attention and labour of men for the purpose of livelihood or profit'.¹¹¹ The latter also defines the term 'business activities' as a term covering all the functions, processes, activities and transactions of an organisation and its employees.¹¹² It will therefore be safe to say that having a business premises, employees and the payment of taxes among others qualify as business activities. However, the qualification of the phrase 'business activities' with the word 'substantial' in DOB clauses necessitates the consideration of this particular word and how it impacts on the interpretation of the term business activities.

The word substantial has been defined as meaning 'considerable in quantity; significantly great'.¹¹³ It has also been defined as 'being significant or large and having substance'¹¹⁴. From the above, 'substantial business activities' can therefore be defined as 'functions, processes, activities and transactions of an organisation and its employees, of a significantly great nature or considerable quantity'. This definition it is argued is more representative of the purpose of the DOB clause in

¹¹⁰ Merriam Webster 11th Collegiate Dictionary (11th edn, Merriam Webster 2004).

¹¹¹ Bryan Garner (Ed) *Black's Law Dictionary* (9th edn, Thompson West 2009).

¹¹² *Ibid.*

¹¹³ *Ibid.*

¹¹⁴ *Ibid.*

excluding mail-box and shell companies owned by nationals of a third party from accessing the benefits of an IIA or BIT.

The position canvassed is that the evaluation of what constitutes 'substantial business activities' of an investor, should not be limited to the existence of a purely qualitative yardstick. While this is undoubtedly relevant, it leans more in the fulfilment of 'business activities' which on the surface does not seem to be a difficult requirement for mail-box and shell companies to fulfil. However, a more balanced approach will be the consideration of both the quality and quantity of the investor's activities terms. This it is argued falls in step with the motivation for the incorporation of a DOB clause as a mechanism for limiting treaty shopping and for preventing undue restraint of sovereign and regulatory powers of a state for the benefit of a third party national and or investor.

4.4. Conclusion

The use of mail box companies and shell companies is arguably the most common medium of treaty shopping.¹¹⁵ By channelling an investment through corporate vehicles in one or several third country jurisdictions, corporate investors can effectively change their nationality and thereby come under the scope of application of a particular BIT or IIA.¹¹⁶

¹¹⁵ Nikiema (n 40).

¹¹⁶ Stephan Schill, *The Multilateralization of International Investment Law* (Cambridge University Press 2009) 236.

In fulfilling its function, the DOB clause as it is commonly drafted poses two questions; first, is the determination of who the real controllers of the investment are and second, whether the investor has substantial business activities in the territory of the home country. Though different tests, these tests culminate in arriving at the determination of the genuine nature of the link between the investor and the home state. Therefore, while one test seeks to determine the tenuousness or otherwise of the economic link between the investor and the home state the other attempts to unveil the genuineness of the nationality link between the investor and the home state.

Prima facie, the use of the control criterion in the DOB clause and the consequent requirement of piercing through the corporate veil of the investor allows for the proper identification of the real investors behind an investment. Similar to the use of the control criterion in defining nationality under the BIT, the use of the control test in the DOB clause seeks to prevent third party investors from benefitting from the advantages of a BIT by merely complying with the requirements of incorporation or the *siege sociale* criteria. However, and similar to the snags of the control criterion under nationality provisions, the use of the control criterion under the DOB clause gives room for a number of interpretative issues.

First, most contracting parties do not provide any definition or clarification as to what the term 'own or control' means in their DOB clauses. This has resulted in a conflict in perspective among arbitral tribunals on what constitutes control. While some tribunals have favoured the qualitative approach, which emphasises the influence of the investor on the managerial, administrative and decision making activities in the company, others lean towards the quantitative approach which equates control to the ownership of majority ownership of shares in the company. However, the better

position would be the adoption of an interpretation of control which seeks to balance not one or the other, but both aspects of control.

Second is the issue of the extent to which investment tribunals are to pierce through the different layers in a corporate structure as to arrive at the true controller of the investment. As with the first issue, contracting parties leave out any express indication as to the extent to which the search for control should be conducted. Consequently, investment tribunals in the quest to determine control stop their inquiry at one point or the other of the corporate layers through which the investment has been made. While this might be a possible and perhaps even debatably an objective approach where the control criterion is used in defining nationality, however, it does not do justice to the requirement of control under the DOB clause.

By virtue of its purpose, the design of the DOB clause is crafted for the determination of whether or not nationals of a third country control the investment. To, therefore, stop enquiring at any point in the chain of investors is to defeat the very purpose of the DOB clause in trying to limit treaty shopping through the use of mail box companies. As these companies can be at any layer of the chain, it is imperative that the question of who controls the investment must be asked at every layer until there is no layer to be pierced and the real and ultimate controller revealed. This it is argued is the most plausible intention for the incorporation of the control test in to the DOB clause and should be interpreted as such.

Similarly, on its part, the substantial business activity test also on the face promises the determination of the economic bond between the investor and the home state. However, similar to the issue of control, the term 'substantial business activity' is not defined by contracting states in their DOB clauses. In attempts to consider the issue,

investment tribunals have been reluctant to adopt a formulation of substantial business activity that is tied to the magnitude of an entity's operations in a given country.¹¹⁷ The result is that this view of the concept of 'substantial business activities' increases the chances that mail box and shell companies will meet up with the requirement, thus preventing states from exercising the right to deny benefits under the relevant treaty.

On the contrary, however, it is suggested that the purpose of the DOB clause will be better reflected by the adoption of an interpretation of the term which not only measures the quality of the activity in question, but also the quantity. This approach will ensure that mere business activities engaged in by mail box and shell companies without any form of substantiality or significance will not qualify under the relevant DOB clause. This will allow contracting parties to deny the advantages of the treaty to such companies as intended and thereby ensure that the practice of treaty shopping through the mailbox or shell company route is limited.

In conclusion, the DOB clause has the potential for limiting treaty shopping. Particularly for this chapter, the clause possesses the capacity to effectively limit treaty shopping through the mail box and shell company route. The use of the control criterion and the requirement of substantial business activities reflect the desire of contracting parties to unveil and test the genuineness and effectiveness of the economic relationship and nationality link between the investor and the home state.

Despite these intentions, however, the effectiveness of the DOB is minimised by the absence of the definition of the principal pillars upon which it rests. This has resulted

¹¹⁷ Jennifer Doucleff and Rachel Thorn, 'Disregarding the Corporate Veil and Denial of Benefits Clause : Testing Treaty language and the Concept of Investor' in Michael Waibel and Asha Kaushal et al (Eds), *The Backlash against Investor Investment Arbitration* (Kluwer Law International 2010) 3.

in a lack of consensus by arbitral tribunals on the intent of the parties. Furthermore, some interpretations have the tendency of making the requirements seem like a walk in the park for the very companies whose activities the clause seeks to restrict. Thus, as it is presently drafted in most BITs and IIAs, the DOB is not as effective as it could be in limiting treaty shopping in form of the incorporation of shell companies. However, the question still remains as to how it fares against other treaty shopping routes. The next chapter will consider the effectiveness of the clause as against treaty shopping through the round tripping route.

Chapter Five

The Effectiveness of the Denial of Benefits Clause in Limiting Treaty Shopping: The Round Tripping Route

5. Introduction

The evolution of the international investment law regime as the principal system of state responsibility for injuries to aliens and their property clearly underscores as one of its central points the issue of the foreign origin of the investor and its investment. While host states, and in particular, capital importing developing states subscribe to investment treaties under the regime, this is done in hopes that the much needed capital for development will be committed into the country by foreign investors.¹ However, implicit in the system and workings of international investment law is the reality and or perception of political risks to which foreign investments are considered to be generally susceptible in host countries, principally with respect to developing countries. At the heart of this, is the actual and or perceived bias and unreliability of their legal systems, domestic courts among other factors held by home countries and foreign investors.² In a show of good faith to their commitment to protect the investments of foreign investors, developing countries enter into bilateral investment treaties (BITS) and international investment agreements (IIAs) which seek to

¹ This is separate and apart from local investments made by nationals of the host state in carrying out economic activities and contributing to the development and prosperity of their respective nations. Peter Muchlinski 'Holistic Approaches to Development and International Investment Law: The Role of International Investment Agreements' in Julio Faundez and Celine Tan (Eds), *International Economic Law, Globalisation and Developing Countries* (Edward Elgar 2010) 180; Olivia Chung 'The Lopsided International Investment Law Regime and Its Effect on the Future of Investor – State Arbitration' (2006-2007) 47 Va. J. Int'l L. 953; Andrew Guzman 'Why LDCs Sign Treaties that Hurt Them: Explaining the Popularity of Bilateral Investment Treaties' (1998) 38 Va. J. Int'l L. 639.

² Gus Van Harten, 'Five Justifications for Investment Treaties: A Critical Discussion' (2010) 2(1) Trade Law and Development 19.

internationalise disputes on investments of the foreigner in the host state. Essentially, these countries sign these agreements among others to both signify and guarantee their promise to the foreign investor of access to the stability, predictability and sophistication of the international legal system.³

A major premise upon which the system of international investment law is based and is designed to function, therefore, is the 'foreignness' of the investor and its investment. That investments which enjoy access to an international legal system over and beyond the local and national legal and regulatory systems of the host state are of a foreign nationality is the very essence of international investment law. However, considering the issue of treaty shopping and corporate nationality planning in the regime, the question of the foreignness of the investor and its investment seems to take on decreasing relevance. This is not unconnected to the dominant definition of the concepts of investor and investment in most BITs and IIAs using the incorporation criterion.

By virtue of its nature, the use of the incorporation criterion in these agreements effectively allows third party nationals who are not covered and or protected under a particular BIT or IIA to use the corporate structure, as recognised under the BIT or IIA, to gain access to the advantages of the target BIT. This has led to what has been described as the elevation of form over substance in the determination of the nationality of the investor.⁴ It is this elevation of form over substance that lends itself to the appeal, use and abuse of the treaty shopping practice.

³ Van Harten (n2); Olivia Chung 'The Lopsided International Investment Law Regime and Its Effect on the Future of Investor – State Arbitration' (2006-2007) 47 Va. J. Int'l L 953; Andrew Guzman 'Why LDCs sign Treaties that Hurt Them: Explaining the Popularity of Bilateral Investment Treaties' (1998) 38 Va. J. Int'l L 639.

⁴ Xiao – Jing Zhang 'Proper interpretation of Nationality under International Investment Law to Prevent treaty Shopping' (2013) 6 Contemp. Asia Arb J 49; Pia Acconci, 'Determining the Internationally Relevant Link

As it is, the access of third country nationals to an investment treaty through corporate structuring is one thing. As considered in chapter four, this issue poses a number of questions. In particular, chapter four analysed the effectiveness of the DOB clause as a mechanism designed to limit and prevent access of third country nationals to BITs and IIAs through this means. However, a different scenario comes to fore where nationals of the host state, who are ordinarily to be covered by the domestic legal system of the host state seek to gain access to the protections of BITs and IIAs signed by their country with other countries. By incorporating and controlling corporations in the territory of the other contracting party to a BIT or IIA with their home state, host country nationals are able to access the advantages provided under these agreements. Most importantly, nationals are as a result empowered to sue their own states for injuries done to their investments before international investment tribunals.⁵

This issue raises a number of relevant questions. First is whether international investment law as a system designed for the protection of the properties of aliens in a territory should accommodate nationals of the host state in seeking redress for the actions of their own country with regards to their investment. Second and devolving from the first, is the consideration of whether the international investment law regime is actively or passively substituting and or undermining the role of the national legal system of the home state with regard to its own citizens and their properties?

between a state and Corporate Investor: Recent Trends Concerning the Application of “Genuine Link” Test’ (2004) 5 J. World Investment & Trade 139.

⁵ See for example the cases of *Hulley Enterprises Limited (Cyprus) v The Russian Federation*, PCA Case No. AA 266, Final Award; *Yuko Universal Limited (Isle of Man) v. The Russian Federation*, PCA Case No. AA 228, Final Award and *Veteran Petroleum Limited (Cyprus) v. The Russian Federation*, PCA Case No 226, Interim Award on Jurisdiction and Admissibility, all dated 30th November, 2009; See generally, Delphine Nougayrede ‘Yuko, Investment Round – Tripping and the Evolving Public/Private Paradigms (2015) 26(3) ARIA 1.

In other words, while international investment law demands the restriction of the sovereign powers of the contracting states in relation to the persons and investments of nationals of the other contracting party, does this restriction of state sovereignty and exercise of regulatory and judicial powers extend to its own nationals and their properties? Third, what implications does the elevation of the rights of host country nationals who structure their investments as to take advantage of the international legal system of BIT and IIAs have on other investors who are nationals of the host country but who are unable to access the same level of protection under BITs and IIAs?

While these are questions which seek to consider the ethicality or otherwise of international investment law accommodating nationals of the host state as beneficiaries of BITs and IIAs. There are positions which have also been canvassed for the reasons why investors who are nationals of the host state employ round-tripping measures in the regime.⁶ Furthermore, most investment tribunals, when faced with the question of whether or not to pierce the corporate veil, where there are allegations of the nationality of the ultimate controllers of the investment as being that of the respondent state, take a strictly formalistic approach in only considering the treaty interpretation of 'investor' as it relates to the corporate entity and not its ultimate controllers. Therefore, effectively guaranteeing and in certain instances encouraging the use of investment round-tripping schemes by nationals of the host state.

This chapter will attempt to consider some of the issues raised by the round tripping route of treaty shopping in the international investment law regime. The first part of the chapter will start by seeking to define the concept of round-tripping in

⁶ See, Kalman Kotay, 'Does it Matter Who Invests in Your Country' (2012) 66 Columbia FDI Perspectives 1.

international investment law. It will also consider the reasons behind the decision of investors to embark on round-tripping investment structuring. The second part of the chapter will analyse the questions relating to the intricate dimensions and implications the protection of nationals of the host country under BITs and IIAs signed by their home countries with other contracting parties. And lastly, the third part of the chapter will focus on the effectiveness of the DOB clause as a mechanism for limiting this form of treaty shopping in international investment law and arbitration.

5.1. The Concept of Round Tripping in International Investment Law

The current regime of international investment law and its broad network of BITs and IIAs is characterised by the imposition of obligations on host countries which are necessarily only a possibility with a restriction of the sovereign and regulatory powers of the host states. Being obligations to act or refrain from acting in certain ways with respect to the investment(s) of a foreign investor, the reality of these obligations undertaken by host states must precipitate from the containment of the sovereign and regulatory powers of the host state.

Perhaps, arguably, the most important of these impositions is the jettisoning of the host state's national legal system in favour of international law; and specifically for the purposes of our discourse, international investment law, in serving as the legal regime under which the foreign investor and its investments are to be accorded rights. The availability of these substantive rights is further given enforceability through the system's investment dispute settlement mechanisms. It is to this system that host states must submit, to show and guarantee their commitment to the protection of the investments of the foreign investor.

This abandonment of national laws on investment has been justified by the advancement of certain arguments. For the purposes of the central theme of this chapter, a number of these arguments will be highlighted.⁷ First of these, is that international investment law through investment treaties encourages foreign investment which national laws fail to attract. According to this position, the entering into investment agreement by a host state with the other contracting party will stimulate investment flows from the 'nationals of the other contracting party' to the host state.

A second justification is that the elevation of the international investment law regime over and above national investment laws with regards to 'foreign investment' is an adequate response to the bias, unreliability and underdeveloped nature of the legal systems of most host countries, particularly developing countries of Latin America, Africa, Asia and the Commonwealth of Independent States (CIS). A third argument, closely knit to the second, is that the present international investment regime through BITS and IIAs and its dispute settlement mechanisms allows for fairness and the rule of law in the resolution of investment disputes between the host states and the 'foreign' investor.

Without attempting to go into the veracity or otherwise of these positions which seek to justify the framework of international investment law as it presently stands, it is worthy of note that a central theme of international investment law is the 'foreignness' of the investor and its investment. This should come as no surprise

⁷ See generally, Van Harten (n 2) 19, where the author considered the five common arguments proffered by proponents of the current international investment law regime in justifying the structure of the regime as it presently stands. While the author raises certain salient observations and arguments in an attempt to analyse these positions, our focus is only restricted to how international investment law impacts national investment laws in the jurisdiction of the host states; particularly the accommodation of nationals of the host state in international investment law's structure of substantive and procedural rights against their own states.

when the foundation of international investment law is considered. Having its roots in the international law of state responsibility to injuries to aliens and their properties, the focus of international investment law is one predicated on the 'alien origin' of the investor and its investment. Although the origin of state responsibility is independent of any attempt to create international law on foreign investment, its basic principles had an impact on foreign investment law as it guaranteed a minimum level of security to foreign investors.⁸

For the purposes of this work, it is important to restate that the major reason why most developing capital importing states have allowed themselves to enter into obligations which protect 'foreign investments and foreign investors' is in the hope of attracting foreign investments for economic development. In other words, these countries commit to these set of obligations with investments external to investments by local investors in mind. As such, according to a commentator "countries grant international protection to foreign investment because of the positive externalities they bring".⁹

The argument can be made, however, as to the materiality or relevance of the origin of investments, particularly where infrastructural, technological and other commitments by the investor ultimately culminate in the contribution to the economic development of the host state. Conversely, it is argued that countries do not enter into BITs and IIAs because of locally owned investments within their territories. That is, parties enter into these agreements on behalf of their nationals for their investments in the territory of the other contracting party, where they are considered

⁸ Burns Weston, 'The New International Economic Order and Deprivation of Foreign Proprietary Wealth: Some Reflections upon the Contemporary International Law Debate', in Richard Lillich (Ed), *International Law of State Responsibility for Injury to Aliens* (University of Virginia Press 1983) 89-125.

⁹ Omar Garcia-Bolivar, 'The Teleology of International Investment Law: The Role of Purpose in the Interpretation of International Investment Agreements' (2005) 6 J. World Investment & Trade 751.

'foreigners' and their investment in such territory as 'foreign investment'. While on the face of it the origin or means by and through which investments are brought into a host state are perhaps immaterial, following an end justifies the means approach, the very character of international investment law points to the contrary.

A particularity of BITs and other IIAs entered into by contracting parties strongly suggests that these agreements are not made to elevate local and domestic investments to the status of foreign investments and thus put them in a standing outside of the purview of national laws on investment. Evidently, therefore, the means by which international investment law seeks to achieve its purpose of contributing to the economic development of nations, is the according of international protection to foreign investments, which by their nature are a matter of international law as it relates among others to the transfer of capital from the territory of one country to that of another.

It goes without saying that the protection of domestic investments of nationals of the host states within the territory of the host state should be outside of the purview of international investment law. This view is also expressed in the ICSID Convention, where for the Centre to assume jurisdiction certain requirements have to be met. Among these requirements is that the non-state party to the dispute must not be a national of the host state.¹⁰

¹⁰ Article 25(2) ICSID Convention, Regulations and Rules (International Centre for Settlement of Investment Disputes 2003), which provides:

"National of another Contracting State" means:

- (a) *any natural person who had the nationality of a Contracting State other than the State party to the dispute on the date on which the parties consented to submit such dispute to conciliation or arbitration as well as on the date on which the request was registered pursuant to paragraph (3) of Article 28 or paragraph (3) of Article 36, but does not include any person who on either date also had the nationality of the Contracting State party to the dispute; and*
- (b) *any juridical person which had the nationality of a Contracting State other than the State party to the dispute on the date on which the parties consented to submit such dispute to conciliation or arbitration and*

However, most investment tribunals approach the issue of access of a host state's national to international investment law protection by adopting a private law paradigm.¹¹ Using this approach, many investment tribunals uphold the legal form of the investment structures adopted by investors over economic substance. The primary argument proffered is that the literal interpretation of 'investor' in most BITs and IIAs which stipulates the incorporation criteria does not require the determination of who constitutes the ultimate owners and or controllers of a corporate investor or investment vehicle, even in instances where the beneficial owners of the company or vehicle are nationals of the host country.

A prominent case exemplifying the practice of investment round tripping in international Investment law is *Tokios Tokeles*.¹² In the case, Tokios Tokeles a company incorporated under the laws of Lithuania established a wholly owned subsidiary, Takki Spravy under the laws of Ukraine.¹³ Subsequently, Tokios Tokeles initiated ICSID arbitration proceedings against Ukraine, claiming that Ukraine had breached the BIT between Lithuania and Ukraine by embarking on certain activities which adversely affected its investments in Ukraine.¹⁴

any juridical person which had the nationality of the Contracting State party to the dispute on that date and which, because of foreign control, the parties have agreed should be treated as a national of another Contracting State for the purposes of this Convention. It is worthy of note that with regard to the phrase 'foreign control' as used in the provision, particularly 2(b), two contesting views are held. One view holds that tribunal should search for control by a national of a contracting state until the tribunal has jurisdiction. The other view holds that tribunals should endeavour to look at the true controllers of the company or investment structure, though the direct or indirect control of the nationals of a non-contracting third party or of nationals of the host state, who should be denied access to the ICSID.

¹¹ See generally, Peter Muchlinski, 'Corporations and the Uses of Law: International Investment Arbitration as a "Multilateral Legal Order"', (2011) 1(4) *Onati Socio Legal Series* 1; Delphine Nougayrede 'Yukos, Investment Round Tripping and the Evolving Public – Private Paradigms' (2015) 26(3) *American Review of International Arbitration* 1.

¹² *Tokios Tokeles v Ukraine (Tokios Tokeles)*, ICSID Case No ARB/02/ 18, Decision on Jurisdiction, 29 April 2004.

¹³ *Ibid*, para 3.

¹⁴ *Ibid*, para 1, 2.

Ukraine objected to the tribunal's jurisdiction, arguing *inter alia* that the claimant was not a 'genuine entity' of Lithuania, as it was owned and controlled by Ukrainian nationals, who owned ninety- nine percent of the companies share and comprised two-thirds of the company's management. According to the respondent, the dispute was therefore one that subsists between a state and its own nationals and not a matter for the ICSID. Furthermore, the respondent argued that to find jurisdiction in the case would be tantamount to allowing nationals of the host state to pursue international arbitration against their own government.¹⁵

The position espoused by the Ukrainian government, while indicative of the attitude of states to the practice of round tripping as a means of gaining BIT access does not, however, effectively reflect the position deemed adopted by Ukraine under the relevant BIT. As such, while the position of Ukraine might be appreciated on policy grounds and within the general context of public international law as regards the relationship between the state and its citizens, the *lex specialis* nature of the subsisting BIT under which the claim had be brought dictated that the relevant nationality granting jurisdiction to the tribunal was that defined in the BIT.

The Ukraine – Lithuania BIT defined foreign investors as those entities incorporated in the other state party. Based on this definition, the majority of the tribunal held that the claimant, though owned and controlled by nationals of the respondent state, were covered by the BIT and could access the ICSID. According to the tribunal:

"...Contracting Parties are free to define their consent to jurisdiction in terms that are broad or narrow; they may employ a control-test or reserve the right to deny treaty protection to claimants who otherwise would have recourse

¹⁵ Ibid, para 21, 22.

under the BIT. Once that consent is defined, however, tribunals should give effect to it, unless doing so would allow the Convention to be used for purposes for which it clearly was not intended.”¹⁶

Furthermore, the majority also stated that the “ICSID Convention contains no inchoate requirement that the investment at issue in a dispute have international character in which origin of the capital is decisive”.¹⁷ Similarly, they also did not view the decision to allow access of nationals of the host country through the use of corporate entities as being tantamount to the “Convention to be used for the purposes for which it clearly was not intended”.¹⁸

However, the chairman of the tribunal Professor Prosper Weil in dissent, argued that the purpose of the ICSID Convention was to govern international investments, that is, investments characterised by a trans-border movement of capital and not investment disputes between a country and its citizens.¹⁹

In making his point, the Professor stated:

“...when it comes to ascertaining the international character of an investment, the origin of the capital is relevant, and even decisive. True, the Convention does not provide a precise and clear-cut definition of the concept of international investment- no more than it provides a precise and clear-cut definition of the concept of investment - , and it is therefore for each ICSID

¹⁶ Ibid, para 39.

¹⁷ Ibid, para 82.

¹⁸ Ibid, para 39.

¹⁹ *Tokios Tokeles v Ukraine*, Dissenting Opinion of Prosper Weil, 29 April, 2004, para 19 (hereinafter *Tokios Tokeles, Dissenting Opinion*).

tribunal to determine whether the specific facts of the case warrant the conclusion that is before an international investment”^{20 21}

However, before analysing the positions presented by the tribunal,²² the next section will venture to consider the meaning and reasons why investors engage in investment round tripping, particularly as regards the international investment law regime.

5.2. The Nature and Objectives of Investment Round Tripping in International Investment Law.

Investment round tripping is the process whereby investors who are nationals of a host country structure their investments in ways which allow them to route their investments through other countries and jurisdictions back into national economies.²³ It involves a process through which a local investor seeks to internationalise, or in the least confer on its investment the nationality of another country and reintroduce the investment back into its local economy as a foreign investment.²⁴ Therefore, the investor, holding the nationality of the host state in which it has invested is in fact not a foreign investor and consequently, its investment is not foreign investment.

This method of treaty shopping, allows a local investor who wishes to access and take advantage of the protection conferred on foreign investors in a BIT between its

²⁰ Ibid, para 20.

²¹ Arguing further in respect of the particular case, he noted:

“what is decisive in our case is the simple, straightforward, objective fact that the dispute before the ICSID Tribunal is not between the Ukrainian State and a foreign investor but between the Ukrainian State and an Ukrainian investor-and to such a relationship and to such a dispute the ICSID Convention was not meant to apply and does not apply” Ibid, para 21.

²² These will be dealt with in the latter part of the chapter.

²³ Delphine Nougayrede ‘Yuko, Investment Round – Tripping and the Evolving Public/Private Paradigms’ (2015) 26(3) ARIA, 1.

²⁴ See, Muchlinski (n 1); Nougayrede (n 23). Peter Muchlinski particularly argues that the interpretations of investment treaties in ways which seek to allow claimants possessing the nationality of the host country itself to claim against the host state of which they are nationals lack real legitimacy and create unacceptable procedural burdens on the host country.

own country and the other contracting party to the BIT, to structure its investments as to acquire the nationality of the other contracting party to the BIT.²⁵ To achieve this, the investor reroutes its investment into the local economy not directly through a local company, but makes use of intermediary foreign entities that are interposed between them and the target of the investment itself.²⁶ According to the Organization for Economic Cooperation and Development (OECD), “round-tripping refers to the channelling abroad by direct investors of local funds and the subsequent return of these funds to the local economy in the form of direct investment.”²⁷

There are a number of reasons why investors engage in investment round-tripping.²⁸ First among these is the maximization of tax incentives. Through round tripping their investments, local investors are able to access domestic tax benefits which are reserved for foreign investors under the national investment laws of their countries.²⁹ Second, local investors engage in round-tripping to avoid certain administrative and regulatory restrictions. This includes instances of currency controls or restrictions on the ability of the local investor to hold assets in foreign currency. Therefore, in such instances, round tripping facilitates access to and repatriation of foreign capital when needed.³⁰

²⁵ Suzy Nikiema, *Best Practices Series: Definition of Investor* (The International Institute for Sustainable Development 2012) 1.

²⁶ See, Nougayrede (23).

²⁷ See OECD, *Benchmark Definition of Foreign Investment*, (4th edn, OECD 2008)1 (hereinafter BMD4); OECD, *How Multinationals Enterprises Channel Investments through Multiple Countries* (OECD February 2015)1.

²⁸ On the concept of round-tripping and its objectives in the foreign investment regime, see OECD, (n 27).

²⁹ Svetlana Ledyeva, Päivi Karhune and John Whalley, 'If Foreign Investment is not Foreign: Round-Trip Versus Genuine Foreign Investment in Russia' (2013) CEPII Working Paper 2013- 05. <http://cepii.fr/PDF_PUB/wp/2013/wp2013-05.pdf > accessed 22 November 2016; authors argue that that it is the institutional imperfections of the country of the local investor that prompts firms to escape home country institutional constraints. As such, according to the authors, through firms may relocate their business activities to avoid high home country taxes or other burdensome regulation. Also, capital flight from developing countries has been identified as driven by political instability, economic risk and policy uncertainty; See also OECD (27).

³⁰ Nougayrede (n 23).

A third reason why investors engage in the practice is as a result of instances where the legal institutional framework of the home country is insufficiently mature and or sophisticated. This includes company law, contract laws and courts in the country.³¹ Therefore, to access legal frameworks and institutions that are more advanced and developed than that of the home state; that is, legal systems which can sufficiently cater for the corporate and or contractual needs of the investor, investors round trip their investment through jurisdictions where such legal facilities are accessible. This has been the case with regards to China and Russia.³²

A fourth objective for engaging in round tripping by local investors, and particularly relevant to international investment law regime, is that local investors, particularly in countries with a high level of political risk are able to access, and claim property right protections and compensations under international investment law. This is done by securing the nationality of the other contracting party or parties to a BIT or IIA with the home country of the local investor.

These reasons are not without implications. Notably, while a domestic investor engaging in this practice can find it to be of great the advantage to its investment. And particularly with regard to an unstable country, it has been argued that round tripping allows the ability of domestic investors to keep investments in the country that would otherwise leave altogether.³³ While this position holds some credibility, however, a crucial point which must not be overlooked is that where round tripping is permitted, it effectively allows for the substitution or imposition of international law

³¹ Ibid.

³² See, Wei Shen, 'China's Dilemma: How Can a Weak Company Law Regime Support a Strong Market for International Private Equity Investments? A Real "Piggybacking" Case' (2010) 11 Bus. L. Int'l 195; Delphine Nougayrede, 'Outsourcing Law in Post-Soviet Russia', (2013) 3 J.Eurasian Law 383.

³³ See, Thomas Jost, 'FDI in Russia in Difficult Times' (2015) 150 Columbia FDI Perspectives 1.

over the national law of the state on issues of domestic investment between the state and its own nationals.

The essence of international investment law is the creation of a legal framework for the protection of the investment of a foreign investor in the territory of the host state. As such, international investment law is not designed for the protection of the national of the host state and its investment. Where international investment law is thus employed by domestic investors in seeking to protect their investments in their own states, this undoubtedly raises policy concerns on the part of the host state. Particularly, the practice can be said to undermine the sovereignty of the host state on issues of investments of its nationals.

Seeking to curb the practice for many countries, therefore, is a question of the preservation of the state's national powers in determining and regulating the investments of its nationals within its territory as a sovereign entity against what it perceives as an incursion of international law in its domestic jurisdiction. Consequently, while the practice of round tripping may indeed be of benefit to the investor of a country subject to political risks, and perhaps also allows for the continued presence of such investments within the relevant state, the question of the preservation of state sovereignty within the context of the state and its domestic investors makes round tripping a sensitive issue for host states. It is argued, therefore, that while the idea of round tripping or the availability of international investment protection without restrictions and distinctions on the basis of nationality is subject to debate, however, international investment law should be contained and limited to the protection of foreign investments in reflection of the intent of state parties.

5.2.1. Policy Response to Round Tripping

While the views as regards the concept of round tripping range from the positive to the negative, it is increasingly evident that most states perceive round tripping negatively.³⁴ Consequently, states have sought to address the issue of round tripping through the adoption of different policies. This part of the chapter will seek to highlight some of the policies states have adopted in addressing the issue of round tripping and the objectives investors have for engaging in the practice.

Considering the objectives of the avoidance of tax and regulatory avoidance by local investors, states have initiated both domestic and international initiatives to address and discourage round tripping for these purposes. One of such measures is the use of *ex ante* administrative controls on outbound capital transfers by domestic residents.³⁵ For example, China has a history of regulating the use of foreign offshore repatriations through the use of such capital controls and restrictions at the point of exit from the country.³⁶

Another approach that has been adopted by states is the implementation of tax on income received by residents from foreign companies under their ownership or control. This is applicable where the companies in question benefit from low tax regimes through the use of “controlled foreign corporation” (CFC) taxation mechanisms that look through layers of intermediary companies in order to impute

³⁴ Nougayrede (n 23).

³⁵ Ibid.

³⁶ Editorial, ‘End Round-Tripping, Tackling the Controversial Mauritius Route’, *Business Standard* (New Delhi, 18 July 2013) <http://www.business-standard.com/article/opinion/end-round-tripping-113071801058_1.html> accessed 10th May 2016.

income directly into the hands of the ultimate beneficiaries at the top.³⁷ This approach allows the state to disregard the legal existence of the intermediary holding companies in low tax jurisdictions.

Round tripping can also be addressed through the use of international tax law and the use of double tax treaties between states. This technique requires that to claim the protection of tax treaties the beneficiary must satisfy the condition that the recipient is not merely a resident of one of the contracting states, but also the beneficial owner of the income. More recently, the OECD has lead initiatives for a more substantive definition of beneficial ownership for the purpose of these treaty provisions.³⁸

This initiative seeks to introduce the requirement that companies that do not have enough local substance should not be able to claim exceptions or reduced tax rates on dividends.³⁹ This prerequisite for the existence of real substance in foreign holding companies is a reflection of the growing shift in state policies not to allow shell companies and empty corporate structures unconditional access to tax treaty benefits and thereby allowing local nationals of the home countries access benefits of tax treaties and thereby denying their countries revenue.

Also, worthy of note are the increasing global initiatives set up by states in combating money laundering as well proceeds from corruption and tax evasion under different national jurisdictions. While these do not expressly focus on round tripping but on the

³⁷ Nougayrede (n 23). It is worthy of note that CFC taxation mechanisms do not by themselves address round tripping specifically. This is because they only impute income routed through holding companies regardless of the location of these investee companies, but do not effectively capture within their scope companies owned through round tripping structures.

³⁸ Ibid.

³⁹ Dirk Dewitte, Finsen Chan, Yves Knel and Jim Chung, 'The Use of Various Jurisdictions in China' (2010) Tax Notes Int'l. <<https://www.taxnotes.com/document-list/contributors-authors/knel-yves>> accessed 18 November, 2016.

creation of transparency requirements that will reduce the transnational “misuse” of corporate vehicles,⁴⁰ they are also instrumental and contribute to the policing of round tripping. These initiatives seek to place requirements on banks and other financial service providers as well as other “gatekeepers” of the global financial system including accountants, lawyers and providers of corporate and trust services who tend to be actively involved in the implementation of round tripping.⁴¹

The idea sought to be expressed through these initiatives is largely the elevation of substance over form. As such, these initiatives give “limited credit to the legal form of structures and requires gatekeeper professionals to delve behind the paperwork and examine the reality of what is happening before their eyes”.⁴² ⁴³ Indeed while none of these regulations directly targets round tripping or render it as unlawful, they however, reflect the growing perspective and its expressions through state policies on the reality of ownership and control within legal structures, beyond the formal

⁴⁰ See generally, FATF, ‘The Misuse of Corporate Vehicles Including Trusts and Company Service Providers’ (FATF 2012), < <http://www.fatf-gafi.org/documents/documents/themisuseofcorporatevehiclesincludingtrustandcompanyserviceproviders.htm> > accessed 17 December 2016.

⁴¹ This initiative as regards “gatekeepers” which effectively includes lawyers and other professions within the ambit of anti-money-laundering purposes started in October 1999, when a ministerial meeting of the G8 decided to “consider putting certain responsibilities...on those professionals, such as lawyers, accountants, company, company formation agents, auditors and other financial intermediaries who can either block or facilitate the entry of organized crime money into the financial system”. See Communiqué of the Ministerial Conference of the G-8 Countries on Combating Transnational Organized Crime (Moscow 2007) 7

⁴² See, Nougayrede (n 23). This position was aptly described by the Financial Action Task Force (FATF) as follows:

“An essential element of the FATF definition of beneficial owner is that it extends beyond legal ownership and control to consider the notion of ultimate (actual) ownership and control. In other words, the FATF definition focuses on the natural (not legal) persons who actually own and take advantage of capital or assets of the legal person; as well as those who really exert effective control over it (whether or not they occupy formal positions within that legal person), rather than just the natural or legal) persons who are legally (on paper) entitled to do so.”

⁴³ See, FATF, ‘Transparency and Beneficial Ownership’ (2014 FATF) available at <<http://www.fatf-gafi.org/media/fatf/documents/reports/Guidance-transparency-beneficial-ownership.pdf>. > accessed 17 December 2016.

documentation employed by shell and holding companies for the purposes of engaging in round tripping practice.⁴⁴

These advancements it is submitted contribute importantly to the development of international investment law, in that with the awareness of state parties to the reality of the structures and systems of ownership employed by companies, states are in a better position to formulate policies and draft investment agreements which effectively address the questions of treaty shopping and round tripping in particular. In other words, while these regulations might not culminate in an immediate remediation of the issue, they can be considered as foundational policy constructs upon which concrete solutions and legal mechanisms can be drawn and put in place in limiting the practice.

With respect to the objectives of accessing sophisticated legal systems and the protection of their property rights under international investment law, some states have expressed dissatisfaction with the accommodation of round tripping schemes under the international investment regime. This is because the covering and the treatment of local investors as foreign investors under investment treaties does not seem to be part of the intent of most state parties, particularly capital importing developing states in signing BITS and IIAs under the regime. This opinion has been expressed by commentators stating that “it was never evident...that round tripping investors would be treated as foreign investors under...investment treaties”.⁴⁵The case of *Tokio Tokeles* referred to earlier is a classic example reflecting the attitude of most state parties to being sued by their own nationals through the use of companies

⁴⁴ See, Nougayrede (n 23).

⁴⁵ Ibid.

established according to the laws of the other contracting party to a BIT or IIA though round tripping measures.

However, the complexity of the conceptual and normative framework of international investment as an amalgamation of both public and private spheres of international law is also expressed in the difficulty of arriving or achieving a balance in the regime. In his opinion in the *Tokios Tokeles* case, Professor Prosper Weil presenting his position along the public – private nature of international investment argued that international investment law is a branch of public law and as such should endeavour to give precedence to the consideration of substance-over-form over the private element of the regime. He further opined that it was not acceptable to allow investment law to become a tool for the evasion from the jurisdiction from domestic courts by local investors of the respondent state.⁴⁶

While Professor Weil touches on a number of salient points in his dissenting argument, particularly the evasion of jurisdiction by national corporations and the accessing of BITs and IIAs through the use of round tripping methods by local investors; his position remains in the minority till date.⁴⁷

This is perhaps not unconnected to the notion that while international investment law may undoubtedly concern states and the exercise and or restriction of their

⁴⁶ *Tokios Tokeles, Dissenting Opinion. According to the Professor:*

“insofar as business law and issues of business liability are involved, there is no need for denying effect to the corporate structure chosen by the economic agents. When it comes to mechanisms involving States and implying, therefore, issues of public international law, economic and political reality is to prevail over legal structure, so much that the application of the basic principles of public international law should not be frustrated by legal concepts and rules prevailing in the relations between private economic and juridical players. The object and purpose of the ICSID Convention is not – and its effect, therefore, should not be – to afford domestic, national corporations the means of evading the jurisdiction of their domestic, national tribunals.”

⁴⁷ See Omar Garcia – Bolivar, ‘The Teleology of International Investment Law : The Role of Purpose in the Interpretation of International Investment Agreements’ (2005) Vol 6 J.World Investment & Trade 751; Nougayrede (n 23); Markus Burgstaller, ‘Nationality of Corporate Investors and International Claims against the Investor’s Own State’, (2006) 7 J.World Investment & Trade 857.

sovereign and regulatory powers, the private paradigm of investment law, which focuses on the international recognition of companies, contracts and most importantly, the sanctity of the will of the contracting parties, places a high premium on the expression of the will of the parties as contained in the BITs and IIAs signed by the contracting states.⁴⁸

As such under the international investment law regime, treaty shopping through round tripping is treated similarly as other treaty shopping routes by investment tribunals. Therefore, where the relevant BIT or IIA provides for a definition of a covered investor using the incorporation criteria, tribunals have leaned towards the consideration of the nationality of the investor strictly based on the definition provided by the parties, this is regardless of whether or not the ultimate beneficiaries of the corporate entity are themselves nationals of the respondent state in the investment claim.

This allows the nationals of the host state the opportunity to access the advantages of BITs and IIAs signed by their countries with other contracting parties, which ordinarily are not intended for them. Not only do tribunals tend to lean towards the interpretation of BITs in this light, there are instances where tribunals encourage nationals of host countries to engage in round tripping methods to allow them gain access to BIT protection. An instance is the case of *Soufraki v UAE*⁴⁹. Here the tribunal in expressing its thoughts on the dual nationality of the claimant, stated:

⁴⁸ Nougayrede (n 23).

⁴⁹ *Soufraki v United Arab Emirates (UAE)*, Award, 7 July 2004.

“ ...had Mr. Soufraki contracted with the United Arab Emirates through a corporate vehicle incorporated in Italy, rather than contracting in his personal capacity, no problem of jurisdiction would now arise”⁵⁰

The argument in support of this stance as considered earlier in this work,⁵¹ is that arbitral tribunals are only obliged to interpret the provisions of BITs and IIAs “in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose”.⁵²

However, it can be argued, as already done in the earlier part of this work, that the strict formalistic stance taken by most investment tribunals as regards the interpretation of BITs and IIAs is partly a failure to take cognisance of certain factors. This leads us to the consideration of some of the issues raised by investment round tripping and how these issues should impact the considerations of investment tribunals in the determination of the coverage of nationals of the host state under BITs and IIAs.

5.3. Investment Round Tripping: Issues and Considerations

⁵⁰ Ibid, para 83.

⁵¹ Chapter two of this work deals extensively on this issue. For example, this position was expressed in the case of *Saluka v Czech Republic* where the tribunal stated:

“ the predominant factor which must guide the Tribunal’s exercise of its functions is the terms in which the parties to the Treaty now in question have agreed to establish the Tribunal’s jurisdiction. In the present context, that means the terms in which they have agreed upon who is an investor who may become a claimant entitled to invoke the Treaty’s arbitration procedures. The parties had complete freedom of choice in this matter, and they chose to limit entitled “investors” to those satisfying the definition set out in Article 1 of the Treaty. The Tribunal cannot in effect impose upon the parties a definition of “investor” other than that which they themselves agreed. That agreed definition required only that the claimant-investor should be constituted under the laws of (in the present case) The Netherlands, and it is not open to the Tribunal to add other requirements which the parties could themselves have added but which they omitted to add”.

⁵² United Nations, *Vienna Convention on the Law of Treaties*, 23 May 1969, United Nations, Treaty Series, vol. 1155, p. 331, art 31.1 < <http://www.refworld.org/docid/3ae6b3a10.html> > accessed 14 May 2018. Hereafter referred to as The Vienna Convention.

The position that BITs and IIAs should be interpreted strictly with regard to the expressed intentions of the contacting parties as contained in the relevant agreement is largely representative of the private international law paradigm of international investment law. This approach to international investment law consequently places less consideration on the nature of international investment law as a species of international law has having a public international law background. This point is further appreciated when the fact is considered that private individuals who are not in the employ of any nation serve as adjudicators in investment disputes between states and private persons; and in many instances having largely international commercial law leanings.⁵³

The cornerstone of this position in the interpretation of these agreements, as stated earlier, rests on the provision of Article 31(1) of the Vienna Convention. However, while it is evident that the position of this provision is clear and applicable no doubt to disputes relating to international investment law, most arbitrators seem to neglect or in some instances seem to wish away or proffer some form of argument to undercut the relevance of Article 32 of the Convention. Article 32 of the Convention provides:

“Recourse may be had to supplementary means of interpretation, including the preparatory work of the treaty and the circumstances of its conclusion, in order to confirm the meaning resulting from the application of article 31, or to determine the meaning when the interpretation according to article 31:

(a) leaves the meaning ambiguous or obscure; or

(b) leads to a result which is manifestly absurd or unreasonable.”

⁵³ See, Gus van Harten, *Investment Arbitration and Public Law* (OUP 2007) 124, 125. This point is further explored in Chapter 7 of this work.

The issue brought to fore here is the seeming disregard of most investment tribunals for article 32, particularly 32(b). A consideration of this provision brings to light the “absurd and unreasonable” nature the notion of empowering nationals of a host state to bring investment claims against their own state, particularly through the mechanism of corporate structuring and nationality planning. It is argued that were individuals to directly institute claims against their states, the position of investment tribunals will reflect this absurdity clearly. Regardless, the same principle should hold true, where nationals of the host country hiding behind the cloak of incorporation to bring claims against their own countries.

5.3.1. Policy and Legal Implications of Investment Round Tripping in International Investment Law.

The first issue the accommodation of round tripping in the international investment law regime raises is the question of whether contracting parties to BITs and IIAs sought to allow the nationals of their country to find redress for the actions of their own government with regards to investment they have made locally within the territory of their own country. This question does not suggest an affirmative response. A consideration of the history and development of international investment law and the practice of drafting and entering into BITs does not lend credence to this either.

As mentioned earlier in this work,⁵⁴ BITs and other IIAs are signed by contracting parties with the underlying idea that parties agree to protect the person and investments of the other contracting party within its territories. As such, the central

⁵⁴ See generally chapter two of this work; where the issue of the motivation for BITs and the underlying reciprocal nature of these agreements is considered.

target of BITs and IIAs is the “foreignness” of the investor and investment sought to be protected. Consequently, the reasonable conclusion would be to assert that international investment law was not designed to constitute a platform under and through which nationals of the host state are equipped to sue their states under international law for acts committed by the states with regard to domestic investment. According to a commentator “it was never evident, to begin with, that round tripping investors would be treated as foreign investors under the ICSID and international treaties”⁵⁵

Similar to the first issue is the question of the erosion and substitution of national legal systems by international law on domestic issues within the sphere of national territories. Specifically, where nationals of a country are allowed access to the benefits of a BIT or IIA through round tripping, the result is the imposition of international investment law over national investment laws within the territory of the host state over its own citizens.

National investment legislations are relevant sources of investment law and influence the fabric of international investment law to the extent that they assist in the “appreciation of the background and specific legal scope”⁵⁶ of treaties within the investment regime.⁵⁷ However, international investment law being the relevant legal regime for the protection of foreigners and their investment in the territory of contracting parties, underscores the relevance of national investment laws with

⁵⁵ See Nougayrede (n 23).

⁵⁶ Thomas Walde ‘International Investment under the 1994 Energy Charter Treaty: Legal, Negotiating and Policy Implications for International Investors and Commonwealth of Independent States/Eastern European Countries’, in Thomas Walde (Ed), *The Energy Charter Treaty: An East – West Gateway for Investment & Trade* (Kluwer Law International 1996) 251, 266.

⁵⁷ Ibid.

regard to the obligations and remedies available to nationals of a country with respect to their investments in that particular territory.

Put in another way, national investment laws and their application to the nationals of the relevant country as well as their investment is an expression of the sovereign power of the state over its own citizens. It is undeniable that the signing and entering into a BIT or IIA with another state involves the surrender by a state of some aspects of its sovereignty and scope of exercise of regulatory power as regards the investments of foreign investors in the territory of each party. In other words, for the purpose of securing the same treatment for its own citizens and their investments in the territory of the other contracting party, a state must necessarily restrict the exercise of its own powers as regards foreign investments, but not for its own nationals to whom the domestic national investment laws still apply.

Consequently, the extension of the benefits of a BIT to a national of the host state amounts to the guaranteeing of more onerous obligations by the host state to the local investor for and in respect of an investment already covered by local investment laws. Furthermore, this is done with no extra set of obligations or duties assumed by the local investor. It is posited, that the condoning of such a practice will result in an undoubtedly uneven outcome, one in which the host state does not stand in an advantageous position. At the heart of the absurdity with regard round tripping is that it purports to include among the restrictions and curtailing of sovereign power, the power of the state to exercise and determine the extent of obligations it has towards its citizens with respect to their investment. Similarly, it attempts to dictate the form and scope of the legal remedies or recourse available to the local investor in instance when such is breached.

Therefore, round tripping has the resultant effect of placing on the country of the local investor a set of international obligations over and beyond that which the state owes such a local investor within the purview of the relevant national investment laws. This consequently results in effectively transferring a set of international obligations a contracting party owes to the nationals of other contracting parties or party to its own domestic community. Accompanied with this, is the obvious result of rendering ineffective the national legal regime for investment established by the exercise of the country's sovereign power within its own territory. This erosion of national laws on investment with regards to its own nationals, it is submitted, cannot be the intention of contracting parties in entering in to BITs and IIAs.

A third issue round tripping in international investment law raises is the question of the equality of legal rights. The accessing of BIT protection by a local investor in the host state suggests the introduction of an imbalanced legal regime in the protection of property and assets for economic development in the host state. That is, the availability of BIT protection to a set of local investors one the one hand, who can afford to hire international law firms, in the structuring of their investments to acquire the nationality of the other contracting party, and on the other hand, other investors who cannot. This creates a distortion in the degree and scope of legal protection available to different investors essentially resulting in an 'economic power makes right' scenario. This dichotomy in the protection of property rights in relation to local investment cannot be the intent of signatory states in entering into investment agreements.

Furthermore, in the instance where a claim made by a 'local investor' is made against the host state and succeeds, the payment of damages totalling huge sums of money to a single investor, at the expense of the welfare of other citizens at large,

raises a question of whether or not the rights of the other citizens of the state are not being violated by the local investor. Financial resources which are meant to be expended on the welfare and development of infrastructural and other capital project by these countries end up being used to pay damages to claimants in international investment claims. Making such payments to a handful of nationals of the respondent country is tantamount to such local investors benefitting at the expense of the human rights of other citizens of the country in question.

5.4. The Denial of Benefits Clause and Round Tripping in the International Investment Law Regime

The use of the DOB clause as an in-treaty mechanism designed to confer authority on a host state to carve out from the definition of 'investor' shell companies owned by nationals of a third state and indeed nationals of the host state⁵⁸ is evidenced through the incorporation of the clause in a number of BITs in the investment regime.⁵⁹As noted earlier in this work, the DOB clause has been increasingly employed by other states besides the United States in their BITs.⁶⁰

Countries such as Austria, Australia, New Zealand, Korea, China, Peru and Lebanon have incorporated the DOB clause into their BITs to varying degrees. However, what is interesting is that while these countries comprise a few which have actually included the DOB clause in their BITs or IIAs, the incidence of DOB clauses which

⁵⁸ Barton Legum, "Defining Investment and Investor: Who is Entitled to Claim?" (2006) 22(4) *Arbitration International* 521.

⁵⁹ For example, Article 17(2) of the 2012 US Model BIT provides:

" A Party may deny the benefits of this Treaty to an investor of the other Party that is an enterprise of such other Party and to investments of that investor if the enterprise has no substantial business activities in the territory of the other Party and persons of a non-Party, or of the denying Party, own or control the enterprise."

⁶⁰ See generally, chapter 3 of this work, detailing the evolution, purpose, relevance and use of the denial of benefits clause in the international investment law regime.

address treaty shopping through round tripping is comparatively small even within the already minute number of countries who use the DOB clause.

The US which is generally considered to be the originating state of the clause,⁶¹ has out of a total of forty seven BITs⁶² all of which contain the DOB clauses, only a total of three, specifically those with Argentina⁶³, Rwanda⁶⁴ and Uruguay⁶⁵ that have DOB clauses addressing round tripping as a treaty shopping route.

In the case of Canada, of a total of forty three BITs reviewed⁶⁶, twenty have DOB clauses, of this sum, ten have DOB clauses which address round tripping as a treaty shopping route sought to be prevented as a means for accessing treaty benefits. In the instance of Japan, of a total of twenty seven BITs reviewed⁶⁷, all have the DOB clause with the exception of the BIT between Japan and Mongolia.⁶⁸ However, only one of these DOB clauses addresses round tripping⁶⁹. This result is similar to that of Austria, which of a total of sixty two BITs reviewed⁷⁰ all of which, with the exception of the BIT with Belarus,⁷¹ have DOBs. However, none of these address round tripping.

⁶¹ See, Kenneth Vandeveld, 'The Bilateral Investment Treaty Program of the United States' (1988) 21 Cornell Intl L J 202; Herman Walker, 'Provisions on Companies in United States Commercial Treaties' (1956) 50 AJIL 373.

⁶² Of this total, six BITs are not in force and one, with the Plurinational State of Bolivia has terminated.

⁶³ See, Treaty between United States of America and the Argentine Republic Concerning the Reciprocal Encouragement and Protection of Investment. Signed 14 November, 1991, entered into force 20 October, 1994, art 1(2).

⁶⁴ See, Treaty between the Government of the United States of America and Government of the Republic of Rwanda Concerning the Reciprocal Encouragement and protection of Investment. Signed 19 February 2008, entered into force 1 January 2012, art 17(2).

⁶⁵ Treaty Between The United States Of America And The Oriental Republic Of Uruguay Concerning The Encouragement And Reciprocal Protection Of Investment. Signed 04 November, 2005, entered into force 01 November, 2006).

⁶⁶ Of this total, eight BITs are not in force, and a total of five have terminated.

⁶⁷ Of this total, seven BITs are not in force.

⁶⁸ See Agreement between Japan and Mongolia Concerning the Promotion and Protection Of Investment. Signed 15 February 2001, entered into force 24 March, 2002.

⁶⁹ See Japan – Iran BIT signed 05 May, 2016, art 12.

⁷⁰ Of this total, three BITs are not in force, and a total of six have terminated.

⁷¹ See Treaty between the Government of the Republic of Austria and Government of the Republic of Belarus for the Promotion and Protection of Investments. Signed 16 May, 2001, entered into force 1 February, 2003.

With regard to Australia, of a total of twenty one BITs⁷² only two BITs contain the DOB clause⁷³ neither of which addresses round tripping. In the instance of China, of a total of a hundred and twenty nine BITs⁷⁴, only three contain the DOB clause and of these, only two address round tripping.⁷⁵ On the consideration of thirty four BITs signed by Mexico⁷⁶ a total of six have DOB clauses and none of these in turn address the round tripping route of treaty shopping.

Similarly a number of IIAs include the DOB clause, prominent of which are the North America Free Trade Agreement (NAFTA) and the Energy Charter Treaty (ECT).⁷⁷ However, neither of these clauses address the round tripping route of treaty shopping as they only exclude mail box and shell companies controlled by nationals of third states. On the other hand, more recent IIAs such as the 2009 ASEAN Comprehensive Investment Agreement⁷⁸, the ASEAN Australia New Zealand Free Trade Agreement (AANZFTA)⁷⁹ as well as the US – CAFTA DR FTA contain DOB clauses which address round tripping.⁸⁰

This short survey reveals, that, first, the presence of the DOB clauses in BITs and IIAs is still relatively small, particularly as against BITs and IIAs that do not have

⁷² Of this total, two BITs have been terminated.

⁷³ These are BITs between Australia and Mexico and Australia and Sri Lanka.

⁷⁴ Of this total, twenty one BITs are not in force (of this number fourteen are not available for review), and fourteen have terminated.

⁷⁵ See China - Canada BIT. Signed 09 September, 2012, entered into force 1 October, 2014, art 16(2), China – Uzbekistan. Signed 19 April, 2011, entered into force 1 September, 2011.

⁷⁶ Of this total, three BITs are not in force, and one has terminated.

⁷⁷ It has been reported that Professor Walde has noted that the NAFTA DOB and one of the U.S Model Agreements have both been used as a guide for the drafting of the corresponding clause in the ECT. See, Panayotis Protopsaltis, 'The Challenge of the Barcelona Traction Hypothesis: Barcelona Traction Clauses and Denial of Benefits Clauses in BITs and IIAs' (2010) 11 J. World Investment and Trade 561, 588; NAFTA art 111392); the ECT art 17(1).

⁷⁸ See ASEAN Comprehensive Agreement on Investment. Signed 26 February, 2009, entered into force 29 March, 2012, art 19(1) (b).

⁷⁹ See ASEAN Australia New Zealand FTA (AANZFTA). Negotiations started 2005; agreement came into force for all countries in 2012, Ch 11, art 11(2).

⁸⁰ See, US CAFTA DR FTA (comprising United States and Costa Rica, the Dominican Republic, El Salvador, Guatemala, Honduras and Nicaragua. Implementation dates, depending upon the country, ranged from March 1, 2006 through January 1, 2009), Ch 10, art 10:12(2).

them. Second, even with countries who have incorporated the use of the clause for decades such as the United States to others who have recently adopted its use, the prevalence of DOB clauses structured to address treaty shopping through round tripping is even less.

A potential argument this observation is likely to educe is to the effect that state parties recognize the nature of international commercial practice and the underlying reasons why investors engage in treaty shopping through round tripping.⁸¹ Consequently, state parties have structured their DOB clauses, as to leave room for round tripping, effectively allowing local investors to hold investments in the host country as foreign nationals. This position of state parties it can be argued culminates ultimately in the fulfilment of the intent of promoting and protecting investment in the territory of the host state.

However, as tempting to adopt as this position may be, it is important to recognise the fact that comprehensive information on the relevance, amount and impact of round-tripping in international investment law regime has been unavailable until recently.⁸² As such states have only lately embarked on initiatives recommending and encouraging the compilation of statistics on inward foreign direct investment (FDI), using the criteria of the ultimate investing country (UIC), that is the ultimate country from which the FDI originates among others. This allows countries to look through the complex ownership structures of multinational enterprises (MNEs) to see

⁸¹ These have been mention earlier in this work. Predominantly, reasons why investors engage in round tripping are for purposes of tax relief, avoidance of regulatory inefficiency, access to sophisticated legal systems and access to better property rights protection under relevant BITs and IIAs; See, Xiao Geng, 'Round Tripping Foreign Direct Investment and the People's Republic of China' (ADB Research Paper Series No. 58 2004) <<https://www.adb.org/sites/default/files/publication/157240/adb-rp58.pdf> > accessed 15 January 2017; Thomas Jost, 'FDI in Russian in difficult times' (2015) 150 Colombia FDI Perspectives 1.

⁸² Maria Borga, 'Not all Foreign Direct Investment is Foreign: The Extent of Round Tripping' (2016) 172 Colombia FDI Perspectives 1; Kalman Kalotay, 'Does it matter who Invests in your Country?' (2012) 66 Colombia FDI Perspectives 1.

the country of the direct investor that ultimately controls an investment and, thus, bears the risks and reaps the rewards of the investment.⁸³

This lends credence to the fact that most BITs reviewed in this study which have DOB clauses incorporating a structure and design addressing the round tripping route of treaty shopping were signed by state parties in recently. For example, DOB clauses of the US which address round tripping were signed in 2005⁸⁴ and 2008⁸⁵ with both BITs modelled on the 2004 US Model BIT which contain a DOB clause addressing round tripping treaty shopping.⁸⁶ Similarly, BITs signed by Canada containing DOB clauses with structures addressing round tripping treaty shopping were signed between the years 2012 and 2016⁸⁷. In the case of Japan, the only BIT with a DOB clause addressing round tripping was signed in 2016 and yet to be in force.⁸⁸ Also, with regard to China, the DOB clause addressing round tripping were signed in 2011⁸⁹ and 2012⁹⁰ respectively. IIAs with this specie of DOB clause also range from negotiations starting around 2005 and majority entering into force after conclusion of negotiations in 2012.

⁸³ Maria Borgia, 'Not all Foreign Direct Investment is Foreign: The Extent of Round Tripping' (2016) 172 *Colombia FDI Perspectives* 1, making reference to efforts of states to provide more meaningful FDI measures, such as the OECD's initiative in the development of the fourth edition of its Benchmark Definition of Foreign Direct Investment (BMD4). BMD4 recommends that countries compile statistics on inward FDI by the ultimate investing country (UIC). This presentation allows countries to look through the complex ownership structures of multinational enterprises (MNEs) to see the country of the direct investor that ultimately controls an investment and, thus, bears the risks and reaps the rewards of the investment. The presentation by UIC identifies the amount of round-tripping in an economy by identifying that portion of inward investment that is controlled by a resident of the host economy.

⁸⁴ See, US - Uruguay BIT. Signed 04 November, 2005, entered into force 01 November, 2006, art 17(2).

⁸⁵ See, US - Rwanda (signed 19 February, 2008, entered into force 01 January, 2012, art 17(2).

⁸⁶ The only exception in the case of the US BITs is the US – Argentina. Signed 14 November, 1991, entered into force 20 October, 1994.

⁸⁷ These BITs have been concluded mostly between Canada and African States. They are BITs between Canada and Benin, Cameroun, Cote d'ivoire, Guinea, Mali, Nigeria, and Senegal; other states being China and Hong Kong and Serbia.

⁸⁸ See Japan – Iran BIT, signed 05 May 2016, art 12.

⁸⁹ See, China – Uzbekistan, signed 19 April, 2011, entered into effect 01 September, 2011, art 10(2)

⁹⁰ See, Canada – China BIT, signed 09 September, 2012, entered into force 01 January, 2014, art 16(2).

While most BITs and IIAs signed by state parties at the beginning of the international investment law regime did not include DOB clauses at all⁹¹, the inclusion of DOB clauses in attempts to limit treaty shopping in the investment law regime is on the rise.⁹² The inference to be made from this is to the effect that as states become aware of the shifts and general course of international arbitration, they make and incorporate treaty provisions into their BITs and IIAs which reflect their intentions⁹³ and thus requiring investment arbitrators to give effect to such expressions of intentions when adjudicating investment claims arising from such agreements.

It is posited, therefore, that the non-inclusion of DOB clauses with structures limiting round tripping in BITs and IIA before recent times is borne from the non-realisation, (inspired largely by absence of knowledge) as to the nature, impact and effect of round tripping as a treaty shopping route in international investment law by many state parties. It is upon the appreciation of impact of round tripping as a mode of treaty shopping that states in the investment regime have begun to incorporate DOB clauses which do not merely address shell companies owned by third country

⁹¹ This is with regard to the United States BITs being the exception. On the recent inclusion of denial of benefits clauses and their use in the international investment regime, see; Rudolf Dolzer and Christoph Schreuer, *Principles of International Investment Law* (2nd edn, OUP 2012) 55, 56; Muthucumswamy Sornarajah, *The International Law on Foreign Investment* (Cambridge 2010) 329; Stephan Schill, *The Multilateralization of International Investment Law* (Cambridge 2009) 223; Mark Feldman, 'Setting Limits on Corporate Nationality Planning in Investment Treaty Arbitration', (2012) 27(2)ICSID Review 281; Panayotis Protopsaltis, 'The Challenge of the Barcelona Traction Hypothesis: Barcelona Traction Clauses and Denial of Benefits Clauses in BITs and IIAs' (2010) 11 J. World Investment & Trade 561; Loukas Mistelis and Crina Baltag, 'Denial of Benefits and Article 17 of the Energy Charter Treaty', (2009) 113 Penn St.L. Rev 1301; Matthew Skinner, Cameron Miles and Sam Luttrell, 'Access and Advantage in Investor – State Arbitration: The Law and Practice of Treaty Shopping', (2010) 3(3) JWELB 260; Xian-Jing Zhang, 'Proper Interpretation of Corporate Nationality Under International Investment Law To prevent Treaty Shopping' (2013) 6(1) Contemp. Asia Arb. J. 49.

⁹² Ibid.

⁹³ Muthucumswamy Sornarajah, *The International Law on Foreign Investment* (Cambridge University Press 2010) 329.

nationals, but also those routed into the host country by the nationals of the host country as foreign investment.

5.4.1. The Yukos Arbitration: Making a case for the effectiveness of DOBs in addressing round tripping.

It is worthy of note that BITs and IIAs which contain DOB clauses which address round tripping are a recent phenomenon, many of which are still not in force. As arbitral jurisprudence on DOB clauses generally is only beginning to develop, there is much less jurisprudence on DOB clauses addressing round tripping. However, a consideration of the case of *Yuko International Limited (Isle of Man) v. Russian Federation*⁹⁴ highlights the potential effectiveness and relevance of DOB clauses with structures addressing round tripping and the costly implications of its non-inclusion.

Structurally, the DOB clause which addresses round tripping shares the same fundamental structure with DOB clauses which address only the issue of treaty shopping through shell companies by third party nationals. The former only differs from the latter in one major regard, that is, the inclusion of the phrase “ or national of the denying party” or a phrase having similar effect. In other words, where DOB clauses addressing only shell company treaty shopping through third parties read, using as an example the DOB clause in the Energy Charter Treaty (ECT), as follows:

“ Each Contracting Party reserves the right to deny the advantages of this Part to

⁹⁴ *Yukos International Limited (Isle of Man) v. Russian Federation*, PCA Case No. AA 227, Interim Award on Jurisdiction and Admissibility, 30 November 2009. (hereinafter *The Yukos Case*).

(1) A legal entity if citizens or nationals of a third state own or control such entity and if that entity has no substantial business activities in the Area of the Contracting Party on which it is organized.”⁹⁵

A DOB clause which addresses the round tripping treaty shopping route on its part reads, using the DOB clause in the 2012 US model BIT as a representative example of such clauses:

“A party may deny the benefits of this Treaty to an investor of the other party that is an enterprise of such other Party and to investments of that investor if the enterprise has no substantial business activities in the territory of the other Party and persons of a non-party, **or of the denying Party**, own or control the enterprise”⁹⁶ (Emphasis added)

Notable from these examples is that the conditions and requirements for denying benefits under DOB clauses addressing shell company treaty shopping, that is, the conditions of substantial business and control (or ownership) of the company also apply to DOB clauses which address round tripping. With this in mind, the arguments made in the last chapter as regards the effectiveness of the DOB stemming out of the structure of the clause also apply here.⁹⁷ Therefore, the attempt of this part of the work is not a restatement of these arguments, but rather to endeavour to show case the potential of the DOB clause as an in treaty mechanism which can limit treaty shopping through round tripping. This as mentioned earlier will be done by considering *The Yukos Case*.

⁹⁵ The ECT, art 17(1).

⁹⁶ US Model BIT, 2012, art 17(2).

⁹⁷ See chapter four, addressing the issue of the effectiveness of the denial of benefits clause as a mechanism for limiting treaty shopping through mailbox companies.

The case of the Yukos group was a classic example of round tripping of investment.⁹⁸ In this case, the shares of the Russian Company, OAO Yukos, were held at the first level by two holding companies both registered in Cyprus and then at the second level by companies registered in Isle of Man and Jersey. These were all in turn directly or indirectly owned by GML, a company registered in Gibraltar, constituting the third level in the chain. At the next layer, GML is in turn owned by seven British Virgin Island (BVI) Companies which were in turn owned by seven Guernsey trusts created in March and October 2003. The Yukos shareholders had settled their GML shares into the trusts and were in turn named as beneficiaries.

Through these trusts, the former shareholders took on the positions of “protectors” (an institution of offshore trust law)⁹⁹, whose consent was required before important decisions could be taken by the trustees.¹⁰⁰ Under these trusts, settlors issue what is popularly referred to as “letter of wishes” through which settlors express their wishes for the use of the trusts. These letters of wishes, although not formally binding on the trustees, however, are conventionally understood to be generally followed by trustees in satisfying the wishes of the settlors. Using this method, the shareholders were able to control their holdings in Yukos.¹⁰¹

⁹⁸ See, Nougayrede (n 23).

⁹⁹ Ibid.

¹⁰⁰ The trust mechanisms employed by Yukos were similar in structure to the type of asset management protection trusts presently a commodity offered in the offshore wealth management industry. The central purpose of these set ups is the protection and preservation of wealth by placing it beyond the reach of creditors. See generally, Geraint Thomas, ‘Asset Protection Trusts’, in John Glasson and Geraint Thomas (Eds), *The International Trust* (2nd edn, Jordans 2006).

¹⁰¹ Thus, the question of whether or not the Yukos group had engaged in corporate structuring for the purpose of gaining access to the benefits of the ECT was central to the determination of the jurisdiction of the tribunal. Were the ownership structure of the company to be “set aside as a construction seeking to disguise the ownership of Russian shareholders in order to benefit from investment treaty protection, the claimants would perhaps not qualify as protected investors owning qualifying investments under the ECT and the tribunal would not have jurisdiction” See Nougayrede (n 23).

On its part, the Russian Government in canvassing its position, argued that, first, the claimants, which were the two Cypriot companies and the Isle of Man company, did not qualify as foreign investors under article 1(7) of the ECT. That the claimants were themselves shell companies, and did not own or control the shares of OAO Yukos under article 1(6) of the ECT. But in reality were under the control of Russian nationals. Second, the Russian government argued that the DOB clause under article 17 of the ECT gave it the right to deny the benefits of the treaty to the claimants, who according to the government had no substantial business activities and were owned and controlled by nationals of a third state. According to the respondent:

“ The Tribunal lacks jurisdiction rationae personae and materiae (a) because Claimants are shell companies, (b) because Claimants are owned and controlled by Russian oligarchs, including Khodorkvsky, Lebedev and other Russian nationals, and (c) because Claimants are mere nominees who do not own or control the Yukos shares that are the subject of these proceedings.”¹⁰²

In canvassing its argument on the application of the DOB clause to round tripping in the ECT, the respondent observed:

“The object and purpose of the Treaty is to promote and protect foreign investments and foreign investors. The Treaty was never intended to protect Russian investors investing in Russia, and does not provide a remedy for host State nationals. Under “rules and principles of international law” applicable to this proceeding under Article 26(6) of the Treaty, a shell company dominated and controlled by host State nationals has no right to bring a claim against the

¹⁰² *The Yukos Case*, para 42.

host State. Like other fundamental principles of customary international law, the rule that nationals of a State may not assert an international claim against their own State cannot be dispensed with tacitly."¹⁰³

As a rejoinder to the position of the respondent, the claimants argued that even where the claimants were to be owned or controlled by Russian nationals, which the claimants deny, the Russian Federation is not a "third State" under the ECT.¹⁰⁴

According to the claimant, it is plain that "third State" in Article 17(1) refers to a non-contracting Party under the ECT and this is confirmed by the Vienna Convention on the Law of Treaties, as well as the *travaux préparatoires* of the ECT. By contrast, when contracting states intend to exclude the benefits of an investment protection regime to entities controlled by nationals of the host State, they do so expressly.¹⁰⁵ This according to the claimant was not done by the ECT drafters. The Russian Federation, which is bound by the ECT, cannot therefore claim to be a "third State" for the purposes of Article 17(1).^{106 107}

However, while the position of the Russian government is quite understandable, in having Russian nationals institute an investment claim against their own country, the DOB clause in the ECT makes no provision which supports the position of the Russian State. Article 17 of the ECT provides that contracting parties only have the right to deny the advantages of the ECT where the legal entity in question is "owned or controlled by a third party national". Thus, the DOB clause in the treaty makes no

¹⁰³ Ibid, para 46.

¹⁰⁴ Ibid, para 33.

¹⁰⁵ Ibid.

¹⁰⁶ Ibid.

¹⁰⁷ As a rejoinder, the respondents argued that the

" Claimants' contention that host State parties are not third State nationals is unavailing. If Treaty benefits may be denied to third State nationals, a fortiori they may be denied to host State nationals. In any event, the term "third State," which is not defined in the Treaty, is used there in a manner that does not exclude the possibility that a third State may be a Contracting Party or a signatory..." See para 51.

structural provision for the limiting of round tripping as in the instance of *The Yukos case*.^{108 109}

According to the tribunal, the rule of interpretation set out in article 31 of the Vienna Convention of the Law of treaties, stating that a treaty must be interpreted in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of their object and purpose, did not give the tribunal any right to look beyond the single criteria of incorporation established by article 1(7) of the ECT. The tribunal also made reference to the cases of *Tokios Tokeles*,¹¹⁰ *Saluka Investments BV v The Czech Republic*¹¹¹ as well as *Plama v Bulgaria*¹¹², where the majority of the respective tribunals although faced with instances of round tripping, refused to pierce through the corporate structure to unveil the effective nationality of the ultimate beneficiaries.

With a combined award of fifty billion dollars issued against Russia by the tribunals of the *Yukos cases*,¹¹³ the question of the relevance and effectiveness of the DOB

¹⁰⁸ The tribunal in deciding on the application of the DOB clause to the case set aside the use of the clause on the ground that the respondent state should have notified the claimants before the dispute that it would not extend treaty benefits to them. This is notwithstanding the fact that the DOB clause in the ECT contains no such notification requirement. Having reached this conclusion, the tribunal noted that there was no need for a review of the substance, ownership or control over the claimant companies. Ibid, para 456,459.

¹⁰⁹ The tribunal engaged this approach, although the claimants accepted that they did not have substantial business activities in Cyprus or the Isle of Man. Ibid, para 461.

¹¹⁰ *Tokios Tokeles v Ukraine*, (n 12).

¹¹¹ *Saluka v Czech* (51).

¹¹² *Plama Consortium Limited v Republic of Bulgaria*, ICSID Case No. ARB/03/24, Decision on Jurisdiction, 27, August, 2008.

¹¹³ There were three separate awards, all formulated in quasi-identical terms: *Hulley Enterprises Limited (Cyprus) v. The Russian Federation*, PCA Case No. AA 226, Final Award; *Yukos Universal Limited (Isle of Man) v. The Russian Federation*, PCA Case No. AA 227, Final Award and *Veteran Petroleum Limited (Cyprus) v. The Russian Federation*, PCA Case No. AA 228, Final Award, all dated July 18, 2014. These July 2014 awards were preceded by jurisdictional awards in 2009; *Hulley Enterprises Limited (Cyprus) v. The Russian Federation*, PCA Case No. AA 226, Interim Award on Jurisdiction and Admissibility; *Yukos Universal Limited (Isle of Man) v. The Russian Federation*, PCA Case No. AA 227, Interim Award on Jurisdiction and Admissibility and *Veteran Petroleum Limited (Cyprus) v. The Russian Federation*, PCA Case No. AA 228, Interim Award on Jurisdiction and Admissibility, all dated Nov. 30 2009. There were two more investment tribunal decisions rendered in the *Yukos case*, one under the United Kingdom-USSR treaty; *Rosinvest Co UK Ltd v The Russian Federation*, SCC Case No. 079/2005 (Sept 2010), and one under the Spain-USSR bilateral investment treaty, *Renta 4 S.V.S.A.*

clause as a mechanism capable of limiting round tripping and its effects comes to fore. However, while the DOB clause on the face of it has the potential of conferring the right on state parties to deny treaty benefits to their own nationals who have invested in the home state to the end of accessing benefits of BITs and IIAs, the structure of a DOB clause, particularly as to whether or not it is designed to address round tripping can have consequences of great magnitude for the respondent host state as in the *Yukos case*.

Arguably, were the construction of the DOB clause in the ECT couched as to address treaty shopping through round tripping, the tribunal might have taken a different view with respect to whether or not the DOB excludes host state nationals.

5.5. Conclusion

The prevalence of round tripping as a favoured route for effecting treating shopping has been said by commentators to work due to the influence in the field of transnational corporate structuring of the private paradigm of party autonomy and private ordering.¹¹⁴ This position is further entrenched by the prevalence and dominance of the “incorporation” theory in company and private international law,¹¹⁵ which in turn plays a pivotal role as one of the principal paradigms upon which the international investment law regime rests. In addition, the reliance on this position by many investment tribunals who adopt a literal and formal reading of BITs and IIAs

Ahorro Corporación Emergentes F.I., Ahorro Corporación Eurofondo F.I., Rovime Inversiones SICAV S.A., Quasar de Valores SICAV S.A., Orgor de Valores SICAV S.A., GBI 9000 SICAV S.A. v. The Russian Federation, SCC Case No. 24/2007, 20 July 2012). These awards are, however, not addressed in this work, as the claimants were legal entities for which there was no indication of ultimate beneficial ownership or control by Russian nationals, in other words, they did not involve domestic investment round-tripping structures.

¹¹⁴ Nougayrede (n 23).

¹¹⁵ *Ibid.*

further adds a layer to the susceptibility of host states to investment claims by their own nationals under the guise of international corporations.

The central argument of the proponents of this view is that the very accession to a BIT or IIA is an exercise of the sovereign powers of a contracting state and as such, the use of the incorporation theory by contracting parties in their investment agreements suggests that such states agreed to be bound by these definitions. In the light of this, investment treaty protection is not lost when multinationals use common corporate devices of intermediate holding companies and special investment holding companies organised under the laws of a third country.¹¹⁶ Indeed, from this perspective, nationals of the host state can make use of similar mechanisms and be protected under these agreements.

While the purpose for which nationals of a host country embark on round tripping treaty shopping routes lends credence to the dynamics of corporate international practice. Involving an analysis of the most suitable economic, political and legal climates under which business can be most profitably conducted, with deference for considerations of tax benefits, ease of carrying out business activities and the protection of property rights among others. The question still remains whether or not in the light of the intention of state parties in the signing of BITs and IIAs, parties intended to allow the protection of their own nationals under these agreements.

Under international law, the domestic jurisdiction of a state is an integral part of the sovereignty of a state. The term refers to the supreme power of a state over its territory and inhabitants.¹¹⁷ It is the exclusive internal competence of the highest

¹¹⁶ Legum, (n 58).

¹¹⁷ Marek Korowicz, *Introduction to International Law : Present Conceptions of International Law in Theory and Practice* (Martinus Nijhoff 1958) 157.

legislative, judicial and administrative or executive authorities of a state.¹¹⁸ Being the supreme authority within its jurisdiction, the state through its organs has powers to enact laws which in turn establish and define the set of obligations which exist between the state and its citizens, inclusive of national laws regulating domestic investment.

Through this, the liability of the state to the domestic investor is defined within the context of the established laws and through the instrumentality of the judicial mechanism of the state. Consequently, following this principle, a shell company owned or controlled by host state nationals has no right to bring an international claim against the host state, an act tantamount to the elevation of international laws and adjudication mechanisms over and above the sovereign powers of the state over its territory and its own citizens.

This analysis assists in giving a clear idea as to the conceptual framework for international investment law as being complicated by its nature as an area of public international law applicable law to investor-state disputes.¹¹⁹ With arbitration, which, even though not unknown in international law to settle state-to state disputes, is most widespread as a mechanism to settle disputes between private parties arising in the context of international commercial transactions.¹²⁰ However as noted earlier, while public international law undoubtedly serves as one of the paradigms upon which international investment law is based, the prevalence of the private international law paradigm in international investment system almost invariably dictates the tone of the regime.

¹¹⁸ Ibid.

¹¹⁹ Stephan Schill, 'Enhancing International Investment Law's Legitimacy: Conceptual and Methodological Foundations of a New Public Law Approach' (2011) 52(1) 52.

¹²⁰ Ibid.

The precursor to the central argument of this work, is that states in an attempt to attain and achieve a balance in international investment law through the mitigation of the effects of the implications of broad definitions “investor” and “investment” employed in BITs and IIAs have resorted to mechanisms through which regulatory and sovereign powers which have been surrendered – without the intent of surrendering same – can be clawed back.¹²¹ The resultant effect of the use of far reaching and open ended definitions of “investor” and “investment” in these agreements is the accessing of treaty benefits by third parties and nationals of the domestic jurisdiction of the contracting parties.

The DOB clause has in recent times become a mechanism through which states can limit this practice. States sign BITs and IIAs in significant part to secure protection for their nationals investing abroad¹²² and conversely to grant similar protections to foreigners and their investments in their territory. Thus, the relationship subsisting between the contracting parties is one which establishes a bilateral set of obligations and in the case of multilateral agreements an *inter partes* set of obligations, owed independently and individually to the contracting party or parties with which a state has entered into an agreement. This begs the question of persons entitled to enforce these obligations when breached by a contracting party.

¹²¹ In this instance particularly, the sovereign power of a state over the inhabitants of its territory and their investments. See the argument of the Respondent in *The Yukos Case*, para 46, arguing that the object and purpose of the ECT (and more generally of international investment law) is to promote and protect foreign investments and foreign investors, and was never intended to protect Russian investors investing in Russia, and does not provide a remedy for host State nationals; See generally, Olivia Chung, ‘The Lopsided International Investment Law Regime’ (2007) 47 Va. J. Int’l L 953, arguing that the benefits of investment treaties have become lopsided as a result of the unequal BIT negotiation process, the broad, far reaching and unclear treaty terms, which most developing states have no idea of their meaning and effect until they are served with investment claims among others.

¹²² Mark Feldman, ‘Setting Limits on Corporate Nationality Planning in Investment Treaty Arbitration’, (2012) 27(2) ICSID Rev 281.

While investment tribunals have often considered states to owe these sets of obligations not only to genuine foreign investors, but also its extension to third party nationals who through corporate structuring are 'labelled' nationals of the other contracting party, the high point is the extension of these obligations to nationals of the host state itself, who through the instrumentality of juristic persons established in the other contracting party are able to round trip and reroute their investment back into their home state.

The question which underpins the round tripping treaty shopping route, therefore, is whether or not the respondent state should owe or indeed owes its own national an obligation under the international agreement entered into with another country. The central idea of the "foreign-ness" of the investor and its investment in international investment law suggests that host states ought not to owe their own nationals such obligation.

However, the incorporation of DOB clauses into BITs and IIAs confer on host states the right to deny treaty benefits to nationals of third state and their own nationals, and, therefore, lends voice to the expression of state not to extend treaty benefits to their own nationals and consequently allowing them assert their domestic sovereignty over their territory and inhabitants. Notwithstanding the potential of the DOB clause in limiting round tripping as a treaty shopping route, evidence of the effectiveness of the clause in round tripping treaty shopping claims under the regime has been next to none existent. It must be noted, however, that this 'ineffectiveness' of the clause is the result of a lack of evidence of use and not borne from its lack of potential in limiting the round tripping form of treaty shopping. In other words, it is but a product of the non-inclusion of DOB clauses with structures which address round

tripping in BITs and IIAs and not a consequence of the ineffectiveness of the clause upon application.

While tribunals are quick to express the non-inclusion of these clauses as an unequivocal expression of the intent of the contracting parties, the position is that most BITs and IIAs signed by state parties at the beginning of the international investment law regime did not include DOB clauses at all. The inclusion of DOBs in attempts to limit treaty shopping in the investment law regime is only on the rise as a result of the observable impact of treaty shopping by states. As mentioned earlier, the inference to be made from this is that as states become aware of the shifts and general course of international arbitration, they make and incorporate treaty provisions into their BITs and IIAs which reflect their intentions and thus requiring investment arbitrators to give effect to such expressions of intentions when adjudicating investment claims arising from such agreements.

As such, the argument sought to be made here is that the non-inclusion of DOBs with structures limiting round tripping in BITs and IIA before recent times is borne from the non-realisation of the impact and effect of round tripping as a treaty shopping route in international investment law. It is upon the appreciation of impact of round tripping as a mode of treaty shopping that states in the investment regime have begun to incorporate DOBs which do not merely address shell companies owned by third country nationals, but also those owned by the nationals of the host country itself.

It is, therefore, worthy of note that BITs and IIAs which contain DOBs which expressly address the issue of round tripping of investments are a recent phenomenon, many of which are still not in force and as such arbitral jurisprudence

on DOBs generally is only beginning to develop, much less jurisprudence on DOBs addressing round tripping. It is, therefore, suggested that the efficacy of the DOB in limiting round tripping be considered once again when arbitral tribunals have had the opportunity of adjudicating on claims of investment round tripping, where the relevant BIT or IIAs includes a DOB which gives states the right to deny their own nationals the right to claim against the state before an international tribunal, in accordance with the principles of international law.

However, in conclusion, based on the structure of DOB clauses which address round tripping, with the exception of the issues raised on the requirements of 'control and substantial business activities' raised in the preceding chapter, the DOB clause which addresses round tripping has the potential to limit round tripping treaty shopping in international investment regime. Allowing states to reclaim domestic sovereignty over their nationals and their investments, as well as restoring much needed balance to the international investment regime as a whole.

Chapter Six

The Effectiveness of the Denial of Benefits Clause in Limiting Treaty Shopping: The Assignment of Treaty Claims Route

6. Introduction

Having considered the effectiveness of the denial of benefits (DOB) clause in limiting treaty shopping through free riding and round tripping routes in chapters four and five, this chapter will attempt to analyse the effectiveness of the clause with regard to treaty shopping practice through the transfer or assignment of investment treaty claims. Treaty shopping as defined in the earlier parts of this work, is the structuring or restructuring of investment by foreign and or local investors in deliberately seeking to acquire the benefits of an international investment agreement by making foreign investments or bringing claims from third countries that have more favourable treaty terms with the target host state.¹

Fundamentally, treaty shopping in international investment law breaches the principle of reciprocity which is central to all investment treaties. State parties to these agreements restrict the exercise of their sovereign and regulatory powers for the purpose of protecting foreign investment in their territory. This is done in expectation of similar treatment granted to the investments of their own nationals in the territory of the other contracting state.²

¹ See generally chapter 2 of this work, giving a description and analyses of the nature, character and forms of the practice of treaty shopping; Matthew Skinner, Cameron Miles and Sam Luttrell 'Access and Advantage in Investor State Arbitration: The Law and Practice of Treaty Shopping' (2010) 3 *Journal of World Energy and Business Law* 260.

² However, where third party nationals or nationals of the host country gain access to the benefits of these agreements without a corresponding commitment on the part of their own states, the very intention of entering into the agreement is defeated. As such, the practice of treaty shopping brings to fore the

However, as this work argues, the introduction of the DOB clause into an increasing number of BITs and IIAs is an attempt by some state parties in the regime to achieve a balance with regard to the rights, duties and obligations subsisting between state parties and foreign investors.³ The DOB clause, therefore, is a mechanism through which state parties can refuse to restrict the exercise of their sovereign and regulatory powers on behalf of an investor where such an investor does not meet the necessary requirements underlying the purpose and intention of the parties when entering into the relevant agreement.⁴

This chapter contributes to the overall objective of this work by considering the question of the effectiveness of the DOB clause as a mechanism for limiting treaty shopping through the assignment of claims. First, the chapter will consider the question of whether or not a foreign investor who does not have the nationality of a contracting party to a BIT or multilateral investment treaty (MIT) with the host state, can transfer or assign its investment claim or its shares in an investment to another investor which has the nationality of a contracting party to a BIT with the host state.

To answer this question, the chapter presents a review and analyses of international investment treaty claims and awards where arbitral tribunals have addressed the transfer or assignment of treaty claims as a treaty shopping route. The purpose of this is principally to determine the position of investment tribunals on the question of the transfer of investment claims. Secondly, it is to give an opportunity for an

international investment law regime's institutional, structural and procedural latitudes which allow investors through the structuring of their investments to take advantage of these agreements. See Suzy Nikiema, *Best Practices Series: Best Practices Definition of Investor* (International Institute for Sustainable Development 2012) 4.

³ See generally, Peter Muchlinski, 'Holistic Approaches to Development and International Investment Law: The Role of International Investment Agreements' in Julio Faundez, Celine Tan, *International Economic Law, Globalisation and Developing Countries* (Edward Edgar Publishing 2010) 205; Peter Muchlinski, 'Corporations and Uses of Law: International Investment Arbitration as a Multilateral Legal Order' (2011) 1(4) *Onati Socio – Legal Series* 1, 22.

⁴ Nikiema (n 2).

evaluation of conditions under which such transfers can validly or arguably be made, where such are considered permissible by tribunals.

The second question this chapter will seek to answer, which is central to this work, is the question of whether or not the DOB clause as it is presently drafted in most BITs and IIAs can effectively limit treaty shopping through the assignment of treaty claims by foreign investors. This is an important question, particularly as it is said that there is an increasing market for investment treaty claims coupled with a “growing number of highly sophisticated investors dedicated to trafficking in BIT claims”.⁵

This fact also emphasises the importance of stemming the tide of such practices, particularly for state parties in the investment regime and consequently the relevance of a consideration of the potential and effectiveness of the DOB clause in this regard. Furthermore, if left unattended and unchecked, these treaty shopping routes, in particular the assignment of treaty claims for the purposes of this chapter, have the capacity of further undermining the attempts to bolster the legitimacy of the international investment regime.⁶ As this work canvasses, failure to effectively deal with the issue of treaty shopping has the potential of birthing more ‘ex-regime’

⁵ One of the constant challenges of law as a mechanism for social ordering is its ability to readily adapt and address the issues presented by an often rapidly changing society. In recent times, questions of artificial intelligence, access and use of data, intellectual property among others have challenged the constructs of law to proffer frameworks within which the issues posed by these areas and frontiers can be regulated and managed. This pressure on law and its systems to catch up with the dynamics of society is not absent within the context of international investment law. Speaking more to the question of this chapter is that the treaty shopping as a practice is a notion which has not assumed a static position in the past few decades. Consequently, while the attempts of state parties to address this issue has been largely focused on the traditional forms of it, the present reality seems to be that treaty shopping as a practice has evolved from the traditional forms of free riding and recently, round tripping to arguably ‘untraditional forms’. Particularly, the assignment of treaty claims is becoming an important medium for accessing treaty benefits by third party investor and nationals of a host state. See Matthew Skinner, Cameron Miles and Sam Luttrell ‘Access and Advantage in Investor State Arbitration: The Law and Practice of Treaty Shopping’ (2010) 3 *Journal of World Energy and Business Law* 260.

⁶ Susan Franck, ‘The Legitimacy Crisis in Investment Treaty Arbitration: Privatizing Public International Law through Inconsistent Decisions’ (2005) 73 *Fordham Law Review* 1521; Stephan Schill, ‘Enhancing International Investment Law’s Legitimacy: Conceptual and Methodological Foundations of a New Public Law Approach’ (2011) 52(1) *Virginia Journal of International Law* 57.

reactions from state parties as in the case of Ecuador, Venezuela and South Africa.⁷ Consequently, the evaluation of the effectiveness of the DOB clause as an in-treaty mechanism designed to address treaty shopping in international investment law and arbitration is crucial and timely.

6.1. The Concept of the Assignment of Treaty Claims in International Investment Law

The availability of BIT protection has become one of the pivotal issues considered by investors particularly multinationals in seeking to determine the profitability or otherwise of a potential investment in a target host state.⁸ This is spurred among other factors, by the fact that once an investment is made, the investor is considered to be vulnerable to the arbitrary and unilateral exercise of sovereign and regulatory powers of the host state.⁹ Consequently, investors at the inception of the commitment of their resources, increasingly tailor their investment structures in ways that allow access to international legal protection.

However, there are instances where investors might have overlooked the relevance of BIT coverage at the outset of the investment. Even where they are considered,

⁷ Guzman Perez and Rosa Amili, 'Ecuador's Withdrawal from ICSID Moving towards a Regional Regime of Dispute Resolution' (2009) 4 *Transnational Dispute Management*, 1484; Adam Green, 'South Africa: BIT in Pieces' *Financial Times* (London 19 October 2012) <<http://blogs.ft.com/beyond-brics/2012/10/19/south-africa-bits-in-pieces/>> accessed 17 October 2016.

⁸ Barton Legum, 'Defining Investment and Investor: Who is Entitled to Claim?' (2006) 22(4) *Arbitration International* 521.

⁹ This is what has been referred to as the "hostage factor". See Thomas Walde, Abba Kolo, 'Stabilizing International Investment Commitment: International Law Versus Contract Interpretation' (1996) 31 *Tex. Int'l. L. J* 215; making the point (particularly with regard to international investment in the context of international energy and mineral investment) where the long-term, capital-intensive nature of the investment creates a hostage effect especially susceptible to political risk. This is a reflection of the near total loss of the bargaining power of the foreign company, which often very strong when contemplating high-risk investment, may have waned dramatically once the investment has been made in the territory of the host state.

issues such as the evaluation of the commercial risks and viability of the investment itself, the rate of returns or tax benefits etc. may be considerations which outweigh the political risks of the investments and which sway the investor to commit resources to the investment without having the legal protection of a BIT or similar IIA with the host state.¹⁰ In the event of a dispute, however, without having structured its investment at the initial instance of the investment, an investor might find the transfer or assignment of the 'claim' or the investment to another investor who has the nationality of a contracting party to a BIT or IIA with the host state as a means of accessing treaty protection. Through this means, a potentially successful claim can be made against the host state.¹¹

It is worthy of note that even in instances where an investor does not overlook the importance of BIT protection, the paucity of these agreements in certain regions of the world poses another challenge. Notably, while there has been a rise in the number of BITs and IIAs in the international investment law regime generally. A number of states have themselves entered into few of these agreements.¹² This is the case with a greater number of sub-Saharan African countries. Though signatories to the ICSID Convention, for example, most of these countries nonetheless have a relatively few number of BITs.

Countries of sub - Saharan Africa (with the exception of Ethiopia, Mozambique, Madagascar, Nigeria, Sudan and Tanzania)¹³ have about a total of sixty treaties with

¹⁰ See, William Kirtley, 'The Transfer of Treaty Claims and Treaty Shopping in Investor – State Disputes' (2009) 10 J. World Investment and Trade 427.

¹¹ Ibid.

¹² Ibid.

¹³ South Africa also had about 15 BITs before its withdrawal from its BIT scheme.

other states.¹⁴ This is compared to Germany's 135, China's 129, Switzerland's 114, The United Kingdom's 106, France's 104 and the Netherland's 95 BITs per country.¹⁵ A similar situation is observed in other developing regions of the world.¹⁶ Consequently, with these countries being recipients of a reasonable percentage of foreign investments, investors find themselves in positions where they do not have access to investment protection afforded by BITs and IIAs.

This motivation to assign claims and investments in the face of disputes is further exacerbated by the fact that these countries tend to be among states where political risk of investment is considered to be high. Therefore, investors who do not enjoy the coverage of a BIT with the relevant host state may opt for the transfer of a potential claim to a third party with the nationality of a contracting party to an IIA with the host state. This can also be done by incorporating a company in the third state, or a restructuring of investments as to accommodate a company with the required nationality, through which the investor can claim against the host state as considered in chapters four and five.¹⁷

In describing this treaty shopping medium, treaty shopping through the assignment of claims can be defined as the sale and or transfer of a potential or actual investment treaty claim, or shares in the corporate entity having such a claim to another investor having the nationality of a contracting party to a BIT with the host state, with the intent of gaining protection under the BIT and claiming against the host state. It is the transfer of an investment in the face of a potential or actual claim

¹⁴ Many of these BITs were signed within the last ten years. See, <<http://investmentpolicyhub.unctad.org/IIA/liasByCountry#iialInnerMenu>> accessed 9th September 2016.

¹⁵ Ibid.

¹⁶ See, William Kirtley, 'The Transfer of Treaty Claims and Treaty Shopping in Investor – State Disputes' (2009) 10 J. World Investment and Trade 427.

¹⁷ Julien Chaisse, 'The Treaty Shopping Practice: Corporate Structuring and Restructuring to Gain Access to Investment Treaties and Arbitration' (2015) 11 Hastings Bus. L.J. 225; William Kirtley, 'The Transfer of Treaty Claims and Treaty Shopping in Investor – State Disputes' (2009) 10 J. World Investment and Trade 427.

to an investor with a nationality of a country which has a relevant BIT or IIA with the host state and potential respondent, and through which the investment is sought to be protected under the said BIT.

Generally, this mode of treaty shopping is often used but not limited to instances where an investment dispute or claim between the foreign investor has begun, or where signs as to the eventuality of a dispute or claim are observed by the foreign investor.¹⁸ However, by virtue of its nature, the assignment of treaty claims as a treaty shopping route raises certain questions. First, is whether or not a foreign investor who does not have a BIT with a host state of its investment, and therefore, is not covered under a relevant BIT, can effectively sell, assign or transfer its 'right' to the 'claim' against the host state to another investor or vehicle, which then initiates a suit against the host state. Second, if this is a possibility, under what conditions can an investor effectively transfer its 'claim' to an investment under a non-subsisting BIT to another investor with a subsisting BIT?

Simply put, these questions seek to determine the crucial issues of whether or not there is a right which accrues to the investor which allows it assign its right to a claim to another investor, where the investor itself is not covered under a relevant agreement. Most importantly, the central question concerns the source of the investor's right in such circumstances, if any. Similarly, in the instance that there is a legal rule in international investment law which allows the investor the exercise of such a 'right', what are the parameters under which such a rule allowing for the exercise of such a right might be exercised? To arrive at an answer to these questions, a survey of arbitral jurisprudence on the assignment of investment treaty claims will be considered in the next section.

¹⁸ Nikiema (n 2) 4.

6.2. Assignment of Investment Treaty Claims: A Question of Right or Abuse of Right?

The principle of abuse of rights as discussed earlier in chapter three, has been one of the means international investment tribunals have sought to address the issue of treaty shopping in international investment law. At its centre, the doctrine of abuse of rights is built on a premise among others, that although rights are the objects of the exercise of legal protection in respect of a legally recognized interest, however, no right is absolute.¹⁹ Consequently, “the malicious, arbitrary or fictitious use, or an exercise of a right to the end of seeking to evade the rule of law or a contractual obligation, even in instances where such exercise does not particularly adversely affect the right of another state or person”, cannot be considered as worthy of protection and as such to be denied as an abuse of rights.²⁰

This doctrine also extends to the processes involved or sought to be used in attempts to exercise a right in such manner. The abuse of process has also been described as consisting:

“...of the use of procedural instruments or rights by one or more parties for purposes alien to those for which the procedural rights are established... This includes the exercise of a right for fraudulent, procrastinatory or frivolous purpose, for the causing of harm or obtaining an illegitimate advantage, for

¹⁹ See, Robert Kolb, *La Bonne Foi en Droit International Publique* (Universitaires de France 2000) 463; Michael Byer, ‘Abuse of Rights: An Old Principle, A New Age’ (2002) 47 McGill L. J 391, 397.

²⁰ Bin Cheng, *General principles of Law as Applied by International Courts and Tribunals* (Stevens and Sons 1953) 121.

the purpose of reducing or removing the effectiveness of some other available processes or for the purpose of pure propaganda.”²¹

From the foregoing, the transfer of international investment claims as a particular form of treaty shopping then begs the question of, on the one hand, whether or not such transfers constitute legitimate exercise of rights to engage the power of ownership or control of property or an investment by way of its disposal to another entity. Or on the other hand, does it constitute an abuse of rights and the processes of international investment law and arbitration by the investor to the intent of engaging these in a manner outside of the scope of their purposes. Does an investor lacking the relevant nationality under a BIT have the right to assign its claim or its interests to another party where and when a dispute arises with the host state?

The consideration of these issues, however poses a challenge in that the transfer of treaty claims from one investor to the other in an attempt to secure the protection of a BIT or IIA against a host state is not a relatively frequent issue adjudicated upon by investment tribunals. Cases which deal with the issue are scarce and comparatively minute when other treaty shopping routes, particularly the use of shell companies is considered. However, in a number of cases, tribunals have had to consider to a greater or lesser degree the pertinent questions of this practice in an attempt of setting its legal boundaries and policy implications.

The case of *Mihaly International Corporation v. Democratic Socialist Republic of Sri Lanka*²² gives perhaps one of the most elucidating analyses of the concept of the assignment of treaty claims in international investment law. In the case, Mihaly

²¹ Robert Kolb, ‘General Principles of Procedural Law’ in Andreas Zimmermann, Christian Tomuschat, and Karim Oellers – Frahm (Eds), *The Statute of the International Court of Justice: A Commentary* (OUP 2nd edn, 2012) 904.

²² *Mihaly International Corporation v. Democratic Socialist Republic of Sri Lanka*, ICSID Case No. ARB/00/2, Award, 25, March, 2002. Hereinafter *Mihaly*.

International Corporation, a company incorporated in the United States sued the Democratic Republic of Sri Lanka before an ICSID tribunal. The claimant's claim was brought on the basis of a purported breach by Sri Lanka of the BIT between the United States and Sri Lanka.²³

In making its claim, the claimant argued that it is known by name as Mihaly International Corporation organized under the laws of California in the United States and as such is fully entitled to the protection under Article 25(2) of the ICSID Convention.²⁴ The claimant further argued that Mihaly International Corporation (USA) "*eo nomine*" could initiate the proceedings in its own name as well as on behalf of its partner, Mihaly International Corporation organized under the laws of Ontario, Canada. The claimant based its contentions on two legal theories, namely, partnership and assignment.²⁵

As regards its argument on partnership the claimant advanced the theory that under the laws of California where it was incorporated, the partnership formed between the claimant and its Canadian counterpart, Mihaly International Corporation organized under the laws of Ontario, Canada, Mihaly International Corporation (USA), the claimant, was empowered to file a claim on its own behalf as well as on behalf of its other partner, the Canadian counterpart.²⁶

The claimant, Mihaly International Corporation (USA) further argued that it is the lawful assignee of all the rights, interests, and claims of its Canadian partner, Mihaly International Corporation (Canada), and that under the assignment instrument, the

²³ Treaty between the Government of the United States of America and the Government of the Socialist Republic of Sri Lanka concerning the Encouragement and Reciprocal Protection of Investment signed 20 September, 1991 and entered into force 1 May, 1993.

²⁴ Mihaly (n 22) para 13.

²⁵ Ibid.

²⁶ Ibid, para 14.

claimant is authorized to bring a claim for all the rights and interests that Mihaly International Corporation (Canada) had against the respondent. According to the claimant, these grounds provide sufficient legal basis for the claimant to file a claim which is the subject-matter of the current dispute before the Tribunal.²⁷

However, the respondent in canvassing its own position rejected the purported “linkages” between the claimant, Mihaly International Corporation (USA) and its alleged partner, Mihaly International Corporation (Canada).²⁸ First, as regards the position of the claimant on the theory of partnership, the respondent rejected the notion for what it considered a lack of evidence. Second, and on the theory of assignment, the respondent argued that that the personal nature of the transactions and negotiations between Mihaly (Canada) and Sri Lanka precluded any possibility of a valid assignment of any claim of rights without the consent of Sri Lanka to Mihaly (USA), the claimant, which is not privy either to the negotiations or to any agreements with Sri Lanka. The respondents, therefore, contended that the claimant, Mihaly (USA), had no standing before the tribunal, neither by reason of its partnership with Mihaly (Canada), nor in its capacity as an undisclosed assignee.²⁹

In its analysis, the tribunal observed that the partnership between Mihaly (USA) and Mihaly (Canada) did not translate into the creation of a separate juridical personality of its own distinct from its members, neither did the members acquire dual or joint nationality, nor was any of the partners divested of its original US or Canadian nationality.³⁰ The tribunal concluded that the existence of an international partnership, wherever and however formed, could neither add to, nor subtract from,

²⁷ Ibid, para 15.

²⁸ Ibid, para 16.

²⁹ Ibid, para 17.

³⁰ Ibid, para 22.

the capacity of the claimant, Mihaly (USA), to file a claim against the respondent for whatever rights or interests it may be able to substantiate on the merits in connection with the proposed power project in Sri Lanka, upon fulfilment of the other requirements of ICSID jurisdiction.^{31, 32} In justifying its position, the tribunal pointed out that Mihaly (Canada) could not bring a claim as Canada was not a party to the ICSID.³³

The tribunal further stated that if Mihaly (Canada) had a claim which was procedurally defective against Sri Lanka before ICSID because of Mihaly (Canada)'s inability to invoke the ICSID Convention, Canada not being a Party thereto, this defect could not be perfected vis-à-vis ICSID by its assignment to Mihaly (USA).³⁴ In the tribunal's opinion, to allow such an assignment to operate in favour of Mihaly (Canada) would defeat the object and purpose of the ICSID Convention and the sanctity of the privity of international agreements not intended to create rights and obligations for non-Parties.³⁵ On the nature and propriety of the assignment of investment claims under the international investment law regime, the tribunal stated:

'A claim under the ICSID Convention with its carefully structured system is not a readily assignable chose in action as shares in the stock-exchange market or other types of negotiable instruments, such as promissory notes or letters of credit. The rights of shareholders or entitlements of negotiable

³¹ Ibid.

³² Ibid. According to the tribunal:

"the fact remains undisputed that the designated Claimant in the case at bar is unmistakably Mihaly (USA) eo nomine and not the Mihaly International or Binational Partnership (USA and Canada)."

³³ Ibid, para 24. According to the tribunal,

"it follows that as neither Canada nor Mihaly (Canada) could bring any claim under the ICSID Convention, whatever rights Mihaly (Canada) had or did not have against Sri Lanka could not have been improved by the process of assignment with or without, and especially without, the express consent of Sri Lanka, on the ground that nemo dat quod non habet or nemo potiore potest transfere quam ipse habet. That is, no one could transfer a better title than what he really has."

³⁴ Ibid.

³⁵ Ibid.

instruments holders are given different types of protection which are not an issue in this case before the Tribunal."³⁶

A similar position was reached in the case of *Banro American Resources Inc. and Societe Aurifere du Kivu et du Maniema S.A.R.L. v. Democratic Republic of Congo*³⁷. In this case, the tribunal adopting a similar argument to the case of *Mihaly*, found it lacked jurisdiction to arbitrate the claim. In the case, Banro Resources, a Canadian corporation had assigned its shares in its Congolese investment to its subsidiary, Banro American, incorporated in the United States. According to the tribunal, Banro American could not bring the claim on behalf of its parent company Banro Resources as Banro Resources; a Canadian company was a national of Canada, which at the time was not a contracting party to the ICSID Convention. As such, Banro Resources could not have transferred a valid claim to its U.S subsidiary.³⁸

In the view of the tribunal, in order to consider the right of access to ICSID arbitration, as 'extended' or 'transferred' to Banro American it would still be necessary that such right existed first for the benefit of the entity Banro Resource, the Canadian parent company. However, as Banro Resource, never had, at any time, *jus standi* before ICSID, having never existed for the benefit of Banro

³⁶ Ibid.

³⁷ *Banro American Resources Inc. and Societe Aurifere du Kivu et du Maniema S.A.R.L. v. Democratic Republic of Congo*, ICSID Case No. ARB/98/7, Award, September 1, 2000. Hereinafter *Banro*.

³⁸ According to the tribunal, the issue:

"...involves considerations of international public policy and is governed by public international law. The Tribunal cannot allow the requirements of nationality imposed by the Washington Convention to be neutralized by investors who are seeking to avail themselves, depending on their own interests at a given point in time, simultaneously or successively, of both diplomatic protection and ICSID arbitration, by playing on the fact that one of the companies of the group does not have the nationality of a Contracting State party to the Convention, and can therefore benefit from diplomatic protection by its home State, while another subsidiary of the group possesses the nationality of a Contracting State to the Convention and therefore has standing before an ICSID tribunal." Ibid, para 24.

Resource, the right of access to ICSID cannot be viewed as having been 'extended' or 'transferred' to its affiliate, Banro American.³⁹

It is argued, that the positions of the tribunals in *Mihaly* and *Banro* reflect certain underlying principles. Principally, a purported claimant cannot be said to have effectively assigned or transferred an investment claim to another party when the transferor itself does not have the locus to initiate such a claim. In fact, a claim under the auspices of the relevant investment state dispute mechanism (ISDM) adopted by a BIT only qualifies to be considered a 'claim' on the basis that the purported investor has the required nationality under the BIT. This in turn confers on the investment of such an investor the nomenclature of 'qualifying investment' under the BIT.

Thus, while a dispute no doubt can arise, it is pertinent to state that not all disputes between an investor and a host state constitute claims that can be brought under a BIT. This point underlies the very essence of the reciprocal nature of investment agreements. That is, the host state is only subject to a process of international adjudication by an individual, natural or corporate in instances where it has consented to do so under a BIT. Consequently, where a host state has not consented to the restriction of its sovereignty and regulatory rights to the benefit of the investor; nor precluded the jurisdiction of its legal system as being the proper legal framework and channel for determining and adjudicating on the disputes bothering on foreign investments in its territory. The investor who has no such standing under the relevant BIT cannot be legally said to possess a right to bring a claim under such a treaty, much less to transfer same to the purported benefit of another. This argument also finds credence in two expressions of the principle of

³⁹ Ibid, para 5.

good faith. Notably, these also served as a foundation upon which the reasoning of the tribunals in the cases of *Banro* and *Mihaly* addressed the issue of treaty shopping through the assignment of claims.

First of these is the *nemo dat quod non habet* rule, which states that one cannot give what he does not have. Applying this rule to the issue of treaty shopping through the assignment of treaty claims, it is incontrovertible, that an investor whose investment is not covered by a relevant BIT or similar IIA with the host state of its investment does not have a right to claim against the host state in instances where there is a 'breach' of the host state's obligations. Indeed, it is argued, that the host state in such instances does not owe the investor any obligation under the relevant BIT or IIA. Similarly, the investor does not have a right to bring a claim before an investment tribunal for a non-existent breach. Consequently, an investor cannot be said to be in a position to validly transfer to another investor – who though has the nationality of the relevant BIT – a claim which in fact does not exist.⁴⁰

The second rule is the *non habet* or *nemo potiore potest transfere quam ipse habet* rule, specifically alluded to by the *Mihaly* tribunal.⁴¹ This rule goes a bit further in addressing the issue of the transfer of an investment treaty claim. While the first rule states that the investor cannot assign or transfer a title, or for our purposes a claim it does not have to another. The *non habet* or *nemo potiore potest transfere* expresses the principle that no one can transfer a better title than he has.

As such, where the unprotected investor who does not have standing to bring a claim before an investment tribunal on the basis of a BIT purports to transfer a

⁴⁰ See generally, Mauro Rubino – Sammartano 'Are all Transfers of an Investment Protected by the Treaty which deals with the Original Investment' (2014) 31(1) Journal of International Arbitration 97.

⁴¹ *Mihaly* (n 22) para 20.

“claim” which it actually does not and cannot have, such an assignment cannot be considered to have conferred on the assignee a valid claim or interest. To hold that this is the case would be to confer on the assignee a legal right over and above that which the assignor has and seeks to transfer. In other words, a legal right cannot be said to be transferred where one never existed. The outcome of a process cannot be considered valid where the process itself is not.

A second question, however, is, if an investor which does not possess the required nationality under a BIT cannot or should transfer a ‘claim’. Can the investor in seeking to make a potential claim against the host state, rather than transfer “an isolated treaty claim” create a new juridical entity or transfer its shares to a third party which possesses the required nationality?⁴² This issue was considered by the tribunal in the case of *SGS v Dominican Republic*.⁴³ The case involved among others the transfer of shares in the company Empresa Distribuidora De Electricada Del Este (EDE Este) from the original investor to the claimant who had the nationality of the relevant BIT between France and the Dominican Republic. According to the tribunal, the question of the transfer of investments between or among investors was not a strange practice in the global economy “*and the transfers are not as such disqualified from treaty protection.*”^{44 45}

Notwithstanding, the tribunal observed that while the transfer of investments is a recognised practice, to bring an investment claim against the host state a claimant

⁴² See, Kirtley (n 10) 427.

⁴³ *Societe Generale in Respect of DR Energy Holdings Limited and Empresa Distribuidora De Electricada Del Este, S.A V Dominican Republic*, Award on Preliminary Objections to Jurisdiction, 19 September, 2008. Hereinafter *Societe Generale*.

⁴⁴ *Ibid*, para 44.

⁴⁵ *Ibid*. The Tribunal further added that “*the transfer of AES’s investment in EDE Este to the Claimant does not preclude the existence of a protected asset, and there are no indications that this case might have involved a strategy such as was the case in Mihal and Banro.*”.

must have the nationality of the relevant contracting party at the time of the breach.⁴⁶ The tribunal further added that while the transfer of rights and investments could possibly give rise to claims under a treaty, however, “*the questions of nationality...set a limit as to the application of investment treaties to such transactions*”.⁴⁷ In addition to the requirement of relevant nationality, the tribunal observed that where the claimant indeed has acquired the relevant nationality, it must be shown that the transaction in question must be a bona fide transaction. Such a transfer must not be devised to allow a national of a state not qualifying for protection under a treaty to obtain an inappropriate jurisdictional advantage otherwise unavailable by transferring its rights after-the-fact to a qualifying national.⁴⁸ In other words, such transfer of an investment must not be to the end of facilitating treaty shopping.

Similarly in the case of *Loewen v United States of America*⁴⁹ the tribunal expressed limits as regards the assignment of treaty claims by an investor. In this case, the investor assigned its claim to another entity after dispute had arisen. In this case, the Canadian claimant declared bankruptcy during the arbitral proceedings. However, immediately before going out of business, the claimant assigned its treaty claim to a newly created Canadian corporation whose only asset was its claim against the United States.⁵⁰ According to the tribunal the assignment of the claim changed the nationality of the claimant from Canadian to U.S nationality.⁵¹

The tribunal further stated that;

⁴⁶ Ibid, para 109.

⁴⁷ Ibid.

⁴⁸ Ibid, para 110.

⁴⁹ *Loewen Group Inc. and Raymond Loewen v. United States of America*, Case No. ARB(AF)/98/3, Award, 26 June, 2003. Hereinafter *Loewen*.

⁵⁰ Ibid, para 220, 240.

⁵¹ See generally, Kirtley (n 10) 427, 438.

*“in international law parlance, there must be continuous national identity from the date of the events giving rise to the claim, which date is known as the dies a quo through the date of the resolution of the claim, which date is known as the dies ad quem.”*⁵²

In concluding, the tribunal opined that because the claimant’s nationality was not continuous from the date of the events giving rise to the claim through the date of the resolution of the claim, the tribunal lacked jurisdiction to entertain the claimant’s claim.⁵³ According to the tribunal, *“...whatever the reasons for TLGI’s decision to follow the bankruptcy route it chose, the consequences broke the chain of nationality that the Treaty requires.”*⁵⁴

It is important to note, however, that the tribunal in *Loewen* did not make any statements as to the legality or otherwise of the transfer of investment claims. This is as against the position of the tribunal in the case of *Mihaly*, where the tribunal stated that investment claims are not a readily assignable chose in action as shares in the stock exchange market. However, while the tribunal in *Loewen* did not touch on this, it did require that where such transfers are to be made, the nationality of the claimant must be the relevant nationality from the commencement of the breach until the date of the resolution of the claim.

⁵² *Loewen* (n 49), para 225.

⁵³ *Ibid*, para 240(1).

⁵⁴ *Ibid*, para 235.

However, the tribunal attempted to put forward a central requirement in such instances and rightly so. For the tribunal, while investment transfers are part and parcel of everyday business transactions, however, where such assignments of interests in investments are done, they are to be *bona fide* transactions. A particular indication in this regard is that the relevant nationality of the assignor and the assignee are the same. This is to the end that the transfer is not designed to allow a national of a state not qualifying for protection under a treaty to obtain an inappropriate jurisdictional advantage otherwise unavailable by transferring right to a qualified national.⁵⁵

Another case which addresses treaty shopping through the assignment of treaty claims is the case of *Rumeli v Kazakhstan*.⁵⁶ In this case, the claimants who were companies incorporated in Turkey claimed against Kazakhstan for breaches of the Turkey – Kazakhstan BIT with regard to a telecom company Kar –Tel, in Kazakhstan created by Rumel and Telsim and local Kazakh partners.⁵⁷ However, at the time the claim was initiated, Rumeli and Teslim had been seized by the Turkish Savings Deposit Insurance Fund (TSDIF).⁵⁸

In presenting their claim, the claimants argued that notwithstanding the management of Rumeli and Telsim by the TSDIF, the claimants were still legal entities incorporated in Turkey, and as such had standing to bring an investment claim being nationals of another contracting party and thus satisfying Article 25 of the ICSID

⁵⁵ Indeed, while this position does not explicitly consider the transfer of rights as forbidden in international law and global business, (it also did not state that the assignment of investment claims constitutes as one of such rights) exercisable by the investor. *Societe Generale* (n 43) para 110.

⁵⁶ *Rumeli Telekom A.S and Telsim Mobil Telekomikasyon Hizmetleri A.S v. Republic of Kazakhstan*, ICSID Case No. ARB/05/16, Award 29 July, 2008.

⁵⁷ *Ibid*, para 1-13.

⁵⁸ *Ibid*, para 160.

Convention⁵⁹. According to claimants, Rumeli and Telsim remained legal entities incorporated in Turkey; remained commercially registered legal entities; have employees and own assets; have full legal capacity; pay social charges and taxes and are not immune from enforcement. As such, according to the claimants, they are not owned, but merely managed by TSDIF.⁶⁰ The claimants further alleged that they were never created for treaty-shopping purposes. Nor did they become controlled by TSDIF for this purpose.⁶¹ The claimant also argued that even if Rumeli and Telsim are to be “shell” companies, at the time of the claim, it cannot be seriously argued that they were created for “treaty-shopping” purposes, i.e. to gain ICSID jurisdiction, at the time of incorporation.⁶²

On the respondent’s part, it argued that seizure of the claimants by TSDIF is identical in legal and economic effect to an assignment of claimants’ cause of action to Turkey,⁶³ as TSDIF being a public entity rather than a private investor would not have standing to bring a claim before the tribunal.⁶⁴ According to the respondent, a central question to be decided by the tribunal is the question of whether or not the terms of the host state’s consent to ICSID arbitration extend to the assignee and/or permit assignment of rights and obligations arising out of an investment relationship.⁶⁵ The respondent also argued that the corporate veil of the claimants must be pierced to reveal that the claim by the nominal claimants was a sham designed to conceal the reality of TSDIF as the real claimant, having failed to satisfy

⁵⁹ Ibid, para 183.

⁶⁰ Ibid, para 184.

⁶¹ Ibid, para 185.

⁶² Ibid, para 187.

⁶³ Ibid, para 266.

⁶⁴ Ibid, para 267.

⁶⁵ Ibid, para 267.

the jurisdictional requirement of the ICSID, being a state party and not a private investor.⁶⁶

However, in reaching its decision, the tribunal stated that the claimants were incorporated and exist under the laws of Turkey, which is a party to the ICSID Convention and therefore, the claimants appear *prima facie* as nationals of a contracting party to the ICSID.⁶⁷ The tribunal also noted that the TSDIF was not named the claimant in the arbitration but Rumeli and Telsim, who were clearly the claimants in the arbitration and were not created for treaty shopping purposes.^{68 69}

Importantly, the tribunal also found that the record did not support the respondent's allegation that the claimants claim was assigned to the TSDIF⁷⁰ and as such found no reason to pierce the claimants' corporate veil as requested by the respondent. Making reference to the case of *ADC Affiliate Limited & ADMC Management Limited v Republic of Hungary*⁷¹, the tribunal stated that "*the principle of piercing the corporate veil only applies to situations where the real beneficiary of the business misused corporate formalities in order to disguise its true identity and therefore avoid liability*" which was not found to be the case in the claim before the tribunal.⁷²

⁶⁶ Ibid, para 278, 279.

⁶⁷ Ibid, para 313.

⁶⁸ Ibid, para 325.

⁶⁹ Emphasising the position that Rumeli and Telsim were not created for treaty shopping purposes, the tribunal noted:

"Even if it is correct that Telsim's assets have been sold to Vodaphone and that Telsim may or may not have substantial activities since that sale, it is still a company incorporated and existing under the laws of Turkey. So also is Rumeli which has not sold its assets. Moreover, the companies have existed since 1993 and have certainly not been created for treaty shopping purposes. The fact that Telsim is no longer an active company in the field of telecommunications is no bar to ICSID jurisdiction. The BIT does not provide a basis for looking beyond a company on the alleged basis that it would be a shell company and does not exclude such companies from its scope of application from the moment it is incorporated in another contracting State. The TSDIF's appointment of managers for Telsim and Rumeli did not in any way put an end to their corporate existence or to Claimants' ownership of their claims against Kazakhstan." Ibid, para 326.

⁷⁰ Ibid, para 328.

⁷¹ *ADC Affiliate Limited & ADMC Management Limited v Republic of Hungary* ICSID Case No. ARB/03/16, Award, 2 October, 2006.

⁷² *Rumeli* (n56), para 328.

Consequently, the tribunal found that the claimants had standing to bring the claim and the tribunal had jurisdiction to entertain same.⁷³

In this case, particular notice is to be taken of the emphasis paid by the claimants and similarly adopted by the tribunal that the issue in consideration was not a case of treaty shopping. Considering the facts of the case, this position is the most plausible. First, is the fact that the claimants in question were already existing as legal entities in Turkey before the initiation of the investment dispute, this is regardless of the fact that the claimants were under the control of a state entity at the commencement of the proceedings. Second, control and management of the claimants by the state entity TSDIF is not tantamount to the assignment of an investment claim to another party. In other words, were the issue at hand one of the assignment of the investment claim, there must be “respect for the rules of formal legal assignment” and not the mere “economic effect” of an assignment of an investment as argued by the respondent.

In the case of *Phoenix v Czech Republic*⁷⁴, a Czech national obtained Israeli nationality and created an Israeli company, Phoenix Action Ltd, to buy two Czech companies that had been owned by him.⁷⁵ The tribunal held that the claimant abused the ICSID system, given the timing of the investment, as the facts of the case revealed that all damages claimed by Phoenix had been incurred by the two Czech companies when the investment was made. Also, the timing of the claim for which the claimant had provided notice even before it registered its ownership of the two Czech companies, and the true nature of the operation, as there were ‘strong indicia

⁷³ Ibid, para 331.

⁷⁴ *Phoenix Action Ltd v Czech Republic*, ICSID Case No. ARB/06/5, Award.

⁷⁵ Ibid, para 137.

that no economic activity in the marketplace was either performed or even intended by Phoenix'.⁷⁶

The tribunal noted that the claimant's whole 'investment' was an 'artificial transaction' designed to gain access to ICSID jurisdiction. The investment was 'in essence' a domestic investment 'disguised' as an international investment.⁷⁷ It 'was not an economic investment, based on the actual or future value of the companies', but rather 'simply a rearrangement of assets within a family, to gain access to ICSID jurisdiction to which the initial investor was not entitled'.⁷⁸ The claim was consequently dismissed on this point.⁷⁹

In consideration of the cases reviewed, it is submitted that first a clear distinction exists between the transfer of an international investment and the transfer of an international investment claim. This point was particularly emphasised in the cases of *Mihaly*, *Lowen* on the one hand, and the case of *Societe Generale* on the other. Starting with the transfer of international investments between investors and across national borders and legal jurisdictions, nothing in the customs of international business and indeed legal regimes such as the international investment law regime forbids the sale, transfer or assignment of assets and other forms of investment.

⁷⁶ Ibid, para 136-40.

⁷⁷ Ibid, para 143, 144. See also Chapter 5 on round tripping of investments.

⁷⁸ Ibid, para 140.

⁷⁹ According to the tribunal:

"The conclusion of the Tribunal is therefore that the Claimant's initiation and pursuit of this arbitration is an abuse of the system of international ICSID investment arbitration. If it were accepted that the Tribunal has jurisdiction to decide Phoenix's claim, then any pre-existing national dispute could be brought to an ICSID tribunal by a transfer of the national economic interests to a foreign company in an attempt to seek protections under a BIT. Such transfer from the domestic arena to the international scene would ipso facto constitute a "protected investment" – and the jurisdiction of BIT and ICSID tribunals would be virtually unlimited. It is the duty of the Tribunal not to protect such an abusive manipulation of the system of international investment protection under the ICSID Convention and the BITs. It is indeed the Tribunal's view that to accept jurisdiction in this case would go against the basic objectives underlying the ICSID Convention as well as those of bilateral investment treaties. The Tribunal has to ensure that the ICSID mechanism does not protect investments that it was not designed for to protect, because they are in essence domestic investments disguised as international investments for the sole purpose of access to this mechanism." Ibid, para 144.

Especially where such transfers meet with the necessary legal requirements of the particular jurisdiction(s) involved.

In other words, the issue of the transfer of investments is a normal feature of the global economy and in the absence of fraud and other mitigating factors⁸⁰ enjoys the full backing of legal regimes. Including public international law, international commercial law, international energy law among others, which serve as legal frameworks for the assignment, sale and transfer of cross border goods and services, as well as investments. With this point established, it is evident that where an investment is transferred from one investor to the other, there is the possibility of the assignee having standing to bring an investment claim with regard to such newly acquired investment.

However, where such a claim is to be brought, the question is, first, whether or not it is brought on the strength of the claimant's position as a protected investor under the relevant BIT. That is, whether the claim is brought on the basis of the breach of such BIT within the tenure of the present investor, or it is brought under that of the previous investor who did not have the relevant nationality at the time? Simply put, is the claim brought by the protected investor with regards to breaches of the relevant BIT which have occurred during its acquisition of the investment? Or, second, is such a claim brought by the protected investor who has recently acquired the investment, but with regard to breaches of the BIT to which the previous and unprotected investor has no right to claim, which occurred before the protected investor acquired such an investment?

⁸⁰ Other factors which can vitiate the transfer or sale of international investments include illegality and bribery. See, Muthucumaraswamy Sornarajah 'Reactions to Neo – Liberal Excesses in Investment Arbitration' in Catherine Rogers and Roger Alford (Eds), *The Future of Investment Arbitration* (OUP 2009).

Evidently, where such a claim is brought by a protected investor on the basis of a series of events which occurred during the period of ownership of the previous unprotected investor, the state party cannot be held to be in breach of an obligation or duty it never owed. In other words, the subsistence of the obligation and duties owed by the relevant host state to the protected investor was only initiated and entered into force at the time the investment (being erstwhile unprotected by the BIT) was transferred to the new and protected investor.

To advance an investment claim against a host state with the view of demanding the enforcement of treaty obligations in retrospect where such never existed initially will, therefore, be tantamount to an abuse of international investment law and the process of international investment arbitration. This, it is submitted, justifies the reasoning of the tribunal in *Societe Generale* which although did not consider the issue of the transfer of investment as illegal, nevertheless, pointed out that a claimant must have the nationality of the relevant contracting party at the time of breach.⁸¹

On the other hand, the tribunal in the case of *Mihaly*, expressed its views not in regard to the assignment of investments, but specifically, the assignment of investments claims among investors. According to the tribunal:

*“ A claim...is not a readily assignable chose in action as shares in the stock-exchange market or other types of negotiable instruments, such as promissory notes or letters of credit. The rights of shareholders or entitlements of negotiable instruments holders are given different types of protection which are not an issue in this case before the Tribunal.”*⁸²

⁸¹ *Societe Generale* (n 43) para 109.

⁸² *Mihaly* (n 22) para 24.

It is clear from this statement that the tribunal sought to express a sort of distinction between the nature of international investment claims and other assets or investments held and transferred by investors in the global economy. However, the tribunal did not give its reasons for its observation. Nonetheless, the statement suggests that there is an 'intrinsic' quality or nature possessed by international investment claims which should separate them from being the objects of 'commercialization' by investors.

It is submitted that the reasoning unexpressed by the tribunal relates to the privity of the agreement between contracting parties to an IIA or BIT, wherein state parties agree to be sued before international investment tribunals by individual and juristic nationals of the other contracting party. As such investment claims are offsprings of these agreements which are made specifically between or among the relevant parties. The transfer or sale of an investment claim, therefore, effectively incorporates the issue of whether or not the assignee of the claim is a national of a contracting party privity to the relevant BIT or IIA. Conversely, as the case may be, it relates to the issue of whether the assignor itself is a national of a contracting party to any state privity to an investment agreement with the relevant host state.

From the foregoing, it is submitted that *prima facie* the transfer of an investment claim, in principle, is not restricted in international investment law. However, the relevant question where such is to take place is the question of the nationality of the assignee and assignor. That is, whether or not both parties to the assignment are nationals of contracting parties privity to the relevant BIT upon which the investment claim is to be based. Where the nationality of the assignor and the assignee are the same and as such are protected under the relevant BIT, it is argued that there is no

reason, in principle, – with the exception of fraud and other mitigating factors – why investment claims cannot be transferred by investors.

However, while this seems a legal possibility on the face of it, reference must be made to the observation and reluctance of some tribunals in giving investors the latitude to begin to view investment claims as ‘commodities to be traded’⁸³. In other words, while legally possible, the policy and ethical issues the transfer of investment claims raises are also important. Where investment claims are to be readily transferable between investors and across borders, this will lead to a detraction from the principal objective of international investment law, which is its establishment as a body of law for the facilitation of the economic development and prosperity of all nations.⁸⁴

This purpose has influenced the views of investment tribunals on the question of what constitutes an investment. As such, to be considered as an investment, the commitment of resources by an investor, it should have certain duration, a regularity of profit and return, and element of risk, a substantial commitment, as well as constitute a significant contribution to the host state’s development.⁸⁵ These requirements necessarily demand that an investor commit resources physically, financially, technologically as well as in terms of time for before the venture becomes profitable.

However, the nature of investment claims runs parallel to this. First, by their very nature, investment claims involve huge sums of money being demanded of the host

⁸³ Ibid.

⁸⁴ See Olivia Chung, ‘The Lopsided International Investment Law Regime and Its Effect on the Future of Investor – State Arbitration’ (2007) 47 Va.J.Int’l L 953; Rafael Leal- Arcas, ‘A New Era in Global Economic Governance’ (2009) International Security Forum 1.

⁸⁵ See *Joy Mining Machinery Limited v Egypt*, para 53; *Salini Construtorri S.p.A and Italstrade S.p.A v Morocco*, para 52; *Bayindir Insaat Turizm Ticaret Ve Samayi A.S v Islamic Republic of Pakistan*, para 122- 138.

state. These awards range from hundreds of millions to billions of dollars.⁸⁶ Second, while investment claims can run for a number of years in some instances, these cannot be compared to the period of time it would take a greenfield investment before it starts to make profits. Third and related to the second, investment claims in and of themselves do not require a substantial commitment by the investor to the host state. Fourth and consequently, these claims where successful do not constitute any significant contribution to the host state's development.⁸⁷

From the foregoing, where investment claims themselves become 'investments' which investors can buy and sell, with the intent of 'profiting' from the award largesse where successful, it is undeniable, that there is a great chance and in fact is the present case, that investment claims in and of themselves can become commodities for trade on an international investment claim market.⁸⁸ This situation undoubtedly undermines the purpose of the international investment law regime and detracts from the underlying objectives for its establishment as a species of international law and specifically international economic law.

On the one hand, it is submitted that while the assignment of investments between and among investors is an acceptable global practice. The assignment of investment claims in the international investment regime on the other hand does not lend itself as a practice to be promoted in the international investment regime for two principal reasons. First, the assignment of treaty claims effectively removes the thrust of international investment law from its purpose as an instrument for the economic

⁸⁶ The *Yukos Cases*, readily come to mind in this instance, with an award of over US\$50 billion in favour of the former majority shareholders in the Yukos Oil Company. Also worthy of note is the case of *Occidental Petroleum Company v. Republic of Ecuador*, with an award of US\$2.3 billion, inclusive of interest against the Respondent State, Ecuador. See also *Mohamed Abdulmohsen Al-Kharafi & Sons Co. v. Libya and others*, where the Libyan Government was ordered to pay a sum of US\$935 million in favour of the Claimants.

⁸⁷ This is outside of the fact that the host state maintains a reputation of maintaining an 'investor friendly' reputation by submitting itself to the award.

⁸⁸ See, Skinner (n 5) 260.

development of the participating states through the protection of investments using the vehicle of the right to claim against a contracting party. Instead, it possesses the capacity to shift the essence of this area of law to the monetization and profiteering of the right to claim. This in fact is tantamount to the capitalization and commercialization of the restricted sovereignty of contracting states.

Second, while the transfer of an investment claim seems *prima facie* a possibility between investors of the same nationality, and who are nationals of the relevant contracting party to a BIT or IIA with the host state. Nonetheless, the transfer of a claim from an unprotected national to a protected national begs a number of questions. Foremost, is the issue of the nationality of the assignee and assignor of the investment with regard to the relevant host state and the BIT.

As such, where the assignor does not have the nationality of the relevant contracting party to the BIT and is, therefore, unprotected, assignment of the 'claim' is impossible. As there is no initial right to claim. As observed earlier, the assignor in this instance cannot confer a title it never possessed to the assignee, much less a better one. To assign an 'investment claim' by an assignor who does not possess the relevant nationality, to an assignee who does for the purpose of gaining access to a BIT under which a claim is to be brought, arguably leaves room for the assumption an intention to gain rights under a BIT through the assignee where such rights did not exist in the instance of the assignor.

Similarly relevant is the timing of the investment and or claim, particularly the point at which the investment or claim was transferred between the investors. Where the investment or the 'claim' is transferred soon before or after a dispute has occurred, or during the pendency of an investment claim as in the case of *Lowen*, also

suggests that the motivation of the assignment of the investment or claim is not economic but purely legal, to the end that the parties involved in the transaction access treaty right where none existed prior to the assignment.

Third is the question of the substance of the transaction between the previous and present investor. This relates to the process through which such assignment was made and whether or not it is done without violation of relevant laws. Fourth, is the issue of the motive of the investor in assigning the claim or investment to another investor?⁸⁹ The crux of these questions is the determination of whether or not the assignment of the claim or investment was done for the purposes of treaty shopping, to allow the unprotected investor access to a BIT protection it didn't not have access to, thereby, allowing it initiate a claim against the host state through the instrumentality of an investor who has such protection.

Certainly, the nature of this treaty shopping route creates a dynamic and unique legal arrangement through which the benefits of a BIT can be accessed and an investment claim initiated. While a number of issues have been highlighted, however, the question left to be considered is whether or not DOB clauses as they are currently drafted, limit the practice of treaty shopping through the assignment of claims.

6.3. The Denial of Benefits Clause: An in-treaty panacea for treaty shopping through the assignment of claims?

So far, there is yet to be any publicly available international investment claim which addresses the issue of treaty shopping through the assignment of investment claims

⁸⁹ See *Mobil Corporation, Venezuela Holdings, B.V., Mobil Cerro Negro Holding, Ltd., Mobil Venezolana de Petróleos Holdings, Inc., Mobil Cerro Negro, Ltd., and Mobil Venezolana de Petróleos, Inc. v. Bolivarian Republic of Venezuela*, ICSID Case No. ARB/07/27, Decision on Jurisdiction, 10 June 2010; *Phoenix Action, Ltd. v The Czech Republic*, ICSID Case No. ARB/06/5, Award, 15 April, 2009.

as well as a reference to a DOB clause.⁹⁰ While the DOB clause has been the subject of arbitral jurisprudence in the light of treaty shopping through shell companies and round tripping routes, there remains at present any claim which addresses the issue of the assignment or transfer of an investment claim based on a BIT or IIA which contains the DOB clause. However, while there might be a dearth of arbitral jurisprudence in this regard, this part of the chapter will attempt to undertake an analysis of the construction of the clause to determine its effectiveness in limiting treaty shopping through the assignment or transfer of investment claims.

The DOB clause in limiting treaty shopping is designed to achieve its objective through the employment of a structure which incorporates the use of a couple of principal factors. These requirements can be considered largely generic to DOB clauses regardless of the style of drafting. Fundamentally, DOB clauses seek to limit treaty shopping by addressing the issue of nationality through requirements of ownership and control and substantial business activity. The quest of the clause is to ensure that the investor who exercises the right to claim against the host state has genuine links to the other contracting party to the relevant BIT or IIA.

In other words, contracting parties incorporate DOB clauses with the intent that the rights and privileges enjoyed by a protected investor are not ultimately conferred on nationals of countries which have not entered into such agreements. With the central objective of the DOB clause being to weed out nationals of third countries or of the host state from accessing BIT protection, the requirements of control, ownership and

⁹⁰ So far, the DOB clause has been considered in the light of two principal treaty shopping routes, that is, the accessing of treaty rights through corporate structuring and restructuring by third party nationals and corporate structuring and restructuring by nationals of the host state. These have been considered in chapters four and five of this work.

substantial business activities are used as ‘tests’ a purported protected investor must pass to authenticate its claim as a national of the other contracting party.

However, the very nature of treaty shopping through the assignment of claims suggests that the nationality of the claimant is the nationality of the contracting party to the relevant BIT or IIA. This is only natural, as the motivation for the transfer or assignment of a claim is premised on the fact that the assignor does not possess the nationality of the relevant contracting party with a subsisting BIT with the host country. Or in another instance, it possesses the nationality of the host country itself and therefore cannot claim against the host state directly before an international investment tribunal. The claim is then assigned to an investor who possesses the relevant nationality of the other contracting party to a BIT and has the locus to bring an arbitral claim before an international investment tribunal.

This nature of this form of treaty shopping, therefore, demands that ownership rights or control of the investment or claim as the case may be resides in the claimant and assignee of the investment and or claim. This is different from the other treaty shopping routes where upon lifting the corporate veil, the ultimate controller is found to be the national of a third party or a host state national. It is this character of the assignment of treaty claims that makes it susceptible to the consideration of whether or not such ownership or control at of the claimant is the result of a legal arrangement designed for the sole purpose of accessing treaty benefits, done for the sole purpose of accessing treaty benefits where they originally were beyond reach.

In other words, while the transfer of an investment claim can be part of the assumed liabilities and acquired rights in the acquisition or sale of an investment, however, where such transfer or arrangement is done for the purpose of circumventing the

structure of international investment law, (in requiring relevant nationalities as a prerequisite for accessing treaty benefits and bringing claims), this can be considered an abuse of the process of the ISDS mechanism particularly and international investment law more broadly. It is in addressing such circumvention and abuse of process through this treaty shopping route that the present structures and drafting technique of DOB clauses generally seem ill qualified to effectively address.

First, the test of control adopted by DOB clauses to verify the nationality of the ultimate owner or beneficiary of the investment as the nationality of the other contracting party, fails to address the issue raised by treaty shopping through the assignment of treaty claims. Considering the issue from this perspective, where an investment claim is transferred by an unprotected investor to a protected investor, who then owns and controls the investment or assumes proprietorship of the claim, and on the basis of its nationality brings a claim against the host state, such a claimant will on the face of it 'pass the test' of nationality. As the nationality of the owner or controller of the investment in this case is not that of a third party national, but indeed the nationality of the other contracting party to the investment.

This makes the control test redundant against the assignment of treaty claims. At its centre, the control test endeavours to give factual evidence as to the ownership and control of an investor. This it does by looking behind the veil and through to the persons behind the investor. This in turn forms the basis for the determination of the nationality of the investor. In that the investor is conferred or conceived to possess the nationality of its owners and or controllers. This system is indeed workable within the scope of treaty shopping through mailbox companies and round tripping practices. As these forms of treaty shopping essentially pose factual questions, which for the large part are measurable and definable through the determination of

shareholding and day to day running and management of the investor. By their nature, they ultimately give the advantage of drawing objective conclusions in identifying these treaty shopping routes and denying same through the exercise of the DOB clause.

However, unlike the others, the assignment of treaty claims route is not a vehicle of treaty shopping in which its determination is reliant so much on the factual evidence of the ownership or control structure the investor. Where the control requirement is engaged in this respect, it fails to find the claimant, to whom the claim has been transferred in breach of its requirement. This is because at its core, the assignment of treaty claims by character is premised not on hiding the true ownership of the investor, but on a motivation to assume a new and beneficial one in the face of a potential or action dispute.

Being motive driven, the question posed by the assignment of claims route turns on how the motivation behind the transfer of an investment or investment claim is to be determined? Being largely in the mind of the assignor, this is indeed difficult to answer. Though the acts and processes of the parties leading to the assignment can be considered and evaluated. Yet, these are no less independent of what the parties express their motivations to be.

Importantly, with respect to DOB clauses as they are generally being drafted, the control test falls short in serving as a mechanism to reveal this treaty shopping method for what it is, much less to limit it. By assuming the relevant nationality, the assignment of claim route bypasses the test of control. As when the veil is pierced, the claimant ticks all the boxes for this requirement. The pertinent question, therefore, is not whether or not the assignee which brought the claim has the

relevant nationality and controls the investment. Rather, the concern to be asked with respect to this treaty shopping route is 'how' and 'when' did the assignee get to own the investment or claim and 'why'? These are questions DOB clauses as they are presently drafted have not asked much less answered.

The second requirement of most DOB clauses is the test of substantiality of economic or business activities. While the question of what constitutes the substantiality of business activities remains a vague concept with respect to these clauses, the general intention of contracting parties in including this requirement is evident. In addition to the requirement of nationality, the test of substantial business activities is set up to determine the veracity of the economic ties subsisting between the purported national of a contracting party and the contracting party it claims to be a national of. Particular attention in this respect is paid to corporate investors, with a view that the economic link between a corporate investor and its purported home state is proof enough of its connection to the latter.

In this regard, having satisfied the test of control and ownership, the issue of substantiality of business activities is the only requirement which has the potential of upturning the cart where a claim has been assigned. In other words, where the claimant, who is the assignee of the claim, does not have substantial business activities in the territory of the contracting party it claims to be a national of, this might suffice to be a ground for the denial of benefits to such an investor.⁹¹ On the other hand, where the investor is able to satisfy this requirement, this form of treaty shopping can be easily carried out.

⁹¹ The question of what amounts to the 'substantiality' of an economic activity has been addressed in Chapter 4.

Moreover, even in instances where the claimant does not meet the substantial business activity requirement, most DOB clauses are framed in a way that their requirements apply conjunctively. A representative example of this is the DOB clause in the Energy Charter Treaty (ECT), of which article 17(2) provides:

“Each Contracting Party reserves the right to deny the advantages of this Part to:

*(1) A legal entity if citizens or nationals of a third state own or control such entity **and** if that entity has no substantial business activities in the area of the Contracting Party to which it is organized.”* (emphasis added)

Therefore, DOB clauses having this kind of structure – which most actually have – do not effectively address the issues of treaty shopping through the assignment of treaty claims. In all, DOB clauses as they are presently drafted are not effective in treaty mechanisms with regard to limiting treaty shopping through the assignment of treaty claims.

6.4. Conclusion.

The issues raised by treaty shopping through the assignment of treaty claims are largely dissimilar to those of the round tripping and shell company routes. Whilst the latter involve the use of nationals of the relevant contracting party to the BIT or IIA with the host state, the third party national or the national of the host state itself still possesses ownership or retains ultimate control of the investment. On the other hand, treaty shopping through the assignment of investments and treaty claim cuts a different path. Unlike the other two instances of treaty shopping, this route

characterises a total transfer or assignment of the claim or investment to a national of the other contracting party who has a relevant BIT or IIA with the host state.

This particular nature of this treaty shopping route allows the claimant, who is the assignee of the claim to on the face of it meet the requirement of nationality for bringing a claim before an international investment tribunal. Effectively bypassing DOB clause in its attempt to ensure that nationals of a third party or in other instances, of the host state itself do not get to access and enjoy protection of a BIT where contracting parties do not intend to extend such to them. Unlike the other forms of treaty shopping, in the instance of the assignment of claims, the claimant is indeed a national of the other contracting party.

Importantly, this is not a mere assertion as probable under the other treaty shopping routes, but can be substantiated by ownership and the exercise of control of the investment or claim. Similarly, where the claimant is able to show substantial business activities or economic ties with the contracting party it claims to be a national of, the claimant can potentially successfully sue against the host state. Indeed, even where the claimant is unable to prove such, the conjunctive nature of the requirements employed by most DOB clauses still makes this a possibility.

This chapter has revealed that the central issues posed by treaty shopping through the assignment of treaty claims are of a more dynamic nature than those posed by the other routes. First, while treaty shopping through the assignment of claims does not raise the issue of control by a third party national or host state national, it however, raises importantly, the questions of the nationality of the assignee and assignor of the investment; the question of the timing of the transfer of the

investment and or claim and the question of the overriding motive for the transfer or assignment of the claim in question.

Added to this is the issue of the potential of trade in investment claims detracting from the purpose of international investment law as a vehicle for the promotion of economic development among states. The shifting of focus of investors from the establishment of investments in host countries and the commitment of the required resources on the one hand, and the increasing growth and subsequent embrace of the perception of investment claims as a commercial venture by itself on the other. In other words, the relative ease and the huge financial rewards attached to investment claims make them in themselves attractive commercial commodities to be bought and sold while respondent host states empty their national coffers but to fill the treasury of BIT claim traffickers.⁹²

From the foregoing, it is clear that the DOB clause as it is presently constructed – using the control and substantial business activity tests - is ill equipped to address treaty shopping through the assignment of claims route. Indeed arbitral tribunals which have addressed the issue of treaty shopping, and reached conclusions which addressed the limitation of the practice particularly the tribunals in the cases of *Lowen*, *Banro*, *Milhaly*, *Mobil v. Venezuela*; *Phoenix Action, Ltd. v. The Czech Republic*⁹³ among others as addressed earlier in this work did so without recourse to the DOB clause. These tribunals reached their conclusions using the abuse of right principle among others. While the position can be taken that the DOB clause was not

⁹² See, Skinner (n 5) 260.

⁹³ *Mobil Corporation, Venezuela Holdings, B.V., Mobil Cerro Negro Holding, Ltd., Mobil Venezolana de Petróleos Holdings, Inc., Mobil Cerro Negro, Ltd., and Mobil Venezolana de Petróleos, Inc. v. Bolivarian Republic of Venezuela*, ICSID Case No. ARB/07/27, Decision on Jurisdiction, 10 June 2010; *Phoenix Action, Ltd. v. The Czech Republic*, ICSID Case No. ARB/06/5, Award, 15 April, 2009. See Chapter 3, where the approach of arbitral tribunal to the issue of treaty shopping generally outside of the application of the DOB clause is addressed.

incorporated into the BITs upon which the claims in these cases were brought, the point remains that even if DOB clauses were present in such agreements and in the present format in which they are drafted, the tribunals cannot reach these conclusions relying on the clauses.

This dynamism in the nature of the assignment of claims as a form of treaty shopping makes it the only route against which the DOB clause as it is presently drafted is largely ineffective. However, it must be noted that as pointed out in the preceding chapter, the evolution of the construction of the DOB clause has been principally to combat treaty shopping through the use of shell companies by third party nationals. A more recent drafting of the clause is seeing the use of a drafting style which also tackles treaty shopping through round tripping.⁹⁴

One can deduce, therefore, that the given the increasing spread of this treaty shopping route, states in the international investment law regime will begin to draft and incorporate into their agreements DOB clauses which address this treaty shopping route. In the meantime, however, tribunals are engaging the issue through the use of the abuse of right principle, which though useful, has led to unpredictability and conflicting findings on treaty shopping in the regime.⁹⁵ However, as this work argues, the DOB clause as in-treaty mechanism has the capacity to introduce predictable limits on corporate nationality planning, though this does not

⁹⁴ The principal method the DOB clause employs to achieve its goal of limiting and restricting the conferment of rights to non-nationals of contracting parties or nationals of the parties themselves as to allow them claim against their own home state is the use of the control criteria. The use of the test of control is designed to serve as sieve which allows the piercing of the corporate veil(s) behind the corporate entities to the end that that the nationality of the persons behind the company will be conferred on the company itself. As an additional safe-guard, international investment law's purpose being ultimately the encouragement of economic development, a requirement of the economic ties of the investor to the contracting party it claims to be a national of is also required. See generally chapter 5 of this work on the issue of the denial of benefits clause and round tripping treaty shopping. See also appendix outlining BITs with denial of benefits clauses and how these address the different treaty shopping routes.

⁹⁵ See generally, Mark Feldman, 'Setting Limits on Corporate Nationality Planning in Investment Treaty Arbitration' (2012) 27(2) ICSID Review 281.

seem to be the case at present with regard to the assignment of claims route. Were the DOB clause to be redrafted as to address this treaty shopping route, it is a preferable alternative to the abuse of rights principle.⁹⁶

Chapters four, five and six of this work have attempted to analyse the construction of the DOB clause to show its effectiveness or otherwise as in-treaty mechanism capable of limiting treaty shopping in the international investment regime. However, while these chapters have focused principally on the construction and internal make-up of the DOB clause in achieving the objective of this work, the next chapter will attempt to focus on a different theme. In determining the effectiveness of the DOB clause, it will consider an extrinsic factor which has the potential of limiting the effectiveness of the clause. The major idea is, while the intrinsic character of the DOB clause might make or mar it, what external factors in terms of its application and operation contribute to its effectiveness (or otherwise) in achieving its objective?

⁹⁶ Ibid.

Chapter Seven

Procedural Requirements and the Effectiveness of the Denial of Benefits Clause

7. Introduction

Although arbitral jurisprudence on the DOB clause is relatively nascent,¹ the bulk of the available material on the clause has centred on issues which relate to the procedural requirements for its exercise and invocation. Indeed the recent attention paid by stakeholders in the international investment regime, particularly the legal community, stems from reactions to the position of the tribunal in the case of *Plama v Bulgaria*² with regard to the application, exercise and impact of the DOB clause.³ The interpretation of the DOB clause by the tribunal in *Plama* and other subsequent international investment tribunals as to when, how and to what effect the DOB clause can and should be invoked by state parties has resulted in the emergence of parallel camps on questions raised by this clause.⁴

¹ The first public arbitral decision under the international investment law regime which discussed the denial of benefits clause was the case of *Plama v. Bulgaria* in 2005.

² *Plama Consortium Ltd v Republic of Bulgaria*, ICSID Case No. ARB/03/24, Decision on Jurisdiction, 8 February, 2005. Hereinafter *Plama*.

³ See generally, James Chalker, 'Making the Energy Charter Treaty Too Investor Friendly: *Plama Consortium Limited v. the Republic of Bulgaria*' (2006) 4(4) OGEL, 1; Holger Essig, 'Balancing Investors' Interests and State Sovereignty: The ICSID-Decision on the Jurisdiction *Plama Consortium Ltd v. Republic of Bulgaria*' (2007) 5(2) OGEL 1.

⁴ See, James Chalker, 'Making the Energy Charter Treaty Too Investor Friendly: *Plama Consortium Limited v. the Republic of Bulgaria*' (2006) 4(4)OGEL, 1; arguing that the *Plama* tribunal *Plama* constructed a legal standard overly deferential to the investor and interpreted the ECT's object and purpose with an overemphasis on investor protection to dismiss Bulgaria's jurisdictional objection and reliance on the denial of benefits clause; Holger Essig, 'Balancing Investors' Interests and State Sovereignty: The ICSID-Decision on the Jurisdiction *Plama Consortium Ltd v. Republic of Bulgaria*' (2007) 5(2) OGEL, 1; arguing that the interpretation of the tribunal in *Plama* was convincing as requiring prior exercise of right and the denial of benefits clause having prospective effect.

The preceding chapters of this work have attempted to consider the evolution, purpose, character and construction of the DOB clause to the end of determining the effectiveness of the clause in limiting treaty shopping in the international investment regime. This chapter, however, endeavours to answer the question of the effectiveness of the clause by focusing its lens not on its structure or other intrinsic factors but the role(s) played by external factors, particularly the interpretation of the clause by international investment tribunals.

An international investment Agreement (IIA), similar to any legal or other authoritative text does not possess the powers of self-explanation.⁵ In other words, an investment treaty, though occupying the position of the documented and expressed intent of the contracting parties, however, does not speak for itself.⁶ For the intent of the drafter to be implemented, it must first be discovered and understood. Therefore, a BIT or IIA does not operate or take effect as a matter of course, it must be interpreted. This also applies to in-treaty mechanisms such as the DOB clause which have been incorporated into the treaty to contribute to the overarching objectives and structural consistency of the treaty in achieving such objectives.

However, as it is with most written works, the absence of the author or drafter at the time, place and instance where the intent of the drafter is to be applied gives room for the subjectivity of interpretation. That is, according to Thomas Walde, “the reading into the treaty of meaning that is relevant in the particular linguistic and

⁵ In other words, for the DOB clause to achieve its purpose, its internal consistency with respect to its drafting is not alone sufficient to guarantee its effectiveness. As such, while the DOB clause like any other product of legal craftsmanship might be drafted or designed as to express the intent of the drafter, there remains the important issue of the interpretation of the clause by an interpreter, in this instance, an international investment tribunal. See Thomas Walde, ‘Interpreting Investment Treaties: Experiences and Examples’ in Christina Binder, Ursula Kriebaum, August Reinisch, and Stephan Wittich (Eds) *International Investment Law for the 21st Century: Essays in Honour of Christoph Schreuer* (OUP 2009) 730, 746.

⁶ Ibid.

social context of the interpreter”.⁷ Similarly, as treaty drafters who have incorporated the DOB clause into their treaties are oftentimes not present⁸ when investment tribunals seek to determine the application, exercise and effect of the clause, international investment tribunals have interpreted the DOB clause along dissimilar lines. This dichotomy is particularly evident when arbitral cases involving the DOB clause under article 17 of the Energy Charter Treaty⁹ (ECT) are considered against the interpretation of the DOB clause under other investment agreements.

This chapter in its endeavour to determine the question of the effectiveness of the DOB clause will seek to engage the issue of how the interpretation of the DOB clause by investment tribunals has impacted on the effectiveness of the clause. Particularly, the chapter will seek to analyse how interpretations of the DOB clause as to how, when and to what effect it should operate, allow for the fulfilment of the purpose of the clause or restrict the same. To answer this question, a review and analysis of international investment treaty claims and awards where arbitral tribunals have interpreted the DOB clause will be undertaken.

7.1. The Denial of Benefits Clause: A Right to be Exercised or an Automatic Rule?

The first question to be considered in this regard is the requirement of whether or not the DOB clause operates automatically or actively exercised by a respondent state before it can take effect. Once again, it is worthy of note, particularly with regard to this question, that DOB clauses while generally designed to limit the practice of treaty shopping in the international investment regime, possess textual differences

⁷ Ibid.

⁸ Even in instances where the drafter or contracting parties are present, the fact that these parties are not empowered to make determinative decisions on the treaty by themselves at best places them in a position to make recommendations to the tribunal. Consequently, the decision to view the treaty or issue raised from the view point of the contracting parties ultimately rests with the tribunal.

⁹ The Energy Charter Treaty, signed December 1994, entered into force, April 1998. Hereafter (ECT).

which impact on the interpretation of the exercise of a particular DOB clause. This is an important point, as the couching of the clause can play a crucial role in determining the jurisdiction of an investment tribunal.¹⁰ Nonetheless, what remains unchanged is the purpose and objective of contracting parties in incorporating these clauses into their treaties. As such, while the expressions of the parties as regards the clause may differ. These must be considered in the light of the overarching and central aims of such parties in including the clauses in their agreements.

Generally, DOB clauses are couched in terms which express the right of choice of the state party concerned to exercise the right or refrain from invoking it. These terms, phrases and expressions in the construction of the DOB clause evidence the intention of the parties in making the denial of the advantages of a treaty a subjective right to which the state party involved makes a decision to engage. For example, under the ECT, the operative expression which underscores the exercise of the right vested in the state to deny benefits to an investor is the phrase “reserves the right to deny”¹¹. This is similar to the wording used in most US BITs¹². Also, Article 1113 of the North American Free Trade Agreement (NAFTA)¹³ makes use of the subjective term ‘*may*’ with regard to the exercise of the DOB clause.

In the case of *Plama*,¹⁴ a case brought under the auspices of the ECT, the respondent argued that the DOB clause required no action and operated

¹⁰ Taking the DOB clause in the ECT as an example, the DOB clause under article 17 of the treaty is headed ‘Non – Application of Part III in certain circumstances’. In its beginning, the provision reads as follows “ Each Contracting Party reserves the right to deny the advantages of **this Part** to...” (Emphasis added). The use of the expression “this part” alongside the heading of the provision has greatly impacted on the interpretation of the DOB clause under the ECT as against its use and interpretation in other treaties.

¹¹ The ECT, art 17(1).

¹² See for example the US- Ecuador BIT, Signed August 27, 1993, entered into force May 11, 1997.

¹³ North American Free Trade Agreement (NAFTA) entered into force January 1, 1994.

¹⁴ *Plama v Bulgaria* (n 2).

automatically.¹⁵ However, the tribunal distinguished between the existence of a right and the exercise of the right.¹⁶ This reasoning of the tribunal is correct. Indeed the ordinary meaning of the wording of the DOB clause in the ECT “reserves the right” suggests that the right that exists is not the denial of benefits *per se*, but rather the existence of the right to choose to deny benefits to an investor. In other words, the use of terms such as ‘reserves the right’ or ‘may deny’ express the intent, that for benefits of the relevant BIT or IIA to be denied to an investor, there must be an active choice to do so. It is this decision that translates into an exercise or invocation of the right by the host state.¹⁷

In consolidating its point on the issue, the tribunal reasoned that were the DOB clause in the ECT designed to operate automatically, drafters could have couched it as to have such an effect. In this regard, the tribunal made reference to article VI of the ASEAN Framework Agreement on Services¹⁸ titled ‘Denial of Benefits’ and which provides for an automatic application of the clause.¹⁹

Similarly, in the case of *Yukos v Russia*²⁰, the respondent argued that article 17(1) of the ECT operates automatically in denying the benefits of the Part III of the Treaty to

¹⁵ Ibid, para 72, 154.

¹⁶ Ibid, para 155.

¹⁷ Ibid, para 155. Expressing its thought on this point, the tribunal posited:

“ In the Tribunal’s view, the existence of a “right” is distinct from the exercise of that right. For example, a party may have a contractual right to refer a claim to arbitration; but there can be no arbitration unless and until that right is exercised. In the same way, a Contracting Party has a right under Article 17(1) ECT to deny a covered investor the advantages under Part III; but it is not required to exercise that right; and it may never do so. The language of Article 17(1) is unambiguous”

¹⁸ ASEAN Framework Agreement on Services, signed 28 January, 1992, entered in to force 15 December 1995.

¹⁹ Ibid, article VI. “ *The benefits of this Framework Agreement shall be denied to a service supplier who is a natural person of a non-Member State or a juridical person owned or controlled by persons of a non-Member State constituted under the laws of a Member State, but not engaged in substantive business operations in the territory of Member State(s).*”(Emphasis Added).

²⁰ *Hulley Enterprises Limited (Cyprus) v The Russian Federation*, UNCITRAL, PCA Case No AA 226, Interim Award on Jurisdiction and Admissibility, 30 November, 2009; *Veteran Petroleum Limited (Cyprus) v The Russian Federation*, UNCITRAL PCA Case No. AA 228, Interim Award on Jurisdiction and Admissibility, 30 November, 2009; *Yukos Universal Limited (Isle of Man) v The Russian Federation*, UNCITRAL, PCA Case No AA 227, Interim Award on Jurisdiction and Admissibility, 30 November, 2009. Hereinafter, *Yukos case*.

any company which does not satisfy the requirements of the clause.²¹ Expressing its disagreement, the tribunal stated:

*“ Article 17(1) does not deny simpliciter the advantages of Part III of the ECT—as it easily could have been worded to do—to a legal entity if the citizens or nationals of a third State own or control such entity and if that entity has no substantial business in the Contracting Party in which it is organized. It rather “reserves the right” of each Contracting Party to deny the advantages of that Part to such an entity. This imports, that, to effect denial, the Contracting Party must exercise the right.”*²²

Also in the case of *ASCOM v Kazakhstan*²³, the tribunal in its discourse on article 17(1) of the ECT stated that the clause would “only apply if the state invoked the provision to deny benefits to an investor”. However, according to the tribunal, Kazakhstan as the respondent state “did not exercise this right”.²⁴

It is worthy of note that the question of whether or not a respondent must affirmatively exercise its right to deny benefits²⁵ is perhaps the one area of the interpretation of the DOB clause where investment tribunals have expressed a convergence of opinion. Other cases where arbitral tribunals have made reference to this point include the case of *Limited Liability AMTO v. Ukraine*²⁶; *Liman v.*

²¹ Ibid, para 446.

²² Ibid, para 456.

²³ *Anatolie Stati, Gabriel Stati, Ascom Group SA and Terra Raf Trans Trading Ltd v Kazakhstan*, SCC, Case No 116/2010, Award, 19 December, 2013. Hereafter *Ascom case*.

²⁴ Ibid, para 745.

²⁵ This of course relates to denial of benefits clauses that have been couched to require active exercise of the right to deny.

²⁶ *Limited Liability AMTO v Ukraine*, SCC, Case No 080/2005, Final Award, 26th March 2008. Where the tribunal noted that there must be the existence of the two requirements of ownership or control by the national of a third party and the absence of substantial business activities before the respondent state can ‘exercise’ the right to deny benefits to an investor. See para 62.

*Kazakhstan*²⁷; *Ulysseas v. Ecuador*²⁸; *Guarachachi America, Inc. and Rurelec Plc v Bolivia*²⁹; *Pac Rim v. Ecuador*.³⁰

It is argued that a careful perusal of this line of interpretation of the DOB clause by investment tribunals as to its requirement to be actively invoked by the host state accords with the purpose of the clause. That is, its design to prevent nationals of third parties (or of the host state itself, where included in the clause) whose states have not undertaken any obligation under the treaty to benefit from it. Thereby, the clause allows the preservation of reciprocity of assumed obligations and available rights between contracting parties to the relevant IIA. This, however, is in itself built on another fundamental principle. This is the principle of sovereignty.

In other words, put in another way, the DOB clause can be considered as a sovereignty preserving clause and simultaneously a sovereignty dependent clause. That is, central to the purpose of the clause is the protection of the sovereign rights

²⁷ *Liman Caspian Oil BV and NCL Dutch Investment BV v Republic of Kazakhstan*, ICSID Case No ARB/07/14, Award, 22 June, 2010. The Tribunal observed that a state must expressly invoke the denial of benefits clause, as this is the only interpretation that can be drawn from the wording of Article 17, that the host state “reserves the right to deny the advantages of this Part”. To reserve a right, it has to be exercised in an explicit way. See para 224.

²⁸ *Ulysseas Inc v The Republic of Ecuador*, UNCITRAL, Interim Award, 28 September, 2010. The tribunal noted that a valid exercise of the denial of benefits clause has the effect of depriving the tribunal of jurisdiction under the BIT. See para 172.

²⁹ *Guarachachi America, Inc. and Rurelec Plc v The Plurinational State of Bolivia*, UNCITRAL, PCA Case No 2011-17, Award, 31 January, 2014. Hereinafter *GAI v Bolivia*. According to the tribunal the denial of benefits clause can and usually will be used whenever an investor decides to invoke one of the benefits of the BIT. It will be on that occasion that the respondent State will analyse whether the objective conditions for the denial are met and, if so, decide on whether to exercise its right to deny the benefits contained in the BIT, up to the submission of its statement of defence. See para 378.

³⁰ *Pac Rim Cayman LLC v Republic of El Salvador*, UNCITRAL, Interim Award, 28 September 2010. Where the tribunal stated its view that it is primarily for the Respondent to establish, both as to law and fact, its positive assertion that the Respondent has effectively denied all relevant benefits under CAFTA to the claimant pursuant to CAFTA Article 10.12.2 containing the denial of benefits clause and that, conversely, it is not primarily for the claimant to establish the opposite as a negative. See para 4.60. See generally the case of *CCL v. Republic of Kazakhstan*, SCC, Case No 122/2001, Jurisdictional Award, 1st January, 2004. However, the adoption of denial of benefits clauses which are worded in mandatory terms and operate automatically have been proposed. See generally, UNCTAD, *Series on Issues in International Investment Agreements II, Scope and Definition* (UNCTAD 2011) 98 – 99; Earth Justice, ‘Key Elements of Damaging US Trade Agreement Investment Rules That must not be replicated in the TPP’, *Citizen* (February 2012). <<http://www.citizen.org/documents/tpp-investments-fixes.pdf>.> accessed 10 January 2017.

and powers of the host state, from the free loading activities of third party investors and or nationals of the host state. However, this very mechanism though designed for the protection of sovereignty of the state party is itself based on the exercise of the sovereign will of the party which seeks to protect itself. This particularly holds true where permissive expressions such as “reserve” and “may” are used in the determination of the exercise of the right of denial.³¹ As such, the use of words such as “may” or “reserve the right” to deny advantages of the treaty in these clauses also conversely suggest that the relevant state ‘may not’ decide to deny benefits of the treaty to a third party.

States parties may have a number of justifications for not denying benefits of the treaty to free riders or indeed nationals of the host state itself investing as nationals of the other contracting party. One of such reasons might be the country’s desire to attract more investors into its economy, without restrictions on the real nationality of the investors. This is particularly plausible in the case where the state party considers the benefits which it receives from the accommodation of such third party nationals as outweighing the costs to be borne when an investment dispute arises for which it is found in breach of treaty obligations.

As such, the argument by the respondents in the cases of *Plama* and *Yukos* as to the automatic application of the DOB provision cannot be maintained in the light of the expressions used by the parties with respect to the provision of the DOB clause under the ECT. As suggested by the tribunal in *Plama*, where state parties desire an

³¹ Consequently, while the DOB clause is intended and designed to protect nationals of a third state from benefitting from the restrictions placed by treaty obligations of contracting parties to a BIT or IIA on their sovereignty. This cannot be done except the state exercises its sovereign power to engage the DOB clause as a mechanism to protect its sovereignty. That is, while the DOB clause affords the opportunity to protect the sovereignty of host state, the determination of “whether to extend treaty benefits when the involvement of the nationals of either party is relatively minor” Pamela Gann, ‘The US Bilateral Investment Treaty Program’ (1985) 21 *Stan.J.Int’l.L.* 373.

automatic application of the right, the DOB clause should be crafted in terms which express such an intention. If the view of the tribunal on this point were to be adopted, contracting parties can couch their DOB clauses in ways which included clause such as “shall deny benefits” or any other such similar expression. This is as against the more common use of the phrase “may deny benefits” as used in most DOB clauses presently.

7.2. The Denial of Benefits Clause and the Question of Exercise: How and When?

While the establishment of the need to exercise the right to deny benefits to an investor as conferred by the DOB clause is one thing, the positive exercise of the right in itself raises another set of questions. First, if the right to deny benefits is to be exercised or the DOB clause is to be invoked, in what form is this to be done? Second, at what time in particular can or should a host state (as an actual or potential respondent) seek to invoke the denial of benefits against an investor? In other words, when and how is the DOB clause to be effectively invoked by a state party?

It is worthy of note that while these are pertinent questions as to the procedural contours necessary for the engagement of the DOB clause. However, most DOB clauses are silent on these issues.³² Consequently, BITs and other IIAs which contain DOB clauses with the exception of a few make no reference to or give any indication as to how and when the clause should be exercised. Notably, certain

³² See Lindsay Gastrell, Paul – Jean Le Cannu, ‘Procedural Requirements of ‘Denial-of-Benefits’ Clauses in Investment Treaties: A Review of Arbitral Decisions’ (2015) 30(1) ICSID Review, 78; Rachel Thorn, Jennifer Doucleff, ‘Disregarding the Corporate Veil and Denial of Benefits Clauses: Testing Treaty language and the Concept of Investor’ in Michael Waibel, Asha Kaushal et al (eds) *The Backlash against Investment Arbitration* (Kluwer Law International 2010) 24, 25.

investment agreements such as the NAFTA³³, the Dominican Republic – Central America Free Trade Agreement (CAFTA DR)³⁴ and the Australia – Sri Lanka BIT³⁵ contain in particular the form or process of invoking the DOB clause. These agreements are the few that contain express terms as to the procedure for the invocation of the right to deny benefits.

Regardless, for a majority of BITs and IIAs and Multilateral Investment Treaties (MITs) such as the ECT, investment tribunals are saddled with the responsibility of determining what procedural requirements reflect the purpose of the clause and the treaty in which it is found. As such tribunals have had to look beyond the text of the treaty – while prudently keeping the substance of same in mind – to “define the contours of the procedural requirements applicable to a State’s exercise of the right of denial”³⁶

7.2.1. Exercising the Denial of Benefits Clause: Form and Timing of the Notice Requirement.

The tribunal in the case of *Plama*³⁷ in determining the parameters for the invocation of the DOB clause imposed on respondents the requirement of notice to the investor. According to the tribunal, its interpretation of Article 17 (1) of the ECT suggests that:

³³ NAFTA (n 13).

³⁴ The Dominican Republic – Central America Free Trade Agreement (CAFTA DR), entered into force January 1, 2009.

³⁵ See, Agreement between the Government of Australia and the Government of the Democratic Socialist Republic of Sri Lanka for the promotion and Protection of Investments, signed on 12 November 2002, entered into force, 14 March 2007, art 2(2).

³⁶ Lindsay Gastrell, Paul – Jean Le Cannu, ‘Procedural Requirements of ‘Denial-of-Benefits’ Clauses in Investment Treaties: A Review of Arbitral Decisions’ (2015) 30(1) ICSID Review 78.

³⁷ *Plama v Bulgaria* (n 2).

“the covered investor enjoys the advantages of Part III unless the host state exercises its right to deny benefits under Article 17(1), and a putative covered investor has legitimate expectations of such advantages until the right’s exercise. A putative investor therefore requires reasonable notice before making any investments in the host state whether or not the state has exercised its right under Article 17(1).”³⁸

Speaking on the form such notice or exercise of the DOB cause should take, the tribunal observed that the exercise of the DOB clause would “necessarily be associated with publicity or other notice so as to become reasonably available to investors and their advisers.”³⁹ In the view of the tribunal, “a general declaration in a Contracting State’s official gazette could suffice; or a statutory provision in a Contracting State’s investment or other laws; or even an exchange of letters with a particular investor or class of investors.”⁴⁰ In further advancing its argument on this point, the tribunal expressed its view that the DOB clause as contained in the ECT constituted “only half a notice”⁴¹ which “without further reasonable notice of its exercise by the host state, its terms tell the investor little”.⁴² It is argued, that this view as held by the tribunal is incorrect.⁴³

However, in justifying the reasonableness and practicality of its position, the tribunal alluded to Article 1113(2) of NAFTA as an example of a term providing for the denial of benefits which provides for a form of prior notification and consultation.⁴⁴ This is notwithstanding the material difference in the wording of the provision from Article

³⁸ Ibid, para 161.

³⁹ Ibid, para 157.

⁴⁰ Ibid.

⁴¹ Ibid.

⁴² Ibid.

⁴³ Reasons for this position are discussed below.

⁴⁴ Ibid.

17(1) ECT. Furthermore, according to the tribunal, and in regards to the time at which such a notice must be expressed, the notice to deny the benefits of the treaty must be made to the putative investor before it makes a decision to commit resources into the country.⁴⁵

Following the position of the *Plama* tribunal, the issue of notice was also considered in the *Yukos case*⁴⁶. In canvassing its position, the respondent state, Russia, pointed out that the *Plama* case as being a “weak authority with respect to its treatment of denial of benefits clauses” and “is suspect in its reasoning.”⁴⁷ The respondent also argued that “the *Plama* standard, if accepted, would also impose an impossible standard for States”⁴⁸. The respondent further drew a distinction between the DOB clause contained in Article 17(1) of the ECT, which does not provide for prior notification and consultation and DOB clauses such as Article 1113(2) of the NAFTA, which expressly provides for such procedure.⁴⁹ These arguments, however, did not persuade the tribunal, which decided that the exercise of the DOB clause can only be effective where notice is given to the investor.⁵⁰

With regards to timing, the tribunal did not make specific pronouncements as to the time limit within which the host state in exercising its right to deny benefits is to notify the investor. Indeed unlike the *Plama* tribunal, the tribunal made no express

⁴⁵ According to the tribunal:

“ A putative investor therefore requires reasonable notice before making any investment in the host state whether or not that host state has exercised its right under Article 17(1) ECT. At that stage, the putative investor can so plan its business affairs to come within or without the criteria there specified, as it chooses. It can also plan not to make any investment at all or to make it elsewhere. After an investment is made in the host state, the “hostage-factor” is introduced; the covered investor’s choices are accordingly more limited; and the investor is correspondingly more vulnerable to the host state’s exercise of its right under Article 17(1) ECT.”
Ibid, para 161.

⁴⁶ *Yukos case* (n 20).

⁴⁷ *Ibid*, para 343, 452.

⁴⁸ *Ibid*, para 343.

⁴⁹ *Ibid*, para 444, 445.

⁵⁰ *Ibid*, para 460.

declaration as to the invocation of the DOB clause before the investor commits its investment in the territory of the host state. However, the tribunal in the *Yukos Case* refused to allow Russia exercise the right to deny benefits to the claimants after the commencement of the arbitration. According to the tribunal:

*“In sum, the Tribunal finds, on the basis of the evidence before it, that Respondent has not denied and cannot now be heard to deny, and will not be able to deny to Claimant in any merits phase of these proceedings, the advantages and the benefits of Part III of the ECT on the basis of Article 17.”*⁵¹

This is notwithstanding the fact that the DOB clause in the ECT makes no provision for a time frame within which the clause must be exercised. The position adopted by the tribunal, arguably does not reflect the intention of the contracting parties as to the timing within which the DOB clause can be exercised.⁵² A similar position as to the timing of the notification was adopted by the tribunal in the case of *Liman v. Kazakhstan*⁵³. However, the tribunal made no reference to the need of the respondent state to notify an investor of its intent to apply the DOB clause to the investor as in the case of *Plama*^{54 55}

⁵¹ Ibid, para 459.

⁵² The arguments on this point are discussed later in the chapter.

⁵³ *Liman Caspian Oil BV and NCL Dutch Investment BV v Republic of Kazakhstan*, ICSID Case No ARB/07/14. Award, 22 June, 2010.

⁵⁴ *Plama v Bulgaria* (n 2).

⁵⁵ The tribunal, however, stated:

“ In view of the above conclusions, the Tribunal does not have to deal with the question of whether the intention to rely on the right under Article 17(1) of the ECT must be notified to the investor prior to the making of the investment. To decide the case at hand, it is sufficient to note that when Respondent invoked Article 17(1) of the ECT for the first time in the Counter-Memorial on 4 August 2008, it did so belatedly since it was more than one year after Claimants had filed their Request for Arbitration.”. See, *Liman v Kazakhstan*, para 226.

Notably, outside of ECT cases, investment tribunals have adopted different views on the issue. In the case of *Ulysseas v. Ecuador*⁵⁶ the tribunal, in its analysis of the DOB clause contained in Article I(2) of the US – Ecuador BIT, ventured first to consider whether a time limit subsists within which a state must exercise the right to deny benefits. In the tribunal's view, it found nothing in the DOB clause preventing the respondent state from exercising its right after an investor had sought benefits of the treaty through a request for arbitration.⁵⁷

For the tribunal,

*“...conditions for a valid and effective denial of advantages are to be met...on the date the claimant has claimed the BIT advantages that the Respondent intends to deny”*⁵⁸.

The tribunal consequently applied the time limit provided in Article 21 of the UNCITRAL Arbitration Rules, which provides that a jurisdictional issue can only be raised by the respondent state no later than in statement of defence.⁵⁹ This reasoning of the tribunal followed that of the tribunal in the case of *EMELEC v Ecuador*⁶⁰, also with regard to the US – Ecuador BIT, where the tribunal, rightly considered that Ecuador announced the denial of benefits to EMELEC at the proper stage of the proceedings, that is, upon raising its objections on jurisdiction.⁶¹

In *GAI v. Bolivia*⁶², the claimants challenged the application of Article XII containing the DOB clause on the basis that the respondent state had failed to exercise the

⁵⁶ *Ulysseas v The Republic of El Salvador* (n 28).

⁵⁷ *Ibid*, para 172.

⁵⁸ *Ibid*, para 174.

⁵⁹ See generally, *Gastrell and Le Cannu* (n 36).

⁶⁰ *Empresa Electrica del Ecuador, Inc v Republic of Ecuador*, ICSID Case No ARB/05/9, Award, 2 June, 2009.

⁶¹ *Ibid*, para 72.

⁶² *GAI v Bolivia* (n 29).

clause in a timely fashion. However, the tribunal aligned itself with the position of the *Ulysseas* tribunal. According to the tribunal, the respondent made the objection to jurisdiction in good time, taking into account Article 23(2) of the UNCITRAL Rules that a jurisdictional objection must be raised not later than the statement of defence.⁶³ The tribunal also affirmed the position that nothing in the DOB clause included in the BIT excludes the right to deny the BIT's advantages by the State at the time when such advantages are sought by the investor through a request for arbitration.⁶⁴

Unlike the aforementioned cases, the relatively recent decision of *Pac Rim v. El Salvador*⁶⁵ approached the issue of the form and timing of the notification of the DOB clause differently. This difference in approach is a reflection of the wording of the DOB clause contained in the CAFTA. Similar to the NAFTA article on the DOB clause, the CAFTA DOB clause subjects a state's right to deny benefits to an investor subject to the notification⁶⁶ and consultation⁶⁷ provisions of the treaty. This requirement places a standard against which the proper exercise of the clause can be measured. In this case, a year after the claimant had filed a request for ICSID arbitration, El Salvador notified the USA of its intent to deny Pac Rim the benefits of the CAFTA. The respondent then raised the issue for the first time in before the tribunal as an objection to its jurisdiction.⁶⁸

Furthermore, in addition to the position of the parties, non-disputing parties of the CAFTA, that is, the US and Costa Rica made their submissions as regards the

⁶³ Ibid, para 382.

⁶⁴ Ibid.

⁶⁵ *Pac Rim Cayman v El Salvador* (n 30).

⁶⁶ NAFTA, art 1803(1); CAFTA, art 18.3(1).

⁶⁷ NAFTA, art 2006(1); CAFTA, art 20.41(1).

⁶⁸ *Pac Rim v. El Salvador* (n 30), para 4.84.

intention of the parties in respect to the DOB clause contained in the treaty. In their submissions the non-disputing parties expressed their support for the stance of the respondent. Both the USA and Costa Rica observed that the treaty places no obligation upon a CAFTA party to invoke the DOB clause before the investor submits a dispute to arbitration or to provide any prior notice to an investor.⁶⁹

In its analysis of the object and purpose of the DOB clause and its inclusion in the CAFTA, Costa Rica submitted:

“...the denial of benefits clause of [CAFTA Article 10.12] aims to correct a situation where investors, who may formally be from a Party to the Treaty but are not such in reality, attempt to benefit from the Treaty. In this regard it is a clause that privileges substance over form ... An interpretation of [CAFTA Article 10.12] that creates formal requirements, including as to the moment of invocation, that are not present in the text of the treaty and that have the effect of denying the provision of any practicality goes against the object and purpose of the Treaty.”^{70,71}

It is argued, that the position adopted by the *Plama* tribunal as regards the requirement for notification and timing for the invocation of the DOB clause, and consequently followed by other tribunals under the auspices of the ECT, albeit in part, does not effectively reflect the nature, objective and purpose of the DOB clause. Interestingly, the approach of the tribunal has found support in a number of

⁶⁹ Ibid, para 4.55 - 4.57.

⁷⁰ Ibid, para 4.53.

⁷¹ In expressing its own view, the tribunal observed that the:

“denying benefits to the Claimant under CAFTA was a decision requiring particular attention by the Respondent, to be exercised upon sufficient and ascertainable grounds. Inevitably, such a decision requires careful consideration and, inevitably, also time. It is not apparent to the Tribunal that the Respondent thereby deliberately sought or indeed gained any advantage over the Claimant, by waiting until 1 March 2010 (as regards notification to the USA) or 31 August 2010 (for its invocation of denial of benefits to the Claimant).”
Ibid, para 4.84.

quarters, with scholars affirming the reasoning and position of the tribunal.⁷² However, the position of the tribunal overlooks certain points.

First, according to the *Plama* tribunal, an investor who commits to investing in a host state who is a contracting party to the treaty which contains the DOB clause is a 'covered investor' who enjoys the rights contained in the treaty before the state exercises the right to deny. Furthermore, according to the tribunal, this status of the investor places a requirement on the state to notify the investor beforehand of its intention to exercise its right of denial. This conclusion it is posited is incorrect and does not reflect a holistic appreciation of the issues as regards the DOB clause.

The reasoning behind this argument precludes the factors considered by investors before committing to invest in a host state. Particularly relevant in this instance, is the attention paid (and increasingly so), by investors to the legal framework under which their investments would be placed in a host country. The point has been made that "more and more multinational corporations" are "adding an analysis of the best BIT protection to their standard checklist of items to consider in making an investment...".⁷³

It is worthy of note, that whereas the legal framework of the host state as regards the prospective investment is no doubt a factor considered by investors before committing to a host state. However, investors do venture into areas where political climates and legal frameworks are less than optimal, especially where the returns or gains on the investment are considered to outweigh such risks.⁷⁴ From this it is clear

⁷² See generally, Holger Essig, 'Balancing Investors' Interests and State Sovereignty: The ICSID-Decision on the Jurisdiction *Plama Consortium Ltd v. Republic of Bulgaria*' (2007) 5(2) OJEL 1.

⁷³ Barton Legum, 'Defining Investment and Investor: Who is entitled to Claim?' (2006) 22(4) *Arb Int'l* 521.

⁷⁴ See generally, Zhiguo Gao, *International Petroleum Contracts: Current Trends and New Dimensions* (Graham & Trotman/Martinus Nijhoff 1994); Thomas Walde and Abba Kolo, 'Stabilizing International Investment Commitment: International Law Versus Contract Interpretation' (1996) 31 *Tex. Int'l. L. J* 215.

that most investors are not ignorant of the content of these treaties and actually strategize and structure their investments in such a way as to allow them access the maximum protection available. This also extends to instances where investors do not possess the nationality of either of the contracting parties to the relevant IIA.

This leads to another point, that is, the inclusion of the DOB clause in an IIA suggests the intention of the parties to make access to the substantive and procedural benefits under the treaty provisional. This is particularly true in the case of the procedural rights or access to enforce or claim compensation for a breach of obligation under the treaty. As such when critically considered, the provisions which define ‘investor’ under a treaty and the DOB clause constitute two tests under the treaty.

First, the provisions on nationality are designed for the prospective investor to have access to the legal framework covered by the treaty. This, however, is with a caveat in the form of the DOB clause to the effect that the substantive rights provided under the treaty, and enjoyed by an investor who does not satisfy the conditions of control and substantial business activities are enjoyed merely at the goodwill of the host state. In other words, and in the terms used by the AMTO tribunal,⁷⁵ the DOB clause and clauses on the definition of investor –whether or not both clauses are under the same article or part of the treaty – create two classes of investors.

First is the class of investors with an “indefeasible right”⁷⁶ to investment protection as well as procedural rights to enforce such rights under the treaty. Inclusion in this class is founded not just on the fulfilment of the requirement of the definition of

⁷⁵ *AMTO v Ukraine* (n 27).

⁷⁶ *Ibid*, para 61.

'investor', but also the meeting of the requirements of control and substantial business activities as required by the relevant DOB clause.

The second class are investors with a "defeasible right"⁷⁷ to investment protection, because the state has the power to divest the investor of this right. This is particularly the case where the investor attempts to enforce its rights before an international investment arbitration tribunal. This class consists of investors who qualify as investors in form with regard to the definition of 'investor' in the treaty but fail to meet up with the test of substance as required by the DOB clause. This class can also include investors who initially met the requirements of control and substantive business activities under the DOB clause at the inception of the investment, but over time have undergone changes as to fall short of the standard prescribed by the clause.

This reasoning was mirrored in the case of *GAI v. Bolivia*⁷⁸, where the tribunal observed that whenever a treaty includes a DOB clause, the consent by the host state to grant substantive rights of protection under the treaty as well as to arbitration itself is conditional, and as such may be denied by it.⁷⁹ This right of denial can be exercised by the host state provided that certain objective requirements concerning the investor are fulfilled. For the tribunal, it is not an overstatement or a groundless assertion to state that the inclusion of the DOB clause in the treaty is part of the offer granted between the contracting parties for and on behalf of their nationals. As such, "no one can accept more than what is being offered"⁸⁰.

⁷⁷ Ibid.

⁷⁸ *GAI v Bolivia* (n 29).

⁷⁹ Ibid, para 372.

⁸⁰ Ibid, para 373.

In this case, what was offered by both Bolivia and the US, in the BIT concluded between them, was a package of benefits to investors of both countries, including the benefit of being able to submit disputes to arbitration, coupled with an express prior reservation of the right to deny those benefits if and when the respondent so decides (subjective requirement) and if the investor's company is or becomes a "shell company" controlled by a company incorporated in a third country (objective requirement).⁸¹ The reservation of the right of denial of benefits contained in Article XII operates on the contracting parties' offer of consent to arbitration as much as every other benefit conferred by the BIT.⁸² Ergo, any US investor who invests in Bolivia already knows in advance of the possibility of a denial of benefits by Bolivia, and if it decides to accept the offer of arbitration made by Bolivia in the BIT, it accepts it at face value.⁸³

This argument flies in the face of the notice requirement as espoused by the *Plama* and other ECT tribunals. Indeed contrary to the position held by the latter tribunals, the argument that the inclusion of the DOB clause is "at best only half a notice" is not persuasive. If this argument were to hold true, then provisions in BITs and other IIAs which provide for the settlement of investment disputes between investors and host states should be considered as being at best half notices. For example Article IX of the US – Jordan BIT⁸⁴ provides under the heading "Settlement of Disputes between One Contracting Party and a National or Company of the Other Contracting Party" gives a comprehensive fork in the road approach to available avenues for dispute resolution. ⁸⁵ These are by themselves optional and have to be exercised. Yet they

⁸¹ Ibid.

⁸² Ibid.

⁸³ Ibid.

⁸⁴ US – Jordan BIT, signed 2nd July, 1997 and entered into force June 6, 2003.

⁸⁵ Ibid, Article IX(2), provides as follows:

are not considered a “half notice”, which “tells the investor little” about its right to institute a claim before an international investment tribunal.

Another interesting point raised by the *Plama* tribunal and supported by a commentator⁸⁶, is the reference of the tribunal to the notification and consultation requirement of the Article 1113(2) DOB clause of the NAFTA, as an example of a term providing for the denial of benefits, which provides for a form of prior notification and consultation. ⁸⁷This comparison is inapposite. While the tribunal recognised that the wording of the DOB clauses in the two treaties are dissimilar in some respects, it believed the inclusion of the notification and consultation requirement in the NAFTA DOB clause justified the rationality of the requirement to notify the investor of the intention of the respondent to exercise the right to deny. This approach is unbalanced on two fronts.

First, this analysis of the tribunal is a direct contradiction to its own assertion on the expressed intention of parties as documented in the treaty. With regard to the issue of the automatic exercise of the DOB clause, the tribunal referred to the provision of the ASEAN Framework Agreement on Services, and rightly stated that if state parties were desirous of making the exercise of the DOB clause automatic, a similar format would have been adopted under the ECT. It is, therefore, interesting to find the tribunal shortly afterwards, indeed in the very next paragraph, demand the application of the requirement of notice and consultation with the investor where this

“ 2. A national or company that is a party to an investment dispute **may** submit the dispute of resolution under one of the following alternatives:

(a) to the courts or administrative tribunals of the Party that is a party to the dispute; or
(b) in accordance with any applicable, previously agreed dispute-settlement procedures; or
(c) in accordance with the terms of paragraph “.

⁸⁶ See, Essig (n 72).

⁸⁷ *Plama v Bulgaria* (n 2) para 157.

was not expressed under Article 17 of the ECT. This can be viewed as an inconsistent approach to interpretation of the treaty.

Second, the very reference of the tribunal to the provision of the DOB clause under the NAFTA is not the appropriate justification upon which such an argument can be canvassed. The tribunal's reference to the NAFTA DOB clause was made in its attempt to justify the reasonableness and practicality of notifying the investor by the respondent of its intention to in the future, exercise the right to deny. This interpretation was supported by the Hoger Essig in his commentary on the case.⁸⁸ Article 1113(2) upon which this argument is founded provides:

“ Subject to prior notification and consultation in accordance with Articles 1803 (Notification and Provision of Information) and 2006 (Consultations), a Party may deny the benefits of this Chapter to an investor of another Party that is an enterprise of such Party and to investments of such investors if investors of a non-Party own or control the enterprise and the enterprise has no substantial business activities in the territory of the Party under whose law it is constituted or organized.”⁸⁹

While, on the face of it, this provision seems to lend support to the position of the tribunal. However, it in fact, does more damage to its argument than it helps. The provision of Article 1113(2) as seen, places the exercise of the right of denial as being subject to notification and consultation. The important question to be asked, therefore, is who is to be notified and consulted before the contracting party wishing to exercise the right to deny can. The answer to this question is provided in the Article 1803 of the NAFTA itself. Article 1803 on notification provides:

⁸⁸ Essig (n 72).

⁸⁹ NAFTA, art 1113(2).

- “ 1. To the maximum extent possible, each Party shall notify any other Party with an interest in the matter of any proposed or actual measure that the Party considers might materially affect the operation of this Agreement or otherwise substantially affect that other Party's interests under this Agreement.*
- 2. On request of another Party, a Party shall promptly provide information and respond to questions pertaining to any actual or proposed measure, whether or not that other Party has been previously notified of that measure.”^{90 91}*
- (Emphasis added).*

As seen, the requirement for consultation and notification has nothing to do with the investor, but rather other contracting parties to the agreement. Consequently, the position adopted by the *Plama* tribunal and other tribunals under the ECT on the notification of the investor before the exercise of the DOB clause by the host state is not persuasive and robs the DOB clause of its effectiveness.

The second leg of the issue of notice is the timing of the notice of invocation of the right of denial. According to the tribunal in *Plama*, notice as to the exercise of the right to deny benefits to an investor should be done before the investor commits its resources in the territory of the host state. This in the tribunal's reasoning is to prevent the respondent from breaching the legitimate expectations of the investor.⁹² However, the DOB clause contains no indication as to a time frame within which the clause must be exercised. Furthermore, the requirement to notify and exercise the right before the investor brings the claim before the tribunal would be contrary to the very intent of state parties for attracting investments through IIAs. This position was

⁹⁰ NAFTA, art 1803.

⁹¹ Similarly, NAFTA art 2006 on consultation provides:

1. Any Party may request in writing consultations with any other Party regarding any actual or proposed measure or any other matter that it considers might affect the operation of this Agreement.

⁹² *Plama v Bulgaria* (n 2) para 161.

articulated by the tribunal in *GAI v. Bolivia*.⁹³ Being a subjective right of state parties,⁹⁴ it is argued that the exercise of the denial of benefits is a right exercisable at any time. This is more so because putative investors, who are aware of the inclusion of the DOB clause under IIAs of host countries they intend to invest in, as earlier argued, in real terms cannot be said to have legitimate expectations. This is particularly the case where and when such investors do not satisfy the requirements of the relevant DOB clause. Consequently, where no such legitimate expectations exist, they in turn cannot be breached by a subsequent exercise of the right to deny by the host state. To, therefore, prescribe a time limit within which a state party can invoke the denial of benefits, where state parties have made no express indications to do so, effectively erodes the impact of the DOB clause.

In the case of *Pac Rim Cayman v. El Salvador*⁹⁵, Costa Rica a non-disputing party to the claim, observed that the CAFTA DOB clause - like many others - is silent on when a party may deny benefits. Costa Rica in its view expressed the position that the “denial of benefits may occur at any time, regardless even of the existence or not of an investment arbitration”, particularly when a tribunal is examining its jurisdiction. However, the state pointed out, and rightly so, that such a denial could not be legally effective after an award was made.⁹⁶ Going further, the party expressed its disapproval of the interpretation of the intention of parties by tribunals in a manner

⁹³ *GAI v Bolivia* (n 29).

⁹⁴On this point, the tribunal in *GAI v Bolivia* stated:

“ it would be odd for a State to examine whether the requirements of Article XII had been fulfilled in relation to an investor with whom it had no dispute whatsoever. In that case, the notification of the denial of benefits would—per se—be seen as an unfriendly and groundless act, contrary to the promotion of foreign investments. On the other side, the fulfilment of the aforementioned requirements is not static and can change from one day to the next, which means that it is only when a dispute arises that the respondent State will be able to assess whether such requirements are met and decide whether it will deny the benefits of the treaty in respect of that particular dispute.” Ibid, para 379.

⁹⁵ *Pac Rim v El Salvador* (n 30).

⁹⁶Ibid, para 4.52.

which imposes requirements of timing among others which parties did not include in their agreements.⁹⁷

Lending its voice to the position of Costa Rica, the US from which the practice of the DOB clause evolved stated:

“The USA observes (in common with Costa Rica) that a CAFTA Party is not required to invoke denial of benefits under CAFTA Article 10.12.2 before an arbitration commences; and that it may do so as part of a jurisdictional defence after a claim has been submitted to arbitration (paragraph 5). The USA likewise observes that this CAFTA provision contains no time-limit for its invocation; and that a contrary interpretation would place an untenable burden on a CAFTA Party, contrary to the purpose of CAFTA Article 10.12.2.”⁹⁸

The impracticalities of such notification and timing have also been expressed by scholars⁹⁹, who have observed that in contractual investment relations, that is, investments specifically backed by state contracts, the host state may be presumed to know the investor with whom it is contracting. However, in the case of IIAs and BITs, the host state may not be aware of the establishment of an investment its territory until a claim is made by such an investor.¹⁰⁰

⁹⁷ Ibid, para 4.53. According to Costa Rica:

“ An interpretation of [CAFTA Article 10.12] that creates formal requirements, including as to the moment of invocation, that are not present in the text of the treaty and that have the effect of denying the provision of any practicality goes against the object and purpose of the Treaty... Failing to allow the invocation of the denial of benefits clause even when an investment arbitration has already commenced deprives this provision of any effectiveness.”.

⁹⁸ Ibid, para 4.56.

⁹⁹ See, Anthony Sinclair, ‘The Substance of Nationality Requirements in Investment Treaty Arbitration’ (2005) 20 (2) ICSID Review 357.

¹⁰⁰ Stephen Jagusch and Anthony Sinclair, ‘The Limits of Protection for Investments and Investors under the Energy Charter Treaty’ in Clarisse Ribeiro (Ed), *Investment Arbitration and the Energy Charter Treaty* (JurisNet 2006) 73, 101.

Where the position of the tribunal in the case of *Plama* is to be followed, invoking the clause after the investment has been made has already foreclosed its effect. This position does not convincingly reflect the intentions of the parties for including the DOB clause in their agreements. According to the US in the case of *Pac Rim* mentioned earlier, to adopt the approach in the case of *Plama* would impose a daunting task on state parties to monitor the complex and always changing nature of the business activities of all investors in the territories of the respective states to the treaty. In the view of the US, this is undertaking which militates against the effect and purpose of the clause.¹⁰¹

As a counter argument, it has been stated that it is very easy for a state party to fulfil the condition of prior exercise of the clause.¹⁰² A state party, it is posited, can fulfil this requirement by enacting a law containing an abstract and general denial of benefits provision. Accordingly, this would allow states use the DOB clause in a flexible way without being obliged to review all investment activities.¹⁰³ However, as practical as this view seems, it at its core neglects the purpose and nature of the DOB clause.

First, the clause is a right of the state party and can be subjectively applied. More so, the argument and proposition rests on the purported ignorance of the investor and its legitimate expectations. However, as noted earlier, the argument as to the ignorance

¹⁰¹ *Pac Rim v El Salvador* (n 30) para 4.56. According to the US, this position would “...require the respondent, in effect, to monitor the ever-changing business activities of all enterprises in the territories of each of the other six CAFTA-DR Parties that attempt to make, are making, or have made investments in the territory of the respondent. This would include conducting, on a continuing basis, factual research, for all such enterprises, on their respective corporate structures and the extent of their business activities in those countries. To be effective, such monitoring would in many cases require foreign investors to provide business confidential and other types of non-public information for review. Requiring CAFTA-DR Parties to conduct this kind of continuous oversight in order to be able to invoke the denial of benefits provision under Article 10.12.2 before a claim is submitted to arbitration would undermine the purpose of the provision”.

¹⁰² Essig (n 73); arguing that the interpretation of the tribunal in *Plama* was convincing as requiring prior exercise of right and the denial of benefits clause having prospective effect.

¹⁰³ *Ibid.*

of the investor as to the inclusion of the DOB in an IIA which it wishes to serve as the legal framework for its investment is unconvincing. As a result, such an investor cannot be said to have any expectations that can be considered legitimate where it is aware it does not fulfil the requirement of the DOB clause as contained in the IIA. In other words, the clause is not designed to bend to the convenience of the investor as this approach seems to advocate.

Second, and related to the first, the DOB clause is not designed to keep out investors and investments from the territory of the host state. Its purpose is simply to restrict investors who attempt to internationalise domestic investments and take undue and unreciprocated advantage of the restrictions on the sovereign and regulatory powers of the host state. Advocating for the use of a 'blanket denial of benefits' in practical terms, defeats the purpose of the host state for attracting investment. According to the *GAI* tribunal, such an act would amount to an "unfriendly and groundless act, contrary to the promotion of foreign investments".¹⁰⁴

Similarly, the argument for a domestic 'denial of benefits law' does not completely fit in with the perception of the DOB clause in IIAs and BITs, which are international agreements as being nothing more than 'half a notice'¹⁰⁵. One would question whether foreign investors, who are believed to be unaware of the content of an international agreement which relates to their investment, would pay more attention to a domestic law, which in itself might be perceived less than half notice on the issue. As such, this position on the notice and timing of the DOB clause is a hard one to sell. Advocating and supporting this view is tantamount to eroding the effectiveness of the clause.

¹⁰⁴ *GAI v Bolivia* (n 29) para 379.

¹⁰⁵ *Plama v Bulgaria* (n 2) para 157.

7.3. The Denial of Benefits Clause: The Question of Effect.

The purpose of the DOB clause, as reiterated in this work, is underpinned by the desire of state parties to protect their sovereign and regulatory powers and oversight from being restricted by the actions of third party nationals who claim the nationality of the other contracting party to the relevant IIA.¹⁰⁶ Central to the purpose of the DOB clause, therefore, is the question of its effect when invoked by state parties. In other words, when a state party to the treaty denies advantages to an investor, does the denial take effect from the point of invocation and forward, without affecting facts and issues preceding such invocation? Or, does the denial effectively cover the facts, actions and issues from the point of invocation and before.

Being the first case to undertake an interpretative consideration of the DOB clause, the *Plama* tribunal ventured to reach a conclusion on the effect of the DOB clause. On this point, the tribunal's first observation was that the language of Article 17(1) of the ECT containing the DOB provision was not in itself clear.¹⁰⁷ However, the tribunal in its analysis proceeded in proffering arguments on the improbability of the DOB clause having retrospective effect. In presenting its views, the tribunal anchored its position on two principal factors.

¹⁰⁶ See, Gann (n 31) 373; Herman Walker 'Provisions on Companies in the United States Commercial Treaties' (1956) 50 AM.J.Int'l.L 373; observing that the denial of benefits clause was devised as a safeguard against free riders, that is, nationals of third countries who would gain right or interests despite the fact that the contracting parties to the treaty did not wish to accord them those benefits.

¹⁰⁷ *Plama v Bulgaria* (n 2) para 159. Put in another way, the question is: what is the chronological scope of the effect of the DOB clause? Does the invocation of the DOB clause require a prospective or retrospective effect in preventing a third party national from gaining access to the benefits of the treaty? This question like other interpretative questions raised in the exercise of the DOB clause has been viewed by investment tribunals in two distinct approaches. Interestingly, this dichotomy of views also runs across the line of decisions made under the claims brought under the ECT on the one hand and claims brought under other BITs and MITs.

The first factor raised by the tribunal is the legitimate expectation of the investor. According to the tribunal, an investor has legitimate expectations that it will enjoy the benefits of the treaty unless and until the host state exercises its right of denial.¹⁰⁸ Therefore, where an investor has not been given prior notification of the contracting party's desire to exercise the DOB clause, it makes its decision to commit its investment into the host state.

Consequently, in the tribunal's view, after an investment is made in the host state, the "hostage-factor"¹⁰⁹ is introduced and the covered investor's choices are accordingly more limited. ¹¹⁰Therefore, the investor is correspondingly more vulnerable to the host state's exercise of its right under Article 17(1) ECT.¹¹¹ At this time, according to the tribunal, the covered investor needs at least the same protection as it enjoyed as a putative investor able to plan its investment.¹¹²

In founding its position, the tribunal considered as its second factor the issue of the object and purpose of the ECT.¹¹³ The tribunal anchored this second leg of its reasoning on the establishment of the treaty as "... a legal framework in order to promote long-term co-operation in the energy field ..."¹¹⁴. According to the tribunal, this expressed object and "long term" purpose of the ECT is irreconcilable and

¹⁰⁸ Ibid, para 161.

¹⁰⁹ See, Thomas Walde and Abba Kolo, 'Stabilizing International Investment Commitment: International Law versus Contract Interpretation' (1996) 31 Tex. Int'l. L. J 215; making the point (particularly with regard to international investment in the context of international energy and mineral investment) where the long-term, capital-intensive nature of the investment creates a hostage effect especially susceptible to political risk. This is a reflection of the near total loss of the bargaining power of the foreign company, which often very strong when contemplating high-risk investment, may have waned dramatically once the investment has been made in the territory of the host state.

¹¹⁰ *Plama v Bulgaria* (n 2) para 161.

¹¹¹ Ibid.

¹¹² Ibid.

¹¹³ Ibid, para 160.

¹¹⁴ Ibid, para 161.

inconsistent with the DOB clause having retrospective effect.¹¹⁵ The tribunal concluded that the DOB clause can, therefore, only operate prospectively beginning from the date of invocation.¹¹⁶ This reasoning and position of the *Plama* tribunal on the effect of the DOB clause has been adopted by other tribunals which have considered the DOB clause under the auspices of the ECT¹¹⁷.

This position, however, has been the subject of debate. While this interpretation of the effect of the DOB clause by the tribunal has been supported as being a true interpretation of the intentions of the party, and one which accords with the purpose of international investment law,¹¹⁸ others have, however, argued as to the imbalance

¹¹⁵ In further consolidating its view, the tribunal stated:

"If, however, the right's exercise had retrospective effect, the consequences for the investor would be serious. The investor could not plan in the "long term" for such an effect (if at all); and indeed such an unexercised right could lure putative investors with legitimate expectations only to have those expectations made retrospectively false at a much later date.¹¹⁵... For the Investor, the practical difference between prospective and retrospective effect is sharp. The former accords with the good faith interpretation of the relevant wording of Article 17(1) in the light of the ECT's object and purpose; but the latter does not." See *Ibid*, para 163.

¹¹⁶ *Ibid*, para 165.

¹¹⁷ For example in the *Yukos cases*, *Hulley Enterprises Limited (Cyprus) v. The Russian Federation*, UNCITRAL, PCA Case No AA 226, Interim Award on Jurisdiction and Admissibility, 30 November, 2009; *Veteran Petroleum Limited (Cyprus) v. The Russian Federation*, UNCITRAL PCA Case NO AA 228, Interim Award on Jurisdiction and Admissibility, 30 November, 2009; *Yukos Universal Limited (Isle of Man) v. The Russian Federation*, UNCITRAL, PCA Case No AA 227, Interim Award on Jurisdiction and Admissibility, 30 November, 2009. The tribunal following the reasoning of the *Plama* tribunal, concluded that the denial of benefits clause may only operate prospectively on the basis of the object and purpose of the ECT, particularly the principles of long term cooperation and the promotion, protection and treatment of investments. This was also adopted in the cases of *Liman v Kazakhstan* as well as *Ascom v Kazakhstan*.

¹¹⁸ See generally, Holger Essig, 'Balancing Investors' Interests and State Sovereignty: The ICSID-Decision on the Jurisdiction *Plama Consortium Ltd v. Republic of Bulgaria*' (2007) 5(2) OGEL, 1; arguing that the interpretation of the tribunal in *Plama* was convincing as requiring prior exercise of right and the denial of benefits clause having prospective effect.

reflected in the decision,¹¹⁹ its poor interpretation of the ECT generally, and the DOB clause in particular.¹²⁰

However, this approach by tribunals under the ECT has not found similar acceptance with tribunals which have addressed the issue of the DOB clause under other BITs and MITs. Aside the cases which have considered the DOB clause under the ECT, there are four other cases which have addressed the clause and the issues it raises. These are the cases of *EMELEC v. Ecuador*¹²¹, *Ulysseas v. Ecuador*¹²², *Pac Rim v. El Salvador*¹²³ and *GAI v. Bolivia*¹²⁴. Interestingly and quite parallel to the approach adopted by the ECT tribunals, all tribunals in this group have interpreted the DOB clause to have retrospective effect.^{125 126}

However, the most expansive analysis on this issue is that of the tribunal in the case of *GAI v. Bolivia*.¹²⁷ Starting with the timeliness of the notice to deny benefits as advocated by tribunals under the ECT, the claimant in the case argued that allowing states to deny benefits retrospectively without prior notice would “violate the principle

¹¹⁹ See generally, Xiao –Jing Zhang, ‘Proper Interpretation of corporate nationality Under International Investment law to Prevent Treaty Shopping’ (2013) 6 *Contemp. Asia Arb. J.* 49; Mark Feldman, ‘Setting Limits on Corporate Nationality Planning in Investment Treaty Arbitration’ (2012) 27(2) *ICSID Review*. 281; James Chalker, ‘Making the Energy Charter Treaty Too Investor Friendly: Plama Consortium Limited v. the Republic of Bulgaria’ (2006) 4(4) *OGEL*, 1; arguing that the Plama tribunal constructed a legal standard overly deferential to the investor and interpreted the ECT’s object and purpose with an overemphasis on investor protection to dismiss Bulgaria’s jurisdictional objection. The tribunal equated the object and purpose of the ECT with a high degree of investor protection.

¹²⁰ Walde (n5) 730. Expressing his observation as to the paucity of the proper application of the rules of interpretation of treaties, and its effect in the reasoning and decisions of investment tribunals.

¹²¹ *EMELEC v Ecuador* (n 60).

¹²² *Ulysseas v Ecuador* (n 28).

¹²³ *Pac Rim v El Salvador* (n 30).

¹²⁴ *GAI v Bolivia* (n 29).

¹²⁵ *Ulysseas v Ecuador* (n 28). In its consideration of the issue of the effect of the DOB clause, the tribunal in the case of *Ulysseas v. Ecuador* gave a succinct position on the issue.

¹²⁶ According to the tribunal: “*The Tribunal sees no valid reasons to exclude retrospective effects. In reply to Claimant’s argument that this would cause uncertainties as to the legal relations under the BIT, it may be noted that since the possibility for the host State to exercise the right in question is known to the investor from the time when it made its the investment, it may be concluded that the protection afforded by the BIT is subject during the life of the investment to the possibility of a denial of the BIT’s advantages by the host State.*” *Ibid*, para 173.

¹²⁷ *GAI v Bolivia* (n 29).

of *pact sunt servanda* and would contravene the object and purpose of investment treaties”.¹²⁸ That is, the promotion of investments based on rationality and predictability.¹²⁹ According to the claimant, the application of the DOB clause retrospectively would run contrary to the principles of stability, certainty and good faith.¹³⁰

In its reasoning, the tribunal attempted to analyse the foundational argument of the claimant and the conclusions reached under the ECT tribunals. However, without ignoring the impact of the exercise of the DOB on an investor, the tribunal concluded by giving a convincing analysis of the nature and object of the DOB clause and its role in the international investment law regime.¹³¹

According to the tribunal, no one can accept more than what is being offered.¹³² What was offered by both contracting parties in the BIT concluded between them, was a package of benefits to investors of both countries, including the benefit of being able to submit disputes to arbitration,

¹²⁸ Ibid, para 216.

¹²⁹ Ibid.

¹³⁰ Ibid.

¹³¹ Ibid, para 383. Expressing its views on the effect of the DOB clause, the tribunal noted it was:

“...cognisant that this puts the investor in something of a fragile position, since the investor will never know if there might be a denial of benefits exactly when the investor needs them the most. At the same time, one cannot say that such a denial will come as a total surprise for the investor, since the BIT is not secret and we are dealing in this case with an investor who has opted to use an investment vehicle controlled by a company of a third country, which has no substantial business activities in the territory of the Contracting Party under whose laws it is constituted or organized.”

¹³² The tribunal, however, added:

“...Whenever a BIT includes a denial of benefits clause, the consent by the host State to arbitration itself is conditional and thus may be denied by it, provided that certain objective requirements concerning the investor are fulfilled. All investors are aware of the possibility of such a denial, such that no legitimate expectations are frustrated by that denial of benefits...” Ibid, para 372.

coupled with an express prior reservation of the right to deny those benefits¹³³ if and when the respondent so decides, itself a subjective requirement.^{134 135}

With regard to the chronological effect and scope of the DOB clause, the tribunal reasoned that it:

“...cannot agree with the Claimants when they argue that the Respondent is precluded from applying the denial of benefits clause retroactively. The very purpose of the denial of benefits is to give the Respondent the possibility of withdrawing the benefits granted under the BIT to investors who invoke those benefits. As such, it is proper that the denial is “activated” when the benefits are being claimed.”¹³⁶

Taking its reasoning a step further, the tribunal referred to the fact that the contracting parties to the US – Bolivia BIT could have agreed against the application of the DOB clause, but they decided not to do so.¹³⁷ Instead, the parties agreed that a contracting party could deny benefits (including the benefit of having a dispute decided by an arbitral tribunal) subject to meeting certain conditions, none of which entails that such denial is only effective in relation to disputes arising after the notification of such denial or imposes any other limitation.¹³⁸

¹³³ In the tribunal’s view, “What was offered by both contracting parties in the BIT concluded between them, was a package of benefits to investors of both countries, including the benefit of being able to submit disputes to arbitration, coupled with an express prior reservation of the right to deny those benefits.” Ibid, para 375.

¹³⁴ Ibid.

¹³⁵ This subjective requirement is exercisable where the investor’s company is or becomes a “shell company” controlled by a company incorporated in a third country; being the objective requirement. Therefore, the reservation of the right of denial of benefits contained in the DOB clause operates on the contracting parties’ offer of consent to arbitration as much as every other benefit conferred by the BIT. Hence, any investor who invests in the host state already knows in advance of the possibility of a denial of benefits—as long as the denial of benefits requirements are met—and, if it decides to accept the offer of arbitration made by Bolivia in the BIT, it accepts it at face value. See, Ibid, para 373.

¹³⁶ Ibid, para 376.

¹³⁷ Ibid, para 377.

¹³⁸ Ibid.

On the issue of giving prior notification of the exercise of the denial of benefits clause to the investor as advocated by the tribunal in *Plama* and adopted by other tribunals under the ECT, and also argued by the claimants, the tribunal observed that it would be an impractical and odd act on the part of the state. In the tribunal's view, to examine whether the requirements for the exercise of the DOB clause had been fulfilled in relation to an investor with whom it had no dispute whatsoever does not sit well with the purposes and practical intent behind the DOB clause.

Such notification of the denial of benefits, according to the tribunal, would be interpreted as an unfriendly and groundless act, contrary to the promotion of foreign investments.¹³⁹ Similarly, the fulfilment of the aforementioned requirements is not static and can change from one day to the next, which means that it is only when a dispute arises that the respondent State will be able to assess whether such requirements are met and decide whether it will deny the benefits of the treaty in respect of that particular dispute.¹⁴⁰ This position of the tribunal is at per with the views of the US and Costa Rica in the case of *Pac Rim v. El Salvador*¹⁴¹, where the non-disputing parties of the CAFTA had the opportunity of clarifying the purpose and object of including the DOB clause in their agreement.^{142 143 144}

¹³⁹ Ibid, para 379. The tribunal along this line of thought noted that the invocation of the denial can and usually will be used whenever an investor decides to invoke one of the benefits of the BIT. It will be on that occasion that the respondent State will analyse whether the objective conditions for the denial are met and, if so, decide on whether to exercise its right to deny the benefits contained in the BIT, up to the submission of its statement of defence. See para 378.

¹⁴⁰ Ibid.

¹⁴¹ *Pac Rim v El Salvador* (n 30).

¹⁴² Ibid, para 4.53. According to Costa Rica:

"... the denial of benefits clause of... aims to correct a situation where investors, who may formally be from a Party to the Treaty but are not such in reality, attempt to benefit from the Treaty. In this regard it is a clause that privileges substance over form ... An interpretation...that creates formal requirements, including as to the moment of invocation, that are not present in the text of the treaty and that have the effect of denying the provision of any practicality goes against the object and purpose of the Treaty."

¹⁴³ Ibid, para 4.56. In its own contribution, the US noted that a contracting party is not required to invoke the right of denial of benefits before arbitration commences; and that it may do so after a claim has been

The difference in approach adopted by the tribunals under the ECT on the one hand, and that adopted by tribunals under BITs and IIAs, outside of the ECT, on the interpretation of the procedural requirement of the DOB clause is most pronounced on this question. The sharp distinction in the adoption of positions as to the retrospective or prospective effect of the DOB clause speaks to the core of the power wielded by arbitrators on investment tribunals. Consequently, it is a pointer to the damage that can be done to the intent of State parties by adjudicators when they are interpreted in a way as to render impotent or ineffective the will of the contracting parties.¹⁴⁵

In its argument on the effect of the DOB clause, the *Plama* tribunal posited that the DOB could not operate retrospectively. According to the tribunal, the clause could only apply prospectively from the date it was invoked by the respondent host

submitted to arbitration. Similarly, it pointed out that the CAFTA DOB provision contains no time-limit for its invocation; and that a contrary interpretation would place an untenable burden on a CAFTA party, contrary to the purpose of the clause.

¹⁴⁴ Ibid. According to the US, to place a time limit on the exercise of the clause (and consequently its prospective or retrospective effect) would among other things:

"... require the respondent, in effect, to monitor the ever-changing business activities of all enterprises in the territories of each of the other six CAFTA-DR Parties that attempt to make, are making, or have made investments in the territory of the respondent... This would include conducting, on a continuing basis, factual research, for all such enterprises, on their respective corporate structures and the extent of their business activities in those countries. To be effective, such monitoring would in many cases require foreign investors to provide business confidential and other types of non-public information for review. Requiring ...Parties to conduct this kind of continuous oversight in order to be able to invoke the denial of benefits provision...before a claim is submitted to arbitration would undermine the purpose of the provision".

¹⁴⁵ Once again, it is important to restate the purpose of the DOB clause and its recent adoption by contracting parties in their IIAs in the international investment regime. The DOB clause is principally designed to prevent nationals of third countries, whose countries do not undertake any obligation under a treaty, from gaining access to the advantages of the treaty. As such, the DOB clause prevents free riders and round trippers from gaining access to the protections under a treaty. The importance of this is appreciated when it is considered that the entering into investment treaties equals the promise by state parties to forgo some form of the exercise of its sovereignty and regulatory power of the state on behalf of the investor and its investment. The promise to guarantee certain rights such as refraining from acts of expropriation without compensation, fair and equitable treatment, protection and security among others, places an internationally binding obligation and restriction on the host state. This becomes more important to the host state when the rights and guarantees under an IIA involve access to international arbitration where the investor can bring claims directly against the host state for breach of its obligations under the relevant IIA. See Suzy Nikiema, *Best Practices Definition of Investor* (International Institute for Sustainable Development, 2012) 1.

state.¹⁴⁶ Central to the tribunal's argument was the object and purpose of the ECT. Specifically, the tribunal referred to what it considered to be the express "purpose" of the ECT under Article 2 of the treaty, as the establishment of "... a legal framework in order to promote long-term co-operation in the energy field ... in accordance with the objectives and principles of the Charter".

According to the tribunal, it is not easy to reconcile how any retrospective effect is consistent with this "long-term" purpose of the treaty.¹⁴⁷ In the construction of its argument, the tribunal made reference to the legitimate expectations of the investor which a retrospective exercise and effect of the DOB clause could render false.^{148, 149}

However, a critical analysis of the argument of the tribunal on this point suggests the tribunal's misconstrued the intent of the parties and the purpose of the DOB clause. While it is undoubted that Article 2 of the ECT refers to the establishment of a legal framework in order to promote long-term co-operation in the energy field, what the tribunal left unsaid is the latter part of the provision. In full, article 2 of the ECT reads:

*" This Treaty establishes a legal framework in order to promote long-term cooperation in the energy field, **based on complementarities and mutual benefits**, in accordance with the objectives and principles of the Charter."*¹⁵⁰

(Emphasis added).

¹⁴⁶ This position was supported by Holger Essig in his commentary. See, Holger Essig, 'Balancing Investors' Interests and State Sovereignty: The ICSID-Decision on the Jurisdiction Plama Consortium Ltd v. Republic of Bulgaria' (2007) 5(2) OGEL 1 10.

¹⁴⁷ Plama v Bulgaria (n 2) para 161.

¹⁴⁸ Ibid, para 162.

¹⁴⁹ Ibid. In the tribunal's view:

"For the Investor, the practical difference between prospective and retrospective effect is sharp. The former accords with the good faith interpretation of the relevant wording of Article 17(1) in the light of the ECT's object and purpose; but the latter does not."

¹⁵⁰ The ECT, art 2.

Evidently, from the above, the foundation upon which the legal framework instituted by the treaty in promoting long term cooperation in the energy field is one which rests on complementarities and mutual benefits of the parties. It will be safe to argue, therefore, that a legal framework which is underscored by one sidedness or lack of reciprocity was not envisaged by the contracting parties. This is also a pointer to the inclusion of the DOB clause in the treaty.

The DOB clause as reiterated in this work is designed to serve as a means for guaranteeing the principle of reciprocity in IIAs.¹⁵¹ To allow benefits of an IIA to third party nationals or investors would in essence be "to abandon... (the) right to negotiate corresponding privileges and obligations from those countries."¹⁵² From the foregoing, the objective of the ECT contracting parties in the creation of legal framework in the energy industry built in the foundation of complementarities and mutual benefits fits in perfectly with the inclusion of the DOB clause into the treaty as an in-treaty mechanism instrumental to the contribution of this overall objective.

With the object of the ECT being clearly stated, it is not difficult to see the role the DOB clause plays in the treaty. Indeed, were nationals of third states allowed to free ride and enjoy the benefits of the ECT without their states undertaking any corresponding obligations under the agreement, this arguably has the potential of upsetting the balance of reciprocal rights, mutual benefits and complementarities the treaty seeks to achieve and operate by.¹⁵³

¹⁵¹ Loukas Mistelis and Crina Baltag, 'Denial of Benefits and Article 17 of the Energy Charter Treaty' (2009) 113 Penn St.L.Rev 1301.

¹⁵² Jeswald Salacuse, 'BIT by BIT: The Growth of Bilateral Investment Treaties and Their Impact of Foreign Investment in Developing Countries' (1990) 24 Int'l.L 655, 665.

¹⁵³ See, Anthony Sinclair 'The Substance of Nationality Requirements in Investment Treaty Arbitration' (2005) 20(2) ICSID Review 357,385.

In fact, the inclusion of the DOB clause is a pointer to the intention of the parties to the attainment of this objective. With investment treaties being increasingly considered as too pro investor and pro investment at the sovereign, legal and regulatory expense of the host states, the DOB clause plays the role of a balancing mechanism. With the impact of IIAS on state parties, particularly with regard to the restriction placed on their sovereign powers, regulatory authority and its impact on policy – making among others¹⁵⁴, the inclusion of a clause such as the DOB is optimal in introducing and operating a balanced international investment law and arbitration system.

The DOB clause gives the host/respondent state an “absolute right to object to claims brought against it by a mailbox investor.”¹⁵⁵ This allows the state party to determine whether or not the investor truly qualifies to take advantage of the benefits of the treaty, which comes at the cost of the restriction of its own sovereignty. This should not be a problem where the investor satisfies the condition of control with regard to the nationality of the relevant parties, as well as that of substantial business activities. The DOB clause is not an arbitrary exercise of state power, but indeed one which has the potential of giving balance and predictability to the international investment law regime.¹⁵⁶At its core, the DOB clause prevents an arbitrary imposition of limitations on state powers.

¹⁵⁴Muthucumaraswamy Sonarajah ‘The Neo – Liberal Agenda in Investment Arbitration: Its Rise, Retreat and Impact on State Sovereignty’ in Wenhua Shan, Penelope Simons and Davinder Singh(eds) *Redefining Sovereignty in International Investment Law* (Hart Publishing 2008) ;Olivia Chung, ‘The Lopsided International Investment law Regime and Its Effect on the Future of Investor-State Arbitration’ (2006-2007) 47 Va.J.Int’L. 983; Gus Van Harten, *International Treaty and Arbitration and Public Law* (OUP 2006).

¹⁵⁵ See, Anthony Sinclair ‘The Substance of Nationality Requirements in Investment Treaty Arbitration’ (2005) 20(2) ICSID Review 357,385.

¹⁵⁶ Being a subjective right of the state, albeit exercisable based on the fulfilment of objective criteria, the essence of the DOB clause is the protection of the host state from the result of a breach of obligations it never had towards the third party investor, or its own nationals as the case may be. The DOB clause does not prevent the third party investor from investing in the host state, or seeking protection under the national investment

Indeed, the investor is permitted to seek redress under such national legal frameworks where its rights have been affected. However, what the DOB clause does is to prevent the internationalisation of investment disputes which fall within the jurisdiction of its domestic law on investment by third party nationals or nationals of the host state. Consequently, the right prevents the state party from incurring penalties and costs for obligations it never had, or obligations having a defeasible character; much less breached.

This being the case, it is only logical that the denial of advantages under a treaty to a third party national or a national of the host state be denied when such an investor seeks to enforce its 'purported' rights under the treaty. In other words, it is at the point at which the investor seeks to internationalise a domestic investment dispute that a host state can express its position on whether or not it permits such an investor to have indefeasible and enforceable rights under the relevant IIA. This view was adequately captured by the tribunal in *GAI v. Bolivia*¹⁵⁷ when it objected to the claimant's view on the non-retroactive application of the DOB clause. The tribunal clearly expressed its view when it stated that the purpose of the DOB is to give the respondent host state the possibility of withdrawing benefits to investors under the BIT,¹⁵⁸ where such investors failed to meet those requirements expressed in the BIT the claimant purports to be protected by.¹⁵⁹

Therefore, the argument and position of the ECT tribunals as to the 'prospective only' effect of the DOB clause largely fails to appreciate the purpose and objective of the ECT upon which it based its argument. Similarly, it completely neglects the

laws and regulatory framework of the host state. See Mark Feldman, 'Setting Limits on Corporate Nationality Planning in Investment Treaty Arbitration' (2012) 27(2) ICSID Review 281.

¹⁵⁷ *GAI v Bolivia* (n 29).

¹⁵⁸ *Ibid*, para 376.

¹⁵⁹ *Ibid*, para 377.

purpose and objective of the DOB clause and therefore the intention of the parties for including it in their agreements. Consequently, the tribunal failed to recognize the role the DOB clause plays in the context of the fulfilment of the objectives of the ECT as a treaty based on the complementarities and mutuality of benefits of the parties and stakeholders.

This narrow approach taken by the tribunals under the ECT has resulted in a misinterpretation of the intention of the parties. More importantly the conclusions arrived by these tribunals has effectively resulted in the creation of a theoretical box of sorts, capable of confining the DOB clause from effectively limiting treaty shopping in the international investment regime. Commenting on this issue with regard to the poor treaty interpretation by most investment tribunals, Thomas Walde observed:

“The Plama v Bulgaria’s tribunal’s approach towards the reference to ‘part III’ in the title and text of Article 17(1) Energy Charter Treaty (denial of advantages) is another example. Over the past 50 years, since its origin in US FCN/BIT and NAFTA practice, standard practice has been to consider ‘denial of benefits’ as an objection that a host State can raise against diplomatic protection, and its successor, investment arbitration against companies controlled from outside the treaty. The Plama tribunal did not look towards such practice; there was no indication in the travaux or elsewhere that Article 17(1) ECT was intended by the drafters (accepting a US proposal to adopt US practice) as anything else. The part III reference, in an interpretation of the context (Articles 26(1)–17(1)) should be seen as nothing but a reminder that

the denial of benefits, for example, raising a jurisdictional objection, only applied to the arbitrable (justiciable) part III investment obligations."¹⁶⁰ ¹⁶¹

This view effectively reflects the impact of these interpretations on the effectiveness of the DOB clause and the pro – investor and pro-investment stance the international investment law and arbitration regime has been perceived to have.¹⁶²

7.4. The Denial of Benefits Clause: Who bears the Burden?

Generally, arbitral decisions which consider the DOB clause are few. Among these, fewer still have considered in any depth the question of which of the parties before the tribunal bears the burden of proof required in establishing the factual basis upon which the clause is to be exercised.¹⁶³ Not unlike the preceding issues discussed in this chapter, the approach taken by an investment tribunal in deciding which of the parties bears the evidentiary responsibility plays a crucial role in the determination of the success or failure of a state party in invoking the DOB clause. Consequently, the question of who bears the burden of proof for establishing the satisfaction of the

¹⁶⁰ Walde (n 5) 730, 746.

¹⁶¹ He further added:

"The Plama tribunal, however, developed from its exclusive focus on the part III reference in Article 17(1) ECT a novel theory of a 'prospective, non-retroactive disapplication of the part III obligations'. This theory required prior notice—which is largely impossible before the individual claimant and its qualification under Article 17 (1) have been identified. It based this on the principle of legitimate expectation, despite the fact that all relevant literature warned that ECT companies controlled from outside the ECT could not expect protection. It borrowed from Argentine arbitrations the idea that denying the advantages would be 'self-judging'. However, self-judging has always been seen as a government's right (Article XXI of the GATT) to prejudge the factual determinants of a legal rule rather than raising a jurisdictional objection which tribunals can determine in their Kompetenz-Kompetenz. In sum, the Plama jurisdictional decision illustrates the dangers of paying lip-service to the Vienna Rules when, in effect, the tribunal is applying a very contract-text-focused standard commercial arbitration approach without regard to the context (Article 31(1)), international law and treaty-practice background (Article 31(3)), and the need to establish a 'special meaning' that deviates from the well-established standard treaty practice (Article 31(4)) of the Vienna Rules." Ibid.

¹⁶² This point is further discussed below.

¹⁶³ Rachel Thorn and Jennifer Doucleff, 'Disregarding the Corporate Veil and the Denial of Benefits Clauses: Testing Treaty language and the Concept of Investor' in Michael Waibel, Asha Kaushal (Eds) *The Backlash against Investment Arbitration* (Kluwer law International 2010) 3.

requirements necessary for the invocation of the clause goes to the root of the effectiveness of the DOB as a mechanism for limiting treating shopping in international investment law and arbitration.

In *AMTO v. Ukraine*¹⁶⁴, the tribunal observed that the DOB clause under Article 17(1) of the ECT is “expressed in a neutral manner in respect of the burden of proof.”¹⁶⁵ In view of this neutrality of the provision, the tribunal relied on the principle of *onus probandi actori incumbit*, that is, the burden of proving an allegation rests on the party advancing the allegation. Applying the principle, the tribunal expressed its view that the burden of proving that it fulfilled the requirement of being an investor under the ECT was to be borne by the claimant.¹⁶⁶ However, on satisfactorily discharging its burden, the burden shifted to the respondent to when it invokes the DOB clause and argued that the investor was only entitled to ‘defeasible protection’ under the treaty.¹⁶⁷

However, while the evidentiary burden as proposed by the tribunal in this case seems simple, straightforward and clear cut, the nature and complexity of corporate investors makes it a feat which a respondent is unlikely to discharge successfully. Corporate investors are made up of complex shareholding, control and ownership structures and layers which have the propensity of evolving and changing over the duration of an investment.¹⁶⁸ In the light of this, while the burden of proof normally rests on the party making the claim, in the instance of the DOB clause, however, the more plausible position would be to place the burden of proof on the claimant who is

¹⁶⁴ *AMTO v Ukraine* (n 164).

¹⁶⁵ *Ibid*, para 63.

¹⁶⁶ *Ibid*, para 64.

¹⁶⁷ *Ibid*.

¹⁶⁸ *Thorn and Doucleff* (n 163) 24, 25.

in the best position to give evidence as to the control and nature of its business activities.¹⁶⁹

This was not lost on the tribunal in the case of *AMTO*¹⁷⁰, where the tribunal observed the importance of the issue of burden of proof with regards to the DOB clause. The tribunal noted that the difficulty the discharge such evidentiary responsibility might place on the respondents in determining who owns or controls an investor when ownership or control might involve a number of entities in different jurisdictions.¹⁷¹ Similarly, the tribunal acknowledged the fact that the claimant knows exactly what its business activities are in a particular area, and can easily present the evidence to establish those activities, while this information might not be accessible to the respondent.¹⁷²

To resolve this, the tribunal ventured to highlight the available mechanisms for disclosure usually available to either the respondent or the tribunal depending on the relevant procedural rules adopted by the parties.¹⁷³

Similarly in the non-ECT case of *Pac Rim Cayman v. El Salvador*¹⁷⁴, the tribunal decided that the burden of establishing the lack of substantial business activities on

¹⁶⁹ Ibid.

¹⁷⁰ *AMTO v Ukraine* (n 26).

¹⁷¹ Ibid, para 65.

¹⁷² Ibid.

¹⁷³ Ibid. According to the tribunal:

"...the claimant knows exactly what its business activities are in a particular area, and can easily present the evidence to establish those activities, while this information might not be accessible to the respondent. Nevertheless, the relative accessibility of evidence would not seem to justify any modification to the normal rules regarding the burden of proof. It would support a duty to disclose evidence so that a respondent could request the disclosure of specific documents from the claimant where the documentation is not otherwise accessible. Alternatively, where the agreed procedure, as in this case, provides for Tribunal questions then the Tribunal can request the necessary clarifications. In both cases, negative inferences might be drawn against the claimant for a failure to provide the requested documents or information. Alternatively, as the Respondent sought to do in this case, the respondent might seek to exploit the paucity or ambiguity of the evidence relating to the claimant's business activities to argue these activities have no substance, thereby effectively compelling the Claimant to supplement this evidence, or defend its limitations."

¹⁷⁴ *Pac Rim v El Salvador* (n 30).

the part of the claimants and that the claimant was controlled by third party nationals fell on the respondent.¹⁷⁵ However, although the tribunal placed the evidentiary burden of proving the fulfilment of the requirements for the exercise of the DOB clause on the respondent, it ultimately relied on the testimony of the claimant's witness when finding that Pac Rim did not have substantial business activities in United States whose nationality it claimed.¹⁷⁶

Also, after the respondent had discharged its burden of establishing that the claimant was owned by nationals of a third party. The tribunal in turn placed the burden on the claimant to prove that the ultimate owners of Pac Rim Cayman were US nationals. Indeed the tribunal found that the claimant's evidence was insufficient to establish that US based shareholders of Pacific Rim were US 'persons' under CAFTA-DR Article 10.12.12.¹⁷⁷

Likewise, in the case of *Ulysseas v Ecuador*¹⁷⁸, the tribunal agreed with the claimant and placed the burden of establishing the requirement for the invocation of the DOB clause on the respondent.¹⁷⁹ However, and similar to the positions of the tribunals in the cases of *Ascom*¹⁸⁰ and *Pac Rim*¹⁸¹ the tribunal relied on the documentation which it directed the claimant to make available in reaching its position.¹⁸²

Adopting a slightly different stance, by sticking to its view, in the case of *Generation Ukraine v. Ukraine*¹⁸³, the tribunal held that the evidentiary responsibility, for proving

¹⁷⁵ Ibid, para 4.61.

¹⁷⁶ Ibid, para 4.68, 4.69, 4.70 (making reference to the testimony of the Chief Executive officer of Pacific Rim that Pac Rim Cayman did not have any employees, office space, a bank account or a board of directors).

¹⁷⁷ Ibid, para 4.81.

¹⁷⁸ *Ulysseas v Ecuador* (n 28).

¹⁷⁹ Ibid, para 166.

¹⁸⁰ *Ascom v Kazakhstan* (n 23).

¹⁸¹ *Pac Rim v El Salvador* (n 30).

¹⁸² *Ulysseas v Ecuador* (n 28) para 176, 177, 178, 179.

¹⁸³ *Generation Ukraine v Ukraine*, ICSID Case No. ARB/00/9, Award, 16 September, 2003.

that the conditions for exercising the right to deny benefits to the investor have been met, lies with the state invoking the clause.¹⁸⁴ In this case, the tribunal found that the respondent had failed to meet its burden of proof for proving its assertion that the claimant was owned by a third party national.¹⁸⁵ This was regardless of the respondent's requests to the claimant to produce the relevant evidence with regard to the claimant's third party control and business activities. The tribunal notwithstanding its observance of the paucity of the respondent's factual submission on the issues¹⁸⁶ refused to allow the respondent to 'exploit the paucity or ambiguity' of the claimant's evidence as contemplated by the AMTO tribunal.¹⁸⁷

Conversely, in the ECT case of *Plama v. Bulgaria*,¹⁸⁸ the tribunal expressed the view that a respondent state must positively assert its right to deny rights under the treaty to an investor. It, took a different approach, however, on the evidentiary burden of the DOB clause. Upon the satisfaction of the requirement of invocation by the respondent, the tribunal considered the burden of proof shifts to the claimant.

Therefore, for the tribunal, the evidentiary responsibility for disproving the existence of requirements of third party ownership and control under the DOB clause is to be borne by the claimant. This burden was placed on the claimant as regards the requirement of control and ownership. However, due to the claimant's concession of not having substantial business activities in its home state, the tribunal did not touch on the issue of whether the claimant bore the burden of proving this second requirement.

¹⁸⁴ Ibid, para 15.7.

¹⁸⁵ Ibid.

¹⁸⁶ Ibid, para 15.8.

¹⁸⁷ *AMTO v Ukraine* (n 26), para 65. Also see generally, Mark Feldman, 'Setting Limits on Corporate Nationality Planning in Investment Treaty Arbitration' (2012) 27(2) ICSID Review 281.

¹⁸⁸ *Plama v Bulgaria* (n 2).

This position of the tribunal in *Plama* is unlike those considered in cases above on this issue, where tribunals have placed the responsibility of establishing that the factual requirements for exercising the DOB clause on the respondent. Indeed, the tribunal in *Plama* gave no justification or discussion for why it placed the burden of proving the ownership and control requirement of the DOB clause on the claimant. It has been suggested, however, that this approach as adopted by the tribunal was a result of the point raised by the respondent that “such a position would be consistent with the ECT’s view as regards investment, which places burden on the investor to resolve any doubts as to whether it controls the investment.”¹⁸⁹

So far, only one other tribunal shares this approach with the *Plama* tribunal. In the case of *CCL v. Kazakhstan*¹⁹⁰ the tribunal in considering the issue of the nationality of the investor touched upon the requirements of the DOB clause under Article 1(2) of the US –Kazakhstan BIT. According to the tribunal, the presence of the DOB clause imposes a procedural requirement on the claimant requesting arbitration on the basis of the treaty. This requirement rests on the claimant to provide the necessary information and evidence concerning the circumstances of ownership and control, directly or indirectly, over it at all relevant times.¹⁹¹

For the tribunal, this was particularly necessary in the light of reasonable doubts raised as to the actual ownership of and control over the company seeking protection. This is coupled with the fact that the sole activity of the claimant since the termination of the agreement between the claimant and the respondent by the

¹⁸⁹ Thorn and Doucleff (n 163) 23,24.

¹⁹⁰ *CCL v. Republic of Kazakhstan*, SCC, Case No 122/2001, Jurisdictional Award, 1st January, 2004.

¹⁹¹ *Ibid*, para 10.

Kazakh courts, and the sole asset of the claimant, is the arbitration initiated against the respondent, Kazakhstan.¹⁹²

However, the arbitral tribunal, based on the evidence before it, did not find it necessary to determine in detail what ownership or control is necessary under the treaty.¹⁹³ This according to the tribunal was based on the fact that the evidence provided by the claimant did not provide any degree of probability, let alone proof, that U.S. citizens or companies have any degree of control, directly or indirectly, over the claimant.¹⁹⁴ Based on this inability on the part of the claimant in discharging the evidentiary burden of proving its nationality and consequently the non-application of the DOB clause, the tribunal concluded that it had no jurisdiction on the basis of the treaty.¹⁹⁵

The issue of which party bears the evidentiary burden of proving the existence of the requirements of the DOB clause greatly impacts the effectiveness of the clause. However, as seen in the cases considered above, arbitral tribunals have placed this burden on either the claimant or the respondent. However, the peculiarity of the positions of the parties vis-à-vis access to the relevant information necessary for proving the fulfilment of the requirements of the DOB clause suggests the adoption of a balanced approach. It is argued that where the DOB clause is properly interpreted the effective proportioning of the burden of proof between parties is achievable.

At the root of the of the question of which party bears the burden of proving the requirements of the DOB clause is the perception of the DOB clause as an issue

¹⁹² Ibid.

¹⁹³ Ibid.

¹⁹⁴ Ibid.

¹⁹⁵ Ibid.

which relates to the jurisdiction, admissibility or merit of the issues before it. Generally, tribunals under the auspice of the ECT have viewed the DOB clause as one which does not present a jurisdictional hurdle that claimants must clear.¹⁹⁶ This view is anchored on the analysis of the tribunals on the distinctness and absence of connection among Article 1(7) on the definition of investor, Article 17 on the right to deny benefits and Article 26 on the settlement of disputes between an investor and a contracting party under the ECT.^{197 198}

However, this approach by the tribunal fails to consider over fifty years of practice of the DOB clause.¹⁹⁹ From its inception and incorporation in US Friendship, Commerce and Navigation Treaties (FCN), BIT and NAFTA practice²⁰⁰, standard practice has been to consider the DOB clause and the invocation of the right to deny advantages as “an objection that a host State can raise against diplomatic

¹⁹⁶ Thorn and Doucleff (n 163) 23, 24.

¹⁹⁷ *Plama v Bulgaria* (n 2) para 147. At the centre of this position, is the emphasis placed on the heading of Article 17 of the ECT, “Non-application of PART III under Certain Circumstances”. This position was articulated by the Plama tribunal when it stated:

“ In the Tribunal’s view, the Respondent’s jurisdictional case here turns on the effect of Articles 17(1) and 26 ECT, interpreted under Article 31(1) of the Vienna Convention. The express terms of Article 17 refer to a denial of the advantages “of this Part”, thereby referring to the substantive advantages conferred upon an investor by Part III of the ECT. The language is unambiguous; but it is confirmed by the title to Article 17: “Non-Application of Part III in Certain Circumstances” (emphasis supplied)... the denial applies only to advantages under Part III. It would therefore require a gross manipulation of the language to make it refer to Article 26 in Part V of the ECT.”

¹⁹⁸ *Ibid*, para 148. The tribunal further noted:

“Article 26 provides a procedural remedy for a covered investor’s claims; and it is not physically or juridically part of the ECT’s substantive advantages enjoyed by that investor under Part III. As a matter of language, it would have been simple to exclude a class of investors completely from the scope of the ECT as a whole, as do certain other bilateral investment treaties; but that is self-evidently not the approach taken in the ECT. This limited exclusion from Part III for a covered investor, dependent on certain specific criteria, requires a procedure to resolve a dispute as to whether that exclusion applies in any particular case; and the object and purpose of the ECT, in the Tribunal’s view, clearly requires Article 26 to be unaffected by the operation of Article 17(1). As already noted above, for a covered investor, Article 26 is a very important feature of the ECT.”

¹⁹⁹ Walde (n5) 730, 746.

²⁰⁰ See generally, chapter 3 of this work where the evolution, purpose and practice of the denial of benefits clause have been discussed.

protection, and its successor, investment arbitration, against companies controlled from outside the treaty.”²⁰¹

It is argued that where the purpose of the DOB clause is properly construed as a jurisdictional objection to the claimant’s request for redress under the treaty, the appropriation of the evidentiary burden between the parties can be efficiently balanced. Underlying this position is the undeniable relationship of the DOB clause and the definition of investor in an IIA. Or put in another way, the impact of the requirements of the DOB clause in determining the validity of the purported nationality of the investor make its interpretation and application a matter which relates to the jurisdictional competence of the tribunal. Where the clause is not viewed from this perspective, as in the instances where it has been construed as an issue of admissibility, it leaves room for arriving at a result which is “manifestly absurd and unreasonable”.²⁰²

Put in its proper place as a jurisdictional objection to the *locus standi* of the claimant as a covered investor under the relevant treaty, the invocation of the DOB clause effectively places the burden of proof on the claimant. As such, being materially interwoven with the definition and requirements of investor under a treaty, the claimant, in its attempt to prove its satisfaction of the requirements of being an investor under the treaty, must in doing so discharge the evidentiary responsibility of proving it is indeed controlled by nationals of the other contracting party, and has substantial business activities in the party.

²⁰¹ Thomas Walde, ‘Interpreting Investment Treaties: Experiences and Examples’ in Christina Binder, Ursula Kriebaum, August Reinisch, and Stephan Wittich (Eds) *International Investment Law for the 21st Century: Essays in Honour of Christoph Schreuer* (OUP 2009) 730, 746.

²⁰² United Nations, *Vienna Convention on the Law of Treaties*, 23 May 1969, United Nations, Treaty Series, vol. 1155, p. 331, art 32 (Vienna Convention on the Law of Treaties).

The plausibility of this approach as being correct lies not only in its reasonableness but also its effectiveness and efficiency in allowing a proper discharge of this burden. This point is lent credence by the perception of the AMTO tribunal for example when it observed that:

“ Burden of proof is an important issue...might be difficult, as the present case demonstrates, for the respondent to determine who owns or controls an Investor when ownership or control might involve a number of entities in different jurisdictions. Similarly, the claimant knows exactly what its business activities are in a particular area, and can easily present the evidence to establish those activities, while this information might not be accessible to the respondent.”²⁰³

In other words, where the DOB clause is correctly viewed as a jurisdictional hurdle for the claimant, it allows the claimant to readily and for the sake of its case establish its standing as a protected investor under the treaty. This can be easily and readily achieved with the information perhaps solely and in the exclusive possession of the claimant. This is as against the position that the respondent who does not have access to such information to do so. Or in the instance where it does, it does not possess such information, to the same degree as the claimant.

This position it is argued falls within the objective of the DOB clause as a means of preventing nationals of third party state or of the host state from gaining access to treaty benefits. By imposing certain requirements on the putative investor, it also in essence requires such prospective investor-claimants to prove such requirements

²⁰³ AMTO v Ukraine (n 26) para 65.

have been met. Effectively the DOB clause as a jurisdictional objection places a burden on the claimant to prove it qualifies to gain access to such benefits.

However, where the claimant is able to *prima facie* prove it qualifies as a covered investor under the treaty, the burden shifts to the respondent to disprove the claimant's assertion as to its fulfilment of the requirements of control and substantial business activities. It is at this point that the suggestion of the tribunal in the case of AMTO comes in handy. That is, to the extent approved by the procedural rules agreed to by the parties; the tribunal can question the claimant or request necessary clarifications.²⁰⁴ Also, according to the tribunal, "a duty can be placed on the claimant to disclose evidence so that the respondent could request the disclosure of specific documents from the claimant where the documentation is not otherwise accessible".²⁰⁵

Furthermore, negative inference might be drawn against the claimant for a failure to provide the requested documents or information. Alternatively, the tribunal observed, the respondent might seek to exploit the paucity or ambiguity of the evidence relating to the claimant's business activities to argue these activities have no substance, thereby effectively compelling the claimant to supplement this evidence, or defend its limitations.²⁰⁶ It is argued that, if this approach is adopted with regards to the issue of burden of proof, the potential of the clause in limiting treaty shopping can be better achieved.

²⁰⁴ Ibid.

²⁰⁵ Ibid.

²⁰⁶ Ibid.

7.5. Conclusion.

One of the most popular arguments against the current structure of the international investment law regime is its adoption of a private mechanism of adjudication of questions which are of a public nature. This argument along with others has come to be identified as a ‘backlash’ against international investment treaty law and arbitration.²⁰⁷ Notable - with regard to the question of the use of a private mechanism of adjudication in what is considered a public law sphere - is the work of Professor Gus Van Harten²⁰⁸.

Central to his position is Professor Harten’s view of international investment arbitration as having an inherently biased structure.²⁰⁹ According to Harten,

*“Investment treaty arbitration is characterized by an apparent bias in favour of claimants against the respondent states. This perception is reasonably held in the light of structural features of the system, especially its use of arbitration to decide public law.”*²¹⁰

Contributory to this inherent bias, according to Harten, is the key conceptual difference between investment treaty arbitration, on the one hand, and international commercial arbitration or interstate adjudication, on the other.²¹¹ In drawing this

²⁰⁷ See, Michael Waibel, Aisha Kaushal, et al (Eds) *The Backlash against Investment Arbitration* (Kluwer Law International 2010); contributors posited a number on arguments on issues which raise questions on the nature, structure and process of the international investment regime.

²⁰⁸ See, Gus Van Harten, *Investment Treaty Arbitration and Public Law* (OUP 2007), where he argues and critiques international investment treaty arbitration from a public law perspective.

²⁰⁹ This viewpoint is also shared by Olivia Chung with respect to international investment treaty law and arbitration. See generally, Olivia Chung, ‘The Lopsided International Investment law Regime and Its Effect on the Future of Investor-State Arbitration’ (2006-2007) 47 *Va.J.Int’L*. 983; Gus Van Harten, *International Treaty and Arbitration and Public Law* (OUP 2007).

²¹⁰ Gus van Harten, ‘Perceived Bias in Investment Treaty Arbitration’ in Michael Waibel, Aisha Kaushal, et al (eds) *The Backlash against Investment Arbitration* (Kluwer Law International 2010) 433; See generally, Gus Van Harten, *International Treaty and Arbitration and Public Law* (OUP 2007).

²¹¹ *Ibid.*

distinction, he also stresses the point that both of the latter forms of arbitration are used to resolve disputes arising from a reciprocal legal relationship between the disputing parties.²¹² In these instances, either disputing party is capable of bringing a claim and of possessing the same sets of legal rights and obligations.²¹³

Conversely, in investment treaty arbitration, adjudication is used to resolve disputes arising between a private party and the state in relation to the state's sovereign authority, rather than a reciprocal, legal relationship between state and individual, defined as such by the idea that the state exercises regulatory authority that no private person can possess.²¹⁴ It is this recognition of the state as "a legal entity (or a legal fiction) with unique characteristics, arising from its role as the representative of a political group associated with a particular territory, that provides the basis for public law as a concept."²¹⁵ In addition it allows one to distinguish cases in which adjudication is used to resolve regulatory disputes from those in which it is used to resolve disputes between juridical equals."²¹⁶

With this foundation, Harten argues that international investment law being public law, the adjudicative power to review finally the state's decisions and actions, as the ultimate legislator and regulator for the people, is the reserve of a distinct branch of government called courts.²¹⁷ These branches of government are particularly considered to be characterised by their impartiality and independence. This is contrary to the system presently obtainable under international investment treaty arbitration, which involves the parties having considerable input into who is

²¹² Ibid.

²¹³ Ibid.

²¹⁴ Ibid.

²¹⁵ Ibid.

²¹⁶ Ibid.

²¹⁷ Ibid.

appointed to adjudicate on their claims. In other instances, international institutions are saddled with the responsibility. One of the points particularly stressed by Harten is the influence of investors in this process as well as the institutions designated as appointing authorities leaning heavily toward the capital-exporting/investor interest.²¹⁸

This view is also echoed by Peter Muchlinski, who has argued against the view that international investment law and arbitration through the network of IIAs and arbitral case law has evolved to a multilateral order introducing principles of “global administrative law”.²¹⁹ In his view, Muchlinski argues that the international investment law is not a multilateral order, but rather “an unstructured process of privatised legal entrepreneurship which seeks to further professional interest in developing an extensive or legitimate legal review of administrative action”.²²⁰ In describing the pro-investor nature of the regime, he considers the role of international investment law practitioners. Notably, he observed:

“...international investment lawyers are highly adept at taking BITs and reading into their vague and general language meanings that ensure the most client-friendly outcome. In this case the clients are foreign investors – who can range from large multinationals to small and medium sized enterprises with overseas investments, or even passive shareholders in foreign investment venture – and the aim is to ensure that national regulatory action is kept under as tight a control as possible so as to reduce investment risk to a minimum.

²¹⁸ Ibid.

²¹⁹ The proposition that international investment law as a multilateral global administrative law has been particularly advocated by Stephan Schill. See generally, Stephan Schill, *The Multilateralization of International Investment Law* (Cambridge University Press 2009).

²²⁰ Peter Muchlinski, ‘Corporations and Uses of Law: International Investment Arbitration as a Multilateral Legal Order’ (2011) 1(4) Onati Socio-Legal Series 1.

That aim is backed up by an expansive reading of jurisdiction of investor-state tribunals both as regards subject matter and personal jurisdiction.^{221 222}

In aiding the determination of the purpose of this work, the consideration of questions concerning the legitimacy of the structure and process of investment arbitration plays a contributory role. This it does by assisting in giving a holistic approach to the analysis of external factors which impact on the effectiveness of the DOB clause. Consequently, the question of the approach of investment tribunals in adjudicating investment disputes between investors and state parties is relevant.

A critical point is the distinction made above as to the parallel nature of international investment arbitration on the one hand, and commercial investment arbitration and state to state arbitration on the other.²²³ Furthermore, the fact that most investment arbitrators who adjudicate on international investment claims between states and investors are drawn from a pool of practitioners from the international commercial arbitration industry is arguably a practice which reflects in the way investment treaties are interpreted and given effect by tribunals.

While the international investment regime might be considered as structurally biased towards the investor in the light of the substantive obligations contained in IIAs and the heavy damages host states incur during investment disputes among other

²²¹ Ibid.

²²² He further observed:

“ The system of arbitration itself is the engine of this growth. In particular, it is well understood that the arbitrators are themselves drawn from the pool of international investment law practitioners that represent clients in such procedures, thus conflicts of interest arise that arbitrators may need to ensure the developments of interpretations of BITs that are client friendly. Since the main clients will be foreign investors who seek redress under a BIT against the host country, it is not possible to maintain independence with any confidence in such cases. The temptation to read the general wording of the BIT in favour of investor rights, and in favour of widening jurisdiction over increasing types of transactions and wide class of claimants, must be irresistible, indeed natural” Ibid. See also, Gus Van Harten (n 208); Yves Dezalay, Bryant Garth, *Dealing in Virtue: International Commercial Arbitration and the Construction of a Transnational Legal Order* (University of Chicago Press 1996).

²²³ Waibel (n 207), Van Harten (n 208), Chung (n 209).

factors, ²²⁴it is argued that the introduction of the DOB clause is an attempt by contracting parties to achieve a measure of balance in the regime.²²⁵ This is noteworthy in the light of the increased inclusion of the clause in most recent investment treaties, many of which are concluded after state parties have been respondents to investment claims and have experienced or witnessed the impact of IIA provisions and the attendant issue of treaty shopping occasioned by broad definitions of investor.²²⁶

Therefore, the analysis of the DOB clause, in a manner which effectively reflects the intention of the contracting parties to a relevant IIA, is of utmost importance. However, the approach adopted by a number of arbitral tribunals on the issues which relate to the DOB clause suggests the practical reality and plausibility of the argument as to the pro-investor nature of IIAs as well as the investor-client friendly nature of investment arbitration. Arguably, these positions and interpretations of the clause are not a far-cry from what can be viewed as a carry-over of the style used by arbitrators under international commercial arbitration.

According to Thomas Walde, modern investment arbitration is not only influenced by general public international law,” but also very much by the style and culture of

²²⁴ Olivia Chung, ‘The Lopsided International Investment law Regime and Its Effect on the Future of Investor-State Arbitration’ (2006-2007) 47 Va.J.Int’L 983; Gus Van Harten, *International Treaty and Arbitration and Public Law* (OUP 2007).

²²⁵ Mark Feldman, ‘Setting Limits on Corporate Nationality Planning in Investment Treaty Arbitration’ (2012) 27(2) ICSID Review 281; Loukas Mistelis and Crina Baltag, ‘Denial of Benefits and Article 17 of the Energy Charter Treaty’ (2009) 113 Penn St.L.Rev 1301; Anthony Sinclair, ‘The Substance of Nationality Requirements in Investment Treaty Arbitration’ (2005) 20(2) ICSID Review 357, 385; Jeswald Salacuse, ‘BIT by BIT: The Growth of Bilateral Investment Treaties and Their Impact on Foreign Investment in Developing Countries’ (1990) 24 Int’l.L 655, 665.

²²⁶ See generally Chapters 3, 4, 5 and 6, where the evolution and increased incorporation of the denial of benefits clause by host states in their IIAs are considered.

international commercial arbitration”.²²⁷ Consequently, according to him, “most of the arbitrators (and counsel) in investment disputes having been drawn from the international arbitration community, have come, naturally, with their procedural expertise, but also with their culture, style, ethical standards, and the influence of their peer groups and networks”²²⁸. At the centre of international commercial arbitration is the provision of “an effective resolution of dispute between the parties—and nothing further”.²²⁹ Thus, in doing this, this approach favours and places major emphasis on the facts rather than on the law; ²³⁰ this is evident “in the style of reasoning that is meant to assuage the losing party rather than to show in depth and detail how the law is applied and developed. Since awards are as a rule not published, there is little concern by the arbitrators about the legal quality of the award and how it will be seen by a critical professional and academic audience.”^{231 232}

It is argued that the fixture of a number of arbitrators adjudicating on claims brought under the auspices of IIAs on the ‘naked’ text of the agreement makes a profound impact on the interpretation and giving of effect to the intention of the contracting states. A candid example is the interpretation of the DOB clause by the tribunal in

²²⁷ Thomas Walde, ‘The Special Nature of Investment Arbitration – Report of the Director of Studies of the English-Speaking Section of the Centre’ in Phillipe Kahn and Thomas Walde (Eds), *New Aspects of International Investment Law* (Brill 2007) 42.

²²⁸ Thomas Walde, ‘Interpreting Investment Treaties: Experiences and Examples’ in Christina Binder, Ursula Kriebaum, August Reinisch, and Stephan Wittich (Eds) *International Investment Law for the 21st Century: Essays in Honour of Christoph Schreuer* (OUP 2009) 730, 746.

²²⁹ Ibid.

²³⁰ Ibid.

²³¹ Ibid.

²³² Ibid. Drawing a contrast in the treaty interpretation approaches of international public law and international commercial arbitration, Professor Walde observed:

“That ICJ style is by contrast more scholarly approach and involves researching extensive authority and careful interpretation of treaty language before context, purpose, relevant comparable practice, and history, in short: a (usually and increasingly) reasonably faithful application of the Vienna Rules. In addition, the culture of commercial arbitration comes with a great focus on the text—irrespective of context, purpose, and history—of specific contracts between international parties considered to be professionally competent, interacting on a level of presumed equality. That is the appropriate approach to interpretation of international commercial contracts, drafted, as a rule in great detail, in order to minimize the likelihood of different interpretations arising from the values and backgrounds of disparate parties. That focus on the ‘naked’ text is, however, not the appropriate approach for international law, nor is it compatible with the Vienna Rules.”

Plama, and its emphasis on the reference to 'Part III' in the title and text of the clause. Furthermore, in its attempt to proffer a legal foundation within which to root its position, the tribunal looked at the purpose and objective of the treaty. While this is a laudable approach to the interpretation of treaty text in international investment law, the conclusion drawn by the tribunal is largely 'investor-centric'.

On the face of it, the consultation of the purpose and overall objective of the treaty is indeed relevant, however, the tribunal failed in its refusal to consider the specific purpose of the DOB clause as an in-treaty mechanism. It is argued that with treaty mechanisms such as the DOB clause, tribunals should not look merely to the text of the treaty, or stop at the consideration of the purpose outlined by the treaty, but also at the particular clauses and mechanisms state parties have employed within the treaty to achieve their objectives. Where this approach is adopted, it generally more effectively expresses the intention of the contracting parties.

The DOB clause is designed to prevent third party nationals and nationals of the host state from gaining access to treaty benefits contracting parties did not intend to extend to them. This effectively prevents nationals of states which have not undertaken any obligation under the relevant treaty to free ride on the restriction on the sovereignty and regulatory powers of the contracting parties. Thus, the DOB clause preserves reciprocity of obligations and rights between or among relevant states to the agreement. By its nature, the right of denial that the clause grants is subjective; as such it can be exercised by the relevant state parties at any time, albeit subject to a number of objective criteria. Therefore, with the exception of its inclusion in the clause, there is no time frame within which a state party must comply in its exercise of the clause.

Practically, the clause cannot be exercised until a purported claimant seeks redress under the relevant treaty. It is at this point that the host state can look into the real nationality and substantiality of the business activities of the investor. Similarly, the very purpose of the DOB clause is to give the host state the benefit of withdrawing from the purported investor, rights under the treaty; where such investor fails to meet with the requirements contained in the agreement from which it seeks to benefit. This very intention of withdrawal of benefits necessitates a retrospective application of the effects of the clause.

IAs are not self-interpreting. By extension, mechanisms employed by state parties in their agreements do not possess powers of self-interpretation. As contracting parties cannot adjudicate their own cases, it is imperative that an impartial, independent and unbiased adjudication mechanism be employed. This ensures giving effective implementation of the intention of the contracting parties. The DOB clause as an in-treaty mechanism in international investment law, has the potential of limiting the question of treaty shopping in the regime, albeit the current versions of the clause are structured and couched in terms which do not give room for the full expression of this potential in the light of the present and evolving forms of treaty shopping. However, more important is the interpretation of the clause and the procedural requirements established by investment tribunals for its exercise.

The imposition of procedural requirements stemming from interpretation of the DOB clause without the consideration of the evolution and purpose of the clause erodes, perhaps more than any other factor, from the effectiveness of the clause. The interpretation of the clause as prospective, non-retroactive, requiring prior notice, as well as the imposition of a near Herculean burden of proof among others as adopted by the tribunal in *Plama* and other tribunals under the auspices of the ECT does not

effectively reflect the intention of the parties to the ECT. In including the DOB clause, parties envisage its use as a mechanism capable of bringing balance to the treaty and thus contributing to its objective of a legal platform in the energy industry built on complementarities and mutual benefits.

However, the approach taken by tribunals outside of the ECT in interpreting and giving effect to the clause bellies a holistic and effective reflection of the intention of contracting parties. While the argument as to the textual peculiarity of the ECT DOB clause have been canvassed, the point remains evident that the 'naked' textual approach to the clause excluding its purpose and its necessary design as subjective (though based on objective requirements) and retrospective in effect ultimately conveys a perception of investor bias and does not do justice to the intent of state parties for incorporating the clause in their IIAs.

Holistically viewed and interpreted, the DOB clause allows the creation of a balanced, practical, predictable, and stable international investment and arbitration regime. In other words, while IIAs with DOB clauses give rights to investors, including the right to bring states before international tribunals, they also allow states a complementary right to withdraw such benefits which come at the cost of their sovereignty and welfare of citizens in certain instances. Objectively, states are allowed the right to withdraw such substantive and procedural rights from investors who fail to meet the criteria established by the parties through the clause. It is this reality of a balanced regime that desperately needs to be perceived and believed by stakeholders. However, that such a reality and perception remains a mirage where the DOB clause is ineffectively interpreted goes without saying.

Chapter Eight

Conclusion

Arguably, the nationality of the investor seats as one of the cornerstones of international investment law. The importance of this concept in this field of international economic law is particularly evident and appreciated within the context of its impact within the regime. In general terms, the nationality of the investor is central to the determination of the scope of rights and obligations accessible and assumed ¹under international investment agreements (IIA).

As such, the nationality of the investor in international investment law can be viewed as a gate keeping device granting or denying access to the benefits and advantages of the regime to those who qualify. This concept flows from the reciprocal nature of the IIAs, which largely form the substantive framework upon which the international investment regime is built. However, it has been argued that distinctions in international investment law on the basis of nationality, creates the establishment of double standards. While distinctions on the basis of nationality are central to the determination of the jurisdiction of an arbitral tribunal, conversely, distinctions on the basis of nationality are considered unwelcome at the merit stage of arbitration.²

What is clear, notwithstanding, is that the very structure of international investment law, with its vast network of BITs and IIAs was designed to be discriminatory. That is,

¹Specifically, the nationality of the investor is the key to investor access to substantive guarantees and provisions on investment protection contained in bilateral investment treaties (BITs) or other IIAs. Also, where such agreements include an investor – state dispute settlement mechanism (ISDS), a fundamental requirement upon which an investor has a locus standi before the tribunal is the satisfaction of the requirement of the investor being a national of a specific foreign country to the agreement. Christoph Schreuer, 'Nationality of Investors: Legitimate Restriction vs. Business Interests' (2009) 24(2) ICSID Rev 521, 527.

² Ibid.

the favouring of a group of persons based on their nationality with respect to an IIA or BIT to the exclusion of other nationals. Thus, even if perceived or labelled as discriminatory in nature, the definition of who qualifies as a protected investor under an IIA is a fundamental issue for state parties in international investment law and arbitration. This gravity of the issue of nationality, however, does not just devolve from its being a foundational principle in international investment law, but also because of its link to the sovereignty of state parties and the exercise or restriction of same.

The entering into a treaty is the expression of the sovereign right of a state. Undertaking obligations under a treaty is a sovereign act of a state to restrict its sovereignty with regards to its obligations under the particular treaty. As such, on the one hand, it is within the right of the state to extend treaty benefits to as many investors as possible. On the other hand, however, the state in the exercise of its sovereign right can also choose to limit the protection afforded by its treaties to investors who have fulfilled certain criteria.

The latter point is particularly embodied in the reciprocal nature of BITs and IIAs in international investment law. In principle, therefore, by signing a BIT, a state party does not intend for investors with nationalities of state parties who are non-parties to the treaty to have access to the benefits of the treaty. Similarly and equally important, such states do not intend their own nationals to access the benefits of such treaties and thus become respondents to investment claims brought by their own nationals.

The prevalence of treaty shopping in the international investment regime is presently one of the most controversial issues in international investment law and arbitration.

That is, the structuring and restructuring of investments in ways which afford foreign investors access to the protection under particular BITs or IIAs in instances where such investors would erstwhile not have access to such treaties. In defence of the practice, it has been argued that the practice of treaty shopping is the ideal expression of the purpose of international investment law. This position is supported by the postulation of the argument that the purpose of international investment law is the promotion and protection of foreign investments.

This argument concludes on the preceding premise, that if the purpose of international investment law is the promotion of foreign investments, consequently, the origin of investments should matter less. According to the proponents of this view, the concept of nationality under international investment has next to no relevance as a mechanism for determining which investor or not is covered under IIAs. More importantly and the centre point around which this conclusion is reached is that nationality requirements constitute obstacles to the proper expression of the purpose of international investment law, that is, the promotion and protection of foreign investment in a territory.

However, as argued in chapter two, to argue the nationality requirement as being irrelevant and unnecessary in international investment law and in fact inhibitive of its purpose is first a conclusion which fails to appreciate the position of all stakeholders in the international investment regime, particularly states. Second, while the purpose of international investment law is conventionally stated to be the promotion and protection of foreign investment, the more teleological position is that the promotion and protection of international investment law is not in itself the ultimate purpose of this field of law. Rather, the promotion and protection of foreign investment is a

means to the end of the attainment of world economic development, peace and security.³

This view is further appreciated by the reaction of state parties to the treaty shopping practice. While it has been argued that the definitions of investor contained in BITs and IIAs suggest at the minimum a covert assent to treaty shopping and perhaps in some cases as an express permission for the engagement of the practice, recent events suggest otherwise. The positions adopted by respondent states before arbitral tribunals on the issue of treaty shopping reveal that not a few state parties are advocates of the limiting the practice.

Consequently, state parties have in recent times relied on a number of mechanisms and principles within and outside treaty text in the attempt to limit the impact of this phenomenon on their sovereign, regulatory and policy autonomy. This reaction of state parties should come as no surprise. For many states, the entering into BITs and IIAs was done with only an appreciation and anticipation of the purported potential benefits the signing of these agreements were to attract. Many countries, both developed and developing, had no full appreciation of the potential impact of the substantive provisions of these agreements; provisions on the definition of investor inclusive. As a result, states have responded in a number of ways to the practice of treaty shopping in the international investment regime.

³ This view, while often not considered, fits in readily into the economic approach of globalisation to which international investment law serves as a legal framework. Furthermore, it is difficult to sell the argument that the sole purpose for which states, particularly, developing, capital importing host states sign IIAs and BITs is merely for the sake of the protection and promotion of investments of nationals other than theirs. A more sustainable argument is that these states do not agree to restrictions on their sovereignty merely for the protection of foreign investments, but rather are willing to shoulder the obligations and consequent implications of signing these agreements because of the promise of much needed economic development the signing of these agreements are expected to yield.

The purpose of this study has been to *critically analyse the effectiveness of the denial of benefits clause (DOB) as one of the major mechanisms adopted by states in attempts to limit treaty shopping*. Secondly to consider *where the clause is indeed noted to have the potential of being effective in limiting treaty shopping, what limitations if any impact on its effectiveness*.

The DOB clause as argued in chapter three presents at the moment, perhaps the most potentially viable means of limiting treaty shopping in international investment law. Furthermore, the clause is capable of bringing balance into the regime through the conferral of rights on contracting parties to deny advantages to certain classes of investors. To this end, the clause also allows for the preservation and protection of the sovereignty and regulatory powers of the state. By limiting treaty shopping, the clause gives room for the impact of treaty obligations and consequent restrictions on state autonomy and sovereignty only in instances where the state parties agree to do so.

This research, encompassing an analysis and evaluation of the DOB clause as an in- treaty mechanism capable of limiting treaty shopping and birthing balance in international investment law and arbitration has revealed a number of findings. These findings have been made with regard to the practice of treaty shopping along the three major treaty shopping routes of free riding, round tripping and the assignment of claims. Generally, however, a number of conclusions can be drawn from the nature and effectiveness of the DOB clause.

First and addressing the question of *whether the DOB clause is effective in limiting treaty shopping* broadly, the DOB clause as it is presently and commonly drafted does not limit treaty shopping. In fact, these clauses are largely designed not to. In

other words, if treaty shopping is to be understood as the practice whereby investors who contracting states did not intend to extend protection to, structure and restructure their investments to gain access to favourable investment treaties, then the DOB clause does not limit treaty shopping in the real sense of the term.

What the current versions of the clause seem to do, however, is to restrict treaty shopping under 'certain' circumstances. The essence of the DOB clause is, therefore, to determine and streamline these instances and circumstances under which treaty shopping is considered unacceptable. As such, DOB clauses allow third party nationals to gain access to the advantages of BITs and IIAs. Indeed one can even read into some of them acquiescence to local investors to engage in the practice.

Consequently, state parties who desire the denial of treaty benefits to investors outside of the intent of the contracting parties must have in mind the nature and construction of the present clauses. The analyses conducted in this study reveal that treaty shopping, that is, the practice of structuring and restructuring investments by otherwise unprotected investors is allowed. This is possible, so far as, the otherwise unprotected investor though owned and or controlled by third party nationals or nationals of the host state, 'has substantial business activities' in the territory of the other contracting party. As shown in chapter three, there is a clear distinction between the earlier forms of the clause as contained in US treaties which seek to give effect to a blanket denial of benefits to all unprotected nationals as against present forms of the clause which permit such restructuring, but, subject to the satisfaction of certain criteria.

Second, this permissive nature of most current DOB clauses has a number of implications. For one, the DOB clause while perceived to be contrary to the interest of the investor and more inclined to the protection of the state sovereignty and regulatory autonomy seems to possess a counter intuitive character. Arguably, the DOB clause as it is presently drafted in most treaties gives permission to the investor to structure and restructure its investment so as to gain access to favourable treaties. In this manner, DOB clauses do not completely bar treaty shopping. As such it allows the incursion of the erstwhile unprotected investor on the sovereignty of the investor so far as it satisfies the business substantiality test.

In addition, this perception of the DOB clause detracts from the potency of the argument that the clause is a mechanism for discrimination on the basis of nationality in international investment law. This study has shown that the DOB clause does not discriminate on the basis of nationality, what the clause frowns on is nationality without substantiality. Perhaps, in this regard, the most important word in the present wave of DOBs is the word 'and' or any other conjunctive expression of the cumulative nature of the requirements of the clause.

Though often overlooked, the presence of this conjunction makes a significant impact on the dynamics and implications of the clause. Most DOB clauses are drafted to require that the exercise of the right of denial can only be engaged by the denying party only in instances where the investor is owned or controlled by third party nationals of nationals of the host state 'and' does not have substantial business activities in the territory of the home state. Consequently, where the purported investor is owned and or controlled by the national of a third country or the host state but has substantial business activities in the home state, the clause permits treaty shopping. As such, the DOB clause only constricts the practice of investment

structuring by investors who do not possess the nationality of the other contracting party under an investment treaty under certain instances.

On a more particular note, this study has endeavoured to consider and answer the question of the effectiveness of the DOB across three treaty shopping routes, that is, free riding, round tripping and assignment of treaty claims. These routes of treaty shopping present peculiar dynamics as to their workings. As such, the effectiveness of the DOB clause as regards the three routes reveals certain and distinct levels of effectiveness among the three routes.

First, with regards to free riding, the DOB clause presents a number of issues as regards its construction. As argued in chapter four, while the majority of DOB clauses are drafted with the free riding treaty shopping route as the central target, the drafting of majority of the clauses leave room for treaty shopping by free riding investors. As noted earlier, DOB clauses as they are largely used presently seem to have been designed to prevent treaty shopping to the extent that third party owned or controlled investors do not have substantial business activities in the territory of the purported home state. Consequently, the definition of the terms ownership, control and substantial business activities are central to the determination of the potential of the clause in limiting treating shopping through free riding.

However, this is where a vast majority of DOB clauses fail. For many of these clauses, what constitutes control or ownership with respect to the nationality test when determining the effective nationality of the investor is seldom clearly stated if at all. The result is that room is made for investment tribunals to interpret the intent of the contracting parties as they perceive to be adequate. This in itself presents opportunities for the limitation of the effectiveness of the clause. Equally important,

the definition of what constitutes substantial business activities remains a grey area over which investment tribunals have had to rely on their understanding and leanings of what constitutes the substantiality of business activities within the context of the application of the DOB clause. As with other requirements of control and ownership, the diverging conceptions of these requirements as expressed by investment tribunals further add to the maze of unpredictability in the regime and particularly as regards the DOB clause.

With regards to the round tripping treaty shopping route in which the nationals of the home state own or control the investor, very few DOB clauses make provision for the denial of treaty benefits to nationals of the host state. While the inclusion of the phrase '*deny benefits of this treaty to third party nationals or nationals of the denying (or host) state*' might seem inconsequential. However, the failure to include the words '*and of the denying state*' or a similar expression potentially allows room for the internationalisation of domestic investment disputes where the investor is owned and controlled by the national of the host state. As such, a host state national through this means has the opportunity of claiming against its own state under international law.

As pointed out in chapter five, central to international investment law is the 'foreignness' of the investor and its investment. Majority if not all state parties did not enter into BITs and other IIAs for the purpose of protecting domestic investment or investors with international rules and standards. It is also difficult to hold the position that state parties consciously took steps which would result in the internationalisation of disputes arising from domestic investments by signing these agreements. As such, through round tripping treaty shopping, the principle of reciprocity which is

embodied by BITs and on which basis state parties enter into these agreements is forfeited.

As shown in the short survey in chapter five and evidenced in the appendix, the presence of DOB clauses which address the round tripping route of treaty shopping is relatively small. This fact is better appreciated when the number of BITs and IIAs which contain DOB clauses are considered. This makes the larger percentage of DOB clauses ill equipped to prevent treaty shopping through round tripping. On what can be considered a positive note in this respect, however, what this study has also revealed is the fact that comprehensive information on the relevance and impact of round tripping treaty shopping has been unavailable until recently. Consequently, states have only relatively recently embarked on the inclusion of DOB clauses which address round tripping in their agreements.

The deduction to be made from this is that with more state parties being aware of the nature and impact of round tripping treaty shopping on their sovereign and regulatory powers vis a vis domestic investors, more state parties will include in their agreements DOB clauses which address the round tripping treaty shopping. This, however, is notwithstanding the challenges presented by the present construction of these clauses as mentioned earlier. The extent to which this would be done by state parties and the question of whether or not these agreements will in time curb this increasingly pervasive form of treaty shopping remains one left for future events and research.

The assignment of claims treaty shopping route, however, poses a different set of issues for the current DOB clauses. Unlike the other two primary forms of treaty shopping, treaty shopping through the assignment of claims is a relatively recent

development. As this study as shown in chapter six, the particular issue the assignment of treaty claims raises is where an investor who does not have protection under a BIT or relevant IIA assigns his claim to an investor who has the nationality required under the relevant treaty. Hence, the eventual claimant possesses the required nationality under the relevant IIA. This has been a popular method in instances where the unprotected investor senses that a dispute is about to arise or indeed has already entered into a dispute with the host state.

In instances such as this, particularly where such assignment of investment claims are done shortly before or during an actual dispute, the construction of all the DOB clauses presently incorporated into BITs, IIAs and indeed multilateral investment treaties (MITs), does not grant any recourse to the host state to deny the advantages of the treaty. This is because fundamentally, the DOB clause seeks to limit treaty shopping by addressing the issue of nationality through tests of control, ownership and substantial business activities. In other words, the major drive of the DOB clause is to ensure that the investor who exercises the right to claim against the host state has genuine links to the other contracting party. Contracting parties, therefore, include these clauses with the intent of engaging the clause as a legal sieve to separate third party nationals and nationals of the host state from accessing BIT protection. As such, the tests of control and substantial business activities seek to authenticate the claim of the purported investor as a national of the other contracting party.

However, the dynamic of treaty shopping though through the assignment of claims suggests that the nationality of the claimant is that of the other contracting party to the relevant treaty. In other words, the tests of control and substantial business activities adopted in the construction of DOBs fail to address the issue raised by

treaty shopping through the assignment of claims. What is evident as shown in chapter three of this study is that the DOB clause as an in-treaty legal mechanism was designed primarily with treaty shopping through the free riding route in mind and to a lesser extent, the round tripping route.

This purpose which birthed the DOB clause shaped its design and construction. As such, treaty shopping through the assignment of claims falls outside of the mode of treaty shopping the DOB was designed to address. While the present forms of the DOB clause seemed to be designed to address a factual determination of nationality using the tests of control and substantial business activity, the nature of the assignment of treaty claims is more subtle, in that the question it poses are not about whether or not the claimant has the desired nationality, but importantly the questions of why, when and how. Answers of which in turn possess a subjective quality often within the contemplation of the assignor and assignee.

Consequently, the DOB clause as it is presently drafted is not an effective in-treaty mechanism for the limiting of treaty shopping through the assignment of treaty claims. As shown in chapters three and six, arbitral tribunals which looked into treaty shopping through the assignment of claims route did so without recourse to the DOB clause. In addressing the issue of treaty shopping through assignment of claims (and in some instances, the assignment of the investment itself), investment tribunals approached the issue through the use of out of treaty principles such as the principle of the abuse of right and process.

Summarily, analysis of the internal constitution and construction of the DOB clause in weighing its effectiveness in limiting treaty shopping has revealed that while the clause has been argued to have the potential of limiting treaty shopping, this might

perhaps not be an absolutely correct observation. The DOB clause as it is presently drafted in most BITs and IIAs does not limit treaty shopping in the true sense of the term. In fact, since the 1990s the DOB clause has been designed to permit treaty shopping limitedly and in certain instances and not as a mechanism for the complete limitation of the practice in general. This is evident in the drafting style of the clause in many BITs and IIAs. The requirement for the fulfilment of the cumulative requirements of 'control or ownership' and 'substantial business activities' streamlines the effectiveness of the clause to certain instances of treaty shopping specifically.

The question of the effectiveness of the DOB clause, therefore, bothers on the effectiveness of the clause in so far as the nationality of the investor is that of a third party or of the host state without evidence of substantial business activities. In addition, the reason which birthed the DOB clause makes it an unsuitable in-treaty mechanism for limiting treaty shopping through the assignment of treaty claims. As this form of treaty shopping is a departure from the other two primary routes against which the clause was originally designed to address.

However, while the structure of the DOB clause does impact on its effectiveness in limiting treaty shopping, the internal construction and drafting of the clause is not in itself the sole factor that impacts on its effectiveness. In achieving its objective of analysing the effectiveness of the DOB clause, this study has looked into the not just the internalities of the clause, but has also extended its analysis to factor(s) outside of the clause which play a role in the determination of its effectiveness as an in-treaty mechanism for limiting treaty shopping in international investment law.

Investment agreements are not self-interpreting. By extension, the DOB clause as an in-treaty mechanism employed by state parties in their BITs and other IIAs do not possess powers of self-interpretation. This is expressed in the operation of not what the DOB clause means or intends to achieve, but perhaps even more importantly, what the interpreter of the clause thinks it expresses or should achieve. While this study has shown and argued as to the limitations of the DOB clause in limiting treaty shopping as a result of its drafting and construction, the analysis of the external factor of interpretation of the clause plays perhaps a more important role in effectiveness or otherwise of the clause in international investment law and arbitration.

As shown and argued in chapter seven, the impact of the interpretation of investment tribunals on the DOB clause and consequently its effectiveness in limiting treaty shopping is in no way inconsiderable. The interpretation of the purpose, requirements, effect and impact of the clause as a mechanism for denying benefits of BITs and IIAs by state parties by the majority of tribunals which have had the cause to address the exercise of the clause has greatly impacted the effectiveness of the clause. Through the conclusions reached by the majority of investment tribunals who have considered the DOB clause (particularly, under the auspices of the Energy Charter Treaty, ECT), the effectiveness of the DOB clause is whittled down considerably.

The requirements of notice, prospective effect of the clause, burden of proof, among others imposed by the majority of tribunals all constrict the potential of the DOB clause from being an effective in-treaty mechanism for the limitation of the forms treaty shopping it is purposed to prevent. While the construction of the clause does pose certain questions and restrictions on the effectiveness of the clause, however,

the impact of interpretations of the clause by tribunals can be considered to be the proverbial final straw that breaks the back of the camel. However, notwithstanding, the adoption of restrictive interpretations of the clause by the majority of tribunals, particularly under the ECT, certain tribunals, have interpreted the clause in the light of its purpose and the intent of its inclusion in BITs and IIAs by contracting parties.

From the foregoing, the question of the effectiveness of the clause impacts on its role as a mechanism for sovereignty of states in international investment law and arbitration. With the practice of treaty shopping in its different forms being perceived as incursions into the sovereignty of contracting parties, the effect of the DOB clause where it effectively limits treaty shopping will be to allow states to only allow the restriction of their sovereign rights and regulatory powers where they intend to extend same only. However, with the limitations faced by the DOB clause as a result of both internal and external conditions which impact on its effectiveness, the sovereignty of contracting parties and their regulatory powers are still actually and potentially curtailed for the benefit of third party nationals and nationals of the host state.

Consequently, to birth balance in international investment law, through the use of the DOB clause by contracting states to BITs and IIAs, state parties must address the issues of the internal and external factors which impact the effectiveness of the clause. Addressing these issues will allow the DOB clause reach its full potential as an in-treaty mechanism for the limiting of treaty shopping in international investment law as well as the balancing of the international investment law and arbitration regime.

Importantly, the issue of the drafting and construction of the DOB clause by contracting parties must be addressed. To effectively limit treaty shopping, DOB clause must clearly express the position of the parties. Similarly, states should consider whether or not the cumulative nature of the requirement of the DOB clause suits their particular aims and objectives. Is the clause to be designed in terms which give automatic application where investors do not have the required foreign nationality? Should the clause operate in a blanket format against all third party nationals? Or, should investors who are owned or controlled by third party nationals, but possess substantial business activities be allowed to access BITs or IIAs? These among many others are potential questions contracting parties must be ready to ask and address in their review of these clauses.

To leave the DOB clause without clearly stating the intent of the contracting parties leaves room for interpretations by investment tribunals which do not effectively reflect the purpose of the inclusion of the clause by contracting parties. State parties will also do well to design their DOB clauses in ways which address all the forms of the treaty shopping. This study as revealed that the free riding form of treaty shopping has largely been the focus of most DOB clauses. However, round tripping and the assignment of claims are treaty shopping routes which are becoming increasingly prevalent in the international investment. As such effective engagement of the mechanism of the denial of benefits to investors outside of the scope and intent of the contracting parties must take into consideration the dynamics of these treaty shopping routes. In turn, DOB clauses should reflect the understanding of the contracting parties on nature of these routes and their consequent impact on their sovereignty and regulatory authority, as well as effectively address same.

It is safe to conclude that where the internal factors which impede on the effectiveness of the clause are comprehensively addressed, the external factor of the interpretation of the clause will become less restrictive. A clear wording as to the requirements, exercise, effect and scope of the DOB will give less room for investment tribunals to interpret the clause in ways which defeat its purpose and the intent of the contracting parties for its inclusion in their agreements.

Also, investment tribunals will do well to not just interpret BITs and IIAs in the light of the formal terms used in the text of the treaty but also the purpose for the inclusion of treaty mechanisms such as DOB clause. To focus solely on the text of the treaty, even in the face of manifestly absurd results, not only detracts from the effectiveness of such mechanisms, but contributes to the perception of the international investment law and arbitration regime as unpredictable, unbalanced and possessing investor bias, exacerbating the concerns of stakeholders over the legitimacy and credibility of the regime.

Finally, with regards to limiting treaty shopping, one can say that the DOB clause has come so close, yet so far. While the clause does have the potential of limiting the treaty shopping practice and serving as a means of protecting state sovereignty and regulatory rights within the context of the international investment law regime, however, issues as regards the construction, drafting and interpretation of the clause impact restrictively on its effectiveness. Also, the practice of treaty shopping has evolved from the prevalent routes which existed when the DOB clause was first drafted. As such, for the DOB clause to be an effective and relevant tool in the international investment and arbitration regime, it must keep up with the evolving nature and dynamics of treaty shopping. Ultimately, for the existing investment treaty regime to evolve into a balanced and sustainable international mechanism, both the

drafting of the DOB clause and their interpretation must be substantially reviewed. Where these issues are addressed, the DOB clause can be a powerful tool for birthing the much needed predictability and balance in international investment law and arbitration.

Further Research

Having considered the DOB clause with respect to its effectiveness, this study can be considered as a foundation and a springboard for other points of research on the clause and by extension other issues of international investment law. These include issues such as the concept of state rights in international investment law as a tool for rebalancing the international investment and arbitration regime, the concept of the national security, state responsibility and investor rights. Particularly the following research ideas on the clause pave way for the consideration and research of the clause within the broader context of issues in international investment law:

1. The Denial of Benefits Clause: Redefining the Concept of State Rights in International Investment Law.
2. Rethinking the Denial of Benefits Clause: The Case of an Outdated Remedy for an Evolving Question?
3. Engaging the Question of the Nature and Character of International Investment Law: An Issue of Definition, Redefinition and Realignment.

APPENDIX

AUSTRALIA

COUNTRY	DOB CLAUSE	DOB: RT	DOB: AOC	ARTICLE	SIGNED ON	ENTERED INTO FORCE
ARGENTINA	x	x	x	x	23/08/95	11/01/97
CHILE	x	x	x	x	18/11/79	09/07/96
MEXICO	✓	x	x	2(2)	23/08/05	21/07/07
...	✓	x	x	2	12/11/02	14/03/07
TURKEY	x	x	x	x	16/06/05	29/06/09
URAGUAY	x	x	x	x	03/09/01	12/12/02
VIETNAM	x	x	x	x	05/03/91	11/09/91
ROMANIA	x	x	x	x	21/06/93	22/04/94
POLAND	x	x	x	x	07/05/91	27/05/92
PAKISTAN	x	x	x	x	07/02/98	14/10/98
PAPUA NEW GUINEA	x	x	x	x	03/09/90	20/10/91
LITHUANIA	x	x	x	x	24/11/98	10/05/02
LAO P.D.R	x	x	x	x	06/04/94	08/04/95
INDONESIA	x	x	x	x	17/11/92	29/07/93
INDIA	x	x	x	x	26/02/99	04/05/00
HUNGARY	x	x	x	x	15/08/91	10/05/92

HONG KONG	x	x	x	x	15/09/93	15/10/93
EGYPT	x	x	x	x	03/05/01	05/09/02
CHINA	x	x	x	x	11/07/88	11/07/88

CHINA

COUNTRY	DOB CLAUSE	DOB:RT	DOB: AOC	ARTICLE	SIGNED ON	ENTERED INTO FORCE
MEXICO	✓	x	x	31	11/07/08	06/06/09
CANADA	✓	✓	x	16(2)	09/09/12	01/10/14
UZBEKISTAN	✓	✓	x	10(2)	19/04/11	01/09/11

MEXICO

COUNTRY	DOB CLAUSE	DOB: RT	DOB: AOC	ARTICLE	SIGNED ON	ENTERED INTO FORCE
AUSTRALIA	✓	x	x	10	23/08/05	21/07/07
BAHRAIN	✓	x	x	29	29/11/12	30/01/14
BELARUS	✓	x	x	31	04/09/08	21/08/09

CHINA	✓	x	x	32	11/07/08	06/06/09
KUWAIT	✓	x	x	29	22/02/13	28/04/16
SLOVAKIA	✓	x	x	31	26/10/07	08/04/09

JAPAN

COUNTRY	DOB	DOB:	DOB:	ARTICLE	SIGNED	ENTERED
	CLAUSE	RT	AOC		ON	INTO
						FORCE
CAMBODIA	✓	x	x	26	14/06/07	31/07/08
COLOMBIA	✓	x	x	22	12/09/11	11/09/15
IRAN	✓	✓	x	12	05/02/16	26/04/17
KHAZAKSTAN	✓	x	x	25	23/10/14	25/10/15
KOREA, REP	✓	x	x	22	22/03/02	01/01/03
KUWAIT	✓	x	x	24	22/03/12	24/01/14
LAO	✓	x	x	26	16/01/08	03/08/08
MONGOLIA	x	x	x	x		
MOZAMBIQUE	✓	x	x	25	02/06/13	09/08/14
MYANMAR	✓	x	x	26	15/12/13	07/08/14
OMAN	✓	x	x	23	19/06/15	
PAPUA NEW	✓	x	x	23	26/04/11	17/01/14
GUINEA						
PERU	✓	x	x	27	30/04/13	10/12/09
SAUDI	✓	x	x	22	05/02/15	07/04/17

ARABIA

UKRAINE	✓	x	x	26	05/02/15	26/11/15
URAGUAY	✓	x	x	28	26/01/15	14/04/17
UZBEKISTAN	✓	x	x	24	15/08/08	24/09/09
VIETNAM	✓	x	x	22(2)	01/11/04	19/12/04

AUSTRIA

COUNTRY	DOB	DOB:	DOB:	ARTICLE	SIGNED	ENTERED
	CLAUSE	RT	AOC		ON	INTO
						FORCE
AZERBAIJAN	✓	x	x	10	04/07/00	29/05/01
ARMENIA	✓	x	x	10	17/10/01	01/02/03
BANGLADESH	✓	x	x	10	21/12/00	01/02/03
BELARUS	x	x	x	x	16/05/01	01/06/02
BELIZE	✓	x	x	10	17/07/01	01/02/02
BOSNIA AND	✓	x	x	10	02/10/00	20/10/02
HEZEGOVINA						
ETHIOPIA	✓	x	x	10	12/11/04	01/11/05
GEORGIA	✓	x	x	10	01/10/01	01/03/04
GUATEMALA	✓	x	x	10	16/01/06	01/12/12
JORDAN	✓	x	x	10	23/01/01	25/11/01
KHAZAKSTAN	✓	x	x	12	12/01/10	21/12/12
LEBANON	✓	x	x	10	26/05/01	30/09/02
LIBYA	✓	x	x	10	18/06/02	01/01/04

MACEDONIA	✓	x	x	10	28/03/01	14/04/02
MALTA	✓	x	x	10	29/05/02	01/03/04
NAMIBIA	✓	x	x	10	27/05/03	01/09/08
NIGERIA	✓	x	x	12	08/04/13	NOT IN FORCE
TAJKISTAN	✓	x	x	12	15/12/10	21/12/12
UZBEKISTAN	✓	x	x	10	02/06/00	18/08/01

THE UNITED STATES

COUNTRY	DOB	DOB:	DOB:	ARTICLE	SIGNED	ENTERED
	CLAUSE	RT	AOC		ON	INTO
						FORCE
ALBANIA	✓	x	x	7	11/01/95	04/01/98
ARGENTINA	✓	✓	x	1(2)	14/11/91	20/10/94
ARTENIA	✓	x	x	1(2)	23/09/92	29/03/96
AZERBAIJAN	✓	x	x	12	01/08/97	02/08/01
BAHRAIN	✓	x	x	12	29/09/99	30/05/01
BANGLADESH	✓	x	x	1(b) (ii)	12/03/86	25/07/89
BELARUS	✓	x	x	1(2)	15/01/94	NOT IN FORCE
BOLIVIA	✓	x	x	12	17/04/98	06/06/01
BULGARIA	✓	x	x	1(2)	23/09/92	02/06/94
CAMEROON	✓	x	x	1(3)	26/02/86	06/04/89

CONGO, D R	✓	x	x	1(b) (ii)	03/08/84	28/0//89
CONGO	✓	x	x	1(2)	12/02/90	13/08/94
CROATIA	✓	x	x	13	13/07/96	20/06/01
CZECH	✓	x	x	1(2)	22/10/91	19/12/92
ECUADOR	✓	x	x	1(2)	27/08/93	11/05/97
EGYPT	✓	x	x	1(b) (ii)	11/03/86	27/02/92
EL SALVADOR	✓	x	x	12	10/03/99	NOT IN FORCE
ESTONIA	✓	x	x	1(2)	19/04/94	16/02/97
GEORGIA	✓	x	x	12	07/03/94	10/08/99
GENADA	✓	x	x	1(2)	02/05/86	03/03/89
HAITI	✓	x	x	1(b)(ii)	13/12/98	NOT IN FORCE
HONDURAS	✓	x	x	12	01/07/95	11/01/01
JAMAICA	✓	x	x	1(2)	04/02/94	01/03/97
JORDAN	✓	x	x	12	02/07/97	12/06/03
KHAZAKSTAN	✓	x	x	1(2)	19/05/92	12/01/94
LATVIA	✓	x	x	1(2)	13/01/95	26/12/96
LITHUANIA	✓	x	x	1(2)	14/01/98	13/06/04
MOLDOVA	✓	x	x	1(2)	21/04/93	26/11/94
MONGOLIA	✓	x	x	1(2)	06/10/94	04/01/97
MORROCCO	✓	x	x	1(3) (ii)	22/07/85	09/05/91
MOZAMBIQUE	✓	x	x	12	09/12/98	03/03/05
NICARAGUA	✓	x	x	12	01/07/95	NOT IN FORCE

PANAMA	✓	x	x	1(b)(ii)	27/10/82	30/05/91
POLAND	✓	x	x	1(2)	21/03/90	06/08/94
ROMANIA	✓	x	x	1(2)	28/05/92	15/01/94
RUSSIA	✓	x	x	1(3)	17/06/92	NOT IN FORCE
RWANDA	✓	✓	x	17	19/02/08	01/01/12
SENEGAL	✓	x	x	1(b) (iii)	06/12/83	25/10/90
SLOVAKIA	✓	x	x	1(2)	22/10/92	19/12/92
SRI LANKA	✓	x	x	1(2)	20/09/91	01/05/93
TRINIDAD AND TOBAGO	✓	x	x	12	26/09/94	26/12/96
TUNISIA	✓	x	x	1(2)	15/05/90	07/02/93
TURKEY	✓	x	x	1(2)	03/12/85	18/05/90
UKRAINE	✓	x	x	1(2)	04/03/94	16/11/96
URUGUAY	✓	✓	x	17(2)	04/11/05	01/11/06
UZBEKISTAN	✓	x	x	12	16/12/94	NOT IN FORCE

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