

Seats of Corporate Convenience and International Investment Law

by

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Author's Declaration

I hereby declare that I am the sole author of this thesis. This is a true copy of the thesis, including any required final revisions, as accepted by my examiners.

I understand that my thesis may be made electronically available to the public.

ABSTRACT

Seats of corporate convenience (SCCs) include tax havens, offshore finance centres and other locations frequently used by transnational corporations to channel their investments around the world. They form some of the important structural elements of the global economy. This thesis examines the role of SCCs in the evolution and growth of investor-state arbitration (ISA). By analysing 463 ISA cases through the lens of SCCs, it highlights how bilateral investment treaties (BITs) came to be used in the context of investments that were not bilateral, being routed via one or more SCCs.

The Research Question in this thesis was: If the provision of Investor-State Arbitration (ISA) in Bilateral Investment Treaties (BITs) was intended to promote flows of investments *between* the signatories to such treaties, how did it come to apply to *indirect* investments channelled through one or more seats of corporate convenience (SCCs)? There are two aspects to this question, namely: (a) What crucial changes took place in the global economy after the 1950s to enable ISA to be used in the context of indirect investments? (b) What was the input of key actors such as states (particularly, the US and the developing countries), transnational corporations (TNCs), international organisations (IOs), and professionals (mainly, lawyers) in this process?

ISA was first proposed in the context of a treaty *and* an investor-state agreement. The idea was then promoted in the form of a multilateral convention by Shell and a few individuals led by Herman Abs, a banker, and a British attorney general, Lord Shawcross. It did not culminate into a treaty despite the support of the World Bank, the Organisation for Economic Cooperation and Development (OECD) and other international organisations. Germany and Switzerland then used the draft to enter into BITs, not all of which embraced investor-state arbitration. Around the 1950s and the 1960s, foreign investment in a host state tended to be made by a multinational with a clearly defined home state. The usual mode was the setting up of a subsidiary or a branch office. Foreign direct investment (FDI) was associated with an investor's control and a 10-25% ownership over the investment vehicle. FDI was distinguishable from portfolio investments and debts. It tended to be in the sectors of extraction, production, or manufacturing. The developing countries tended to borrow money for their development objectives. States' right to regulate investments in their territories was generally accepted albeit that the compensation payable tended to be disputed. Indeed, the OECD countries themselves used this right when necessary.

BITs surged in numbers in the 1990s. The oft-cited justification for burgeoning numbers of BITs

was that they would help the developing countries to attract FDI, a source of non-debt financing. However, in a globalised and highly financialised economy, the concept of FDI itself transformed to drop its association with control or a minimum ownership. In the context of ISA, it also ceased to be distinguished from loans, portfolio investments, and indeed, from a need to bring in new capital to a host state. The investors' character was no longer that of a multinational with a clearly defined home state. The major investors were TNCs who can claim allegiance with a home state, if they need to, but whose businesses were increasingly mobile and financialised. BITs clearly contained the expectation that their signatory states would promote and protect investments *from* one state *into* the other, for their mutual benefit. Investments, however, tend to be made via SCCs thus rendering the bilateral focus on their promotion inapposite. Each investment can potentially have several investors and home states, even if they may be under the control of one ultimate investor. Expensive jurisdiction battles waged between the investors and states are indicative of the difficulty of applying BITs to the conditions they were not designed for. The mismatch between the design and function of BITs was not aleatory, but was brought about by landmark ISA awards, and it was facilitated by the actions of key actors (both state and non-state), and by the radical changes in the global economy. FDI statistics are, therefore, difficult to correlate to home or host states, and their BITs. The first twenty years of ISA appear to have been based on express agreements for such arbitrations between investors and home states. This would change to the consent to ISA being derived from BITs and investment laws, without the need for an express agreement between investors and states.

Application of ISA to the radically transformed actors and situations has come about with the input of states (particularly, the US and the developing countries), TNCs, international organisations (IOs), and professionals (lawyers). There was no urgent demand in the 1980s-90s to protect investors against expropriation (the incidence of which had peaked in the mid-1970s, and declined). There was no reasonable justification for states to have privatised and outsourced their disputes in BITs, particularly commercial disputes. Yet, developing countries signed BITs, perhaps reluctantly due to their debt-vulnerability; the BITs did not clearly indicate how ISA would work, if indeed, the developing countries understood it at the time. The BITs that appear to have been against the developing countries' interests were probably signed for the potential (not a promise) of increased investments.

The US, an SCC, legitimised the use of other SCCs and offshore entities. It promoted and encouraged indirect investments. The US legal framework endorses the use, by the US investors, of BITs negotiated by other states. The US used both its aid programme and its influence in the IMF and the World Bank to promote various measures of deregulation, privatisation, and liberalisation

of the developing countries. Various IOs promoted BITs and other liberalisation measures, without a focus on their effect on the developing countries' ability to service, much less reduce, their overall debt. Their emphasis was on the improvement of the investment climate; the World Bank set up a specialist advisory agency for foreign investment. The Multilateral Investment Guarantee Agency (MIGA) and the United Nations Conference on Trade and Development (UNCTAD) actively encouraged conferences and workshops to bring countries together to draft BITs. IOs' thus played an important part in encouraging the developing countries to enter into BITs as a tool to attract FDI. No IO appears to have drawn to the attention of the developing countries to the possibility of BITs, without further agreement, leading to potential ISA with any investor who could fulfil their expansive eligibility criteria.

The US also created and nurtured the conditions that allowed oligopolistic TNCs to emerge, expand and thrive. This involves allowing TNCs a substantial say in the US policy-making and implementation. TNCs made a big contribution to the US drafting of its model BIT. Some of the corporations had the early movers' advantage because they had also contributed to the early drafts at the time of the involvement of Abs and Shawcross; that involvement in international norm-making was spearheaded by the International Chamber of Commerce (ICC). The ICC also led the making of the operative norms that make international arbitration a powerful, effective, and largely self-regulating tool. Various lawyers, accountancy and consultancy firms helped in the convergence of practices of TNCs whether it was in relation to stabilisation clauses, tax-arrangements via SCCs, transfer pricing, or the use of offshore special purpose entities.

Arbitration lawyers were mainly responsible for expanding the scope of ISA to the point that an express consent to arbitration was no longer the cornerstone of this institution that was founded on party autonomy. States' authority to regulate the investments in their territories was transferred to private arbitration tribunals in a continuum; the original idea for such a transfer was promoted by the close association of the banker Abs, the British lawyers Shawcross and Lauterpacht, and the Anglo-Dutch TNC, Shell; this was followed by a wider, looser coordination involving the ICC, the United Nations, International Bar Association, the OECD, and so on. The World Bank set up the International Centre for the Settlement of Investment Disputes (ICSID) in 1964, but it was slow off the mark. Another period of close association of a few arbitration lawyers gave it the boost it needed by (a) dispensing with express consent to arbitration, and (b) deriving a consent to arbitration from states' BITs or investment legislations. A small pool of arbitrators ensured that the early ICSID cases promoted this interpretation.

The scope of ISA expanded by treating BITs as, a) open offers of arbitration for all and sundry investments, and b) the last hoops through which the investment had to pass cursorily, even if it did

so in a restructuring carried out after its initial entry in the host state. The extensive use of SCCs meant that the ISA-eligible investors were an expanding and moveable class in respect of any investment. With the feedback loops provided by the long-term BITs and persuasive awards, the path-dependent ISA got increasingly away from its original justification, while undermining the political bargains underpinning any bilateral commitment to promote investments *from* a home state *to* a host state. This analysis demonstrates the need to re-think the whole concept and the framework of investment protection. The framework needs to be aligned with (a) the realities of the 21st century investments routinely channelled through SCCs, and (b) the balance between states' and private actors' powers and interests. Arbitration awards have interpreted BITs to include within the scope of ISA, not just FDI, but also, portfolio investments and loans. This expansion coupled with the effective operative norms for the enforcement of ISA awards, effectively make BITs work as a regime for the enforcement of sovereign debt. BITs also provide an additional tool to enforce investors' commercial contractual rights. BITs' role in promoting developmental objectives (e.g. by reducing debt) have been all but abandoned along with any need for investors to negotiate express investor-state arbitration agreements with their host states. BITs were primarily drafted in the days of regulated economies, i.e. pre-1990. It is uncertain, however, whether, and to what extent, they remain relevant within a deregulated, neoliberal and *laissez faire* environment. The failure to ask this question indicates how significant an advantage the ISA option is to the interests of TNCs, the main beneficiaries of ISA.

In carrying out the necessary research, I have conducted *library research* (primary and secondary sources) and devoted a large part of my research to the *content analysis* of Bilateral Investment Treaties and 463 Investor-State Arbitration Awards.

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List of Abbreviations

AAPL	Asian Agricultural Products Limited
AIG	American International Group
AIM	Alternative Investment Market
AIOC	Anglo-Iranian Oil Company
APPI	Association for the Promotion and Protection for Private Foreign Investment
ASEAN	Association of South East Asian Nations
ASIL	American Society for International Law
BIS	Bank of International Settlements
BIT	Bilateral investment treaty
BP	British Petroleum
BPM	Balance of Payment Manual (IMF)
BVI	British Virgin Islands
CAFTA-DR	Dominican Republic–Central America Free Trade Agreement
CDS	Credit Default Swap
CETA	Comprehensive Economic and Trade Agreement
CFC	Controlled Foreign Corporations
CRS	Common Reporting Standards (OECD)
DTT	Double Taxation Treaty
EC	European Commission
ECHR	European Court of Human Rights
ECJ	European Court of Justice
ECOSOC	United Nations Economic and Social Council
ECT	Energy Charter Treaty

EEC	European Economic Community
FATCA	Foreign Account Tax Compliance Act 2010
FCN	Friendship, Commerce and Navigation
FDI	Foreign direct investment
FI	Financial Institution
FIAS	Foreign Investment Advisory Service
FTA	Free Trade Agreement
GAO	US Government Accountability Office
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product
GE	General Electric
GM	General Motors Company
Holdco	Holding Company
IASB	International Accounting Standard Board
IBA	International Bar Association
IBC	International Business Company
IBF	International Banking Facilities
IBRD	International Bank for Reconstruction and Development
ICA	International commercial arbitration
ICC	International Chamber of Commerce
ICCA	International Council for Commercial Arbitration
ICJ	International Court of Justice
ICSID	The Convention on the Settlement of Investment Disputes between States and Nationals of Other States
IFC	International Finance Corporation

IIA	International Investment Agreement
ILA	International Law Association
ILC	International Law Commission
IMF	International Monetary Fund
IOs	International Organisations
IPPA	Investment Promotion and Protection Agreement
IPR	Intellectual Property Rights
ISA	Investor state arbitration
ITO	International Trade Organisation
ITT	International Telegraph and Telecommunications Corporation
LAFTA	Latin American Free Trade Association
LCIA	London Court of International Arbitration
LDC	Less Developed Country
LLC	Limited Liability Company
LLP	Limited Liability Partnership
LSE	London Stock Exchange
M&A	Mergers and Acquisitions
MAI	Multilateral Agreement on Investment
MFN	Most Favoured Nations
MIGA	Multilateral Investment Guarantee Agency
MNC	Multinational Corporation
MNE	Multinational Enterprise
NAFTA	North American Free Trade Agreement
NIEO	New International Economic Order

ODA	Official Development Assistance
OECD	Organisation for Economic Co-operation and Development
OEEC	Organisation for European Economic Co-operation
OFC	Offshore Financial Centre
OPEC	Organization of the Petroleum Exporting Countries
OPIC	Overseas Private Investment Corporation
OTC	Over The Counter
PCA	Permanent Court of Arbitration
PLC	Public Limited company
PPP or 3P or P3	Public Private Partnership
PRI	Political Risk Insurance
PTA	Preferential Trade Agreement
SAP	Structural Adjustment Programme
SCC	Seat of corporate convenience
SEC	Securities and Exchange Commission
SOE	State Owned Enterprise
SPE	Special purpose entity
SPE	Special Purpose Entity
SPP	Southern Pacific Properties (Middle East) Limited
SWF	Sovereign Wealth Fund
TIFA	Trade and Investment Framework Agreement
TNC	Transnational corporation
TPP	Trans Pacific Partnership
TTIP	Transatlantic Trade and Investment Partnership

UK	The United Kingdom
UN	United Nations
UNESCO	United Nations Educational, Scientific and Cultural Organization
UNCITRAL	United Nations Commission on International Trade Law
UNCTAD	UN Conference on Trade and Development
UNCTC	UN Centre on Transnational Corporations
UNDP	United Nations Development Programme
UNIDO	United Nations Industrial Development Organisation
US	The United States of America
USSR	United Soviet Socialist Republics
VCLT	Vienna Convention on the Law of Treaties 1969
VCLT	The Vienna Convention on the Law of Treaties, 1969
VOC	Verenigde Oost-Indische Compagnie
WTO	World Trade Organisation

1. Introduction

“Civil government, so far as it is instituted for the security of property, is in reality instituted for the defence of the rich against the poor, or of those who have some property against those who have none at all.”

Adam Smith, *The Wealth of Nations*¹

* * *

1.1 Introduction

1. Theriac was considered an effective antidote to poison in Nero’s times, but later came to be a “remedy for an infinite variety of diseases, and a prophylactic for preserving health.” (Wear et al, 1985, p.108).² International investment arbitration, like theriac, started off as a rare remedy to be used instead of armed conflicts,³ but is now considered a panacea for all and sundry cross-border disputes, despite its price-tag. Arbitration practitioners and institutions are rising in numbers. Investor-state arbitration (ISA) is usually administered with an emphasis on party autonomy despite in many cases there being, at best, a ‘remote’ consent (Stern 2005, p.246,257). Instead of an express arbitration agreement, the consent to arbitrate a dispute between a state and an investor is inferred from Bilateral Investment Treaties (BITs),⁴ or states’ investment laws. The focus of this thesis is on the consent inferred from BITs for indirect investments.

2. ISA has proliferated and changed substantially since its conception. Yet, there is plenty of growing room given the 3,400 BITs in force,⁵ and a few mega-regional treaties in the pipeline that provide the gateway to ISA - the ‘consent’ of the host state. The investor’s consent suffices from the notice of arbitration, *after* a dispute has crystallised. States’ consent is usually contained in a *bilateral* instrument although some treaties have more than two parties (e.g. NAFTA) or the Energy Charter Treaty, (ECT). The oft-cited justification for burgeoning BITs was that they would help

developing countries to attract foreign direct investment (FDI). The reality of the global economy is that investments do not follow the most direct route to their destinations; in fact, a substantial amount of foreign investment is *indirect* in that it does not go from a *home* state to a *host* state; also, despite guarantees of ‘repatriation’⁶ of profits in BITs, profits from investments might not take the same or any route to the home state. On both routes in and out of the host states, investments appear to use one or more seats of corporate convenience. A seat of corporate convenience (SCC) is a location used for its tax and/or other regulatory advantages.

3. Expensive jurisdiction battles waged between investors and states are an indication of the difficulty of applying BITs to conditions they were not designed for. This mismatch between design and function of BITs was brought about by key ISA awards and facilitated by radical changes in the global economy. This Chapter contains the Research Question, the period of research, the methodology followed, and the core argument. The contribution of this thesis to the advancement of knowledge is discussed at the end of the literature survey in Chapter 2. This Chapter also includes a brief outline of the remaining Chapters.

1.2 SCCs and indirect investments

4. By 2012, over half of the reported stock of the United States (US) non-financial firms’ FDI (\$1.9 trillion) went to overseas holding companies, one-third of whose assets were reported in three jurisdictions, the Netherlands, Luxembourg and Bermuda. This is not unique to the US investments. Almost half of the world’s FDI is offshore – without a direct attachment to productive activities in the economy where it is reported (Haberley and Wojcik, 2013). India, for example, attracts most of its FDI through the Netherlands, Switzerland and Mauritius, but the leading investors in India are from the US, Britain and Japan. An American investor using Mauritius as an SCC has ISA access against India even when India and the US have not signed a BIT. Mauritius also has a favourable Double Taxation Treaty (DTT) with India (Sachs and Sauvart, 2009, FN68).

5. SCCs, many of which are tax havens, form the key structural elements of the edifice of the global economy with a variety of corporate forms being used as the building blocks.⁷ Various specialist sectors value ‘bespoke’ regulation⁸ (or the lack thereof) that some SCCs provide.⁹ This is not just to do with efficiencies and formalities; the United Nations Conference on Trade and Development (UNCTAD) estimates that the OFCs cause an estimated \$100 billion loss in annual tax revenues for developing countries.

6. In 2012, the British Virgin Islands (BVI) were the fifth largest recipient of global FDI (\$72 billion), receiving more FDI than Britain, whose economy is 3,000 times larger than that of the BVI.¹⁰ If \$11 trillion worth of private wealth is booked in offshore centres,¹¹ and by UNCTAD’s

estimate about 30% of cross-border corporate investments are channelled, in an increasing trend, through ‘offshore conduits’ towards their ultimate destinations, what, if any, is the effect of these developments on the gateway clauses that determine access to international investment law? This is not an easy question to answer given the difficulty of defining tax havens or offshore financial centres (OFCs). Most of global FDI is undertaken by private transnational corporations¹² (TNCs) (Milner, 2014, p.2) and corporations are the biggest users of ISA.

7. This research is framed around the concept of *indirect* investments and focuses on SCCs which include tax havens, OFCs and quasi-tax havens. The phrase ‘SCC’ is inspired by the flags of convenience used by the shipping industry. It is the *indirectness* of the investment route that is of significance to contrast the *multilateral* nature of investments with that of *bilateral* characteristic of treaties.

1.3 Research Question

If the provision of Investor-State Arbitration (ISA) in Bilateral Investment Treaties (BITs) was intended to promote flows of investments *between* the signatories to such treaties, how did it come to apply to *indirect* investments channelled through one or more seats of corporate convenience (SCCs)?

There are two aspects to this question, namely:

(a) What crucial changes took place in the global economy after the 1950s to enable ISA to be used in the context of indirect investments?

(b) What was the input of key actors such as states (particularly, the US and the developing countries), TNCs, international organisations (IOs), and professionals (mainly, lawyers) in this process?

1.4 Period of Research

8. This research briefly covers the period from the 1930s to 1990 to set the scene for the first demand(s) for ISA and the early BITs. The ground-breaking idea of ISA was promoted mainly by a few non-state actors related to the oil industry from 1930 onwards. The focus then shifts to the post-1990s period up to 31 December 2013. The second period explains how bilateralism in principle, and using multiple SCCs in practice, helped to expand the reach of ISA. The date is drawn arbitrarily to avoid having to update the data for the thesis continually.

1.5 Methodology

9. Koskenniemi contends that the eclectic international law – with its “eclectic and pragmatic” legal *praxis* - is not well dealt with by the theories and the vocabulary borrowed from international relations (for example, realism, constructivism or liberalism) (2012, p.19). Mainstream international legal scholarship tends not to employ sociological theories (Hirsch, 2005, p.891) but Koskenniemi suggests using something similar to “historical sociology in international relations,” covering all forms of legal power (2012, p.19). This thesis draws broadly on history, sociology, and critical legal history, to trace the development of international investment law from outside the box (Gordon, 1976, p.11); rather than simply focusing on treaties and awards in isolation to everything external to the legal system, it examines ISA awards by using facts not part of a purely legalistic enquiry.

10. This is primarily a qualitative and analytical research into the evolution of ‘gateway’ norms which entitle investors to the privilege of ISA thus transferring national courts’ jurisdiction over investments in their territories to private authority. Private authority in ISA is expanding using the initial consent to further expand its scope. The lens of SCCs is applied to the gateway clauses in respect of the nationality of the investor (*ratione personae*), the eligibility of the investment (*ratione materiae*), and the timing of the prior two issues (*ratione temporis*).

11. The data include 463 ICSID cases decided under the auspices of the International Centre for Settlement of Investment Disputes (ICSID) which are analysed for the extent of use of SCCs and the arbitrators’ decisions on indirect investments. Other information including the numbers of DTTs and BITs signed by SCCs, is gathered from searching IOs’ publicly available documents (e.g. the World Bank (World Bank), the International Monetary Fund (IMF), and UNCTAD (its database of BITs and FDI flows). BITs signed by Sri Lanka, India and the Great Britain (Britain) were examined for their preambles, definitions of investors and investments, and changes introduced to them since 2000. They were chosen as samples of a developing country with ICSID membership, a non-ICSID developing country, and a developed country respectively.

12. Given that states’ own authority is assumed to be delegated to arbitrators, the framework for this thesis adapts the argument of Curtin that the governmental decision-making authority is transferred to private authority “along a continuum with a very loose coordination among stakeholders and other non-governmental actors at one end of the spectrum and a much closer association of non-state actors with the core political actors at the national, international or supranational level.” (2010, p.35). The experts and expert-networks of non-state actors provide a source of legitimacy. Once there was a foot-in-the-door, the early small commitments from states could be built upon to support a bigger edifice of ISA. It is an old technique to persuade without the

use of force (Freedman and Fraser, 1966).

13. Two close-association periods are highlighted from the case-studies that worked as a wedge to open a gap. The first such period was the conception of a direct arbitration between a private entity and a state (see Chapter 4) – the work of a few lawyers acting in the TNCs’ interests. This was followed by some wider, looser coordination that included state actors and IOs (the United Nations (UN), the Organisation for Economic Co-operation and Development (OECD), and the World Bank) leading to a few BITs, the OECD’s draft for an investment treaty, and the ICSID Convention in 1966 (Chapter 4). The second close-association period was in the late 1980s and early 1990s, when ICSID was not much used. ICSID’s promotion came with a close association between a few lawyers involved in the early ICSID cases *Southern Pacific Properties (Middle East) Limited (SPP)* (1984), and *Asian Agricultural Products Ltd (AAPL)* (1987); the cases pioneered arbitrations using an inferred consent (Chapter 11). This was followed by an expansive interpretation phase in which other arbitrators upheld jurisdiction in ICSID cases by following a similar logic. At that stage, ISA’s progress became path-dependent. Previously challenged ideas found general acceptance. This, for instance, can be seen in the recent acceptance of ICSID jurisdiction for a portfolio investment or a salvage dispute. Also, some of the mega-regional investment treaties under discussion provide for ISA, not host courts’ jurisdiction.

14. There is contextual evidence of regulation capture at each of the close-association periods at a micro level (individual lawyers) and then of the wider, looser cooperation at a macro level (IOs and states). The thesis draws, where appropriate, on works from other fields such as global governance, corporate law, history, and global political economy in order to connect the dots for the context.

15. It is not necessary to show if this process of close associations was ad hoc, or planned, or somewhere in-between. BITs are long-term agreements, automatically renewed in most cases until terminated by a year’s notice. Arbitration is a powerful tool which is self-transforming, particularly with a relatively small number of leading lawyers. In this respect ISA is a narrower field than international commercial arbitration (ICA). The small number of leading arbitrators ensures an effective exchange of ideas, and an ample opportunity to deploy them in practice as they act interchangeably as advisers, counsel and then arbiters of the norms (Puig, 2014). This makes ISA well-suited to bring about changes to international norms. There are several arbitration institutions around the globe which can usefully spread new ideas. ISA awards provide feedback loops (see the case studies discussed in Chapters 12-14). This “concordant practice”¹³ is indicative of how little room there is for an alternative discourse among practitioners. Although there is no system of precedents in ISA, case law is relied upon in the development of the norms.¹⁴ This, together with

the similarities of provisions in the multitude of BITs, “effectively converts investment treaty arbitration into a form of global governance,...which is private and decentralised.” (Montt 2009, p.3).

16. This thesis does not need to deal with the nature of the contract of investment between the state and an investor, or the order to which it belongs, if any. Mayer (1986) has suggested that there is a special kind of state contract, *contrat sans loi* (contract without law), one characterised by its arbitration and stabilization clauses, and possibly expressly governed by international law. However, such contracts use the municipal and international legal orders for enforcement. In practice, this is the goal of those drafting such instruments. What is relevant is the promotion of a new legal order by arbitrators like Mayer,¹⁵ and more recently, Paulsson. Incidentally, Paulsson (2009) does not think that ISA should be considered to be arbitration; the word arbitration in ISA is like the elephant in ‘elephant seal’. This argument neglects that it is as ‘arbitration’ that ISA was conceived, promoted, put into effect, and evolves in case after case; elephant seals never were seals. The theory to make ISA into something else currently appears to be a form of circular reasoning (*circulus in probando*) (Walton, 2008). Rodrik’s hedgehog analogy could be applied to the elite arbitration community, pushing for its autonomy and freedom as if it is *the* right solution and lesser evil than any other dispute resolution ideas (or even better, dispute-*prevention* ideas) (2011). The other usage to note here is the reference in the most current discourses (newer treaties and the media) to investor-state-dispute-settlement (ISDS) instead of arbitration; the word settlement gives the concept an amicable air. The phrase ISA is used in this thesis.

17. This thesis highlights how key ISA decisions with far-reaching consequences were taken without adequate legitimacy and transparency. When one idea has taken root (whether by being framed in a number of almost identical BITs or in ISA awards that then influence other arbitration awards), it is difficult for new ideas to emerge, particularly when the first idea is framed as arising *consensually*. The privileging of private over public interests occurs both in the structure of the BIT system as well as in its implementation.

18. This thesis excludes non-ICSID ISA cases for two reasons. First, ICSID is a World Bank administered institution, the original provider of ISA facilities, and a promoter of ISA and BITs, and second, ICSID has a website with at least some information on every case, such as, the names of parties, counsel, and arbitrators. Awards are available if all the parties to the arbitration consent to their publication. Some awards and orders are also available on the website www.italaw.com maintained by Professor Newcombe of the University of Victoria, Canada.

19. General statements made about developing countries in this thesis exclude China (unless

specifically mentioned). China's original BITs were different from those of other developing countries; their drafting indicates a direct engagement of the Chinese government. For example, early Chinese BITs limited ISA to the amount of compensation (whether or not expropriation took place was outside the BIT's ambit). The expression 'developing countries' in this thesis refers to the countries in the countries listed in Tables B and C prepared by the UN in 2012. This includes what the UN calls 'economies in transition'; there were several ICSID disputes relating to the 'transition' that arose under BITs signed by such countries.¹⁶ This is not to claim that these countries are homogenous in every way; simply, that they were in a similar situation in respect of their BITs.

1.6 The core argument

20. The first part of the Research Question contains an assumption that BITs were signed to attract FDI. This is based on the contents of the preambles in many BITs and the literature survey (Chapter 2). For example, the Germany-Sri Lanka BIT of 1963 sets out the states' desire to "foster and strengthen economic cooperation" between them, intending to "encourage investments by nationals and companies of either State in the territory of the other State", and recognising that "encouragement and protection" of such investments was "likely to promote investment for the mutual benefit of the two States." (added emphasis). Such an intention was echoed in the BITs signed by most other countries.¹⁷

21. BITs were drafted with non-exhaustive definitions of investments to set out the principles of substantive protection against expropriation, etc. It is argued in this thesis that BITs were not intended to be used as enforceable arbitration agreements or as standing offers of arbitration; not without an accompanying specific investment contract with investors comprising an arbitration agreement. Only a few investors who had negotiated such a deal would have had access to ISA. Such an interpretation would have been in keeping with the objectives of BITs and the expectations of the developing countries.

22. The early ISA arbitrators relied on ambiguous BITs to dispense with the need for an arbitration agreement between an investor and the host state. Host state's consent was inferred from treating BITs as standing offers of arbitration that an investor could accept at the time of giving its arbitration notice. By the time these cases were decided, most developing countries had signed their BITs and undertaken privatisations of public enterprises; these provided the opportunities to enforce the new type of arbitration. IOs had advised the developing countries to undertake an improvement of their investment climates; this included signing DTTs and BITs, liberalisation, deregulations, and privatisations. All developing countries did not suddenly start to consider BITs as a mode of attracting capital in competition with each other; it appears that they were steered in that direction

by the World Bank, UNCTAD, and by other IOs (Chapter 10). Radical changes to FDI and corporations meant that the use of SCCs was routine by 1990. The potential for ISA was enormous given the wide definitions of investments in most BITs. The political bargaining, if any, underpinning a bilateral commitment to promote investments from a certain country lost its meaning as TNCs could easily go treaty shopping before or after making an investment. ISA has thus grown on the basis of a myth of states' consent.

23. After ISA was designed in the 1950s (see Chapter 3-4), the nature of FDI and corporations underwent a transformation. The global economy was characterised by liberalisation, privatisation, and financialisation. Towards the end of the 20th century, most IOs changed their definitions of FDI dropping the conditions of minimum ownership and control. FDI flows in and out of a host state became increasingly indirect, complex, and in some cases difficult to trace back to the origin of funds. Chapter 6 highlights these changes.

24. With the demise of the currency exchange restrictions that had characterised the Bretton Woods system, the number of SCCs grew, and their use became a routine part of most global businesses. Chapter 5 delves into the key characteristics of some SCCs.

25. MNCs no longer expand by setting up subsidiary companies or branches; they have elaborate structures of holding companies and special purpose entities (SPEs) that enable a company to look profitable for shareholders but at a loss for the taxmen. Chapter 7 traces the transformation of MNCs into TNCs that have no home state, or have several home states. The bilateral mechanism of attracting investments is not appropriate to TNCs that do not have to rely on BITs at the time of making their investments; they can access a suitable BIT by a restructuring when a dispute is on the horizon. That BITs attract investments is, therefore, not entirely accurate. This thesis does not argue that there was a direct regulation capture by TNCs after the first close-association period identified in Chapter 11. TNCs' influence on ISA is indirect, through how they operate using SCCs and SPEs to obtain access to ISA. Their professional advisers happen to play important roles of both counsel and arbitrators thus promoting an exchange of ideas supportive to their interests.

26. Looking at their original designs, most BITs have comprehensive definitions of investments and investors. They were drafted to help attract all types of investments from home states to host states. ISA could not have been an option available to all. This is probably why many early BITs tended to contain a listing of arbitration options for investors¹⁸ one of which could be specified in the investor's contract with the state. This would have been a reasonable interpretation of most BITs instead of rendering ISA a skirmish by surprise.

27. For a *typical* definition of an investment see Article 1(b) of the UK-India BIT signed in 1994: “... every kind of asset established or acquired, including changes in the form of such investment, ... and in particular, though not exclusively, includes;

(i) movable and immovable property as well as other rights such as mortgages, liens or pledges;

(ii) shares in and stock and debentures of a company and any other similar forms of interest in a company;

(iii) rightful claims to money or to any performance under contract having a financial value;

(iv) intellectual property rights, goodwill, technical processes and know-how in accordance with the relevant laws of the respective Contracting Party;

(v) business concessions conferred by law or under contract, including concessions to search for and extract oil and other minerals.”

28. The list is non-exhaustive. Developing countries would have thought it an absurd interpretation of BITs if all and sundry investors with a miscellaneous claim, or a fleeting portfolio investment, could call in question in ISA their legislative, judicial or administrative actions or omissions, and yet, such is the result of interpreting BITs as offers of arbitration that could be accepted by anyone making an investment. Given the differences in the risk profiles of contracts, debts, portfolio and FDI, it seems unreasonable to consider that states made an open-ended offer of ISA to all types of investments. The sheer number of potential claims would make this interpretation absurd. The very first draft suggesting ISA that did not lead to a multilateral treaty was the Abs-Shawcross Convention of 1959 (Chapter 4). It contained an arbitration provision in Article VII that expressly referred to the possibility of a state’s consent being contained in agreements or in unilateral declarations, but for a *state-to-state* arbitration. An investor could submit a dispute to direct arbitration provided that the respondent state had declared that it accepted the jurisdiction of the “*said* Arbitral Tribunal in respect of claims by nationals of...” (Article VII(2) of the draft Abs-Shawcross Convention). (Emphasis added). This envisages a state-to-state arbitration in which the investor may join directly, provided there is an express consent of the respondent state.

29. The ICSID Convention (the Convention) does not include any wording referring to a ‘unilateral declaration’ in Article 25. Paragraph 24 of the Report of the Executive Directors on the Convention of 18 March 1965 states that the consent of both the parties to the dispute need not be expressed in a single document suggesting, “a host State might in its investment promotion

legislation offer to submit disputes arising out of certain classes of investments to the jurisdiction of the Centre, and the investor might give his consent by accepting the offer in writing.” This was not included in the main text of the Convention.

30. Cautious interpretation of BITs would not have led to a profusion of ISA cases. Some early landmark decisions of ICSID arbitrators stretched the meanings of BITs from invitations to treat to standing offers that could be accepted any time by giving a notice to commence an ISA, even years after making of an investment. Arbitration – with its confidentiality, finality, enforceability, and self-determination of jurisdiction - is a powerful tool, and once the early decisions blazed the trail, the arbitration ‘without privity’ as called by Paulsson (1995, p.232) got the momentum necessary for its speedy growth.

31. Even if BITs are assumed to be arbitration offers, arbitrators’ interpretation of what would be an eligible investment could have been limited to the direct investor from a home state and perhaps one link of indirect control in cases the investment was made through a local company at the insistence of the host state. This option was rejected so that the arbitrators’ interpretations of BITs rendered them as “portals”¹⁹ through which investments could be made eligible for ISA. No notice was taken by the arbitrators of the transformations in the nature and roles of investments, investors, or states.

32. Chapter 8 discusses the role of the US because the real expansion of BITs started after the US government commenced its BIT programme which was around the same time as it enabled its banks to do offshore business onshore. Despite being a leading FDI provider on paper, the US did not succeed in entering into as many BITs as some European countries. Yet, the US investors have been the principal users of ICSID being involved in 98 out of 463 cases studied for this thesis.²⁰ The US investors thus obtained benefits of ISA even where their host states had no BITs with the US. Further, the US has a significant influence in the IMF and the World Bank; both IOs actively encouraged the improvement of investment climates of the developing countries and in the case of the World Bank, the making of investment treaties. The US treaties were drafted with careful consideration of its policy on indirect investments but not those of developing countries.

33. Chapter 9 discusses the position of the developing countries who appear to have signed BITs without much negotiations. The inference of lack of negotiations is based on the paucity, in ICSID awards, of *travaux préparatoires* in support of the states’ jurisdictional challenges. The developing countries’ debt problems would have made them vulnerable to pressure; most would have agreed to liberalisations accepting BITs for the substantive protection of foreign investments against political risks. BITs themselves mostly followed the terms set out by the capital-exporting states (Allee and

Peinhardt, 2014, p.62). In these circumstances, they should have been interpreted on the basis of *contra proferentem* (interpretation of ambiguous provisions against the drafter), giving the benefit of the doubt to the states which had less bargaining power.

34. The debt crises of the 1980s, at least partly, explain the incongruity between the acceptance of BITs by the developing countries, and their activism for the New International Economic Order (NIEO). However, there is not enough evidence to show that such countries intended to offer ISA to all investors or investments who could fit the extremely wide wording of the BIT definitions. In the newer BITs, most states do not appear to have removed ISA. Whether this is a resigned acceptance of the current state of investment law or a continuing lack of real choice is difficult to determine without further research into states' recent round of negotiations.

35. BITs were at best ambiguous as arbitration agreements. Most could be construed as invitations to treat, not as standing offers. Even if the consent in BITs was, in itself, sufficient to commence an ISA, and it is assumed to extend to indirect investors, it could have been interpreted narrowly to include just the most immediate investor in the host state. Despite the persuasion from IOs and the OECD states to sign BITs in order to attract FDI, the interpretation of BITs is not restricted to FDI. BITs and ISA awards hardly ever refer to the expression FDI. As will be shown in Chapters 12-13, the scope of what is held eligible for ISA makes ICSID an all-encompassing regime, applicable to loans and portfolio investments, rights to money, sovereign bonds, and so forth; it is neither necessary for the source of an investment to be the home state nor for the destination to be the host state. Sometimes investors invoke BITs based on the formal ownership of investments, and at other times the beneficial ownership. The scheme of the Convention was that the host's own investors should not commence an ICSID arbitration unless it was specifically agreed that the local entity was foreign-controlled for the purpose of the Convention. Using BITs as an alternative source of consent to ISA allowed the early arbitrators to ignore the scheme of the Convention and enable round-tripping investments to use ISA. The growth and expansion of ISA was not accidental, but was directed by arbitration lawyers, particularly in a few landmark cases. Given the TNCs' routine use of SCCs in the making and restructuring of investments, BITs are being used in an opportunistic manner.

36. The beneficiaries of the expansion of ISA are private powers (TNCs including banks), the ICSID Centre, and the professionals. Not only does ISA offer an additional remedy to foreign investors in a host country but it has also evolved to provide a regime for the enforcement of sovereign debts so long as some involvement of the host states (through legislative, executive or judiciary) can be shown to have caused the lenders' inability to recover their dues (Chapter 12).

37. BITs' original design (by Lauterpacht) is consistent with their providing a legal foundation for ISA agreements that would have been concluded directly between states and investors. The reason *why* BITs were crafted ambiguously (both in their intentions as to ISA and their scope to investments wider than 'FDI') is difficult to determine. Such ambiguity is not typical for enforceable agreements made by developing states. What is clear from the literature (Picciotto, 2011, Palan et al 2010), and from ISA awards, is the dominant input of arbitration lawyers, and a negligible representation of the governments of the developing countries in the discourse on BITs well into the 1990s.

38. The rise of the SCCs in the 1990s coincided with globalisation (particularly, the large scale privatization of public assets), and the ascent of private power in global governance. However, the operative norms used to develop international investment law were devised in the early to mid 20th century when SCCs were not prolifically used. Complicated rules of offshore economies were also created by the professionals whose clients took advantage of them (Palan et al 2010, p.100; Picciotto, 2011, p.241). This, however, does not prove that the developing countries when signing BITs were aware of the implications of these developments on ISA; indeed, they did not appear to be aware that BITs *per se* could lead to ISA. In the first two decades of ICSID, all arbitration cases arose out of specific arbitration agreements. Consent to arbitration was not derived from BITs at the time they were being signed.

39. The timing of the growth of BITs indicates that structural factors in the global economy enabled it, and again the architects of some of those factors, were legal and financial professionals. The growth and evolution of ISA have taken place at the behest of arbitration lawyers, at least some of whom are keen to promote a law without a state, or a transnational autonomous arbitration order (Michaels, 2013). The building of such an order, which arguably has already commenced, relies on the groundwork of 'consent' of the very states whose actions are the subject of regulation.

40. To recap, the process of the transfer of states' authority over investments in their territory to private arbitrators took place over a continuum, with a specific push by private actors whenever there was a key change towards expansion. It started small, with a foot-in-the-door in the 1950s with a few BITs. A few private actors (Abs, Shawcross, Shell and other TNCs) pushed for a change; although various IOs (e.g. the UN ECOSOC, the IBA, etc.) were involved, their coordination came after the initial push; the early actors were again involved in that coordinated promotion of the radical idea of an investment protection convention. Although the World Bank set up the ICSID Centre, it was not a success initially. The expansion of ISA as a field and of ICSID as a centre for arbitration came after two key decisions in the early 1990s, namely, *SPP v. Egypt* 1984, and *AAPL v. Sri Lanka* 1987. The *SPP* case inferred a consent of a state from its investment legislation, and

the *AAPL*, inferred a consent from a BIT. Very few lawyers were involved in these two cases; once they had brought in the paradigm change, other cases followed. TNCs have encouraged this expansion as users and beneficiaries of the system and by not bothering to negotiate specific investment arbitration clauses as part of their investment contracts (were they to do so, an inferred consent would not be necessary but they could lose some of their flexibility to manipulate company structures for tax and other purposes). States enabled the growth – the developed countries, by drafting ambiguously worded BITs that were perhaps easier to negotiate, and the developing countries, by accepting such BITs without sufficient understanding. IOs (mainly, the World Bank Group and UNCTAD) encouraged the developing countries to sign BITs as part of their overall advice and were probably responsible for some of the convergence of terms. However, by far, the biggest contribution to the expansion of ISA as it applies to indirectly routed investments, came from the arbitrators at critical junctures.

1.7 An Outline

41. Chapter 2 contains a brief literature survey to place this research in the context of other scholars' work and explains the contribution of this thesis. Chapters 3 and 4 examine how ISA first came about with a narrow demand from the oil industry. These highlight the close association among a few key actors, the most prominent ones being Lord Shawcross and Herman Abs. This was followed by a looser, wider coordination of activities by some OECD states and the World Bank. States like Germany, Switzerland and Britain started concluding the early BITs with developing countries and the World Bank set up the Convention.

42. Chapters 5 to 7 are descriptive and analytical. Their aim is to create the context for ISA's evolutionary period, including, defining and describing why SCCs matter to investments, analysing the radical changes to FDI, and the form and substance of corporations themselves. These Chapters show how the global governance of international investments mirrors the larger developments in the global political economy. TNCs did not play a direct role in the second phase of expansion of ISA, except as users of the system. Their role is further expounded upon in Chapters 11-12 that show the case studies of how TNCs use SCCs thus influencing ISA indirectly.

43. Chapter 8 to 10 follow the effect of the actions and omissions of the US government, the developing countries, and IOs respectively, on the role of SCCs in international investment law.

44. Chapters 11 to 14 analyse the broadening of the path taken by ISA with the help of case studies to show how the ISA jurisdiction expanded despite a few decisions that attempted to narrow its scope. Chapter 11 describes the second close-association period between lawyers when ICSID's progress was rather slow as jurisdiction was based on specific ICSID agreements, not derived from

BITs. A few key decisions made ISA expansive by deriving states' consent from its own investment laws and BITs. It also touches upon the role of other professionals briefly. Chapter 12 illustrates the types of indirect investments seeking protection under BITs by reference to case studies to indicate how far removed some of these are from the BIT objectives of promoting mutual prosperity. Chapters 12-14 are based on a detailed study of ISA awards and are indicative of the wider, looser coordination by lawyers and TNCs (as clients or funders of claims) that expanded ICSID's jurisdiction. These case-studies are important to highlight the attenuation of host states' consent to ISA and of their legitimate expectations. These cases show how significant the SCCs are; TNCs' use of SCCs enables arbitrators to interpret BITs broadly and by accepting SCCs as legitimate; and such broad interpretations further legitimize the use of SCCs in the context of BITs.

45. Chapter 15 is the concluding section of the thesis which summarises the thesis but also set out possible areas for further research.

1.8 Summary

46. Neither the Convention nor BITs were designed to dispense with an express arbitration agreement between an investor and a state. That such agreements are not increasingly used shows how malleable the current system of using BITs and SCCs is. It can no longer be argued that BITs encourage TNCs to make any investments; indeed, any investment can now be restructured to bring it within the ambit of a convenient BIT by using a suitable SCC at any time, even after a dispute is probable.

47. ISA, a right without the privity of contract with a state, was innovative. It empowered TNCs with international rights, and that too without having to settle the legal controversy over whether corporations are, or can be, subjects of international law (Alvarez, 2011). Investors were simply given benefits of BITs. To put the enormity of the origin of the concept of ISA in a wider context, until 1999, a third party beneficiary could not sue under a contract in England.²¹ For a *multilateral* investment treaty, the idea of a home-state might not have been relevant. The worldwide network of 3000 plus BITs that exists today is particularly significant in light of the OECD's unsuccessful attempts at achieving a multilateral agreement on investment (MAI) in 1998; that failure, at least partially, was due to a lack of a consensus on its terms. This is more the reason to keep the *bilateral* aspect in mind when interpreting BITs, as has been attempted in this thesis.

48. The governance of FDI through private authority has relied heavily on the exchange of ideas involving several international institutions and individual practitioners, not just state actors. This thesis not only narrates the effect of SCCs on investment treaty law but explains how certain views were promoted and came to dominate others, and how the past is shaping the present and future of

this area of law.

49. The evolution and growth of ISA under BITs has taken place in ignorance of the proverbial elephant in the room, namely that majority of FDI through SCCs is not necessarily *direct* and sometimes not even *foreign*. The territorial concept of BITs is used to support a non-territorial, multilateral ISA access for investments that may have nothing more than a brass-plate in their home country(ies). What ISA does achieve, as will be shown in the following chapters, is a new regime for sovereign-debt enforcement, albeit that this was not considered to be an objective of BITs. Most BITs define loans and claims to money as investments. If a debt is enshrined in an ICSID award, it can be easily enforced in any signatory country.

50. The use of SCCs and indirect investments helps to render “the functional laws that pertain to the management of ‘globalization’ by private actors ... invisible.” (Koskeniemi, 2012, p.24). Unlike the WTO, the ICSID regime can be said to be enforced by the thousands TNC entities engaged in FDI (Sachs and Sauvart, 2009). The enforcement is carried out using the framework set up by the New York Convention and the Convention.²² The influence of private power cannot be understated when majority of ICSID users are not individual investors, but corporate entities. Of the world’s 100 largest economic entities in 2009, 44 were corporations. If one looks at the top 150 economic entities, the proportion of corporations rises to 59. The largest in 2009, Wal-Mart Stores, had revenues exceeding the respective GDPs of 174 countries (Keys and Malnight, 2010). A Swiss analysis of the relationships between 43,000 TNCs has identified that less than 1% of the companies were able to control 40% of the entire network. Most were Financial Institutions (FIs) (Upbean 2011).

51. BITs were drafted with non-exhaustive definitions of investments but were not intended to be used as standing arbitration offers. The early ISA arbitrators relied on ambiguous BITs to dispense with the need for an arbitration agreement between an investor and the host state. Most BITs were signed before these decisions opened up the field of ISA. States had also undertaken privatisations which provided the opportunities to enforce the new type of arbitration. Radical changes to FDI and corporations meant that use of SCCs was routine by this time. The potential for ISA grew enormously given the wide definitions of investments in most BITs. The growth was sustained by TNCs using ISA through SCCs in addition to or along with other disputes provisions in their contracts. IOs themselves used SCCs and encouraged some them. States like the US and Britain are SCCs, and advance them. Developing countries tolerate investments made through SCCs. The legal and accounting professionals do the creation, maintenance and servicing of the nuts and bolts of the SCCs’ network. Little wonder that arbitrators find it legitimate that some companies’ business is to exist on paper.

52. The thesis is aimed at the important gap in the literature relating ISA to showing that (a) SCCs render states' consent to a foundational myth, and (b) there is a need to revisit the justification for ISA for any investments, FDI or not. Particularly, developing countries should pay attention to this area in their newer BITs. If the UNCTAD figure of \$100 billion in lost revenues is accepted, it amounts to an unjust enrichment of investors at the expense of the citizens of the developing countries. There is a similar argument to be made for the lost tax revenues of home countries that enable outward capital flows but do not necessarily gain in terms of profits that could be repatriated. At the heart of this thesis is the unfairness caused by the use of SCCs with SPEs that are nominally different identities from the corporations that create and control them. Encouraging investors to use the SCCs network and to make indirect investments defeats the express objective of BITs to promote development and prosperity, but also the wider, unstated, objective of BITs to enable developing countries to reduce their debt-burdens (by attracting FDI instead of debt). Yet, ISA continues to grow on the back of inferred consents without an assessment as to its value as a panacea for all investments and sectors.

1 Smith, 1904, Ch.I, Part II.55, "On the Expense of Justice".

2 Despite several doctors' doubts over its efficacy, theriac was produced in large quantities in the 16th century by competing pharmacies in Europe always proclaiming that it was getting better with research. Its production ceased in the nineteenth century.

3 The process started in the late 19th century with the Hague Conventions that provided for state-to-state arbitrations.

4 The term International Investment Agreements (IIAs) is not used here to avoid confusion between a treaty called as an IIA between two states, and an investment agreement, i.e. a specific contract between a foreign investor and a state agency.

5 Retrieved from www.unctad.org.

6 The plain meaning of "repatriation" is to send someone or money back to one's home state. Retrieved from www.en.oxfordenglishdictionaries.com.

7 There were called a formality in *Aguas Del Tunari* (2002) decision. Also see, 'specific legalised forms' (Picciotto, 2011, p.449). For further details on the way offshore is systematically used, see Foot, 2009.

8 This is to enable businesses to "avoid the unintended inefficiencies of "catch-all" regulation of larger jurisdictions." The Cayman Islands specialise in hedge funds, wholesale banking and high volumes of the US overnight banking business, and Bermuda in captive insurance market and in enabling the parking of American TNCs' profits before repatriation., "Tax havens are cog in global economy, say defenders." *Financial Times* 7 April 2016. Retrieved from www.ft.com.

9 "The international financial services industry plays a vital and largely positive role in the global economy," said Nigel Green, chief executive of deVere Group, an international financial consultancy firm in Switzerland, *ibid*.

10 *Ibid*

11 *Ibid*.

12 Some FDI is also undertaken by State Owned Undertakings (e.g. From China) and increasingly by Sovereign Wealth Funds (SWFs).

13 *Mondev*, 1999, Award, paragraphs 116 and 125. 11 October 2002.

14 ICSID awards from 2006 were found to refer, on an average, to 9.3 previous ICSID rulings: Commission, 2007.

15 Mayer is in the list of the Most In Demand Arbitrators Worldwide (Band 1), *Chambers Global*, and among the "Incontournable" by *Décideurs Stratégie Finance Droit*.

16 UN Statistical Annex, Country Classification, 2012. Retrieved from www.un.org.

17 A sample of all the BITs of Britain, India and Sri Lanka were checked and found to contain similar preambles. For example, the British BIT with Colombia, 2010. The UNCTAD database of BITs contains numerous examples of this.

18 For example, India-Mauritius BIT includes options of arbitration under Article 8(2) for domestic Indian arbitration, ICSID (if both States were parties to the Convention), an ad hoc UNCITRAL arbitration, or an UNCITRAL conciliation, and then provided in Article 8(4) that notwithstanding anything in Article 8(2) the state that was a party to the dispute would have the option to submit *its* disputes to UNCITRAL. This is just an example of how little

attention was given to the provision as the expectation must have been that the actual arbitration agreement would crystallise specifically at the time of making of the investment. Article 9, by contrast, provides for one kind of arbitration between the Signatory States without options.

- 19 The *Aguas Del Tunari* tribunal so described BITs in paragraph 332 of the decision on jurisdiction, 3 October 2005.
- 20 They could be involved in more cases but all ICSID awards are not in the public domain and parties' nationalities on the database do not always indicate the ultimate controlling investors due to the use of SCCs.
- 21 There were of course exceptions to the rule in that insurance beneficiaries could sue under a policy to which they were not directly parties.
- 22 This entered into force in 1966 after 20 countries had ratified it. As of 2006, 143 countries had ratified it.

2. Literature Survey

2.1 Introduction

1. This Chapter summarises the literature survey to show the gap that the thesis addresses and also explains how the thesis takes some of the other scholars' work forward. The summary below flags the most relevant parts of the literature. The review is divided by themes into private authority, diffusion of BITs, criticisms of ISA, SCCs, and multi-layered global governance.

2.2 Private authority

2. Cutler laid the foundations for the study of private authority in global governance (2002, 2003). She identifies six different types of cooperative arrangements and institutionalisation including a private international regime from the example of translational merchant law (2002, p.28-29). Mattli and Woods use a regulatory capture framework to analyse the evolution of the politics of global regulation (2009, p.4). Actual change, they contend, requires the converging interests of key actors and ideas. This thesis shows how this convergence took place in relation to ISA, particularly when it was first suggested. A limited institutional supply of global due process and a weak demand for change, they suggest, favours sustained regulatory capture. (Mattli and Woods, 2009, p.5) A similar framework was used by Büthe and Mattli (2011, p.19) categorising the supply of institutional rule-setting as private or public, and the selection mechanism (demand) as market or non-market based.

3. Hall and Biersteker refer to authority as "institutionalised forms or expressions of power" (2002, p.4). Whilst they do not consider states as the sole or dominant source of authority, in the case of ISA, private regulation of FDI takes place ostensibly through treaties, i.e. in the name of states; the legitimacy of ISA is based on the states' consent derived from BITs. The agenda was set and the early draft BITs were prepared by private authority - lawyers acting in association with TNCs and IOs. It is possible that the ambiguities in the BITs were deliberate so as to persuade the developing countries to accept the drafts without much negotiation; any attempt to modify customary international law would have resulted in much wrangling. If the developing countries had believed that they were offering ISA to all and sundry foreign investments, it is doubtful that they would have signed scores of BITs. It is clear from the jurisdictional challenges in case after case that states tended not to accept ISA jurisdiction voluntarily. However, it is not necessary for

the argument in this thesis to suggest that the drafting of the BITs was intentionally misleading.

4. The ambiguous provisions in most of the early BITs could have led to a narrow or a wide interpretation but most arbitrators chose the expansive alternatives. Again, the lawyers' close associations described in this thesis are not alleged to be collusive machinations. Social interactions between legal actors can bring about systemic changes in law (Katz, 2010, 460-3), and ISA has cohesion in its professional community. The tool used for bringing about sweeping changes in international investment law was the interpretation of consensual, agreed instruments. The radical changes in the global economy facilitated the process.

5. One factor that the ISA decisions emphasise is the acceptance – tacit or explicit – by state actors, of SPEs routing investment through various SCCs. Helleiner's reminder not to forget the states' role in the financialisation of the global economy in the 1990s is pertinent to the evolution of ISA and, indeed, the effect of SCCs thereon (Coleman and Sajed, 2013). ISA arbitrators usually rely on states' acts and omissions when determining jurisdictional issues.

6. Van Harten (2005) has illustrated how ISA authority was private by referring to the legal structures used. In the operation of BITs, home states need not be involved politically (Montt, 2011, p.1). Investors directly challenge the policy decisions or actions of a host government, or even the judicial decisions of national courts. Given the non-state actors' involvement in it, BIT law has been called hybrid (Douglas, 2004). Another perspective is of Mills (2011) that the system is neither public nor private but simultaneously a complex union. Roberts (2013) believes that the field is still young and that it may generate its own identity like that of a platypus which had the characteristics of a bird, mammal and reptile. This thesis proceeds on the basis that international investment law is, in essence, a private law even if in public vesture – an example of a “historical bloc” (Saul, 2012, p.328). The practices, rules and norms are being created for the benefit of private investors mainly by private authority albeit in the name of the states. States were not the originators of BIT development. Despite the size of its economy, the US did not conclude its first set of ten BITs until the period between 1982-86 (Vandeveld, 1993, p.622) by which time there were 194 BITs between other nations.

7. It has been argued that with its roots in treaties, ISA is part of public international law and that the arbitrators' authority is ‘delegated authority’ of the states (Panitch and Gindin 2012, p.232). The delegated authority appears to be based on states' consent derived from an interpretation of ambiguous BITs. Some BITs might have been adopted in the same manner as in a contract of adhesion or on a ‘take it or leave it’ basis, or without full understanding of the implications of their arbitration provisions. Yet, *contra proferentem* interpretation is not part of investment treaty law.¹

Under domestic law, most states offer remedies to alleviate the harsh terms of adhesion contracts, e.g. the English Unfair Contract Terms Act, 1977. Ironically, BITs were designed to protect investors against arbitrariness by states, but provide no protection to states against investors' arbitrariness or unfairness. Given the long durations of BITs, states cannot terminate their obligations if they become too onerous for reasons outside their control as the home states might not agree to an early termination or a revision of a BIT. Unless states have been sophisticated in their negotiations of BITs, their control on the direction taken by ISA is removed entirely to private authority while BITs remain applicable (and this they do for a considerable length of time, even after their termination).

2.3 Diffusion of BITs

8. The question addressed by several scholars revolves around the reason why developing countries signed BITs that hurt them (e.g. Guzman, 1998). A competition to attract capital features prominently in the answers. The literature on diffusion includes:² Büthe and Milner (2014) on how trade agreements affect FDI; Posner and Sykes (2013, p.292) on a prisoners' dilemma for the developing states;³ Montt (2009, p.118) on network externalities⁴ (during 1959 to the late 1980s only a small group of initial users signed BITs followed by a bandwagon effect); Poulsen and Lauge (2014, also see Poulsen and Aisbett, 2013) on bounded rationality framework (to explain why competing developing countries adopted modern investment treaties with inflated expectations about their economic benefits); Guzman (1998, 2006, 2008) on rational competition model; Van Harten (2005) on the debt crises of the 1980s as a structural factor, and Elkins et al., (2006) on competition and economic pressures among developing countries to attract foreign investment.

9. Büthe and Milner (2014) address the reasons for the positive empirical association between Preferential Trade Agreements (PTAs) and FDI. There is more variation in the dispute resolution clauses in PTAs than in BITs. They conclude that PTAs with investment provisions attract significantly more FDI than PTAs without such provisions (2014, p.112). Some PTAs like NAFTA have a chapter on investment protection embedded in them. Büthe and Milner (2014) test the assumption that signing BITs was expected to increase incoming FDI. Tobin and Busch studied the relationship between PTAs and BITs to conclude that BITs "raise the prospects of getting a North-South PTA with all the deeper and reciprocal obligations that these entail." (2010, p.31). A comprehensive study of the effect of BITs and Double Taxation Treaties (DTTs) on FDI flows was carried out by Sachs and Sauvant (2009), again, citing the uncontroversial theory that DTTs and BITs were signed in order to attract FDI.

10. Arguments relating to diffusion and competition are difficult to prove or disprove (as their

proponents tend to accept) and many are based on an assumption of a free choice for the developing countries. This itself is doubtful given the evidence of the debt crises of the 1980s (see Chapter 9). Büthe and Milner point out that roughly 55% BITs are between a poor host country and a rich home country (2014, p.4). This must entail an inequality of bargaining powers. Although they refer to the general belief that BITs seek to provide a stable investment climate, they acknowledge that it is by no means certain that simply signing BITs necessarily increased FDI in-flows (also see, Büthe and Milner 2008).

11. Competition models can be simplistic as there were alternative options for risk-mitigating such as, for example, internationalised contracts (Yackee, 2008; Alvarez, 2011). Tobin and Rose-Ackerman (2011) conclude that each additional BIT would have a reduced marginal ability to attract capital. Montt rightly questions why the content of BITs did not become more and more investor-friendly as a result of a competition between states (2009, p.110).

12. The studies seeking to prove a relationship between BITs and FDI-flows are of a limited value because of the reality of SPEs and SCCs used to channel capital flows. Whilst BITs may increase the options available to a foreign investor, in theory, one BIT with a host state is sufficient protection and even that need not be with the investor's home state. Brazil has not ratified a single BIT of the twenty or so BITs that it has signed, and it was one of the top recipients of FDI for a number of years in its region; sub-Saharan Africa had difficulties attracting FDI despite entering into BITs. Ireland has no BITs in force but has had no difficulty attracting capital; it had signed one BIT with the Czech Republic which was terminated. Cuba attracted substantial FDI from Canada and Mexico without any BITs with these countries (Hallward-Driemeir, 2003, p.9). Hallward-Driemeir concluded that BITs would be more likely to be effective in attracting FDI where the host state had well-established legal institutions but then the BIT protection is somewhat redundant. Existence of natural resources appears to be a relevant factor for FDI inflows.

13. Whether or not FDI follows on signing of BITs is perhaps not the right question. Despite the 6100 odd treaties in existence today (including BITs, FTAs, PTAs, etc.), a further 14,100 treaties would be needed to cover all possible bilateral relationships (UNCTAD 2011, p.7). The question assumes, wrongly, that when a treaty is signed between say Pakistan and the US, FDI would flow directly from the US to Pakistan. Haberley and Wojcik (2013) found that according to the IMF data when Ireland had inward FDI of \$19 billion from the US, the US records showed outgoing FDI to Ireland of \$158 billion. Not all FDI is truly foreign, some being host-country capital on a round-trip. Further, the competition based models do not answer what the rich states' motivation was for their BIT-signing spree. This is pertinent since it has been shown that BITs tend to be signed on the terms proposed by the rich states (Allee and Peinhardt, 2014).

14. Allee and Peinhardt (2014) suggest and evaluate three explanations for the design of BITs, namely, the need for the host states to show credibility, the power and preferences of capital-exporting home states, and rational design. They do not treat the first two explanations as two sides of the same coin; their study indicates no support for the credibility option. They found that BIT negotiations are likely to occur on the terms set by the home state (2014, p.62). They also consider the areas of variation across treaties after codifying all available treaty texts between 1959 and 2006. The rational design approach was set out in the 2001 *International Organization* special issue but had not been empirically tested on large N. No support was found for the rational design prediction for variation across BITs. They conclude that the design of BITs seems to be determined more by the characteristics of the home state than by any features of the host state; evidence that enables them to conclude that power politics is very much alive. They conclude that the more powerful BIT signatories knew what they were designing (2014, p.82). Their contribution is valuable in taking forward the debate from the generalities of BITs to testing against variations, but their approach remains state-focused. Interests of private authority in home state are merged with those of the state actors. Their study also ignores the effect of the thicket of SCCs, DTTs and BITs that enables the making of indirect investments. The way BITs are used by TNCs thus adds an element of random dynamic that may not be captured by the statistics.

15. Whatever the reason for the diffusion of BITs, the acceptance of ISA, particularly for indirect investments was the effect of the arbitrators' interpretations of BITs. States may well have misunderstood the nature and function of BITs; there is some evidence to support this (Chapter 9). If BITs were signed to attract FDI *by providing an option of ISA*, the developing countries were unlikely to have included debts and portfolio investments in the definitions of eligible investments. If the objective of a BIT between a capital-exporting country A and capital-importing country B were to promote FDI to country B, a reasonable assumption would be that an investor from country A would be eligible for ISA if it owned 10% or more of the ordinary shares or voting power of an incorporated enterprise or the equivalent of an unincorporated enterprise in country B, and vice versa. As it was, the minimum requirement of 10% ownership for FDI (the common definition of FDI) did not find an expression in most BITs. Most investment flows in the global economy after 1990 were *indirect* through SCCs offering tax and other regulatory advantages. This makes it difficult to identify a home state for an investment: the same investment could have several home states some of which had no BITs with the host states. Most 'indirect' investments are held eligible for ISA. What significance then remains, if any, of the *bilateral* nature of the promises in BITs and the objectives to promote *mutual prosperity*, if the ultimate investor need not have much of a connection with the signatory state to the BIT?

16. BITs were promoted by IOs as part of a campaign to improve the investment climate of the developing countries. They were, at least partly, a political compromise by the cash-starved and heavily indebted developing countries. Sornarajah (1994) and Guzman (1998) were questioning why countries signed BITs containing stronger protection than that offered by the Hull rule (prompt, adequate and effective compensation), and the suggested answer was their desire to attract FDI. Yet, the definitions of investment never referred to FDI (e.g. 10% or more ownership). Arbitrators do not concern themselves with FDI because BITs do not refer to them. Many BITs themselves seem to refer to indirect investments, and despite the potential for an indefinitely long chain of investors the arbitrators have not placed a cap on the number of links. In their interpretations, an investment is an ISA-eligible investment unless the state had carved out a specific exclusion. The developing countries do not appear to help their own case when they accept investments by TNCs channelled through tax havens via SPEs. Arbitrators hold that such SPEs have a legitimate business – e.g. that of *holding* other companies.

17. Although the developing countries might have competed for capital, there is not sufficient research on the roles played by the London and Paris Clubs, or the IMF or the large investors (be it oil companies or other corporations). The World Trade Institute launched a program in 2010 to promote research with a focus on, *inter alia*, new paradigms in the economics and political economy of international investments as well as the interaction between international trade and investment regulation (Echandi and Sauve, 2013). Their focus is on new actors and new forms of investment (e.g. non-equity modes of investments).

18. Simmons (2014) compares BITs with the institutions for the protection and promotion of trade; her intention is not to test an explanation for the differences between the two regimes but to explore the consequences for governance. Simmons considered the evidence that BITs may have under-delivered investment and that ISA may be contributing to the expansion of the already asymmetrical legal rights of investors. Simmons (2014, p.30) also found that slow economic growth renders potential host states more willing to accept BIT constraints and that disputes come at the worst possible times when macroeconomic conditions are unstable. Although Simmons focuses on state actors, she acknowledges the comments of Alvarez (2008, p.959) that the emerging arbitration case law is at least as much “a creation of corporate investors as it is of the states that enter into BITs.”

19. Vandeveld (2010; also see Ghouri 2011) has followed the evolution of BITs and argues that access, reasonableness, security, non-discrimination, transparency and due process are the six core principles of BITs, all but ‘access’ having ‘rule of law’ as a common element. The elements he cites are valuable from the perspective of investors. BITs place foreign investors in a special,

unequal position compared to national investors; there was not much public debate when signing BITs; most arbitration cases are confidential even if the public purse pays the awards; and it is arguable that BITs create unreasonable norms in granting any and all investors substantial privileges without any obligations. Using Bingham's (2011) principles, BITs do not qualify as rule of law. Further, Vandevelde refers to Abs and Shawcross, both of whom had close connections with Shell, the British and German governments, and various international organisations.

20. Moran's (2011) suggestion to look at FDI in detail (given its different effect on various sectors, such as extractive, infrastructure, manufacturing, services, and so forth) neither appears to have occurred to those who drafted BITs or the Convention, nor to the IOs who promoted ISA for all sectors alike. Such lack of attention to detail of an enforceable provision was not typical of developing countries in the 1980s. Moran's work coupled with the analysis of ISA cases in this thesis shows the need for bespoke solutions to investment issues. His recognition of the moral hazard (and how political risk contracts are interpreted and arbitrated) is also applicable to ISA. Recognising and allowing marginally legal structures to access ISA discourages mediation or re-negotiation when a contract faces unforeseen difficulties, or is found to have been based on an unrealistic foundation. It also discourages the making of fair contracts in the first place.

21. Williams and Foote (2011, p.63) found that (a) the primacy of parties' consent to ICSID jurisdiction is in the ascendancy over ISA-eligibility being dependent on essential characteristics of an investment, and (b) the requirement that an investment constitute a significant contribution to the host state's economy has been severely diluted if not eliminated. These findings are confirmed in this thesis although the focus here is on the role of SCCs. Also, the consent is not really given by parties as much as being inferred from BITs or investment laws.

2.4 Asymmetries and criticisms of ISA

22. The legitimacy, accountability and transparency of BIT arbitrations have been increasingly questioned in the last decade or so. This discourse is not focused on the effect of SCCs. Several inherent structural asymmetries relating to BITs have been addressed by Sornarajah (1994, 2011), Montt (2009) and Van Harten (2010). Sornarajah (2011) frames the current position of international law using the concepts of *normlessness* and conceptual chaos. Arbitration practitioner Berman (2011) sees the system as still being in the process of evolution. Schneiderman (2008) suggests a constitutional framework and accepts the constraints faced by states.

23. Van Harten (2006, 2010, 2013, 2014) has done extensive work on the systemic bias in arbitration tribunals and casts international investment treaty law as global administrative law. Van Harten's work is an impressive overall critique, particularly comparing the awards of ISA

arbitrators with domestic judicial review cases. Kalderimis (2011, p.157) deals with global administrative law issues, and Mills (2011) with the public-private conflicts and uncertainties – the fault lines - that underlay the BIT arbitration community.

24. The framework of BITs and ISA favours investors, but even where choice existed to construe ambiguous provisions of BITs, most arbitrators appear to have chosen investor-friendly interpretations. This has been documented by legal critics of the system such as Van Harten (2012) (showing systemic bias using content analysis) and by Sornarajah (1994, 2010). They are not wrong, even if there are detractors of this view. Most arbitrators believe that they interpret BITs in an impartial manner – neither in favour of the investors nor of the states, so that any resulting asymmetries are the result of bad drafting of BITs by states. Puig (2014) applied networks analytics to arbitrator appointments to find explanations for the mainly ‘white, male’ club of arbitrators.

25. Brown (2015) shows how neoliberal rationality has changed over time from a productive to increasingly financialised economy and warns of the dangers of economizing the spheres that were previously democratic. She flags up its plasticity (availability to reconfiguration) as an important characteristic. ISA has followed this pattern by proving to be remarkably amenable to change at the instance of arbitrators some of whom wish to push it further towards increased autonomy. Rule of law is a tool that uses the myth of a state’s consent for initial legitimacy, while working to obtain complete freedom from it.

2.5 SCCs

26. This thesis relies on the conclusion of Palan et al (2010) that offshore *is* the global economy. The list of SCCs used in this thesis is largely based on the tax havens set out by those authors. The wider expression SCCs enabled this thesis to develop the idea that some loci that might not be considered tax havens effectively function as such, at least for certain sectors, for example, Canada for mining companies. The enquiry in this thesis was also informed by the eclectic collection of writings of Tett (2009), and several prominent globalisation thinkers/authors including Strange (1997, 1998), Anghie (2005), Klein N. (2007), Sassen (2007), Picciotto (2011), Mazower (2012), Koskenniemi’s history of international law (2001 and 2012) and Brown (2015).

27. Holding companies and SPEs are used as the building blocks of the global economy and most ISA arbitrators assume that there is nothing wrong with this. The structures are legal and there is the rub. Encouraging them for one purpose allows them to thrive potentially for illegitimate purposes. ISA arbitrators try, but it is difficult to distinguish between a sham and a legitimate shell company. SPEs’ role in the previous financial crisis and also generally in skewing markets is part of the essential background for the work in this thesis. There was a recent \$50 billion ISA award in

favour of *Yukos* investors who had used opaque, offshore structures; the award was set aside in the Hague on the basis that Russia has not ratified the ECT under which the arbitration took place.⁵ The arbitrators had upheld jurisdiction despite the lack of ratification of the ECT.

28. Shaxson (2012) wrote how powerful in, and how essential to, the global economy the tax havens are. His work puts into perspective the demands for equality and fairness by TNCs in ISA that are often framed in moralistic terms (e.g. states cannot be excused from having to keep their promises even if they become onerous) while the same investors are enjoying the benefits of tax havens in their operations (not just tax optimization schemes but also transfer pricing, secrecy, and so on). Shaxson's (2012) estimate of the total worldwide annual loss of \$255 billion to such strategies is significant.

2.6 ISA as part of multi-layered global governance

29. Following Picciotto's (2011, p.448), conceptualising, this thesis analyses whether, and if so how, the indeterminacy of the texts of BITs provided the space for the deployment of legal tools (e.g. interpretation) and other basic norms (e.g. consent) to regulate policy preferences in international investment law. Although the language of ISA is rooted in consent, sovereignty and treaties, ISA is unique in that states' consent is no longer needed for revisions or alterations to the process; far-reaching changes are implemented using interpretation.

30. Multi-layered governance of ISA is divided in this thesis into an operative and a normative system adapted from the model of Diehl et al (2003). For example, BITs themselves include the normative part (e.g. provisions against expropriation). The Vienna Convention on the Law of Treaties (VCLT), the Draft articles on Responsibility of States for Internationally Wrongful Acts, (the draft Articles), 2001, and the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards, 1958, (the New York Convention) are parts of the operative system although they too contain norms which provide the structural framework used in other norm-making. At least the initial drafting of the operative norms was predominantly in the hands of lawyers and IOs like the International Chamber of Commerce (ICC).

31. There is some overlap between the operative and normative systems as seen in the 'attribution' doctrine used by BIT arbitrators. Actions or omissions of all sub-national entities, State Owned Enterprises (SOEs), agencies with any state control, civil servants, government ministers, or judges are *attributable* to the central government - the only subject recognised at international law. This is set out in the International Law Commission's (ILC) draft Articles.⁶ The draft Articles are cited and relied on by arbitrators *as if* they codify operative international law. This is on the basis that they simply suggest what the international law is. However, their effect is normative and

expansive. For example, federal states whose constitutions set out separate fields of power for sub-national units are responsible for the actions of sub-national units over which they have no *de facto* control. The potential, and now actual, use of the draft Articles in ISA was perhaps not always obvious to state representatives. The UN did not call a treaty-making assembly on the express recommendations of the ILC.

32. Sassen's (2002, p.92) idea of embeddedness of the global in the local economies is relevant here. States' role continues to be important to provide the domestic and international operative framework. The global is embedded in the national economies but behind a heavy protection of international investment law against local risks. This protection is not simply against egregious forms of governmental misconduct (Sattorova, 2012) or singling a foreign investor for arbitrary treatment. This is clear from the circa fifty ICSID arbitrations against Argentina arising out of its national financial emergency.

33. National courts will, and do, enforce awards rendered under rules other than ICSID, and thus 'enable' BIT arbitrations; ICSID awards are enforceable as if they are final orders of courts, but still need assistance of state's power in the actual enforcement of the final awards. Other area of possible court interference is the provision of interim relief (for example, maintenance of status quo pending the resolution of a dispute or obtaining evidence from an unwilling witness) but increasingly, arbitrators themselves devise and grant interim relief creatively, minimising the need for reference to national courts. In this way they promote arbitration as a self-contained legal order.

34. Contrary to the radical changes in the normative functions after 1990, the operative system of BITs has not changed. BITs are signed between two states and third party investors are beneficiaries of the regime. Alternatives to ISA could have been developed (as for instance, giving foreign investors direct access to ICJ). The EU has recently proposed an international investment court for the Comprehensive Economic and Trade Agreement (CETA). However, the general trend in all trade and investment treaties as well as other businesses is towards private dispute resolution. Indeed, arbitration is provided, at times with an opt-out but mostly on a mandatory basis, even in day-to-day transactions people enter into with private corporations like Dropbox or credit card companies. The "proliferation of private ordering" is "undoubtedly occurring inside and outside the nation-state" (Zumbansen, 2013, p.128). This is why 'private authority's expansion' is an important area of study.

2.7 Key Concepts

35. This thesis stretches the meanings of two core concepts in global governance namely, private authority and IOs. Further, unless identified as FDI or otherwise in the context of a case

study, direct investments refer to home-host state routing of investments and indirect investments mean those that take a route through one or more non-signatories to a BIT. ‘Seats of corporate convenience’ is a phrase coined for this thesis and is discussed in Chapter 5.

36. There can be disagreements over the precise meanings of “private”, “authority” and “private authority” (Hall and Biersteker, 2002, p.203) as the public-private boundary is not always easy to draw. This thesis seeks to add to the provisional typology beyond the trinity of market, moral and illicit authority identified by Hall and Biersteker (2002, p.217) to include ISA arbitrators’ private judicial authority. Hall and Biersteker place Cutler’s private collaborative authority as a subtype of market authority, and this may be appropriate for purely commercial arbitration norms,⁷ but it is not precisely the category in which ISA fits easily. It is the host states’ national courts’ jurisdiction that ISA arbitrators supplant.

37. Strange’s question ‘*cui bono?*’ is pertinent to this thesis. While, some states may win some actions or issues in some actions, they tend to be the respondents in ISA. BIT arbitration was not originally promoted by powerful states in their own interests.⁸ One signatory state (capital-exporting) to the BIT usually has no further involvement with the actual dispute resolution over the long duration of BITs. The regime was designed and evolves for private TNCs, the main users of ICSID arbitration, and benefits bankers, third party funders, the ICSID Centre, and the arbitration industry. This thesis identifies authority of ISA arbitrators as essentially private judicial authority (not hybrid), for the norm-making part of the regime. It does sometimes interact with other forms of private authority (e.g. NGOs’ moral authority as *amicus curiae*) and uses the operative norms in its advancement.

38. Unless otherwise expressed in the thesis, the generic expression IOs includes along with the IMF, the UN agencies (e.g. UNCTAD, the United Nations Commission on International Trade Law (UNCITRAL), the World Bank, and the private institutions, such as, the ICC and other arbitration providers.⁹ The arbitration providers’ activities are influenced heavily by the leading arbitrators.

2.8 Contribution of this thesis to knowledge

39. The literature reviewed in this Chapter confirms the fact that ISA has not been analysed through the lens of SCCs. The possibility, albeit not the timing, of a global financial crisis (in which SCCs played a key part) was foreshadowed by some GPE authors before 2008, and there is some agreement on the capture of the global financial regulatory policy by private interests (Helleiner, 2011). It is an important backdrop against which other international investment decisions of states and TNCs should be studied. For example, almost fifty ISA cases against Argentina did not spring up simply from the unilateral acts or omissions of Argentina; the crisis in that country was part of a

continuum since the 1990s in which many other actors have played a part, and some of whom are not accountable for their contributions (e.g. private TNCs and IOs). In a similar way, the structural position of the SCCs in the global economy makes it essential that their effect on ISA is considered so that any further decisions (on the need of private authority of ISA and of bilateral instruments for promoting or protecting investments) are taken in light of the criticisms of ISA in the literature but, more importantly, the essential characteristics of modern investments and investors. In an interdependent economy, both home and host states need to consider whether they need to carry on with a pretence of a bilateral system designed for a radically different economy.

40. Powerful TNCs using the privileges of SCCs have had an enormous influence on international investment law. Yet, SCCs, like the proverbial elephant in the room, are rarely part of the discourse on ISA. States are concerned about the effect of SCCs, especially the tax havens, on their economies if we consider their public rhetoric and that of the IOs'. The existing literature as surveyed above indicates that it has not examined the influence of tax havens or SCCs on the norms being developed in ISA. To the extent that this study highlights the number of ICSID cases in which investments were indirectly routed, the number of cases using corporate forms such as American LLCs, the number of BITs and DTTs signed by SCCs, and the amounts of FDI inflows and outflows from SCCs at key times (e.g. 1970, 1990, 2007), it is empirical. The thesis is analytical in other respects in that it seeks to show how the use of SCCs has affected the scope of ISA and it relies on case studies to show the complexity of the use of SCCs. The literature (for example, Williams and Foote, 2011) largely focuses on the terms of BITs that define investors and investments, and their interpretation by ISA arbitrators. This thesis highlights the fact that the interpretations are not in keeping with what was drafted, promoted and agreed to.

41. The thesis shows how the transfer of national judicial authority to private arbitrators is continually advanced both by TNCs' use of SCCs, and the arbitrators' jurisdictional determinations. The process is supported by states playing a passive role by signing long-term BITs that are neither carefully drafted nor revised timely. This thesis also shows the lack of a justification for providing indirect investors access to ISA on a *bilateral* basis (in BITs) when majority of investments are not from a home to the host state. The original justification of BITs attracting FDI no longer applies as the origin or destination of funds is irrelevant to ISA eligibility, and can be manipulated. The pre-liberalisation states economies for which BITs were designed are long replaced by neoliberal economies in which states' powers are circumscribed by other actors.

42. This thesis also advances the current scholarship on how at critical junctures, close association of private actors set the evolution of ISA on an expansive path in disregard of the objectives of BITs. The close association involved a few arbitrators working together as counsel,

arbitrators, promoters of certain views, writers, etc. In the small field of arbitration, this would have been enough to support new concepts or interpretations. There was an alternative and a more reasonable interpretation of BITs that the arbitrators did not choose, thus helping to legitimise TNCs' use of SCCs and SPEs. It illustrates, through case-studies, how the evolution of ISA appears to have become path-dependent because of the interpretations of gateway clauses. Once sufficient number of arbitrators took a united view of certain terms, their expert views were not challenged. This thesis also corroborates the argument of Palan et al (2010) that offshore is an integral part of the global economy.

43. Even if states accepted the existence of SCCs and their structural role in the global economy, there is not enough evidence that they intended to accept SCCs for the purposes of arbitration - a special mode of dispute resolution, usually dependent on express consent. If BITs were designed to stimulate *all* types of investments, they could not have been designed also as arbitration agreements without leading to an unreasonable or manifestly absurd interpretation, something to be avoided according to Article 32 of the VCLT. In principle, such an interpretation would enable the transfer of a potentially large number of disputes from the national to the international realm of ISA. The fact that this is not routinely used may be currently a function of the high cost of ISA (with mass claims this may not be an obstacle for long), and the lack of widespread awareness of its potential. For example, a lawyer recently commented in the news about a new tax on the non-Canadian purchasers of residential estate as being in contravention of investment treaties (Appleton, 2016).

1 The rule *contra proferentem* is not entirely unknown in international law: McNair, 1961, at 464-5.

2 As will be discussed in Chapter 3, there was a sudden rise in the 1980s and 1990s in the number of BITs being signed. In 1997 alone, 153 BITs were signed, one every two and a half days (Panitch and Gindin, 2012, p.244).

3 The other explanation offered by Posner and Sykes (2013, p.293) is that the developing countries might have wished to exploit existing sunk investments by insisting on weak protection under customary law but individually could not guarantee receiving future investments without offering further protection to the investors.

4 A change in the benefit, or surplus, that an agent derives from a good when the number of other agents consuming the same kind of good changes.

5 "Dutch court overturns 50 billion Yukos ruling on jurisdiction" *Bloomberg* 2 April 2016. Retrieved from www.bloomberg.com.

6 The rapporteur James Crawford is also one of the well-known BIT arbitrators.

7 Commercial arbitration is between two consenting parties acting in purely commercial interests; ISA can be commenced against a state even when that state was not a party to the original investment agreement.

8 Panitch and Gindin (2012, p. 231) argue that the US model BIT was the institutional innovation that made it possible to transplant the "regulatory takings" doctrine from the domestic US legal system into public international law. However, BITs originated before the US took much interest in them and the US has not signed many BITs relative to other countries and the size of its own economy.

9 For example, the Swiss Chamber of Commerce, the American Arbitration Association and the London Court of International Arbitration.

3. Making of the Operative Norms

3.1 Introduction

1. This Chapter briefly covers the factual and legal background of the rise of international arbitration at the beginning of the 20th century, and why this was not sufficient to address the nationalisation disputes. It recounts the close association between IOs and the ICC. This, with the support of developed countries, led to the creation of the ‘operative’ framework of the New York Convention that would turn international arbitration into an effective remedy for any cross-border dispute. It is not restricted to ICA awards; it can be used to enforce non-ICSID ISA awards. The International Council for Commercial Arbitration (ICCA) and the Permanent Court of Arbitration (PCA) have published, in 2011, a handbook for national court judges that confirms the pro-enforcement bias of the New York Convention and warns them that a non-recognition of a New York Convention award can amount to a breach of international law under a BIT. The ICCA members are dispute resolution specialists. It has an official NGO status at the UN, and it participates in the UNCITRAL meetings. All leading arbitrators regularly attend the biennial ICCA meetings.

3.2 States’ power to nationalise property

2. China challenged British East India Company’s monopoly on trade (exchanging opium grown in India for silver coins) in Guangzhou (Canton) by seizing two million Pounds worth of opium in 1839 (Melancon, 1999). The British gunboat attack, following the failure of negotiations, was led by the *Nemesis* owned by the East India Company and manned by a few officers of the Navy destroyed Chinese war junks in 1841 (Hall and Hutcheon, 1846). Britain secured the island of Hong Kong, and 12 million silver dollars compensation, half of which was for the opium destroyed by China (Hansard 1842). Despite the merchants’ illegal trade in China, the British government assisted in the recovery of compensation. The opium war was a classic example of gunboat diplomacy and an illustration of a harmonious joint endeavour by public and private powers. There was an older remedy available to British foreign investors from 1295 - ‘letters of marque and reprisal’. State’s cooperation with property owners thus has historical precedents. Yet, property rights were never absolute.

3. Property rights of individuals depend on the domestic laws of host states that can create, modify or destroy them (Friedman, 1953 and Kaeckenbeek, 1937). Disputes over such rights are within the jurisdiction of the domestic courts.¹ Expropriation of property was known in Italy in the 1100s, or in Germany from the 1300 onwards (Hübner, p.256). It usually was for a “public

necessity” and on payment of compensation (Reynolds, 2010, p.100). Private corporations did not always abide by this principle in the colonies they administered. Entire kingdoms were taken over by the British East India Company, without the payment of adequate compensation, under the doctrine of lapse invented in the mid-19th century; the Company would annex a kingdom if it decided that its ruler was incompetent or that the ruler did not have a legitimate, biological male heir.

4. The power to nationalise property, including that owned by foreigners, is an undisputed attribute of states’ sovereignty as recognised by the UN General Assembly in 1952. Most property is subject to state’s power, for example, to impose tax, or to permit compulsory purchase of property for widening a highway, etc. ISA’s origin was based on the fear of expropriation of investors’ properties by developing countries, but investors’ own countries had used expropriation policies from time to time. For example, France has nationalised banks, car manufacturer Renault, electricity enterprises, and the UK has nationalised rail, coal, electricity, iron and steel industries although some of which were later privatised. The US Gold Reserve Act 1934 made it illegal for individuals to own gold; the US Treasury acquired such gold at a fixed price (Rosemeyer, 2002).² Foreigners in the US had to surrender their gold too (Nussbaum, 1954). Resources grew in importance by 1918 (Costigan, 1918) but the Friendship, Commerce and Navigation (FCN) treaties designed for traders were not believed to be adequate (Walker, 1958), particularly for the oil investors due to their concerns over “obsolescing bargains” (Vernon, 1971, p.46).

5. Prior to the globalization of the 1870-1913 period, national wealth and power depended on international trade, which, in turn, depended on the capacity of states’ naval forces that protected the merchant ships. International merchants had used commercial arbitration extensively in England.³ Expert arbitrators made final and relatively quick determinations being familiar with issues such as bills of lading, demurrage, lay-time, stowage, and the customary roles of the actors involved. These were purely commercial arbitration cases in which the advantages of arbitration over court were recognised by the parties that voluntarily opted out of the court’s jurisdiction.

3.3 State-to-state arbitration

6. According to a 1928 memorandum by the historical adviser of the British Foreign Office (UK Cabinet Memorandum, 1928), the first state-to-state arbitration was between the British and the American Governments under the Jay Treaty of 1794 over issues of war-debt and the boundary between the US and Canada. The memorandum noted that international arbitration was acceptable for both international and internal issues. It was believed that in respect of some disputes a decision by either party’s court might not be as acceptable to another state as an international arbitration

award, and that an arbitration verdict might be more acceptable if the system did not provide for *compulsory* arbitration. The *willing consent* made a difference. It was because of their experience of the advantages and limitations of arbitration that the British government, at that time, was not keen on a universal agreement for compulsory arbitration.⁴ State-to-state arbitrations tended to be about boundary disputes or private investors' claims.⁵

7. Private investors' complaints to their home government were not always justified. For example, where Don Pacifico claimed £20,000 for his property lost in a riot, the award was for a mere £147 *after* a British gun-boat intervention, and the diplomatic interventions by France and Russia.⁶ Similar was the experience of the US in the claim for \$80,000 for the ship *Virginus*⁷ which was seized by the Spanish authorities; the ship had fraudulently used the American flag.

8. With its experiences, Britain suggested that all private claims could be referred to early arbitration, thus freeing the government from having to act, possibly to its subsequent embarrassment, if the claim was proved to be false or highly inflated. Arbitrators could not make *new law* especially "on questions of large interest by which nations are divided" but they could clear the ground "by eliminating doubts as to the legal position and as to questions of fact".⁸ The first draft General Arbitration Treaty in 1896 proposed by Britain that non-territorial claims involving less than £100,000 should be submitted to an arbitral tribunal was not approved by the US. Soon, the Hague Conventions for the Pacific Settlement of International Disputes, 1899 and 1907 were concluded encouraging the use of state-to-state arbitration as a peaceful alternative to gunboat diplomacy. The Permanent Court of Arbitration (PCA) was established at the Hague (Snyder, 1962). Even for the PCA, a willing consent was necessary. Most disputes did not go to the PCA and were resolved in International commercial arbitration (ICA) whether against private or state parties.

3.4 International commercial arbitration (ICA)

9. ICA was successful primarily because its enforcement was made effective by one of the most successful multilateral treaties, the New York Convention. The ICC prepared the first draft. The draft was amended and promoted by the UN Economic and Social Council (ECOSOC). The predecessor of the New York Convention was the Geneva Protocol on the Execution of Foreign Arbitral Awards in September 1923, also drafted by the ICC. In upholding and enforcing parties' agreements for private arbitration of commercial disputes, states agreed not to enforce their courts' jurisdiction over such disputes. The Geneva Protocol imposed on a court the obligation to enforce an award made in its own jurisdiction. The goal of ICA was to have an award enforceable across borders – in any signatory country. Another Convention was signed in Geneva in 1927 to provide

for enforcement of arbitration awards in any signatory country but this treaty required the award to have become final in the country where it was made. The word ‘final’ was not defined and could lead to disputes. The New York Convention fixed the problems faced in practice.

10. Currently accepted by over 150 countries, the New York Convention makes ICA awards easier to enforce across borders than national courts’ decisions; the latter involves a myriad legal difficulties and procedural niceties. A New York Convention award has to be enforced unless the defendant objects to it on a very narrow set of grounds contained therein. Right or wrong, the decision of a private tribunal ought to be enforced because of party autonomy. ICA awards could be enforced in *any* signatory country where the defendant had assets so long as the parties had entered into a valid arbitration agreement in writing. Using the twin doctrines of *competence-competence* and separability, the Convention enabled ICA to be quite successful as a mode of dispute resolution.

11. The close association of the ICC and other IOs led to the New York Convention which was followed by a wider, looser coordination among other state actors. Further treaties were signed to provide for enforcement of awards. The European Convention on International Commercial Arbitration (the Geneva Convention, 1961) was to govern the enforcement of ICA awards between the Eastern and Western blocs of Europe. The Inter-American Convention on International Commercial Arbitration, (the Panama Convention, 1975) was aimed at ameliorating the effects of the Latin American Calvo Doctrine⁹ for foreign investors. The World Bank promoted ICA by insisting on reference, mostly to ICC arbitration, in projects it funded in the developing countries.

12. The banking sector was not originally keen on arbitration; loans were usually made with security and banks relied on courts to grant quick, interim relief to attach assets or freeze accounts. ICA still flourished using the operative framework of the New York Convention, promoted by the ICC and other arbitration providers as well as investors who insisted on an international arbitration clause in commercial cross border agreements. A large number of international commercial disputes were removed from national courts’ jurisdiction and referred to arbitration, particularly where the respondent was likely to be from a developing country. However, despite the successful evolution of ICA and carefully drafted arbitration agreements, ICA did not cover political risks.

3.5 Nationalisations

13. Oil companies usually arrange their businesses to ensure that royalties and taxes work to their advantage, benefiting oil-users at the expense of hosts (Joffe et al, 2009) but the long term concessions can lead to difficulties of enforcement. In 1938, Mexico nationalised the assets of nearly all foreign oil companies; Shell accounted for over 60% of Mexican oil production at the time.¹⁰ Venezuela would have, but did not, follow suit, but Shell had to concede generous terms to

the government.¹¹ Iran was the first state in the Middle East to nationalise its petroleum resources in 1951. In July 1956, Egypt nationalised the Suez Canal Company and its assets, rights and obligations, even those outside Egypt. The lengthy settlement discussions over the dispute showed that no amount of legal packaging would have been adequate to remove the essentially *political* nature of the dispute between the oil companies and Egypt (Lauterpacht, 1960, p.11). The 1952 UN resolution recognising the right of economic self-determination was invoked, in defence of the legitimacy of their actions, by Guatemala in 1953 and by Iran in the 1950s.¹²

14. In April 1959, the League of Arab States indicated their wish for increased participation in the oil profits by holding the first Arab Petroleum Congress at Cairo. At this time a pipeline project from Qatar to the Mediterranean was shelved because of the investors' lack of trust in the state;¹³ other investments continued to be made in the oil industry and the demand for oil grew from 1950 to 1973 at the rate of 7% per year (Parra, 2004).

15. In the 1950s and 1960s, several newly independent countries believed that neo-colonialist control was exercised through economic means (Nkrumah, 1966). While the extraction sector provided foreign exchange to the hosts, the full potential of their natural resources could not be realised for economic development because the contracts favoured the "large, vertically integrated foreign corporations" (Kirkpatrick and Nixon, 1981, p.381). A number of international contracts used to provide for the jurisdiction of say English High Court and English law to govern contractual disputes, even if the disputes arose in the territory of another country. This trend changed to the investors agreeing to hosts' laws as governing law of the contract so long as the seat of arbitration was outside the host country.

16. A number of countries became independent in the second half of the 20th century, and the membership of the UN increased from 35 in 1946 to 127 by 1970. Where European courts could confidently let private arbitrators decide, with finality, the disputes submitted to them, the new countries had to work within the constraints of their constitutions, laws, economic expectations, and currency restrictions. Parties' from these countries discovered legal strategies to delay or disrupt ICA proceedings or to challenge awards (e.g. challenges to the validity of the arbitration agreement, arbitrators' error of law, or to the award being against public policy) in the national courts with varying degrees of success. Some of these attempts were probably misguided efforts to balance the initial inequalities of the bargains or to ensure that justice was carried out in international arbitration particularly when the nationals could not attend due to cost concerns. The developing countries' lack of trust in international law was understandable, but it was matched by the western investors' distrust in the independence of the hosts' judiciary.

3.6 Summary

This Chapter briefly describes the economic tensions that were rising between the developed and developing countries and the formation of the operative norms of the New York Convention that enabled a rising number of disputes to be referred to ICA instead of the national courts of the hosts. This phase was supported by capital-exporting states who were keen not to have to get involved in investors' claims. The narrower Geneva Conventions were replaced by the New York Convention which forms the bedrock of most international arbitration proceedings by providing for effective enforcement of awards; any Convention award (whether ICA or later a non-ICSID ISA) can be enforced relatively easily in over 150 signatory countries – wherever the defendant may have assets. Along with the twin doctrines of competence-competence and separability, the Convention makes arbitration almost a self-contained remedy. Some leading SCC courts would later help along this process by enforcing awards that had been set aside by the courts of the seat of arbitration. However, ICA was not sufficient to deal with disputes relating to nationalisations which remained the domain of the hosts' courts. It was against this background that the demands for ISA first arose in the context of an oil dispute.

1 *The Panevezys-Saldntiskis Railway Case*, 1938, p.18.

2 Individuals' gold ownership was made illegal earlier on 5 April 1933 by President Roosevelt. On 31 January 1934 the President increased the price of gold to \$35 per troy ounce.

3 Arbitration goes back to 1697 in Britain. Merchants were permitted to submit an arbitrator's award to be made into a Rule of Court if it was not procured by undue influence or corruption (Raithby 1820, p.369-370).

4 UK Cabinet Memorandum (1928), p.3.

5 *Ibid*, p.4.

6 *Ibid*, p.5.

7 *Encyclopaedia Britannica* "Virginius Affair" Retrieved from www.britannica.com.

8 *Opp. Cit.* Note 4, p.10.

9 The Calvo Doctrine aims to ensure that foreigners have the same treatment as nationals so that their only legal redress should be the national courts of the host country. This principle is recognised in the Mexican Constitution. The Calvo Clause in concession agreements implied that investors had waived access to diplomatic protection and international remedies.

10 US Department of State, "Mexican expropriation of foreign oil, 1938", retrieved from www.2001-2009.state.gov.

11 Retrieved from "The Early 20th Century", under "Who we are" from www.shell.com.

12 *Anglo-Iranian Oil Co. Ltd.* (1955), p.41.

13 One American lawyer, Hendryx, argued, on the basis of domestic US law, that states could cancel a contract they had entered into if this was necessary in the public interest (Stevens, 1959).

4. A Foot-in-the-door

4.1 Introduction

1. The origin of ISA has been traced back to a draft Abs-Shawcross Convention of 1959. Contrary to the authors' expectations, the draft itself did not become a multilateral convention but its ideas became embodied in numerous BITs a few decades later. The ground-breaking ideas were promoted by private actors, Hermann Josef Abs (Abs), Lord Hartley Shawcross (Shawcross) and Hersch Lauterpacht (Lauterpacht), all associated with each other, and with Royal Dutch Shell Plc (Shell). This Chapter describes the crossing of the lines between the domestic and the international, the individual and institutional capacities, and the public and private domains by influential individuals who set in motion a paradigm change in the international investment law. The suggestion of an initial small commitment from states led to a paradigm change in international law with both state and non-state actors' involvement. Closeness of the networks continues to be a characteristic of international arbitration. The conditions in which the radical ideas got a foot-in-the-door were very different to those in which ISA flourished. The use of SCCs was nowhere near as prolific as it was to become after the 1990s, but Shell was the first TNC to use a tax haven when it opened an office in Bermuda in 1947 (Palan, 2010, p.126-7). Shell's chairman, Lord Godber, believed that the shortage of capital in 1952 was due to high rates of corporate taxation. He suggested that this compelled the industry to look to the "retention of a large proportion of its earnings for its main finance".¹

4.2 Hermann Josef Abs

2. Abs, an elite German banker (Roll, 1994), had a long business association with Henry Deterding of Shell² (Czichon, 1970, p.49). In 1948, Abs joined the supervisory board of Deutsche Shell AG (Czichon, 1970, p.167). Abs was on the managing board of Deutsche Bank during the Nazi regime. He had connections dating to the 1930s with the Bank of International Settlements (BIS). Abs might have crossed paths with Shawcross, the lead British prosecutor at Nuremberg, and Lauterpacht, the legal adviser of the team, at the time Abs was briefly held in custody at Nuremberg before being released without a charge. Abs's impressive pre-war career became legendary after 1945 (Gall and Underwood, 1999). He was on thirty odd companies' supervisory boards, on the German Committee for Foreign Economic Affairs, on the supervisory board of the Kreditanstalt für Wiederaufbau, the main distributor of the Marshall Plan funds, and an adviser to the Governments of West Germany and other countries, and of the World Bank (Gall and Underwood, 1999, p.149).³ Throughout his career he was seen to work with particular emphasis on collaboration and

networking.

3. Abs led the West German delegation in 1951-1953 to negotiate a settlement of its inter and post-war debts;⁴ he tried to set off the debts against compensation for the expropriation of German foreign assets (Pohl, 1983). In the tough negotiations, the Government representatives played little part (UK Cabinet Note 1952). Abs gave a speech in Cologne in 1954 on West Germany's improved economic position in the world.⁵ A year later, he was negotiating the return of the confiscated German property in US.⁶ In 1957, Britain was concerned about the supply of Middle Eastern oil and the spread of communism (UK Cabinet Paper 1957). Similar US concerns over the Cold War probably benefited West Germany in its debt negotiations. Abs would soon champion the strict enforcement of contracts and debts for other countries.

4. In 1958, the year that Germany signed its first BIT⁷ with Pakistan (without an ISA clause), Germany's flow of private capital abroad was still extremely small.⁸ It offered foreign aid concessions to induce developing countries to sign BITs (Panitch and Gindin, 2012, p.230) although it did not always succeed. Germany offered India a \$40 million loan at the World Bank Meeting in Washington in 1958,⁹ but they did not conclude a BIT until 1995. By early 1959, a marked change was reported in the capital market of Germany, but, German investments did not appear to be large enough for the Government to take a serious interest in the protection of foreign investors' rights and BITs.

5. In 1957, a group of German businessmen set up the German Society to Advance the Protection of Foreign Investments¹⁰ at Cologne. This society¹¹ proposed a draft International Convention for the Mutual Protection of Private Property Rights in November 1957 suggesting the creation of an International Court of Claims (Kronfol, 1972, p.32- 33). Abs had already referred to such a draft in his well-publicised speech at a meeting of the International Industrial Development Conference convened in San Francisco in October 1957 (Miller, 1959).

6. Despite some misgivings expressed on the question of common interests between capital-exporting and capital-importing states (Miller, 1959, p.375), Abs continued to promote the draft treaty and a special court of arbitration.¹² In New York in 1957, Abs spoke against increasing tendencies of states to disregard international law, citing the nationalizations of the Anglo-Iranian Oil Company (AIOC), the United Fruit Company holdings in Guatemala, and the Suez Canal Company. He submitted his draft convention at the 14th session of the Institut International D'Etudes Bancaires,¹³ to bankers from seventeen Organisation for European Economic Co-operation (OEEC) countries.¹⁴ Abs's suggestions were innovative in that banks were advised not to provide loans or capital to countries which denied fair treatment to foreign investors. It was

believed that Eugene Black, the President of the World Bank, was much impressed with Abs's draft.¹⁵

4.3 Lord Hartley Shawcross

7. Hartley Shawcross was a member of the British Parliament from 1945, Britain's attorney-general, the lead British prosecutor at the Nuremberg trials, and Britain's lead delegate at the United Nations (UN). He was a Chairman of the English Bar Council for several years, and a member of the International Bar Association (IBA). He accepted a knighthood and was made a privy counsellor in 1946. Having spoken in favour of the nationalisation of the British coal industry in 1946, his views changed when he became a president of the British Board of Trade. He presented a paper on issues of nationalisation in international law at the 5th International Conference of the IBA in 1954.¹⁶ By 1956, he was against nationalisations and his political opinions moved from the left to the right. In 1958, he quit his career at the bar and became Baron Shawcross, a life peer. Thereafter, his career was mainly as a director of blue-chip companies. In 1953, Shawcross had argued a part of the AIOC case,¹⁷ and advised Shell in its pursuit of Iranian crude oil in tankers in places like Aden, Italy and Japan.

8. Within a few years, he became a part-time legal consultant to, and soon after a legal director of, Shell.¹⁸ In 1956, he argued an arbitration case in Singapore on behalf of Shell.¹⁹ He successfully acted in a planning case in Dorset (which would not normally have been handled by someone of his seniority) for Sir Hopwood, the then chairman of Shell Transport. Due to his long association with the company, Shawcross did not charge a fee (Shawcross, 1995, p.253). Shawcross (1995, p.257) said that Shell had a very effective legal department which needed no help from him; his role had undefined responsibilities. He appeared to be Shell's ambassador, travelling around the world, meeting diplomats, and other influential persons. He sought advice of the British Foreign Office on behalf of Shell on 8 February 1957.²⁰ He also discussed with the British Foreign Secretary potential treaty protection for a proposed Middle East pipeline on 17 July 1957.²¹ Shawcross remembers Abs as a friend but does not mention Lauterpacht in his memoirs.²² Lauterpacht was also involved in advising a group of oil companies in 1956-57 over a pipeline from Iraq through Syria and Turkey to the Eastern Mediterranean.²³ Umbrella treaty protection was proposed for the agreements although in the end the pipeline project did not progress (Sinclair, 2004, p.418).²⁴ Shawcross became a full time director of Shell Petroleum Co. Ltd. in June 1958.²⁵ In December 1961, he joined Shell Transport as a director.²⁶ At the annual dinner at the Inner Temple in October 1956, Shawcross, an MP at the time, made a speech about settling international disputes and of the "regrettably growing popularity of repudiating international contracts".²⁷

9. The British Parliamentary Group of World Government (the Parliamentary Group) prepared and published a report *A World Investment Code* in 1959. This Group comprised interested members from all political parties (Snyder, 1961, p.485) including Shawcross. The Group suggested the establishment of an arbitration tribunal and possibly a specialist investment agency (at the World Bank or the GATT) to deal with international investments. This draft is attributed to Shawcross although Shawcross does not refer to it in his memoirs. He remembers both the Association for the Promotion and Protection for Private Foreign Investment (APPI) that he founded with Abs, and an earlier initiative taken by Abs at San Francisco (Shawcross, 1995, p.307). This was probably a reference to Abs's speech at the International Industrial Development Corporation in October 1957 (Abs, 1959, p.150-151). Abs originally proposed the grant of sanctions against states under a magna carta of foreign investments. But given the opposition to this approach at that time, he had to accept a moderate multilateral initiative with Shawcross (Abs, 1959).

10. The Parliamentary Group was modest in that an enforceable code was not considered achievable, albeit that the Group would attempt "clauses dealing with sanctions and arbitration."²⁸ Its aim was to create a "tradition of 'economic liberties' in this field" where none appeared to exist; something along the lines of the UN Declaration of Human Rights.²⁹ The Code was to be worked out "jointly" by the lenders and the borrowers.³⁰ Fear of communism was a relevant factor in not being too tough on the borrowing countries. At that time, the Soviet Union gave £45 million to India on relatively easy terms and £60 million to Egypt for a five-year industrialization plan. It also gave similar aid to Afghanistan, Indonesia and Syria. China gave aid to Yemen, a ten year loan in Swiss Francs worth \$16 million.³¹ This Group's minutes show how the early investment treaty was considered to be a foot-in-the-door; it would open the new field with radical ideas but not push too strongly for compulsory arbitration. This was the approach taken in the European BITs signed in the 1980s (Chapter 8).

4.4 Hersch Lauterpacht

11. Lauterpacht held a senior chair in the faculty of law at the University of Cambridge, UK. He was an expert in international law. He was involved with the formation of the ILC. (Koskenniemi, 2004). He gave techno-legal advice to the British and American prosecutors at the Nuremberg War Crime Trials in 1946 and had a hand in drafting Shawcross's speeches (Schwebel, 2011, p.331). In 1955, Lauterpacht became a judge at the International Court of Justice (ICJ). He was a critic of state sovereignty. He aspired to establish the supremacy of international law as a guiding principle of international law, however "frequent and deplorable the aberrations" in practice. (Friedmann, p.1959). The Squire Law Library holding at Cambridge University in many areas of Public

International Law was strengthened and had its gaps filled using generous grants from the Shell between 1958-1968.³²

12. Lauterpacht, in his 1930s' advice to AIOC, (after 1954, British Petroleum (BP)), came up with the concept of a host state undertaking international obligations under a treaty for the benefit of an investor. According to a memorandum by the British Secretary of State for Foreign Affairs,³³ the Persian Government and an investor, D'Arcy, entered into a 60 year concession in May 1901 for the exploitation of oil resources in Persia. After oil was discovered in commercially viable quantities, AIOC took over D'Arcy's rights in 1909. AIOC agreed to supply fuel oil to the British Navy in 1914 and the British Government subscribed to shares worth £ 2.2 million acquiring a direct interest in the dispute.

13. In 1930, Persia earned £1.288 million in royalty from Shell but in 1932, a mere £307,000 for the same quantity of oil. The Persian Government accused AIOC of fraud and falsification of accounts. The concession was cancelled in November 1932. A new formula for royalty was agreed between the parties in 1933. The US had a more equitable 50-50 sharing agreement with Saudi Arabia and remained neutral. The Persian Government nationalised the oil industry. The concession contract of 1933 included a stabilization clause against changes to the contract by general or special legislation, or administrative measures.³⁴ Britain argued before the ICJ that the cancellation of the concession was in breach of international law. The ICJ rejected the view that the settlement arrived at between the Persian Government and the investor was at the same time a concession agreement and a treaty,³⁵ the breach of the former did not amount to a violation of international law.³⁶

14. Lauterpacht's suggested solution was that the settlement agreements should comprise an investment agreement between AIOC and Iran (as Persia was called after 1935), and an umbrella treaty between Iran and Britain. The investment agreement would be incorporated or referred to in the treaty in such a way that a breach of the agreement would become a breach of the treaty. This was not a suggestion to confer a benefit on AIOC in a treaty without AIOC also entering into a contract. According to the British Cabinet Papers,³⁷ the US was keen to settle the AIOC dispute so as to avoid Iran becoming communist. The dispute was finally settled in 1954, but without the use of the umbrella treaty advised by Lauterpacht (Sinclair, 2004 p.417). Iran kept its nationalised oil industry but it was forced to sell the oil it produced to a consortium, a group of international oil companies that controlled the oil prices (Joffe et al, 2009, p.3-23). The consortium included BP, Exxon, Socony, Texas Oil, Socal, Gulf, Royal Dutch/Shell Group, and CFP to form the Iranian Oil Participants Ltd (IOP).³⁸ Although at the time Lauterpacht's advice on umbrella treaties was not followed, the IOP members and their legal representatives (like Shawcross) would have been aware of the radical ideas he had proposed and their potential power. Lauterpacht's suggestion did not

include a direct arbitration between AIOC and Iran; his combination of a treaty and an investment contract would have been enforced in a state-state arbitration.

4.5 Draft Abs and Shawcross Convention 1959 – Close association of key actors

15. Shawcross had, early in his career, tutored a Malaysian prince, Tunku Abdul Rahman, for the Bar Examinations. Rahman, after becoming the first prime minister of Malaysia (Shawcross, 1995, pp.22-23), gave an address in March 1958 at the opening session of the UN Economic Commission for Asia and the Far East recommending the drafting of a specific charter to protect investments.³⁹ Rahman's speech is supposed to have "given a boost"⁴⁰ to the Abs-Shawcross efforts, but he was quite likely influenced by Shawcross.

16. Shawcross (1995, p.308) claims to have met Abs, his "good friend", for the first time after Rahman's speech.⁴¹ The French Association de Droit Minier et Petrolier arranged a conference which led to the creation of the APPI, supported by contributions from interested banking and industrial parties. After a series of meetings, Abs and Shawcross drafted and presented a convention to the APPI (Abs and Shawcross, 1960). Shawcross remembers receiving view of "lawyers, diplomats and businessmen from five countries"⁴² that were incorporated in the compromise that the draft. APPI was a non-profit making organisation and appears to have carried on with its role.⁴³ In 1958-1959, it promoted the draft convention with Shawcross on its Directing Committee. The APPI sent its draft to the OEEC for consideration through Germany (Snyder, 1961, p.482).

17. Article II of the draft Abs-Shawcross Convention provided for an early umbrella clause: "Each party shall at all times ensure the observance of any undertakings, which it may have given in relation to investments made by nationals of any other party." The words "any other" indicate the expected multilateral nature of the treaty. The applicability of the principle *pacta sunt servanda* was not expected to be limited to agreements directly concluded between states but include those between states and investors.⁴⁴ Article VII of the joint draft provided for disputes to be referred to arbitration – by the home state, and also by the investor. The wording is consistent with the interpretation that the respondent state's consent was essential to the arbitration and possibly (as indicated by the words "the said tribunal" in Article VII(2) which could only refer to the tribunal set up under Article VII(1) between the home and host states) even with the argument that there had to be an arbitration between the home and host states.

18. The authors believed that there was nothing new in the idea of an individual having a right of access to an international tribunal, and cited examples of the rights enjoyed before the European Commission of Human Rights or the Court of the European Community. This arbitration clause was "entirely optional"⁴⁵ - a small commitment (a foot-in-the-door) - the entertainment of a

possibility of a radical concept. ICSID arbitrators would later conclude that there was no optional element to ISA in BITs. The word “investment” was not defined in the draft but “property” was defined by reference to rights and interests, and not by reference to a “contribution”.⁴⁶

19. Shawcross acknowledged the oil and mining companies’ support and initiative in the formation of APPI (also see, Galvin, 1958). A definition of property by reference to contribution to the host’s economy would not have suited the interests of the extraction industry. *The Times* in London reported on the proceedings and on the recommendations of the APPI in May 1959.⁴⁷ A search through the *Times* archives for the 1980s-90s does not bring up similar news reports about BITs being signed by Britain or other countries. The enormity of the change that ISA represented was not in the public discourse in the 1980s-90s. In May 1959, the same newspaper also reported the proceedings of the Annual General Meeting of Shell Transport and Trading Company Ltd. Godber, Shell’s Chairman spoke, “...In the course of the last year several authoritative statements and decisions have been made by international legal bodies, reaffirming the rule of international law that contracts must be fulfilled. This rule is indeed not only part of the common law of nations, but has been embodied in a number of bilateral treaties.”⁴⁸ He also referred to international judicial settlement of disputes arising out of *such* agreements. Godber’s reference to the authoritative statements by international bodies is mainly to those which were made by Abs and/or Shawcross, or by institutions of which they were members. The first BIT was not signed until five months after his speech. Given the close association of Shawcross and Abs with Shell, this is not surprising.

20. An American law professor Carlston (1959, p.407) supported the view that the territorial state was an inappropriate model for regulating “the international consequences of nationalisation”. Despite most concessions for natural resources being drafted to favour investors, his concern was that the “international society cannot endure and prosper if its law enables one member unilaterally to determine its content, to enrich itself at the expense of the another, to pervert to its exclusive advantage property which should serve an international function, or to interfere with or frustrate with impunity those expectations upon which its system of coordinated activity depends. These are the ultimate forces which bring into being in international law such principles as *pacta sunt servanda* ...”. (Carlston, 1959, p.429). Miller (1960), another American law professor considered corporations as part of private government whose reality should be reflected in the legal norms.

21. Shawcross (1995, p.308) says that as a result of the activities of his own, of Dr Abs’s group, and of the APPI, their draft attracted attention, and was recommended as a model by the European Commission (EC). It is clear from his memoirs that he was not aware of the late success of that initiative.

4.6 Draft Abs-Shawcross Convention – the gateway clause

22. Indirectly held properties were proposed to be within the draft Abs-Shawcross Convention under the widely crafted definitions. Article IX(a) of the draft defined “nationals” to include companies in which nationals of a state held, directly or indirectly, a controlling interest. Property was defined widely to include “all property, rights, and interests, whether held directly or indirectly. A member of a company shall be deemed to have an interest in the property of the company.”

23. Unlike the 1990s’ BITs, the draft Abs-Shawcross and the OECD draft were designed to function as multilateral treaties. This would have necessitated a wide definition of an investor as the investor could have belonged to Party A, controlled a company set up in Party B with a view to making an investment in Party C. As long as all three countries were parties to the convention the host state’s promises to protect investment would have been valid. Routing investments through SPEs in tax havens was not a common practice. The interest to be protected was envisaged to be a *controlling* interest. National currencies were constrained. Most investors tended to have a home country. The draft led to indirect investors and investments being included in other draft treaties that built upon it. Most BITs did not modify the wording when borrowing this model which had been designed to work on a multilateral basis. Host countries probably did not appreciate that the BIT definitions could apply to investors from non-signatory countries. The benefit from being the first-movers has been illustrated in global governance of banking (Lall, 2009).

24. A number of BITs became known as Investment Promotion and Protection Agreements (IPPAs). The word ‘agreement’ has less formal connotations than the word ‘treaty’.⁴⁹ Other operative frameworks as the New York Convention, or VCLT, or even the draft Abs-Shawcross were ‘conventions’ - highlighting the creation of new norms that the title ‘IPPA’ did not suggest. Article 38(1)(a) of the Statute of the ICJ expressly recognised among sources of international law “international conventions, whether general or particular, establishing rules expressly recognized by the contesting states”.

4.7 Wider coordination among states and non-state actors

25. At the time the draft Abs-Shawcross Convention was being discussed, the target hosts were the countries rich in natural resources, not other developing countries that expected aid or capital for their own development. For the latter, the expected capital might have come from public or private resources. The UK Parliamentary Group and the ICC agreed that there could be no “hard and fast boundary between private and public investment”.⁵⁰ In the 1940s, the International Bank for Reconstruction and Development (IBRD, later the World Bank), had a mandate to promote private foreign investment in member countries. It was looking for some international mechanism to

resolve disputes between states and foreign investors.⁵¹

26. Black, a successful banker (Lebor, 2014, p.144), was the president of the IBRD/World Bank from 1949 to 1963. He knew Abs and was impressed by the draft Abs-Shawcross Convention. Both Abs and Black were associated with the Bank of International Settlements (BIS), and in the 1960s, would work together at the Per Jacobsson Foundation in the US promoting international economic cooperation. In 1960, Black and Abs were part of a bankers' mission to India and Pakistan (Abs et al, 1960). Black was a believer in peaceful dispute resolution, having attempted to mediate in the AIOC and the Suez Canal disputes. Although the Bank produced its own Working Paper as a draft convention in 1962, its original view had been that the World Bank or the International Finance Corporation (IFC) should not be involved in drafting the convention. Instead, they recommended that associations like the UK Parliamentary Group should do the "spadework".⁵²

27. The Governments of West Germany and Switzerland presented a draft convention to OEEC.⁵³ The Abs-Shawcross draft was "toned down" (Schwarzenberger, 1969, p.153) by OEEC but remained imbalanced as it did not set out any rights of host states (Larson, 1960, p.172). Proehl (1960, p.363) had called the original draft "a statement of banker's terms sought to be elevated to the dignity of law," and believed that successive revisions still left it lacking in mutuality. The OECD released a draft Convention in July 1962 for comments by members and other interested groups. The OECD Council adopted and published the modified draft in 1967 (OECD, 1967, pp.13-60). In 1961, the Harvard Law School had produced its own draft convention at the request of the UN secretariat (Sohn and Baxter, 1961, p.545). It was proposed that this draft would be used by ILC (Snyder, 1961, p.483).

28. The reservations were directed more against the drafts than the idea of a convention as such.⁵⁴ Shawcross suggested that the hosts could protect their rights in their own legislation and by appropriate terms in the contracts with investors (Snyder, 1961, p.482). This was a little disingenuous in that the international law does not permit states to rely on national law to prove the legitimacy of their actions on the international plane. Abs rightly argued at the Société Royale d'Economie Politique de Belgique in December 1959 that once an international court or arbitral tribunal gave a decision, it was most unusual for governments to fail to carry it out.⁵⁵

29. During the 1950s and 1960s, the UN suggested that capital flows to developing countries were affected adversely by the perceptions of political risk.⁵⁶ This probably was the origin of the belief that investment protection treaties would lead to increased FDI. Standard Oil's Charles Shaw stated at the International Labour Organisation's Conference in Geneva on 12 June 1953 that \$2 billion would be available from the American private capital annually in foreign investment if "the

climate were made attractive” but among the seven conditions he set out for such a climate, he did not include ISA or an umbrella clause.⁵⁷ The US International Development Advisory Board believed that private capital was unlikely to play a major role in the development of Asia or Africa because of the “social overhead” (i.e. lack of power, communication, transportation, and education facilities).⁵⁸ Some commentators in the 1950s acknowledged the impossibility of using a draft code to create an ideal investment climate (Rubin 1956; Gardner, 1959, p.262).

30. Shawcross was probably at the 1959 IBA conference in Cologne. He had submitted a paper at the earlier IBA conference in 1954 on nationalisation. The Cologne conference in 1959 proposed a resolution that international law should accept the principle *pacta sunt servanda*. A similar position was taken by the Institution of International Law in 1950⁵⁹ and in 1958 by the International Law Association (ILA) which Lauterpacht was associated with (Wadmond, 1957, p.160). The ILA’s idea was that contractual obligations should be as binding as treaty obligations. Lauterpacht’s reply to the ILA’s questionnaire prepared for its New York Conference in 1958 was that “where a concession has acquired a certain international status, as, for example, by a provision for international arbitration or by the conclusion of an international “umbrella agreement” to shield the concession, a breach of such provisions would certainly constitute an international wrong.”⁶⁰ This reflected the advice Lauterpacht had given in the AIOC-Iran dispute. In 1959, ILC’s Special Rapporteur concluded that according to a theory “which has gained currency of late,” a state assumes the same international obligations upon entering into a contract with a private individual as when it enters into a contract with another state (ILC 1959, p.24-25). This shows that the view that the draft Abs-Shawcross Convention contained the existing customary international law was wrong. The change to apply *pacta sunt servanda* to investors’ contracts was a paradigm one. Until that time, a contract which was not between states as subjects of international law was based on the municipal law of some country.⁶¹

31. One suggestion to raise investors’ contracts to the international plane included renaming them “international economic development agreements.” (ILC 1959, p.26). Friedmann (1962, p.1147) expected the political and legal gulf between the home and the host states to widen if the focus of a convention was predominantly on protection of foreign investment (an approach characterising most of the draft conventions). The ILC agreed that the line between public and private international law was becoming obscured with the increasing international activities of large corporations, such as the oil companies. (ILC 1959, p. 28).

32. The United Nations Educational, Scientific and Cultural Organization (UNESCO) organised the International Association of Legal Science in March 1958 on the law of nationalisation. The UN ECOSOC, like the UK Parliamentary Group, found it doubtful that a multilateral investment

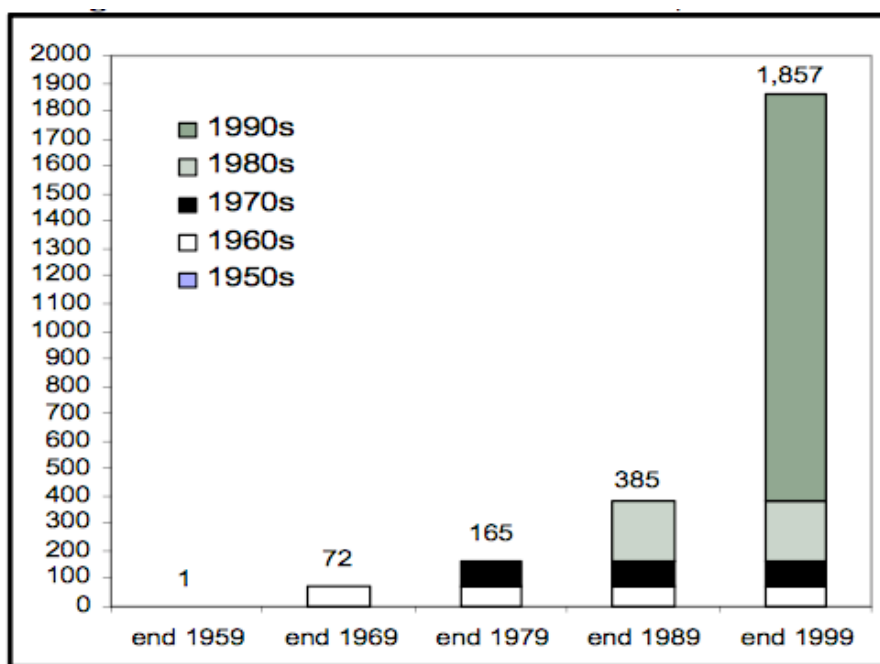
protection code would have been acceptable in the near future. It agreed that the investor should become a party before an arbitration tribunal rather than requiring the investor's government to advance his claim.⁶² The General Assembly did not take any action over this study. Shawcross (1995, p.155) was the leader of Britain's UN delegation, and knew in advance what the ECOSOC proposal would be. He wrote to Snyder with a copy of his article on the subject that was to appear in a Pakistan newspaper at the time of the ICC International Businessmen's Conference at Karachi in December 1960 (Snyder, 1961, 484). The ECOSOC report refers to the APPI, the ILA and the IBA proposals, the Parliamentary Group, the Société Royale d'Economie Politique de Belgique and Shawcross.⁶³ The ECOSOC report also refers "especially" to the "petroleum field" and the need of a self-executing arbitration clause.⁶⁴ These international organisations did not happen to have ideas similar to those proposed in the draft Abs-Shawcross Convention; they simply carried forward the discussion that had been set in motion by Abs and Shawcross. The efforts to promote a multilateral code were also supported by the following organisations: the European League for Economic Co-operation in 1958, the European Federation of Industrial Organisations, the Swiss Bankers' Association, L'Institut International d'Etudes Bancaires and the US Chamber of Commerce.

33. No multilateral convention was forthcoming in the late 1950s despite the above efforts. Germany concluded a BIT with Pakistan in November 1959 which is still in force. It did not include an ISA clause. Out of the first ten BITs, most were between Germany, Switzerland and developing countries. Several other BITs followed after the Germany-Pakistan BIT, but a real surge in the BITs had to wait until after the end of the Cold War. In 1960, Abs and a few bankers visited India and Pakistan at Black's suggestion to advise on conditions that would attract foreign private capital (Abs et al, 1960). West Germany set up its investment guarantee program in 1959, and the Japanese Government in 1956; the US program was started much earlier. These guarantees were tied to other intergovernmental arrangements that enabled the agencies to recover their payments from the host states (Kronfol, 1972, 36-37). Some states (e.g. Turkey, Cambodia, Sudan and Jordan) drafted domestic legislation guaranteeing protections to investors.⁶⁵ Even the UK was considering a legislation for the protection of foreign capital in 1954.⁶⁶

4.8 The ICSID Convention

34. The World Bank Convention on the Settlement of Investment Disputes between States and Nationals of Other States, (the Convention) was drafted between 1961 to 1965, and entered into force in 1966. This was short of what Abs and Shawcross had advocated, but they had achieved an enforceable right at international law so long as an investor had a contract with the state providing for ICSID arbitration. Dr Aron Broches, the general legal counsel of the Bank came to be known as the architect of the Convention.⁶⁷ He was a well-known Dutch lawyer and had been present at the

Bretton Woods Conference. He joined the IBRD/World Bank in 1946. Eventually, about 150 members ratified the Convention.⁶⁸ The idea that BITs should use the ICSID facilities for arbitration at least on an optional basis was raised by Broches in 1967, and followed up by the ICSID Secretariat issuing a model arbitration clause for including in a BIT.⁶⁹ Broches was the first secretary-general of the ICSID Centre and in the 1980s, also an arbitrator on key ICSID cases and a counsel on others. He played an important role in ensuring ICSID's success after a slow start. He became part of the close-association that helped to clear a few bottlenecks in the expansion of ICSID (See Chapter 11). In the 1990s, there was a sudden surge in the numbers of BITs as shown in the UNCTAD chart below (Figure 4.1),⁷⁰ and around the same time, the number of ICSID arbitration cases started to grow.⁷¹ From 1966 to 1972, no ICSID case had been registered, and between 1972 and 1989, only 25 cases were registered. In the 1990s, private actors' influence was exercised through the instrumentality of states and IOs, but not as openly as in the 1950s. In the 1960s, it was thought that (a) foreign trade helped to keep non-communist nations out of the communist bloc, and (b) hungry and poor people could become involved in armed revolution and anarchy (Snyder, 1961). This fear of communism was removed with the collapse of the communist bloc by 1990. However, it would be simplistic to claim that this was the only reason why BITs expanded.



Source: UNCTAD database on BITs.

Figure 4.1: Chart showing the increase in BITs from 1959 to end 1999.

4.9 Summary

35. If mercantile law can be said to have developed to protect international trade, BITs

developed to protect, at least initially, the extraction industry. An estimated two-thirds of the total annual amount of FDI was invested in petroleum and mineral extraction (Gardner, 1959, p.255,257). The close association of private actors set the agenda, and was followed by a looser coordination of IOs and states to bring about a paradigm change in investment law. Just as the shock of the World War I gave rise to many initiatives that would lead to international cooperation (Gorman, 2012), the end of World War II had inspired some actors to work towards peace on the economic front. The World Wars formed the backdrop to Abs and Shawcross's motivation to secure peace and progress by a "fruitful co-operation between all peoples on a basis of international law and mutual confidence."⁷²

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- 1 Report of Company Meetings: "The "Shell" Transport and Trading Company, Limited", *Times* [London, England] UK, 8 June 1953, p.13. Retrieved from The Times Digital Archive.
 - 2 Deterding was a chairman of the Royal Dutch Petroleum and then the combined Royal Dutch Shell Company for 36 years.
 - 3 Encyclopaedia Britannica "Hermann Abs", retrieved from www.britannica.com .
 - 4 Germany hoped for financial support, both from private and the US government.
 - 5 "German Need Of Stability" *Times* [London, England] 29 May 1954: 5. Retrieved from The Times Digital Archive.
 - 6 "News in Brief." *Times* [London, England] 27 Jan. 1955: 7. Retrieved from The Times Digital Archive.
 - 7 The first investor-state arbitration clause was in a BIT concluded between Indonesia and the Netherlands in 1968 (Jandhyala, et al, 2011, p.1057). By 2012, 93% of BITs contained ISA provisions, many offering a choice between different arbitration fora (OECD 2012(b)).
 - 8 "German Loan For Industrial Concern Abroad." *Times* [London, England] 25 July 1958: 13. Retrieved from The Times Digital Archive.
 - 9 City Editor. "Change In Flow Of Private Capital Oversea." *Times* [London, England] 10 Sept. 1958: 14. Retrieved from The Times Digital Archive.
 - 10 Gesellschaft zur Förderung von Auslandsinvestitionen.
 - 11 Their Statement of Purpose was: "The Society unites independent personalities in German business, law and politics, their object being to help remove the disregard of vested foreign rights and interests in international business ...": quoted in Miller (1959, pp.371-378).
 - 12 "Mr. Nixon Calls For Trade Increase." *Times* [London, England] 17 Oct. 1957: 9. Retrieved from The Times Digital Archive.
 - 13 City Editor. "Doubts About Industry's Capital Plans." *Times* [London, England] 30 Sept. 1959: 15. Retrieved from The Times Digital Archive.
 - 14 "Institut International D'etudes Bancaires." *Times* [London, England] 25 Nov. 1957: 15. Retrieved from The Times Digital Archive.
 - 15 City Editor. "Doubts About Industry's Capital Plans." *Times* [London, England] 30 Sept. 1959: 15. Retrieved from The Times Digital Archive.
 - 16 A copy of this is not available but the report is referred to in the UN's Yearbook of the International Law Commission of 1959 Volume II, at footnote 67.
 - 17 *Anglo-Iranian Co. Ltd.*, [1953].
 - 18 "Sir H. Shawcross To Join Shell." *Times* [London, England] 12 Mar. 1957: 8. Retrieved from The Times Digital Archive, Web.
 - 19 *Opp cit. Note 20.*
 - 20 UK Cabinet Archives, FO 371/127201. The British sought to prevent communism from taking hold in the Middle East whilst ensuring that they avoided a conflict with the US (UK Cabinet Paper (1957)).
 - 21 *Ibid.* The pipeline itself became a point of interest because of the Suez Canal nationalisation that threatened oil supplies to the UK.

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- 22 Shawcross was 93 years old when his memoirs were published so that they appear to be based on personal papers and not so much recollection.
- 23 The oil companies sought the US Government's assurance that their actions would be considered legal under antitrust legislation and that it would back their plans up with some sort of treaty protection.: Source: Department of State, Central Files, 880.2553/1-2557. Confidential. Drafted by Williams.
- 24 Sinclair cites a number of sources including Lauterpacht's opinions.
- 25 "News in Brief." *Times* [London, England] 12 June 1958: 8. Retrieved from The Times Digital Archive.
- 26 "Lord Shawcross Joins 'Shell' Transport." *Times* [London, England] 15 Dec. 1961: 17. Retrieved from *The Times Digital Archive*.
- 27 British Institute of International and Comparative Law, retrieved from www.biicl.org.
- 28 *Ibid*, paragraph 15(d)
- 29 *Ibid*, paragraph 16.
- 30 *Ibid*, paragraph 2.
- 31 *Ibid*, paragraph 15.
- 32 Retrieved from Cambridge University: www.squire.law.cam.ac.uk/collections/public_international_law.php.
- 33 UK Cabinet Papers, CP(51) 257, dated 26 September 1951.
- 34 A similar provision was used in a 1963 concession given to Phillips Petroleum Co. by the United Arab Emirates.
- 35 International Court of Justice, Reports of Judgments, Advisory Opinions and Orders, 1952, p.112.
- 36 *Anglo-American Oil Co. Case* (Jurisdiction) 1952.
- 37 C.(52) 354, 23 October 1952.
- 38 Retrieved from <http://www.virginia.edu/igpr/APAG/apagoilhistory.html>
- 39 UN 1960 Report (n.14) 72.
- 40 "History of ICSID law", Blog by Antonia R Parra., a consultant at World Bank. Retrieved from www.blog.oup.com September 2015.
- 41 It is interesting that Shawcross did not know Abs until this point in time. Abs was examined as a witness in 1947 (Gall and Underwood, 1999, pp.147-202.). He was at the helm of Deutsche Bank during the World War. Manning (1981) suggests an even older connection between Shawcross and Abs going to the early 1940s on the basis of the papers in the USA.
- 42 Shawcross (1995, p.308) does not name these; but they were probably the UK, Germany, France, Switzerland and the USA.
- 43 Shawcross (1995, p.308) refers to APPI's ongoing "important co-ordinating" work in the field of investments. He requested Lord Harris to refer to an APPI meeting in Copenhagen in 1986 in the House of Lords' debate on a European decision on nationalisation,: *HL Deb* 6 November 1986 Vol. 48 p.1187-92. However, no other information is easily found on the current activities of the APPI. The Corporate Watch website lists a Nestle director as being a member of the APPI in 2005. That person, Peter Brabeck-Letmathe is listed as "serving" the APPI at another website: <https://www.crunchbase.com/person/peter-brabeck-letmathe#/entity>. He was certainly present at the 1996 UNCTAD Global Investment Forum arguing in favour of a multilateral code for investment protection. Brabeck-Letmathe (1996, p.3).
- 44 "The Proposed Convention to Protect Private Foreign Investment – A Round Table", 9 *Journal of Public Law*, 119, 1960.
- 45 *Ibid*.
- 46 Draft Abs-Shawcross Convention Article IX(b).
- 47 "Protecting Foreign Investments." *Times* [London, England] 5 May 1959: 4. Retrieved from The Times Digital Archive.
- 48 "The 'Shell' Transport And Trading Company." *Times* [London, England] 21 May 1959: 18. Retrieved from The Times Digital Archive.
- 49 There was no legal difference between the use of the words treaty or agreement given Article 2(1)(a) of the VCLT but, this did not enter into effect until 1980.
- 50 The Parliamentary Group, A World Investment Code in 1959, para 7.
- 51 IBRD, 1946-47 Annual Report 13.
- 52 The Parliamentary Group, opp. cit. Note 50, para 11.
- 53 UN Report of the Secretary-General E/3325, p.75.
- 54 The Parliamentary Group, opp cit. Note 50, p.8.
- 55 "Aiding Flow Of Investment Capital." *Times* [London, England] 16 Dec. 1959: 8. Retrieved from The Times Digital Archive.
- 56 *The Promotion of the International Flow of Private Capital: Progress Report* by the Secretary-General, United Nations ECOSOC, E/3325, 8 (February 26, 1960) (UN 1960 Report).
- 57 "Conditions for US Investment Abroad", *Times* [London, England] 13 June 1953, p.5. Retrieved from The Times Digital Archive.
- 58 US International Development Advisory Board, *A New Emphasis on Economic Development Abroad - A report to the President*, 1957, p.13.
- 59 The Final Draft Resolutions on the International Effect of Nationalisation of the Institute of International Law, Bath

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- session, 1950 did not include ISA.
- 60 Prof. Magarasevic, A., and the Swiss Branch of the Law Association, as quoted in ILC 1959, p.30.
- 61 Publications of the Permanent Court of International Justice (the Serbian Loans Case. 1929), *Collection of Judgments*, series A, Nos. 20/21, p.41.
- 62 UN Doc E/3325 (1960) 63-81.
- 63 UN ECOSOC, 3rd Report by the Secretary-General 23 July 1963, 3/3665/Rev.1, p.42 and Report E/3325, pp 75-76.
- 64 Page 77 of UN ECOSOC E/3325.
- 65 The UN ECOSOC, *The Promotion of the International Flow of Private Capital*, A Progress Report by the Secretary general (E/3325) (New York, 1960), p.65. Also see, Snyder, 1961, p.476.
- 66 UK Cabinet Archives, FO 371/112892
- 67 <http://www.univie.ac.at/intlaw/wordpress/wp-content/uploads/2014/01/Do-we-Need.pdf>
- 68 A few members have withdrawn from it.
- 69 Blog by Antonio R Parra, a consultant at World Bank. Retrieved from www.blog.oup.com.
- 70 UNCTAD (2007) *Bilateral Investment Treaties 1959-1999*.
- 71 UNCTAD/EDM/Misc.232, *Course on Dispute Settlement*, the UN, New York and Geneva, 2003.
- 72 These words were in the preamble of the draft Abs-Shawcross Convention.

5. Seats of Corporate Convenience

5.1 Introduction

1. This chapter briefly explains why corporations have seats, why ‘seats of corporate convenience’ (SCCs) are more than tax havens, and how they have evolved over the 20th century to become an important structural element of the globalised economy. This background is essential to understand (a) the radical changes to FDI analysed in Chapter 6, and (b) the reasons behind the argument that ISA arbitrators have expanded the original bargains in BITs to include investments that were not envisaged to be eligible for ISA. This Chapter also describes the extent of SCC-usage as identified in the ICSID cases analysed for this thesis.

5.2 Why do corporations need a seat?

2. TNCs’ business model in the global economy involves setting up a number of special purpose entities (SPEs), some empty shells, others holding companies (to hold other companies, or debts, or intellectual property rights (IPR)), operative companies or managing companies, and so on. There has been a remarkable growth in the number of such entities which was not always given enough attention in statistics (IMF 2004). TNCs use SCCs to enjoy regulatory advantages, and be creative in their accounting. Experts not only keep up with the changing regulations of SCCs, they propose drafts of suitable regulations and lobby for them, acting as “intermediaries between government and private interests” (Picciotto, 2011, p.19).

3. Corporations, being creations of law,¹ belong to some state under whose laws they are created. The corporate seat can also, albeit rarely, change from one country to another, if permitted by the laws of both countries (Hadari, 1974, p.17). What constitutes a corporate seat is not entirely beyond controversy especially as between the American and European systems. Corporate nationality and source of income are the two possible bases for taxation.

4. In the determination of the seat, the US uses the place of incorporation, and Britain uses the place of central management and control. Whilst, a nationality based on the seat of a company (e.g., in most Civil law countries, except the Netherlands) might reflect the economic reality, a nationality based on the place of incorporation offers certainty in the choice of law applicable to a corporation (Hadari, 1974, p.10). For the purposes of ISA, in the absence of specific words, investors may have more than one option especially if they have used more than one SCC with access to BITs.

5. It is arguable that in a globalised economy there is no need for a company to have a seat, but

tax policies and regulations might have to be universally restructured as they are currently based on firms having a nationality (Desai, 2009). BITs are also predicated on investors having a home country which decides their ISA eligibility. The concept of a home country is a lot more fluid now than when BITs were first drafted. This is not to say that corporate nationality as reflected in the composition of TNCs' boards of directors (Jones 2006) has necessarily changed or become diverse.

5.3 What are SCCs?

6. In 2010, an estimated 46-60 tax havens were used by circa two million international business companies (IBCs) (Palan et al 2010, p.6). IBCs include various corporate entities (funds, trusts, companies, captive insurance companies, and so on). The Cayman Islands, the British Virgin Islands (BVI), Bermuda and the Bahamas host 52% of the world's hedge funds (Palan et al, 2010, p.6). The Cayman Islands is a global leader for mutual funds (Deloitte, 2015). At least half of all international bank lending and a third of world's FDI stock are estimated to be held in tax havens.

7. Switzerland is known as a tax haven and a centre for the formation of corporate ideologies (Van Fossen, 2012, p.88). There are other locations that are not easily recognised as tax havens but attract TNCs. The phrase 'seats of corporate convenience' (SCCs) is coined here to include all such seats, including tax havens, offshore financial centres (OFCs) and a few others (e.g. France, Spain, and Germany) that might not be usually considered to be either tax havens or OFCs. Overall, the SCCs include all tax havens identified by Palan et al (2010) although some may be SCCs only for certain sectors (e.g. Canada and Australia for mining). The more neutral phrase SCCs is similar to that used in shipping for the flags of convenience. Not all investments are made by corporate entities. Out of the 463 ICSID cases analysed for this thesis, 10% involved individuals acting with or without a corporate vehicle.² Given that most cases involved corporate vehicles making investments, the phrase SCCs is adequate to understand the expansion of ISA.

5.4 Structure of the global economy

8. Fröbel et al contended that an "international superstructure" was built in the late 1970s with the help of the international capital market that could move and transfer funds speedily around the world which involved, "... institutionalised multilateral or bilateral cooperation in monetary and commercial policy (IMF, GATT); tax agreements to avoid double taxation; treaties for investment protection; increasing harmonization and complementarity of training systems; international military cooperation; "neutral" international organizations which pave the way for transnational capital under the cover of providing technical and managerial expertise for "development" (World Bank, UNIDO, FAO). ... predominantly capital itself ... created the preconditions for its own expansion and accumulation" (1978, p.848).

9. The increase in the use of SCCs started in the 1970s. The excess of foreign assets in nine important tax havens increased 16-fold from 1970 to 1978 (US Treasury 1981, P.17-18).³ By 1978, the Bahamas banks, for example, held \$95.2 billion of foreign assets all but \$1.8 billion of which represented excess international assets. The evolution of this international superstructure in the 1980s and 1990s was not simply the result of developing countries' competition for capital. Capital was keenly seeking markets for expansion and, importantly, for ways to enforce sovereign debt repayments. The offshore system became an essential element of major sectors such as finance, international transport, and industries such as oil and gas (Picciotto 2011, p.96-7, 99). It was not reflected in BITs which continued to be based on the early BIT drafts.

5.5 Use of SCCs in ICSID cases

10. Given that SCCs are a structural element of the global economy, ICSID cases were analysed to identify the proportion of disputes involving investments made through an SCC. A total of 463 cases were registered by ICSID during the period starting from the establishment of the Centre to 31 December 2013; only nine of which were conciliation cases, and 454 were submissions to arbitration. Out of these, 337 (72.79%) involved the use of at least one SCC by the claimant-investors. The most frequently used SCC was the US as shown in Table 5.1 attached to this Chapter, being used in 116 cases (almost 25%). Delaware alone was involved in 66 cases (14.25%). Most of the corporations that use Delaware as an address do not manage a business from Delaware; it is a convenient place from which to create the legal fiction of an office. The second most-used SCC was the UK with 67 cases (14.47%), followed by the Netherlands with 46 cases (9.94%). These numbers only represent the cases registered with the ICSID and are not necessarily an accurate representation of the total number of SCCs used in ISA cases. Arbitration institutions other than the ICSID Centre do not publish as much detail of the cases they administer as the ICSID Centre does. Further, ad hoc cases not administered by an arbitration institution may not be publicised. The ICSID data itself are not accurate about the origin of an investor given that the nationalities shown in the registration information do not always match up with the ultimate investors, or do not indicate all the SCCs involved; such information is gleaned from the awards, and some is simply not available either because the award is not public or is redacted.

11. The numbers are, for the above reasons, not relied upon to make a precise numerical argument but to indicate the trends seen since the advent of globalisation and to support the argument that it is not reasonable to use a bilateral tool for the justification of ISA-eligibility when the investors' nationality is a fluid concept. Capital does not always take the most direct route or the shortest route from the home state to the host state. It prefers the *most convenient* one. If it suits a corporation it may use 'hybrid' entities which are deemed to be a separate corporation by one

country and a branch by another, and also ‘hybrid’ instruments that are regarded as debt or equity depending on which country’s rules are applied to the same transaction.⁴

12. A comparison of the FDI flows in and out of SCCs in Figure 5.1 illustrates how the global economy in the 1970s was radically different from that in the post-1990s. After the collapse of the Bretton Woods fixed exchange rates system, increasing volatility characterised financial markets. The parallel rise of tax havens and financialisation encouraged TNCs to use SCCs to increase their networks of subsidiaries, branches, affiliates, etc. to manage the financing of their operations, risks and profitable opportunities (Van Fossen, 2012, p.88).

13. Figure 5.1 was produced by combining the list of tax havens put together by Palan et al (2010, p.41), and the UNCTAD statistics for FDI in-flows and out-flows for the years 1970 and 1990. The year 1970 is used as an indication of FDI movements before the collapse of Bretton Woods, and 1990 is when over 1800 BITs had been signed (Figure 4.1). The main SCCs are named individually, and the rest are collectively included under the category “other”. The Figure is an indication of the substantial use of tax havens and SCCs by investors. The actual amounts of FDI routing in and out of all these countries increased noticeably in 1990. The same data are shown in line graphs in Figures 5.2 and 5.3 with the added years 2007 and 2013. The data for the year 2007 shows that the FDI flows into these countries on the list increased for most tax havens included in the “other” category. After the financial crisis, the FDI *outflows* appear to have decreased for all of these countries.

14. Figure 5.4 illustrates the post-1990’s increase in the number of double taxation treaties (DTTs) signed by SCCs. This change was similar to the rise in the number of BITs signed by all countries, as shown in Figure 4.1. The conclusion of DTTs may or may not have led to increased FDI for the signatory countries. What is beyond doubt is that a global network of SCCs and DTTs was, and is routinely, used to make FDI and other forms of investments. This global economic structure has affected the development of investment treaty law, especially in the legalistic setting of ISA. The gateway to ISA is the eligibility of investors based on the nationality as defined in BITs or the Convention. SCCs offer a way to exploit or circumvent the nationality, depending on an investor’s objective.

15. It is clear that around the year 1990, *structural* changes took place in the world of FDI. These may have been caused by the early history of tax havens (Palan et al (2010, p.123)). It has been suggested that the golden years of tax havens are finished (Palan et al 2010, p.225). SCCs have, however, continued to be used albeit with some doubts over the secrecy associated with tax havens.

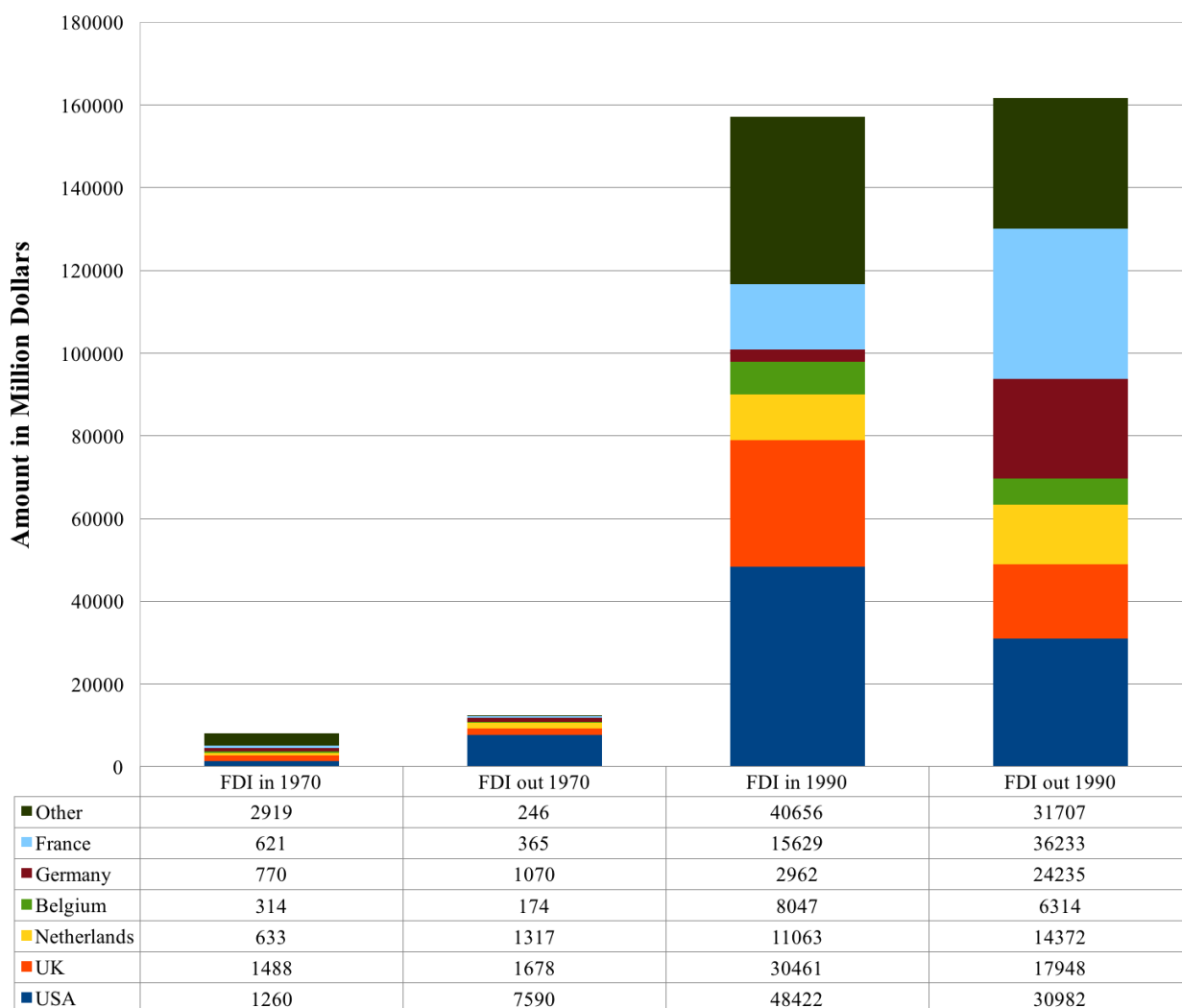


Figure 5.1. Stacked bar chart showing FDI flows in and out of SCCs.

5.6 A brief history of tax havens

16. Tax advantages are a main attraction of the SCCs. The SCCs, like tax havens, are a product of states' sovereignty. The concept behind tax havens is ancient (Wells, 1900, p.91; Doggart, 1979). Anstalt was created by Liechtenstein in 1926, to enable an individual investor to obtain the advantages of incorporation by concealing his/her identity (Glos 1984, p.953). Luxembourg's holding company rules introduced in 1929 exempted from tax any foreign dividends, thus making it a popular seat for holding companies in other European corporations.⁵

17. An ICC initiative from 1905⁶ shows that business lobbies were seeking protection from double taxation. The League of Nations' experts' report followed in 1923 (Picciotto, 1988, p.64). The 1930s saw the conclusion of the early DTTs based on the OECD model, with their number growing to 200 by the 1970s (Hadari, 1974, p.53). The number of DTTs grew in the 1990s, like the

number of BITs did.

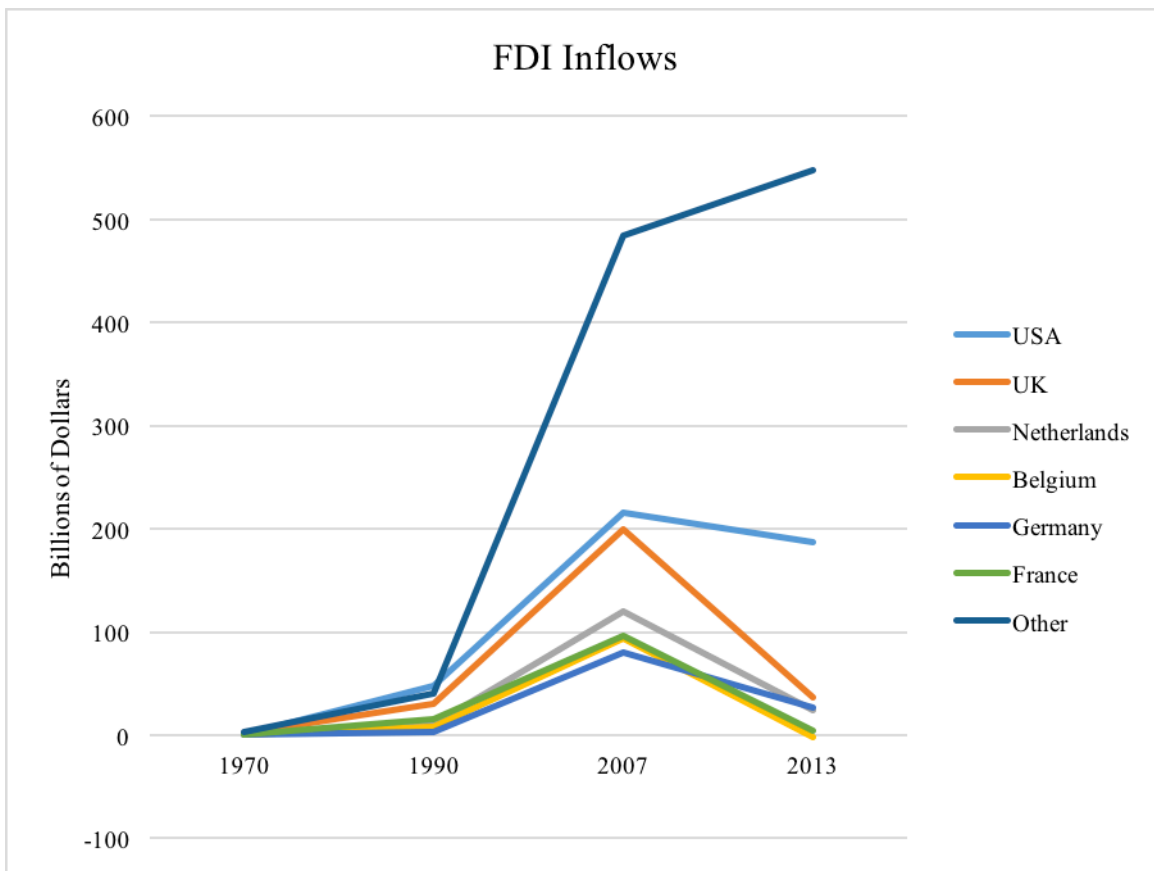


Figure 5.2. Line chart showing FDI in-flows to SCCs at key times.

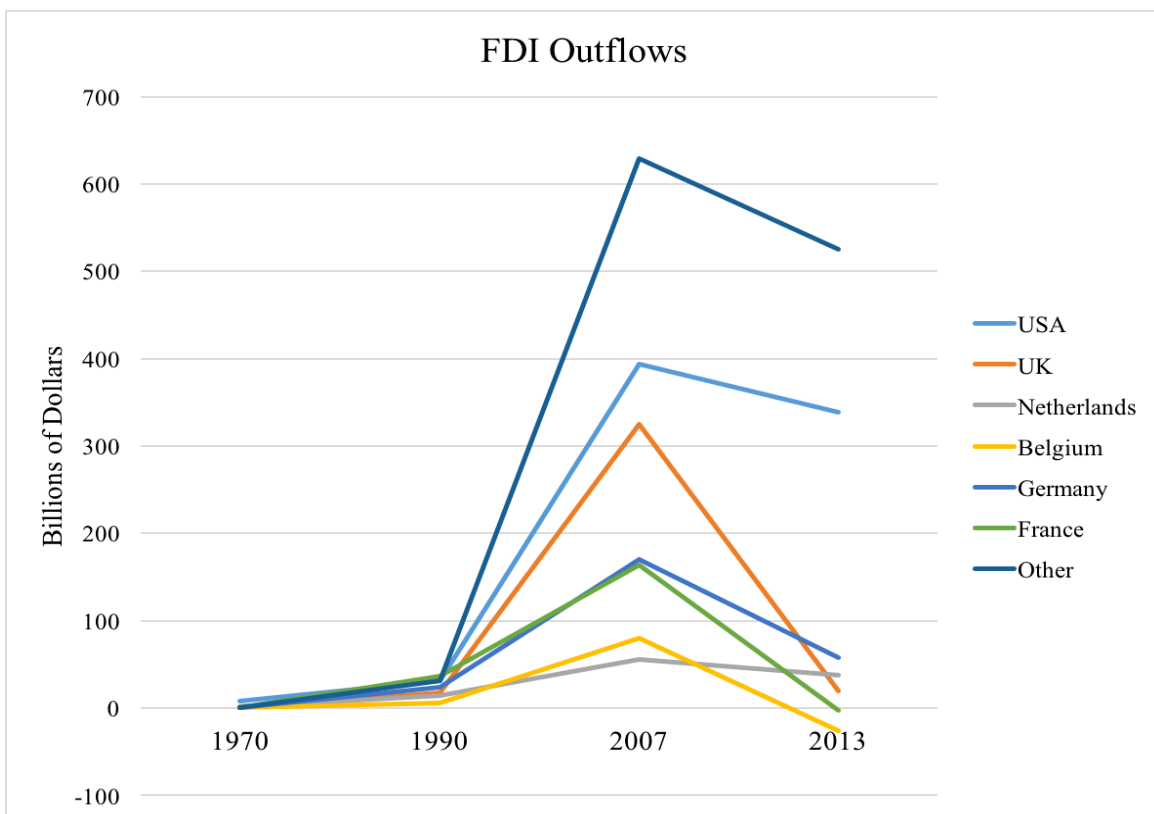


Figure 5.3. Line chart showing FDI out-flows from SCCs at key times.

18. Palan et al (2010, p.108) have identified three stages in the development of tax havens: (a) from the late 19th century to the 1920s, (b) the end of World War I through the early 1970s when few states like Switzerland began developing tax-haven-regimes, and (c) from the early 1970s and through the late 1990s when the number of tax havens rose dramatically, as did the scope, planning and the volume of the financial assets routed through them. It is the last phase that also coincided with the rise in the number of BITs and DTTs.

19. The original holding company was traced by Palan et al (2010 pp 110-1) to a Dutch law of 1893. Before this the Dutch had the Verenigde Oost-Indische Compagnie (VOC). VOCs' end came in 1795-98 because of "short-term speculation, over-leveraging of equity capital, over-valuation of assets, lack of supervision by the investors, uncontrolled agency problems, inefficiency on the part of the supervising governmental authorities..." (Faure and Vander Walt 2010, p.216-7). By the mid-1970s, the Dutch government was designing tax laws to attract TNCs (Palan et al, 2010, p.143).

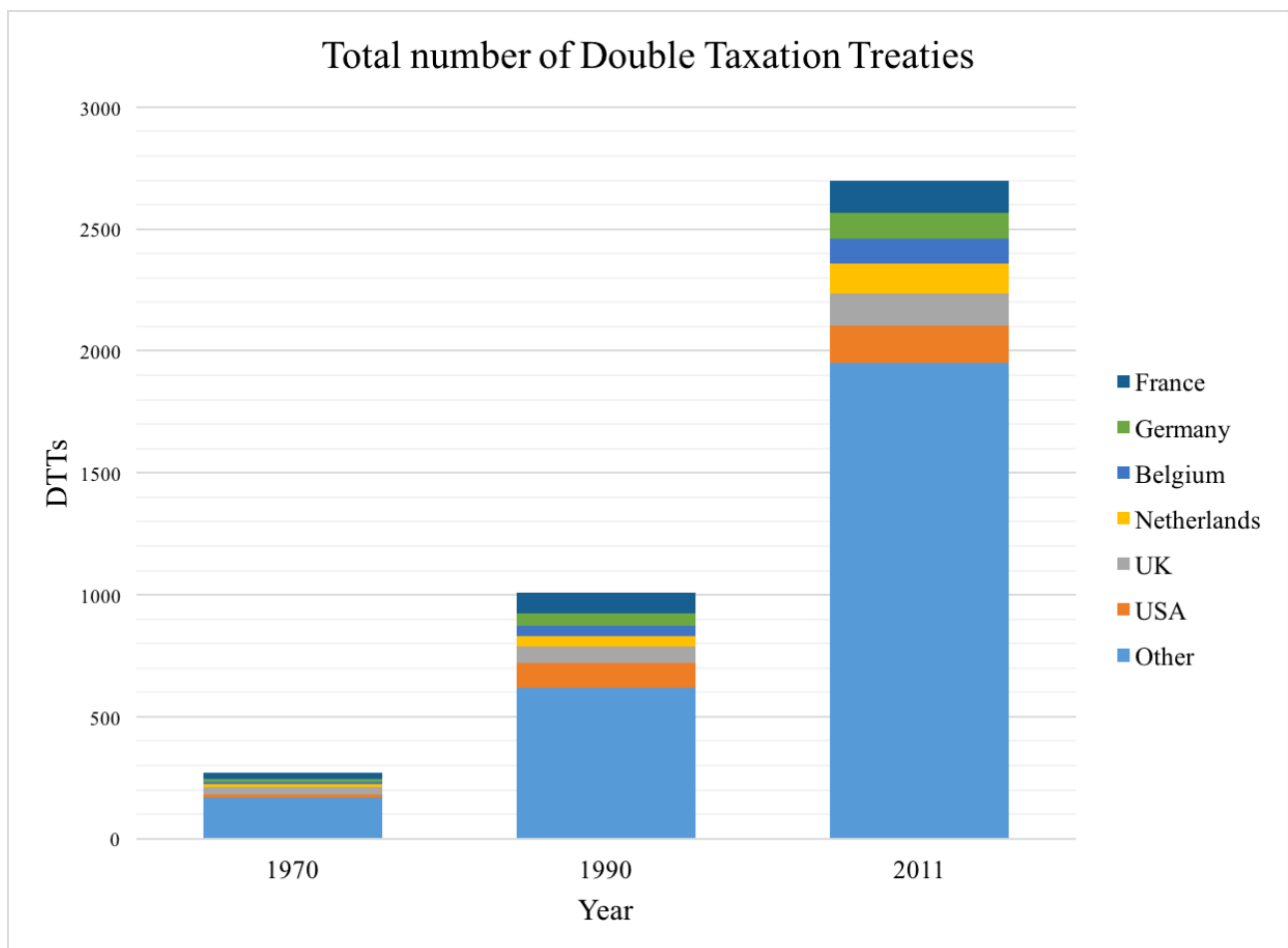


Figure 5.4. Stacked bar chart showing the number of DTTs signed by SCCs for key years.

5.7 SCCs and tax havens

20. Many SCCs implement tax policies for corporations' benefits even if their own revenue may

be adversely affected. For example, the US corporate tax receipts reduced from 25% of total tax revenues in the 1960s to less than 9% in 2000 (Reuven 2000, p.29), caused both by the effective end of withholding taxation for corporations, and the rising use of tax havens (Avi-Yonah, 2000, p.1576.). Further, between \$800 billion to \$2 trillion was estimated to be laundered annually through tax havens at the beginning of the 21st century (Wechsler, 2001). The same formalities are involved in using tax havens for legitimate or illegitimate purposes.

21. The SCCs' growth was affected by the liberalisations of the 1970s and 1980s. Capital controls were being dismantled throughout Western Europe, North America and Japan with some developing countries following suit (Boughton, 2000). Banks were the conduits used to shelter onshore-derived incomes (Jones, 1994, p.27) using tools such as SPEs (as holding, trading, investment, captive insurance companies, or empty shells), tax treaties, and domestic regulations of SCCs. By 1981, the US Treasury in its Gordon Report (Gordon, 1981) could not come up with an objective, clear test to identify a country as a tax haven although it concluded that legal and illegal uses of tax havens were rising. The problem of the definition still persists (Sharman, 2006, p.21). Palan et al (2010, p.21) found that little had altered since the 1980s in the list of tax havens or their roles and functions; they define tax havens as "legislative spaces". OFCs are not easy to define either. Various clusters of tax havens have emerged (Jones 1994, p.27), some with particular associations with specific global financial centres (Hampton 1996B, p.300).

22. In 2000, the IMF defined OFCs as "centres where the bulk of financial sector transactions on both sides of the balance sheet are with individuals or companies that are not residents of OFCs, where the transactions are initiated elsewhere, and where the majority of the institutions involved are controlled by nonresidents." (IMF 2000, Part II(A)). The importance of OFCs to the global economy towards the end of the 20th century is clear from the IMF's calculations (based on BIS data) that the cross-border assets of OFCs – that comprised 50% of the total cross-border assets - had reached \$4.6 trillion as at June 1999. Out of this sum, London, the US IBFs, and the Japan Offshore Market accounted for \$2.7 trillion.⁷ By 2008, the IMF abandoned its OFC program acknowledging conceptual difficulties (Palan et al 2010, p.30). A number of developed countries were offering onshore the services that had been previously offered offshore.

23. Palan et al (2010, p.4) argue that contrary to the most accepted belief, tax havens are "an integral part of modern business practice", existing "not in opposition to the state, but in accord with it.". The peaking of tax havens, FDI, and BITs in the 1990s mirrored the growth of globalisation. States have made it acceptable for a TNC to cherry-pick a route of SCCs for investments to minimize costs and maximise gains. The *bilateral* part of the investment treaties has become a myth given the thicket of BITs and DTTs, with multitude forms of corporate personalities

that can be created, connected and shifted around the globe relatively quickly and cheaply.

5.8 Typical characteristics of some frequently used SCCs

24. Incorporation, banking, brokerage, and internet hosting were the kind of services offered by “predatory microstates” to enable the bypassing of the traditional regulations from other states for disclosure or taxation (Cooley, 2003, p.679). Some advantages of a few SCCs most commonly appearing in ICSID cases are discussed below although these are by no means extensively set out.

25. The US is an SCC, although some consider it the biggest tax haven in the world (Drucker 2016). It was involved in a quarter of all the analysed cases with Delaware being the most used SCC within the US. 285,000 separate businesses reportedly used the same address of a post-box in Delaware in 2012.⁸ More than half the Fortune 500 corporations are incorporated in Delaware (Black, 2007). In 2014, Delaware broke its own 2007 record when 169,000 *new* business entities were established under the Delaware General Corporation Law.⁹ Many of the new entities are not conventional corporations but what are known as ‘alternative entities’. A modest annual fee apart, setting up a corporation or an alternative entity is easy; this can be arranged till 10.30 pm on most nights. Corporations enjoy flexibility in how they are run and shareholders are permitted to limit the liability of the corporation’s directors. The forms of entities include limited liability companies, limited partnerships, statutory trusts, stock or non-stock corporations, close corporations, foreign corporations, foreign limited liability companies, general partnerships, foreign partnerships, foreign statutory trusts, foreign limited partnerships and so on. There is no sales tax. There is no register of out-of-state companies that use Delaware as their corporate domicile. Foreign TNCs using Delaware are not merely seeking a refuge from domestic taxes in the US. Delaware offers confidentiality of trusts, company accounts, and beneficial ownerships, and, unlike say the City of London, it allows companies to change domicile without leaving a record (Mathiason, 2009). Delaware advertises its corporate services by referring to its modern laws (corporate and arbitration), a smooth and speedy management of Chapter 11 proceedings, and business-friendly and speedy courts to deal with corporate governance issues. Whilst bringing foreign income to Delaware may expose it to the US taxes, Delaware and the foreign business can easily be connected by one or more intermediate companies in one or more SCCs to ensure that foreign TNCs using Delaware minimise their tax burden.

26. Foreign investors can set up LLCs in Delaware. LLCs do not need to hold board meetings and keep minutes. An LLC agreement is sufficient to determine its management-shareholders’ relationship. The names of the shareholders, managers, founding members, or the beneficial owner need not be disclosed when setting up an LLC. This increases the attraction of Delaware for the

investors seeking to hold assets in secrecy. The LLC is treated as a partnership for tax purposes (it pays no corporate tax; partners pay tax on their income, unless they too are non-residents for tax) but is structured to be like a limited liability company. At least 37¹⁰ (8%) of the ICSID cases analysed for this thesis involved the US LLC entities.

27. The US SCCs other than Delaware were used by at least 50 investors out of the 463 investors' cases analysed for the thesis. These SCCs include, New York, Nevada, Texas, Florida, Wyoming, etc. New York, like London, allows the payments of interest without withholding tax on deposits and loans to non-resident recipients which has a direct effect on the competitiveness of businesses (Picciotto, 2011, p.240). Nevada only started to offer LLCs around 1990. Wyoming and Nevada permit bearer shares. Under the Revenue Act, 1913, the US MNCs are subject to US tax on their worldwide income except that the income on their 'controlled foreign corporations' (CFCs) is not taxed until repatriated to the US (the deferral rule). Such corporations are allowed a credit for any foreign taxes paid on the foreign income to avoid double taxation. The US corporations also use strategies such as moving their headquarters to a foreign company in another SCC to reduce their tax bill in the US. There have been attempts to tighten the US tax rules but, the US was recently ranked ten countries ahead of Panama as a tax haven (Kasperkevic, 2016). It is now considered to be a safer location for secrecy than Switzerland. *Bloomsberg Businessweek* published a report in January 2016 headed, "The World's Favourite New Tax Haven is the United States: Moving Money out of the Usual Offshore Secrecy Havens and into the U.S. is a Brisk New Business." (Drucker 2016).

28. The UK as an SCC, was involved in at least 67 (14.47%) out of the 463 ICSID cases analysed for this thesis, about half of which involved the use of various British Overseas Territories. Described in 2006 as the "world's most appealing refuge for the super-rich" (Nugent, 2006), London historically was, and has remained, a key financial centre, even if all may not agree to give it a label 'tax-haven.'¹¹ As of September 1957, London transactions between non-residents were not subject to British financial regulations. The scope of this rule was restricted only in April 2008 so that immigrants to Britain do not have to pay tax in Britain so long as they declare their intention to return to their country of origin at some time in the future thus attracting rich foreign oligarchs and US corporate raiders (Palan et al, 2010, p.38-40). Shell, the iconic Anglo-Dutch corporation, changed its hundred-year old holding company structure in 2005 so that it now has a British parent corporation, with a Dutch head-office (Jones, 2006).

29. English law had introduced limited liability partnerships (LLPs) in 2000. Partnerships could have a maximum of twenty partners but, as of 2002, there is no upper limit on the number of partners. As an entity that pays no capital gains or corporation tax, LLP's attraction lies in the fact

that its members pay tax as self-employed entities. If the members arrange not to be liable to pay tax (e.g. by being non-resident in Britain), the profit of an LLP is rendered tax-free. Most large firms of lawyers and accountants are LLPs. In 2005, there were about 12,000 LLPs in Britain and by March 2012, there were 49,000.¹² LLPs may be used for legitimate or illegitimate purposes.¹³

30. In 2013, the British prime minister's rhetoric against offshore tax havens was dubbed a political gesture by a former home office minister of his own party (Pegg and Ball, 2015). The City of London, the financial square mile district, has its own corporation, police force, secret rituals, properties (including outside the boundaries), and democracy (the votes are mainly controlled by companies, not individuals). The 2016 budget for this council with 7,400 human residents is alleged to be £372 million; it holds assets worth £1.05 billion, and a cash fund with assets of further £1.8 billion.¹⁴

31. From a couple of banks that hardly had any non-resident business in 1964, the Cayman Islands, a British overseas territory, had, by 1977, 237 banks and trust companies as well as 8,158 registered companies. By 1991, it grew to be the fifth largest financial centre with the support of the world's 45 of the largest banks (Wells, Jr. and Wint, 1991, pp.87-88). By the mid-1990s it had 25,000 registered companies (Roberts, 1995, p.237). By December 2007, its assets and liabilities were about a third of those in London, although the City of London had 338,000 people managing the activities as opposed to 5,400 people in the Cayman Islands. With the absence of tax and capital reserve requirements, its attractions were easy to understand. Most of this money was theoretically in the Cayman Islands (Workman, 1982, p.683). The *New York Times* wrote in 1991 that this "shadowland of finance" was becoming increasingly important with about half of the industrialised world's stock of money residing in or passing through tax havens, with the main clients being "international banks and corporations seeking higher profits, not tax-dodging rich people or crooks hiding ill-gotten gains".¹⁵

32. The Netherlands, with 50 (10.8%) ICSID cases out of the 463 analysed for the thesis, is just behind Britain in the order of most used SCCs in the ICSID cases (Table 5.1). With thousands of mailbox companies and Special Financial Institutions (SFIs) channelling dividends, royalties and interest incomes, its 2002 gross SFI flows were estimated at €3.6 trillion. Most of the mailbox companies had a parent in a tax haven jurisdiction (Van Dijk et al, 2006). Dutch laws have been designed to attract MNEs looking for tax-efficient locations; some of these involved exemptions or concessions from corporate and withholding taxes. Dutch advance tax ruling system offers predictability and certainty to TNCs. It used to offer a special regime for group finance companies (Van Dijk et al, 2006). The EC's Investigations in June 2013-14 concluded that the "tax rulings" offered to Starbucks' coffee roasting company (similar to the special tax advantages granted by

Luxembourg to the TNC Fiat for its financing company) were illegal under the European state-aid rules. Starbucks' coffee-roasting company could move most of its profits out of the Netherlands without tax; Fiat's financing company could pay lower taxes on its underestimated profits. These instances were held to amount to an unfair competitive advantage.¹⁶ Another recent EC decision, criticised by Ireland, the TNC Apple and Britain, was that Ireland should recover \$13 billion in back-taxes from Apple for similar reasons.¹⁷ These corporation-friendly practices were on-going for several years until the recent challenges. SPEs can be created, and capital imported into Europe from unknown sources, and be repatriated with as little tax as possible (Palan et al, 2010, p.143).

33. Switzerland, involved in at least 27 ICSID cases (5.83%) has long been acknowledged as a tax haven. It offers a network of BITs and DTTs, and a sophisticated legal and accountancy services. Its secrecy is coming under increasing pressure (especially in Europe). Australia and Canada appear to attract mining companies regardless of where in the world their operations may take place. 83% of Australia's mining corporations are foreign owned,¹⁸ although mining companies were among those least likely to pay tax in Australia.¹⁹ In 2013, it was estimated that over 50% of the world's mining companies were headquartered in Canada operating in over 100 countries around the world and that these accounted for 31% of global exploration expenditures.²⁰ The Bahamas and Bahrain were advised by the World Bank in the 1970s on improving their services as SCCs (World Bank 1978A, 1978B). TNCs have long used Bermuda as a seat for their captive insurance business.²¹ Insurance premiums received by an SPE set up in Bermuda are not taxable. They also help reduce the tax bill of the parent company in its onshore business.

34. Multilingual EU member Belgium has been a low corporate-tax region for years. It has a strong network of DTTs and BITs. Belgium applies no tax on the capital gains on sales of shares.²² In 2003, for example, Belgium signed a treaty with Hong Kong so that Hong Kong is no longer considered a tax haven, thus creating potentially lucrative opportunities for a Hong Kong subsidiary or a branch held by a Belgian company. Hong Kong does not tax foreign income of its companies so that a Belgian entity can hold financing, investment, trading, IPR or other companies in Hong Kong (Claes et al 2005, pp.6-7). In 1983, Belgium introduced a legislation to allow corporations to set up a subsidiary to provide services - such as financial planning, insurance, marketing, legal advice, or employee training - to other parts of the group worldwide virtually tax-free, and companies such as IBM, Monsanto, BP started to use it.²³ According to the IMF, banking and financial sectors are significant in Belgium and its assets are estimated to be equivalent to 470% of the GDP in 2007, falling to 310% by mid-2012. Belgium was on the OECD's 'grey' list until 2009 when it concluded some information exchange agreements.²⁴ Its lack of capital gains tax and provisions allowing deductions of notional interests are still attractive to TNCs.²⁵

35. France was involved as an SCC (not as a respondent) in at least 23 ICSID cases (4.96%) up to December 2013. It tends to attract TNCs for research tax credits.²⁶ This is attractive to foreign companies.²⁷ In the early 1990s, France had the lowest corporate income tax rate behind Britain and only 18% rate for capital gains (Cuadrado 1993). Until 1995, French legislation on transfer pricing was exploited by TNCs, primarily from the US and Japan (Monsellato 1998). France offered the advantages of its EU status, business-friendly arbitration and corporate laws, and its network of BITs and DTTs. French banks' heavy reliance on tax havens to increase their profits became public after the first data from the French banks was made available after a change in the EU legislation. Oxfam's recent study showed that five French banks had sixteen subsidiaries in the Cayman Islands alone (but no staff) from which they still declared €45 million in profits.²⁸

36. Like many other developed countries, Germany offers secrecy in banking. It exempts foreign income whether from dividends or as profits of foreign branches, and has low taxation against dividend and capital gains incomes. It cut corporate tax rates in 1994. German banks or other TNCs also use Luxembourg or other tax havens. However, Germany has made efforts to close loopholes against tax evasion (Palan et al, 2010, pp.200-1). Germany was involved as an SCC (not as a respondent) in 16 ICSID cases up to December 2013.

37. Ireland, with its 65 DTTs and an FCN with USA (but no current BITs²⁹), offers an easy tax regime for structured finance activities (with its low corporate tax rate and no withholding tax) and by December 2003, its FDI stock was eight times the size of its GDP for that year (Palan et al 2010, p.144). According to Palan et al (2010, p.145-6), the largest source of FDI into Ireland was the Netherlands (which has a good network of BITs) and then the US.

38. Set up as a tax haven in 1990 after concluding various DTTs in preparation for this role, Mauritius is one of the popular SCCs for TNCs to invest in India but also for the Indian round-tripping capital (Sharman and Mistry 2008, p.41). A sizeable ownership of the Indian stock exchange is held through Mauritius based entities (Palan et al, 2010, p.148). Panama, despite being a tax haven, has required banks' presence in the country, thus contributing to some investment in its onshore economy (World Bank 1979B).

39. Spain was involved in at least 40 ICSID cases (8.64%). In the 1990s, it was a preferred jurisdiction through which to invest in Venezuela (or other South American countries). As an EU-member Spain offered the benefit of its language and liberal regulations to foreign investors, a good DTT and BIT network (with over 70 DTTs), no withholding tax on dividends to non-resident shareholders, exemptions for capital gains, and no capital controls after 1991. According to the *International Financial Law Review*, the Spanish holding structure Entidad de Tenencia de Valores

Extranjeros (ETVE) provided “an unmatched platform to channel FDI into Latin America” which was set to become even more attractive (especially to Chinese investors) in 2012 when Spain and Hong Kong tax treaty entered into force.³⁰ A report from the Observatorio RSC³¹ suggests that almost all of the 35 companies listed on the Spanish Stock Exchange used tax havens in 2012; these showed a 31.9% increase over the use of tax havens in 2010. The favourite locations in 2010 being Delaware, the Netherlands, Luxembourg and Ireland. These companies had 449 subsidiaries in 17 tax havens despite tax evasion being a major problem in Spain.³² This illustrates how Spain is an SCC for investors in certain regions, even if it is not an acknowledged tax haven.

5.9 Summary

This chapter has highlighted how extensively SCCs are used and the complexities involved in taxing TNCs. It also shows the increase in the use of SCCs after 1990. By 1990, a majority of BITs were already signed and they had not provided for the impact the use of SCCs would have on the issue of corporate nationality. In such circumstances, the bilateral nature of the treaties should have guided and restricted the interpretation of nationality of investors. Vernon suggested in 1970 that tax payments by MNEs were a “matter of bookkeeping, chance and the vigilance of national taxing authorities.”³³ TNCs now actively seek out the best tax routes for capital, and negotiate special deals along the intermediary stops. To these, one could also add choosing SCCs based on the BITs the host country may have signed; the choice does not have to be made at the time of making the investment. Investment flows are no longer a *bilateral* matter although the use of SCCs has the potential to affect the host and home country’s expectations of benefit from any investment. For example, its long-term decline in income from corporate taxation may be caused by a number of factors (Palan, 2010, p.65), but there is evidence in the US that the real location of profits to tax havens rose substantially towards the end of the 20th century (Desai et al, 2006). In 1990, the foreign manufacturing profits of the US multinationals from low-tax countries were 20.7%; they rose to 46.8% by 2000. In 2002 “high-tax” countries such as Canada, France, Germany, Italy and Britain gave rise to only 21% of reported foreign profits of the US corporations despite having recorded almost half their sales to these countries.³⁴ Nevertheless, as will be shown in Chapter 6, there has grown, over the last few decades, a general acceptance of the use of SCCs.

Table 5.1. SCCs involved in ICSID cases registered up to December 2013

Seat of Corporate Convenience	Involved in ICSID Cases
Delaware, US	66
Other SCCs US	50
The UK	67 ³⁵
The Netherlands	50 ³⁶
Spain	40
Switzerland	27
France	21
Luxembourg	20
Germany	19
Panama	12
Belgium	10
Barbados	9
Cyprus	8
Bahamas	8
Honduras	6
Hong Kong	5
United Arab Emirates	4
Kuwait	4
Moncao	4
Lithuania	3
Jordan	3
Undisclosed	3
Mauritius	3
Israel	3
Grenada	2
Liberia	2
Liechtenstein	2
Malaysia	2
Seychelles	2
Singapore	2
Canada	2
Australia	2
Malta	1

Dominican Republic	1
Nevis	1
Saudi Arabia	1
Ireland	1
Oman	1
Ivory Coast	1
Macao	1
Russia	1
Guinea	1
Total	471³⁷

¹There is also a theory that corporations are creatures of agreement but they still need to use legal framework in order to have a juridical personality.

²Only four cases out of the 463 included state agencies as claimants and one case was commenced by a US aid-funded corporation.

³Foreign assets grew from 12.5% to 29.1% of all foreign assets held worldwide over the period 1970-1978.

⁴OECD Policy Brief : “Tax effects on Foreign Direct Investment” *OECD* February 2008. Retrieved from www.oecd.org.

⁵ “Luxembourg: old city with a new role.” *Times* [London, England] 23 Oct. 1967: 20. Retrieved from The Times Digital Archive.

⁶First expressed in the International Congress of Chambers of Commerce and Commercial and Industrial Associations in Liege, 1905.

⁷The small OFCs like Bermuda, Panama, or Liberia did not report to the BIS and the above data did not include the substantial assets held by non-bank financial institutions like insurance companies or mutual funds, private trusts and companies.

⁸“Delaware thrives as a Corporate Tax Haven;,” *The New York Times*, 30 June 2012. Retrieved from www.nytimes.com

⁹“Delaware sets record for new businesses”, 6 January 2015. Retrieved from www.delawareonline.com

¹⁰Given that all information is not in the public domain, this is based on the available data and could be a lot higher.

¹¹It was ranked as an OFC in 2007 alongside Switzerland, Bermuda and the Cayman Islands: Nugent and Rozenberg 2007.

¹²“Brass plates, brass neck,” *Private Eye* No. 1340, 17-30 May 2013, p.20.

¹³“Ukraine’s stolen assets: A long, hard slog,” *The Economist* 5 March 2014. Retrieved from www.economist.com.

¹⁴“What really goes on inside the City of London?”, *The Guardian*, UK, 19 February 2016. Retrieved from www.theguardian.com.

¹⁵“Offshore Banking’s Umbrella Shields More Than BCCI”, *The New York Times*, 11 August 1991.

¹⁶European Commission, Press Release, 21 October 2015. Retrieved from www.europa.eu/

¹⁷BBC “Apple should repay Ireland 13bn euros, European Commission rules” Retrieved from www.bbc.com.

¹⁸ABC News 2011, “Mixed reactions to Greens’ mining profits report”. 29 June. Retrieved from www.abc.net.au

¹⁹“ATO reveals tax transparency list”, *The Australian Business Review*, 17 December 2015.

²⁰Government of Canada, “Canada’s enhanced corporate social responsibility strategy to strengthen Canada’s extractive sector abroad.” Retrieved from www.international.gc.ca.

²¹The world’s largest seven pharmaceutical TNCs set up their own insurance company in 2003 like oil and gas companies had done and telecoms companies were considering doing the same. “Drug groups set up own insurer.” *Times* [London, England] 28 May 2003: 25. Retrieved from The Times Digital Archive.

²²“EC Rules create both tax havoc and tax haven”, *Wall Street Journal*, Eastern Ed., 7 February 1992, page A9B.

²³“Focus on Law and Regulation - Belgium Offers Tax Haven To International Companies”, *The Wall Street Journal* Europe, 2 January 1996. Retrieved from www.wsj.com

²⁴“Belgium unimpressed at inclusion on G20 tax haven “grey list””, *BBC Monitoring International Reports* 3 April 2009.

²⁵Tax Justice Network, Financial Secrecy index, retrieved from www.financialsecrecyindex.com.

²⁶“Competitive Alternatives,” *KPMG*, 2014.

²⁷“France a tax haven for firms from Microsoft to Huawei”, *The Jerusalem Post* online ed. 18 November 2014.

²⁸Tax Justice Network, 2016, 16 March “Following the money: French Banks’ Activities in Tax Havens”, Retrieved from www.taxjustice.net.

²⁹Its BIT with the Czech Republic was signed in 1996 and terminated in December 2011.

³⁰“Spanish holding companies for Chinese outbound investment”, *International Financial Law Review*, 25 September 2012. Retrieved from www.iflr.com.

³¹ It monitors corporate social responsibility.

³² “Almost all Spanish stock market firms use tax havens report”, *The Guardian* 30 May 2014, Retrieved from www.theguardian.com.

³³ *Business Week*, 19 December 1970, p.57.

³⁴ See Palan et al 2010, p.67.

³⁵ Cayman Islands 12, BVI 9, Bermuda 6, Jersey 3, Channel Islands 2, Isle of Man 2, Guernsey 2.

³⁶ The Dutch Antilles 2 and Curacao 2.

³⁷ More than one SCCs maybe involved in the same case; hence the number here is larger than the number of cases analysed. It could be larger if the information were available on all ICSID cases.

6. Radical Changes to FDI

6.1 Introduction

1. With the increasing use of SCCs by TNCs, FDI changed radically in the 20th century. The idea that developing countries signed BITs in order to attract FDI underpins several studies that have explored FDI flows. It can also be implied from the preambles of most BITs (Chapter 1). Analyses of FDI flows are not conclusive on the question whether BITs indeed give rise to increased FDI (Chapter 2). This may be caused by the fact that most FDI flows take indirect routes through SCCs to their destinations. There would have been easier ways to attract investments from random states than signing BITs giving investors rights to ISA. The *bilateral* aspect of the bargain in a BIT should not be rendered meaningless by their interpretation.

2. Most BITs and the Convention do not make a reference to FDI. A reasonable interpretation of BITs would have been that (a) investments, as defined broadly, would benefit from substantive protections, but (b) ISA would apply to only such investments as comprised a specific arbitration agreement with the state. Even assuming states' consent to arbitration in BITs, the objectives expressed in the preambles should have limited ISA-eligibility to FDI. Instead, arbitrators' interpretations have evolved to expand the eligible investments using the text of the definitions alone.

3. The changes to the nature of FDI would have been foreseen by TNCs, IOs and the developed countries – most of the actors involved in the drafting and promoting of BITs. The developing countries were advised to improve their investment climates and to reduce the reliance on debt finance (Chapter 10). This Chapter shows how, with the TNCs' extensive reliance on SCCs, FDI flows became increasingly *indirect*. This is part of the essential backdrop for the ISA arbitrators' interpretation of the definitions of investments in BITs. It also describes the acceptance, even encouragement, of SCCs by the developed countries and IOs.

4. This Chapter includes an analysis of the BITs entered into by the three sample countries, the UK, India and Sri Lanka. Even after the arbitrators' views on indirect investments became known through awards, these countries' BITs have not discarded the emphasis on the bilateral element of investments in their post-2000 BITs.

6.2 Why focus on the bilateral?

5. IOs promoted the signing of BITs, and the Convention, as part of developing countries' improvement of investment climates in order to attract FDI (see Chapter 10). Mutual benefit and

reciprocity appear to be the objectives of a majority of BITs. Whether FDI is beneficial to an economy is a complex question. Not all FDI has the potential to bring a net benefit to a host. The developing countries would have ranked non-debt capital or other contribution (e.g. know-how) higher than purely speculative, short-term investments. Given that ISA was to bring about a paradigm change to international law, it would have been reasonable for states to agree to an overall umbrella under which some investments as specifically agreed with investors would have had an ISA option. A blanket consent for ISA for all and any kind of disputes would not have fitted with the objectives of BITs.

6. The definitions in many BITs include ‘investment’ and ‘investor’ but not *FDI*. As between the signatory countries, investment flows must be both foreign and direct, and did not need further labels. Many definition clauses in BITs include “directly or indirectly” held investments but without evidence to guide the meaning of the expression ‘indirect’. This expression could refer to a) an investment in a *bilateral* relationship but held indirectly (e.g. through a locally incorporated company), or b) an investment held in a *multilateral* relationship (e.g. held via entities set up in different countries). Assuming that BITs were intended to encourage flows of FDI *between* the signatory countries, the natural meaning of investments should be the former, except in a minority of BITs that make an express reference to third parties – non-signatory states.

7. When BITs were first proposed, investments across borders were circumscribed by laws and regulations, and were relatively transparent. By the time BITs were interpreted by arbitrators, FDI did not necessarily follow bilateral patterns nor comprise new capital. In 2013, 25% of FDI in-flow to India came from Singapore, 20% from Mauritius and 5% from the Netherlands. The US and Britain together made up 50% of the M&A acquisitions into India, and Japan 10% (Rajan and Gopalan, 2015). Investments from the US, Britain, or Japan were clearly being routed through Singapore, Mauritius or the Netherlands, and, en route, they might have used other SCCs. M&A transactions tend to have a negative impact on the growth of developing countries, but an insignificant impact on developed countries, and greenfield investments have a positive impact on growth in both developing and developed countries (Neto et al, 2010). M&A, e.g. involving share-swaps, does not necessarily move cash-flow. The Indian example is not unique. M&A transactions were estimated to be a third of the 2014 global FDI flows of \$1.23 trillion (UNCTAD, 2015).

8. Financial arbitrage affects the route of FDI. Khalilzadeh-Shirazi and Shah (1991, p.105) studied TNCs’ investment decisions focusing on Thailand. They concluded that MNCs route their income through the countries with the lowest levels of taxation on particular sources of income. For example, interest and dividend remittances can flow tax-free through a Dutch subsidiary, and instead of repatriating the income to a TNC’s home, it could distribute it as interest to, say, a Swiss

branch of the Dutch subsidiary. The Swiss branch would be taxed at a minimal rate. In this manner, a foreign company could repatriate funds out of Thailand to a desired destination and defer taxes in the home state. The effect of such decisions on the home and host states is that an investment might fail to bring a net calculable benefit to either.

6.3 Conventional FDI

9. Most definitions of FDI, at the time majority of BITs were signed, focused on the extent of ownership. An essential element of FDI was understood to be a continuing substantial interest in, and an effective voice in, management of the real assets of a foreign affiliated entity (Brewer-Thomas 1991, p.2). A share of 10% to 25% was commonly considered the minimum threshold for a direct investment, but the essential element was *control* over assets.

a) US government used the measure of 10% equity ownership.¹

b) World Bank definition refers to two economies: "...direct investment is a category of cross-border investment associated with a resident in one economy having control or a significant degree of influence on the management of an enterprise that is resident in another economy. Ownership of 10 percent or more ... is the criterion for determining the existence of a direct investment relationship."² (World Bank, 2012 p.143).

c) The OECD definition of a "direct investment enterprise" referred to an effective voice in the management, and suggested that FDI is mainly distinguished from portfolio investment by "the intention of exercising control over an enterprise." (OECD 1996).

10. Article 12 of the Convention Establishing the Multilateral Investment Guarantee Agency (MIGA) 1985 defined eligible "investments" to include "equity interests, including medium- or long-term loans made or guaranteed by holders of equity in the enterprise concerned, and such forms of direct investment as may be determined by the Board". Shihata, the general counsel of the World Bank, believed that eventually such investments would include profit-sharing, service, management and turnkey contracts, licensing etc. (Shihata, 1985, p.367). The definition was thus left open-ended and expansive as indicated by the words "as may be determined by." MIGA being a *multilateral* convention, did not have the same objective as BITs. Loans, for example, would not have been considered as attractive as non-debt equity in debt-ridden developing countries.

6.4 Indirectly owned direct investment enterprises

11. As investments changed in nature, the IMF included in its definition of FDI, not just the initial transaction between "the direct investor and the direct investment enterprise but all subsequent capital transactions between them and among affiliated enterprises resident in different

economies.” (IMF 2003, p.30) According to this definition, the direct investment enterprises comprise: (a) non-resident subsidiaries in which the investor owns more than 50%, (b) non-resident associates in which the investor owns 10-50%, and (c) non-resident branches (wholly or jointly owned unincorporated enterprises) either directly or indirectly owned by the investor. This FDI definition included some obviously “indirect” investments.

12. The OECD defined an “indirect ownership interest” to exist “when a direct investment enterprise that is directly owned, in turn, has an equity holding in another non-resident direct investment enterprise, thereby making the first direct investment enterprise a direct investor in the second direct investment enterprise. ... the direct investor at the top of the ownership chain holds an indirect ownership interest in the enterprise at the bottom of the ownership chain. ...” (2009, p.63). The OECD called for the treatment of “indirectly-owned direct investment enterprises” as a “Fully Consolidated System” when collecting data of inward FDI, but only 11 out of 61 countries it surveyed could use this system in 2001³ (IMF, 2003, p.30) because TNCs (not states) tend to have access to the information required for the system.

13. In order to appreciate the difficulties of defining FDI for the purpose of its statistics, the IMF (2003) suggestion was not to require control of the investment enterprise since the criterion used is 10% ownership by “one investor or a related group of investors.” The phrase “related group” does not have to include investors from one country; they could be from several countries (IMF 2003).⁴

14. The IMF’s Balance of Payments Manual (BPM) 5 defined FDI as “a category of international investment that reflects the objective of a resident in one economy (the direct investor) obtaining a lasting interest in an enterprise resident in another economy (the direct investment enterprise)” (IMF, 1993). This definition underwent a change in the BPM6 in 2013. Direct investment is a “category of cross-border investment *associated* with a resident in one economy having control or a significant degree of influence on the management of an enterprise that is resident in another economy.” (Emphasis added). Under this definition direct investment includes investments in indirectly influenced or controlled enterprises, investment in fellow enterprises, debt and reverse investments.

15. The BPM editions (using the words “related” and “associated”) support the argument that there was a fundamental change in the understanding of the term FDI sometime around the end of the 20th century. The BPM6 also omitted lasting interest as a characteristic of FDI.

16. Thus, after the majority of BITs were concluded, the general understanding of FDI was expanded, at least as understood by the specialists working with IOs, lawyers and accountants setting up such schemes, and the banks involved in the transactions. However, the “popular

misconceptions” remained, as acknowledged by the IMF staff (2003, p.7), that FDI was based on the nationality or citizenship of the *direct* investor. For the IMF’s staff, FDI was based on residence.

17. The data collected by the developing countries would not have given them much useful indication of FDI flows from a BIT signatory. The advice from the BPM was to allocate FDI to the immediate country of domicile of the direct investment enterprise (host)/direct investor (home) (IMF, 2003, p.37) regardless of the source or control of capital (which would be relevant for the political bargain in the BITs). The OECD advice was that “transactions and positions between all these directly and indirectly owned enterprises should be included in direct investment”. (OECD 2009, p.63).

18. The IMF statistics indicate that the British FDI in the Netherlands was \$247 billion at the end of 2001, but the Netherlands recorded \$44 billion as the corresponding figure; the Dutch FDI in Britain was \$26 billion, but Britain estimated this to be \$90 billion (IMF 2003, p.26). The Dutch did not include any investment by Special Financial Institutions (SFIs) in the Netherlands as FDI. These entities were directly/indirectly owned by non-residents used as conduits to channel funds from non-residents to non-residents. This means that most of the British FDI to the Netherlands was to be ultimately employed in third countries.

19. The methods employed by the countries to keep statistics on FDI differed. Sometimes IOs’ recommendations on keeping statistics were impractical. The host states’ banks would not always have had adequate information to distinguish portfolio from direct investment currency transactions, and the information about reinvested earnings could be only obtained from the private sector which did not have to cooperate. This area is particularly complicated by use of SCCs.

6.5 TNCs’ use of SCCs

20. The Euro-currency market was fuelled by the 1970s’ oil money. New types of Eurobonds were adopted by the TNCs and by the European governments (Versluysen, 1988, p.7). The European companies became more dependent on the banking sector and the capital market for their development capital (Stephenson, 1970). Also, floating exchange rates increased the potential opportunities for speculation. The capital markets started integrating, partly because of technological progress in communications (Versluysen, 1988, p.9, 25). The use of SCCs grew among TNCs not just to hedge currency risks but to expand optimally from tax and regulatory perspectives. Manufacturing and trading corporations started using tax haven subsidiaries in the marketing and invoicing of goods, and the larger TNCs, also for self-insurance (Lutyens, 1972).

21. When the US banks were allowed to operate in London, the British banks lost their early

advantage in the Eurocurrency market. But a series of laws would enable the British banks and businesses to use Channel Island subsidiaries to gain a non-resident status so as to regain the lost advantage (Palan et al, 2010, p.135). A secret internal report of the Executive Commission of the EEC found evidence of tax haven companies serving no economic or financial functions except that of “reducing an overall tax bill for a company.” (Farnsworth, 1970). From as early as 1970s, developed countries were aware of business practices of TNCs using SCCs. As FDI increased in the financial services’ sector between 1977 and 1985, it appeared to be concentrated in SCCs like the Bahamas, Bermuda, Panama, Trinidad and Tobago and other Caribbean islands (Brewer Thomas, 1991, p.12). FDI in tax havens in the Caribbean and the South Pacific grew more than five-fold between 1985-1994 to over \$200 billion (Wells Jr. and Wint, 1991, p.81). Banks and IFIs appear to have facilitated the spread of the use of tax havens.

6.6 A searchlight on *The Times*, the UK

22. As the use of the SCCs grew for tax purposes, it appears that it was rarely censured. A sample search was carried out on the archives of a British newspaper, *The Times*, for a decade from the mid-1960s to the mid-1970s. It illustrates how tax havens were reported in a mainstream newspaper around the time that FDI started to change. The activities of tax havens were openly written about in Britain and the potted view also revealed information about how the usage of tax havens was growing globally. The promotion of tax havens in the 1960s would have been no secret to the British authorities. For instance, *The Times* carried an advertisement on 25 January 1964 offering Bank of Europe’s complete investment and banking services in the “tax-free Bahamas”.⁵ The tax havens were claimed to be “like all forms of income tax consultancy, a field for continuous innovation. Some companies are already experimenting with holding their board meetings in a series of different places – or even in an aeroplane – in order to escape a permanent ‘residence’”.⁶

23. Malta started drafting an Offshore Companies Act and five British banks opened offices in Malta in 1969. Some American banks such as Chase Manhattan, and other investment firms were considering opening branches in Malta.⁷ An editorial in 1965 advised Ireland to capitalise on its being a small nation without a GATT commitment in order to imitate the Swiss secret banking system and set itself up as a tax haven.⁸ Two years later, the Rothschilds moved into the Channel Islands to provide services for their non-resident clients (Pulay, 1967). Over 2,000 new purely financial firms were set up in Luxembourg in 1967 many of which were “internationally known names” and “holding companies” although the French, German and Belgian authorities were supposed to be looking to harmonise tax laws within the EC (Gabrysiak and Gordon 1967). By 1973, there were 3,200 letterbox companies in Luxembourg, 10,000 in Switzerland and 20,000 in Liechtenstein (Berthoud, 1973). Many Luxembourg companies were set up for the sole purpose of

holding shares in other European entities as foreign dividends were not subject to Luxembourg taxes (Spanier, 1967). Wholesale banking was the strength of the Luxembourg based companies. German banks operating on the Euromarkets could lend more profitably from Luxembourg with its minimum reserve requirements than from a branch at home.

24. English law did not permit an insurance company's life funds to be substantially invested in commodities, precious stones or unlisted securities. Yet, insurance companies could purchase a bond linked to any of these assets by using an OFC (Bloch and Godfrey 1981). The fund might be technically based in the Isle of Man, but a London company did the essential work (Prest, 1981). The advantages offered by a location did not involve simply avoidance of tax; there were other financial or corporate tools that each SCC offered.

25. The influx of the new financial and investment companies was seen in Jersey, and Jersey was advised not to join the Common Market with Britain.⁹ A locally registered company would not be liable to tax if it did not conduct any business in Jersey. *The Times* wrote in 1964 that a trust managed from Nassau by the Bank of Nova Scotia Trust Company set up in the Bahamas, would not be liable even to a low rate of tax.¹⁰ In 2000, Jersey was listed under 'harmful' tax havens' list by the OECD, and it had to consider ending its different taxation schemes for resident and non-resident companies; not that the companies had to be taxed but that if they were, they should have been treated equally (Mortished, 2000; Doran 2000).

26. Liechtenstein, in 1968, had a reputation for being the American companies' favourite tax haven but it was not easy to find out which American companies operated holding companies in Liechtenstein as the local laws did not allow an inspection of the official records.¹¹ The then new company law in Britain in 1968 provided for a nominal corporation tax if the companies were registered in, but controlled from outside, the islands within the British Commonwealth. This led to a speeding up of company formations in the Channel Islands.¹²

27. By 1970, the Netherlands Antilles joined the list of tax havens, and the Grand Cayman offered a variety of banking, trust and corporate firms (Buckmaster, 1970). By the early 1970s, Hong Kong started to build a sophisticated financial market (Doggart, 1973). Grenada, soon after its independence from Britain in 1974, made itself into a tax haven; offering investment-citizenships that would involve no income, capital or inheritance tax and no residency commitments.¹³ For international bond issues, Luxembourg or the Netherlands were ideal as they permitted loan interest to be paid gross to foreign investors thus eliminating the need to reclaim taxes.

28. These reports indicate how tax havens were associated with legitimate objectives, and how capital-exporting states were becoming competitive about retaining capital.

6.7 Acceptance of SCCs by IOs and states

29. SCCs quickly became an important part of the structure of the global economy. Profits, dividends, and other types of income took complex, and at times tortuous, route through SCCs, and did not always return to the country that was the source of capital. The treatment of what was an investment, a capital or a revenue income or expense, etc. depended on how a corporation wished to treat the transactions, and the same transaction could have been treated differently in different countries as debt or equity.

30. It was clear in the 1970s that a modern tax-haven could perform a wide range of “perfectly legitimate functions” which for the TNCs would have included “the intelligent routing of operating profits, dividends, royalties and pension contributions” or simply holding of profits in Bermuda or Switzerland until they could be distributed or used later (Doggart, 1972). By the 1970s, it was clear to UNCTAD that TNCs had a large number “non-producing subsidiaries” in tax havens (UNCTC, 1978, p.141).

31. As early as 1972, EEC’s fiscal attitudes showed a “theme of realism” in accepting tax havens as part of the “freedom deliberately allowed to tax-paying mice by the fiscal cat.” (Doggart, 1972). For example, the EEC permitted the Isle of Man and the Channel Islands to participate in the Customs Union and free trade provisions of the Treaty of Rome without having to harmonise their taxation laws. A slightly different carve-out was allowed to Gibraltar.¹⁴ By 2003, Gibraltar’s investment services providers were licensed to operate in other member states of the EU – “passporting.” Insurance companies were allowed the same privileges in 1997, and banking in 1999 (Knipe, 2003). Passporting allows an entity to operate across the entire European Economic Authority (EEA) region,¹⁵ once they have set up in any one member state as e.g. in London. Swiss and the US companies can and do use this facility.¹⁶

32. The US Senate defeated a bill in 2002 that would have avoided the Department of Homeland Security procuring military hardware and services from the US companies registered offshore (Cooley, 2003, p.680).¹⁷ This was an indication of the US acting like the EU, with pragmatism. The developed countries’ rules and regulations did not discourage the use of offshore entities. Financial deregulation and the globalization of capital markets contributed further to SCCs’ growth in the 1980s. It delinked financial activities from other economic activities in the market and increased global speculation for short term profits (Versluysen,1988).

33. As technological and transport innovations allowed TNCs to internationalise production, TNCs started to use increasingly sophisticated tools, involving the use of SPEs set up in SCCs, for hedging currency-risks. Various developing countries set up OFCs (e.g. Singapore, Hong Kong).

Singapore and Hong Kong are noted for their virtual incorporation facilities although they may not be perfect tax havens (Palan et al, 2010, p.141).

34. Monitoring of TNCs' tax activities is not easy. A TNC can change its corporate structures once it invests in the host countries. Any tax incentives offered (e.g. an early tax holiday) can lead to an opaque picture later when the tax authorities face an enterprise whose financial structure is already well established. Its "depreciable assets and accumulated losses" appear on the books as the outcome of the performance of prior years, shaping and conditioning the firm's liability for the future. (UNCTC, 1978, p.141).

35. In the 1980s, one eighth of the foreign income of the American TNCs was booked in tax havens with charges such as costs of research and development, headquarters and management expenses, royalty for intellectual property, or interest payments on loans being booked to a shell company in a tax haven (Picciotto, 1988, pp.65-6). The other legal strategy commonly used by the TNCs was transfer pricing. In 2007, the accounting firm Ernst and Young carried out a survey of 850 TNCs surveyed in 24 countries; 77% placed transfer pricing at the core of their tax strategy for 2008-09 (Palan et al, 2010, p.68).

36. IOs were aware that SCCs were key structural elements of the global FDI flows before the surge in BITs. This is also clear from the fact that the BPM recommended states to include in FDI data, SPEs "frequently established" in OFCs regardless of their structures (e.g. holding companies, regional headquarters) or purposes (e.g. administration, facilitation, financing) as they were an "integral part of the structure of the direct investment network as are, for the most part, SPE transactions with other members of the direct investment group." (IMF, 2003, p.33).

37. IOs made substantial amounts of loans to companies incorporated in tax havens and OFCs (Palan et al, 2010, p.50-52). In February 2009, for example, the IFC approved loans of about \$215 million to Kosmos Energy and Tullow Oil for exploiting oil and gas reserves in Ghana; this was a company indirectly owned by a privately held Cayman Island company.¹⁸ Further, the IMF was also aware of "round tripping" which it defined as "the practice of channelling local funds to SPEs abroad and the subsequent return of the funds to the local economy in the form of FDI capital" (IMF, 2003, p.33). FDI from Hong Kong and the BVI is usually Chinese capital being re-routed; in the first five months of 2007, ten countries (Hong Kong, the BVI, Japan, South Korea, Singapore, the US, the Cayman Islands, Samoa, Taiwan and Mauritius) contributed 85% FDI into China (Palan et al, 2010).

38. It is not just the large TNCs that use SCCs. For example, as soon as the European Court of Justice (ECJ) upheld freedom of incorporation in 1999, 55,000 new private limited companies were

set up in Britain from other EU states; majority were from Germany, France, Cyprus, and the Netherlands. Most were small with one or two directors (Palan et al 2010, p.68). The European case *Centros*¹⁹ is an illustration of how SCCs' use continues to be legitimised even if it circumvents local regulations.

39. There is, among states and IOs, a continued acceptance of SCCs to maximize the benefits of tax and regulatory regimes for TNCs. For example, in 2002, Virgin, a TNC, used a tax haven to reduce its UK bill for value added taxes and paid zero corporate tax when it introduced a flat-rate internet service (Mathieson 2002). 'Blue-chip' companies like Accenture (a consulting firm that was originally a division of Arthur Andersen, and survived the Enron scandal), and Tyco International, an industrial group, were found to be registered in Bermuda and the Bahamas in order to avoid paying the US taxes in 2002 (Ayres 2002). Although Accenture was threatened with losing \$600 million worth of the US government business after this revelation (Doran 2002), in 2015, it was one of the three companies that were awarded by the US Department of Defence a \$4.3 billion contract for military health system's electronic records.

40. There have been calls, for example, from the OECD, to take action against tax havens, not necessarily against the OFCs. In 1980, a meeting of the Council of Europe in Strasbourg discussed the then prevalent practices of TNCs taking advantage of international tax laws. These included overvalued exports, payments for fictitious services, collection of earnings by fictitious companies and false definitions of earnings (Vernholes, 1980). In 1984, accountants offered to help redraft part of the Finance Bill in Britain to ease the clamp on tax havens (Griffiths 1984). In the same year, Robin Cook, a British politician, said, "Future historians are likely to regard as one of the mysteries of Britain's economic decline the enthusiasm with which her financiers led export of capital while investment in their own domestic industry fell from an already lamentable level." (Cook 1984). The British financial services industry worked with skill and determination at keeping Britain as an SCC (Smith 1986).²⁰

41. With the European integration in the early 1990s, tax avoidance and capital flows became part of the discourse in the EU. The European concerns over TNCs' competitiveness prevented action against the use of SCCs (Giovannini, 1992). The US government's lack of enthusiasm to deal with TNCs' tax issues was probably from a similar concern. In 2013, a former chief economist at McKinsey estimated that high net worth individuals may have as much as \$32 trillion in tax havens.²¹ As is seen in Figure 5.2, total FDI flows into tax havens rose after 2007, and fell for other SCCs (the US, the UK, etc.). Despite the OECD's efforts since 2009, the use of SCCs in conjunction with tax havens continues except there is an increased emphasis on transparency, at least, in the EU.

6.8 Recent BITs and indirect investments

42. A sample analysis was carried out on the post-2000 BITs signed by three countries: Britain as an example of a developed country, Sri Lanka as a developing country ICSID member, and India as a non-ICSID developing country. If BITs were intended to be portals from which any third party investors may invest, the references in the preambles might not indicate bilateral objectives and investments. The definitions of investments might indicate how states have dealt with ISA interpretations.

43. The newer BITs do not show a change in the objectives of BITs. There is no particular widening of the criteria to include investments through third party states. If anything, some of the BITs have tightened the definitions of nationals to require an investor's seat to be in the home country. The bilateral focus thus appears to have been retained by the states in this sample.

44. Sri Lanka entered into six BITs after 2000. Its BIT with Germany sets out the signatories' desire to "intensify economic cooperation *between* both States" and to create favourable conditions for investments by "nationals and companies *of either State* in the territory of the *other State*." (Emphasis added). The intention in the preamble is also to increase "prosperity of both nations". The word "companies" is defined by reference to a "seat" in Germany, and simply by reference to "incorporation or constitution" in Sri Lanka. Its BITs with Iran (2000) and Czech Republic (2011) require investors' a seat in the home country. The preambles refer to increasing economic cooperation for "mutual benefit". Its Kuwait and Viet Nam BITs (2009) are not available on the UNCTAD database. Its Australian BIT (signed in 2002) recognises that an investment may be "owned or controlled...under the laws of a non-Party", but qualifies this by expressly requiring "50% or more participation, decisive power over management and operations, or over the composition of the board of directors or of any managing body." In case of a doubt, the investor, not the state, has the burden of proof. Clearly, minority shareholders that do not have decisive control are excluded.

45. India signed 49 BITs after 2000.²² As Indian investors have started to invest abroad the country has capital-exporting and capital-importing interests to balance in its BITs. Most of the BITs still refer to mutual prosperity in the preambles. There is no text available on UNCTAD's website for seven of India's BITs with, Montenegro (2003), Djibouti (2003), Ethiopia (2007), Uruguay (2007), DRC (2010), Seychelles (2010), and UAE (2011).

46. Its BITs with the following thirteen countries indicate a requirement for substantial business operations or a seat in the home state: the Philippines (2000), Portugal (2000), Ukraine (2001) if the investor is from Ukraine, Cyprus (2002), Serbia (2003), Bosnia and Herzegovina (2006), Jordan

(2006) Slovakia (2006), Greece (2007), Mexico (2007), Macedonia (2008), Colombia (2009), and Lithuania (2011). Four BITs require the investor's main, incorporated or registered office in the home state: Finland (2002), Armenia (2003), Iceland (2007), and Saudi Arabia (2006). The India-Syria BIT (2008) requires Syrian companies to be "domiciled" in Syria, but not so for Indian investors in Syria. Sudan obviously expects to be the host as India's 2003 BIT with Sudan specially provides that if an Indian company is making the investment it may do so through a third party, but it needs to show that it is owned and controlled by an Indian national.

47. India's BITs with Sweden (2000) and Kuwait (2001) refer to ownership of at least 51%. Twenty-one Indian BITs do not require any special connection other than incorporation in the home country albeit that their preambles refer to investments *by investors of one State in the territory of the other State*. These are with Thailand (2000), Lao (2000), Mongolia (2001), Croatia (2001), Ghana (2002), Yemen (2002), Taiwan (2002), Belarus (2002), Hungary (2003), Bahrain (2004), China (2006), Trinidad and Tobago (2007), Libya (2007), Brunei and Darussalam (2008), Myanmar (2008), Senegal (2008), Bangladesh (2009), Mozambique (2009), Latvia (2010), Slovenia (2011), and Nepal (2011).

48. Thus, 21 out of 42 recent Indian BITs do not require an express connection with the home state. Arbitrators are likely to hold that India intended half the BITs to allow third-party investors. Its BITs provided for restrictions expressly in the other instances. However, this would be assuming that India entirely controls the terms of its BITs. Its counterparty may not wish to apply such a condition. It maybe that Indian investors were expected to make investments in the other country. Having said that, and ignoring the preambles for this purpose, at least half of India's post-2000 BITs require an investor to be "connected" to the home state; this is indicative of India's desire *not* to welcome indirect investments at least in respect of those countries.

49. Britain entered into twelve BITs after 2000 and two of them are not published on the UNCTAD database: (Serbia) 2002, Kuwait (2009). No special requirements apply to investors other under the British BITs with Sierra Leone (2000), Angola (2000), Gambia (2002), Bosnia and Herzegovina (2002), Vanuatu (2003), Mozambique (2004), Ethiopia (2009). Its BIT with Viet Nam (2002) requires Viet Nam investors to have their seat in Viet Nam. Its BIT with Mexico (2006) requires an enterprise to be engaged in business operations in its home state, and its BIT with Colombia (2010) requires both seat and substantial business activities in the home state.

50. So far as this sample goes, one cannot say with certainty that India or Sri Lanka appear to show their willingness to go along with the generic position that BITs should act as mere portals unless their own investors are exporting capital. As ISA awards started to show how arbitrators

would interpret BITs, the developing countries' BITs show some re-consideration on the matter of indirect investors. The bilateral aspect of FDI appears to be retained by all three sample states.

6.9 Summary

51. FDI is a misnomer since it now comprises 'indirectly held direct investments'. IOs have re-defined FDI to recognise their global nature. This was not necessarily foreseen in the definitions of the first versions of BITs. If it was, there is no evidence that the effect of such a radical change in the nature of FDI on ISA eligibility was clearly understood and agreed to by the developing countries. ISA arbitrators do not consistently use formal or beneficial ownership for determining the nationality of an investor (Chapter 12). The sample of three countries' BITs does not show an express intention to widen the applicability of BITs to investments from non-parties; if anything, it indicates that the conditions of eligibility were tightened in many BITs. Their preambles still shared the objective of reciprocity.

52. Despite some efforts to curb certain types of economic activities or, at the least, to make them transparent, SCCs have continued to thrive. This may be because it is not easy to identify an illegitimate use of an SCC from a legitimate one. The next Chapter discusses how TNCs typically use SCCs. The recent views of arbitrators are that a holding company can have a legitimate business simply to hold another entity and such an interpretation could still defeat the attempt of states in newer BITs to ensure that a claimant investor should have substantial business in a home country.

¹ *Statistical Abstract of the United States* 1984, 104th edition, p 821

² <http://data.worldbank.org/indicator/BX.KLT.DINV.CD.WD>

³ The same as in 1997 – IMF, 2003, p.38.

⁴ Borrowings from unrelated parties abroad that may be guaranteed by direct investors are not included in the IMF's FDI. These could, conceivably be included in BIT definitions of investments.

⁵ "Display Advertising." *Times* [London, England] 25 Jan. 1964: 12. Retrieved from *The Times Digital Archive*.

⁶ Our Special Correspondent. "Tax Haven Playgrounds Meet Challenge of Tighter Laws." *Times* [London, England] 24 Aug. 1964: 14. Retrieved from *The Times Digital Archive*.

⁷ "Malta." *Times* [London, England] 5 Nov. 1969: 20. Retrieved from *The Times Digital Archive*. Malta spent some time in the late 1990s re-building its financial services activities as a more respectable part of its economy as it worked towards its membership to the EU. "Minnow confident that it can swim among the big fish." *Times* [London, England] 2 Dec. 2003: 8[S3]+. Retrieved from *The Times Digital Archive*.

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- ⁸Our City Editor. "Hire-Purchase Debt Swings Into Reverse." *Times* [London, England] 9 Nov. 1965: 16. Retrieved from *The Times Digital Archive*.
- ⁹"Jersey puts its case for staying out of the EEC." *Times* [London, England] 11 Oct. 1967: 22. Retrieved from *The Times Digital Archive*.
- ¹⁰City Editor, "Another tax haven trust", *Times* [London, England] 9 Jan. 1964: 14. Retrieved from *The Times Digital Archive*.
- ¹¹"Who are the 50 U S firms evading tax?" *Times* [London, England] 14 Feb. 1968: 26. Retrieved from *The Times Digital Archive*.
- ¹²"Tightening up on the Islands." *Times* [London, England] 3 Apr. 1968: 29. Retrieved from *The Times Digital Archive*.
- ¹³"Grenada 'tax haven' forecast." *Times* [London, England] 3 July 1974: 19. Retrieved from *The Times Digital Archive*.
- ¹⁴The EU considered ending Gibraltar's status as a tax haven in 2001; its exempt-company status was found by the EC to be a form of illegal state aid: Searle and Binyon, 2001; Mortished 2002.
- ¹⁵All the EU members plus Norway, Iceland and Liechtenstein.
- ¹⁶Walker, A., "What is an EU Bank Passport?" Retrieved from www.bbc.com.
- ¹⁷Page 15033 of Congressional Record vol. 148-Part 11, *Proceedings and Debates of the 107th Congress Second Session*.
- ¹⁸"Ghana's Oil and the Strain of World Bank Financing Conditionalities" Retrieved from www.ghanaweb.com.
- ¹⁹*Centros Ltd.* 1999.
- ²⁰"Britain is the finest "pure" tax haven in the world, offering incentives at least as good as those of the Cayman Islands or Luxembourg, the Economist Intelligence Unit says in a report. ...Britain has been used as a tax haven by knowledgeable foreign business people for many years" and it also has the world's largest network of taxation agreements with other countries. Smith, 1986.
- ²¹"Leaks reveal secrets of the rich who hide cash offshore", *The Guardian*, 3 April 2013.
- ²²India has also indicated its intention to renegotiate 47 BITs recently.

7. Multinational companies to transnational corporations

Impact on FDI

7.1 Introduction

1. TNCs were mostly responsible for the net inflows of global FDI of over \$1.5 trillion in 2012,¹ (Milner, 2014, p.2).² There is a vast difference between today's TNC conglomerates and the multinational companies (MNCs) of the 1950s that engaged in FDI. The objective of this Chapter is to illustrate why the device of bilateral promotion and protection designed in the 1950s is not appropriate for TNCs of the 21st century. TNCs routinely, and legally, use SCCs to maximise their after-tax profits (Larkins, 1991, p.471-2) and obtain other regulatory advantages.

2. This Chapter will briefly differentiate between MNCs, MNEs and TNCs, and trace a few relevant changes in typical corporations in two important periods: 1930-1970, and 1980s-1990s. The first period saw the initial push from TNCs for ISA, and, the second period saw the signing of over half of the total BITs. The nationality of TNCs in their various organisational forms and the concentration of power in a small number of TNCs are discussed next; these are relevant to the determinations of ISA-eligibility. This Chapter will briefly look at how investors' exposure to political risk and contributions to the host's economies differ from sector to sector; this should be relevant to the interpretation of BITs. Designed as one-size-fits-all, BITs appear to offer the same privileges to all investments whether beneficial to the host's economy or not. TNCs' eligibility to rely on BITs depends on their nationality which is easy to manipulate using SCCs and SPEs. Applying *bilateral* instrument of protection to investments skews international legal norms unfairly.

7.2 MNCs, MNEs and TNCs

3. A MNC, as referred to in this thesis, is "an enterprise that engages in foreign direct investment (FDI) and owns or controls value adding activities in more than one country" (Dunning 1993). MNCs used to expand by using wholly-owned subsidiaries.

4. A multinational enterprise (MNE) has the following characteristics: (a) a substantial amount of its business is performed in two or more countries, and (2) its management makes decisions based on multinational alternatives, with a global perspective (Hadari, 1972, p.111). Salacuse defined MNEs by reference to production and marketing in more than one country (1984-85, p.970-1). The emphasis on manufacturing, and the ownership or control of income-generating assets is

clear from another 1980s' definition of MNCs (Kirkpatrick and Nixon, 1981, p.369-70). This would have been also the understanding of FDI when developing countries started to sign BITs.

5. A MNE is not that dissimilar to a TNC except that MNEs commonly operated with a parent company at the headquarters and spread in several countries through subsidiaries. A TNC does not always have a home country, and may use subsidiaries and other forms of organisation to expand in several countries. TNCs have businesses that go beyond production and marketing. Also, the same affiliate may belong to more than one TNC (Desai 2009).

6. As defined by UNCTAD,³ TNCs are “incorporated or unincorporated enterprises comprising parent enterprises and their foreign affiliates.” A parent enterprise controls the assets of other entities in countries other than its home, using a threshold of 10% of the shares or voting power. Lasting interest features in the UNCTAD definition of a foreign affiliate, presumably to distinguish it from mere portfolio investments made by a TNC.

7. TNCs may not be loyal to a home state; this is true by reference to the tax payments of an iconic corporation like GE in the US.⁴ If measured by reference to ownership and control, IBM is American, and Toyota Japanese (Hu, 1992, p.111). The nationality of the boards of directors of TNCs might not necessarily be diverse and may give an indication of a home state (Robinson et al, 1993, p.487). There is no registry for TNCs and all their group entities.

8. From 35,000 TNCs with 150,000 affiliates in 1990, TNCs had grown to 64,000 TNCs with 850,000 affiliates in 2002 (UNCTAD, 1992, p. 11; UNCTAD, 2002, p.44). These numbers represent TNCs engaged in the tangible businesses of production and marketing. The generic expression TNCs in this thesis follows the UNCTAD definition but includes within it not just manufacturing companies but also, banks, insurance companies, marketing companies etc. They all use similar corporate personalities and may have the potential to begin ISA.

7.3 Corporation's home state

9. Corporations have an independent legal personality from their owners. The personality of a corporation with a limited liability has transmuted into different forms and, in the process, become difficult to regulate (Sutherland, 2010, p.267, 270). Partnerships could not limit their liabilities until relatively recently.

10. Not only can a corporation enter into contracts, hold property, borrow, lend, sue and be sued, but it carries with it a succession (e.g. in case of a change of shareholders). Until they are dissolved, corporations can multiply, migrate, merge, and mutate. There are other legal persons (e.g. societies, associations of persons, trusts, partnerships etc.) that can perform similar functions.

However, corporations, are a particularly flexible form.

11. Corporations' nationalities may be difficult to determine. In its original concept, a US company was deemed to be resident in the place of its incorporation, but, by 1860, a company could be incorporated in more than one state in the US (Schane,1986). The Treaty of Rome 1957 (EEC Treaty) allowed companies incorporated in one member-state access to other member-states' markets. In the context of BITs promoting FDI flows, the corporate 'home' state is relevant to its taxation, and ISA eligibility. The American and continental systems look respectively to the place of incorporation and the seat of control to determine the corporate nationality. There is no multilateral treaty on this issue. A preference towards the place of incorporation was perceived in the 1970s (Hadari, 1974, p.41).

12. Boards of directors primarily manage corporations' affairs and shareholders direct their policy. The principle of profit maximisation is an accepted goal of a corporation, but whether illegal acts should be committed in pursuit of this goal is disputed. Arguably, corporate law impliedly charters corporations for "legal purposes" (Greenfield 2001, p.1281-1283). However, corporations could break a law to increase profit and treat any fine paid as cost of business (Fischel and Sykes, 1996, p.323). Justifying a crime to extend profit in the context of, say, a courier van double-parked to deliver a parcel (Greenfield, 2001, p.1295), is different from causing long-term environmental damage for the short-term gain of few. The stakes can be high as seen in the dispute between Ecuador attempting to enforce its court's judgment against Chevron for environmental damage, and Chevron's use of ISA to appeal against that decision by alleging denial of justice and a breach of the US-Ecuador BIT.⁵

13. It is not just developing countries that seek to regulate corporations' activities for national objectives. During the World War II, regulations prescribed what could be manufactured or sold, and embargoes were common during the Cold War (Phythian, 2000, p.2). The ascendance of private interests over the public interests, is a post-1990 phenomenon especially obvious in the field of international investment law; its most striking illustration is in the fifty odd ICSID cases against Argentina for its actions in trying to stabilise its economy.

14. The major objective of the 1970s' corporations was growth (Ragazzi, 1972, p.6). Post-1990s' TNCs seek the maximising of quarterly profits (high dividends for shareholders, and large salaries for CEOs (Chang, 2012). Shareholders comprise more institutions than individuals which may explain the short-term perspective of profit maximisation.

7.4 Organisational forms and concentration of power

15. Legal personality can be organised in various forms. US law offers subchapter C and S corporations,⁶ limited liability companies (LLCs), and limited liability partnerships (LLPs), trusts, cooperatives, funds, risk or cost sharing agreements, anti-takeover agreements, groups with shared interests, etc. Banks and financial institutions (FIs) use similar organisations. Common forms used in England include private limited companies (Ltd.), publicly traded limited companies (PLC),⁷ limited partnership (LP) and limited liability partnership (LLP) which is similar to the American LLC. The European Economic Interest Grouping (EEIG) provides an alternative form of association to mergers, take-overs, and joint ventures in the EU. Some of the 1990s' convergence of organisational structures was due to the influence of McKinsey Consultants (McKinsey). McKinsey was an efficient "producer" of CEOs (McDonald, 2013, p.192). They recommended models for corporations and banks (McDonald, 2013, p.253).

16. From 1945 to 1975, MNCs' mode of expansion involved wholly-owned subsidiaries (UNCTC, 1978, p.62), extending to joint ventures if the host states demanded a share in the enterprises. The British firms started to use holding companies in the 1970s (UNCTC, 1978, p.64). The 1970s' inflation, especially in the US, led to innovations like junk bonds, leveraged buy-outs and mergers and takeovers. These tools are still used today. FDI impact of these kind of transactions is not always positive; absence of new capital and potential for asset-stripping are the downsides for the host states.

17. The international and regional institutional infrastructure formed by the IMF, the World Bank, the General Agreement on Tariffs and Trade (GATT), the EEC, the European Free Trade Association (EFTA), the Latin American Free Trade Association (LAFTA) and the Association of South East Asian Nations (ASEAN), etc. supported the internationalisation of corporations (Ringbakk, 1976, p.4). The complexity of a TNC's nationality derives from the organisational forms they can use in different SCCs coupled with their relations with each other. An OECD paper contains an example of the complexity of an institutional investor. California Public Employees Retirement Society (CalPERS), a public company, includes in its structure of ownership and asset management the following: 5,066 non-US equity companies, 4658 US equity companies, 426 real estate/REITs, 360 debt securities, 296 brokerage firms, 249 private equity funds, 134 private equity firms, 124 real estate managers, 124 custodians/portfolio management/data providers, 50 venture capital funds, 39 consultancy firms, 20 domestic equity managers, 18 global equity managers, 14 legal firms, six auditor firms, four fixed-income asset managers, three proxy advisory firms, etc. CalPERS manages the largest American public pension fund and had, in June 2012, \$237 billion worth net assets under its management. (Çelik and Isaksson, 2013, p.19-20).

18. Vitali et al (2011) demonstrate the concentration of power in the TNCs' networks. They applied a recursive search to 43,060 TNCs in a network with 600,508 nodes and 1,006,987 ownership ties. They found the largest connectivity ($\frac{3}{4}$ of all nodes) to contain "all the top TNCs by economic value", accounting for 94.2% of the total TNC operating revenue (Vitali et al 2011, p.3). The network was found to have a bow-tie structure where ownership of $\frac{3}{4}$ of the densely connected core was in the hands of the entities in that core (a group of 147 TNCs) that cumulatively held the majority share of each other. They pointed out the parallels between the ownership and the financial networks; lending or credit derivatives expose these to a risk of contagion. The network of SCCs obviously facilitates the TNCs' network. A bilateral focus is clearly inappropriate for investment protection or cost-benefit analyses of any investments.

7.5 Corporations in the 1930s to 1970s

19. Around the time Shell and Abs-Shawcross intensified their demand for BITs and ISA, the petroleum industry was looking for investment opportunities in Latin America to obtain concessions for large tracts of land despite any concerns of expropriation and Calvo clauses (Galvin, 1958, pp.217-218). MNCs' influence as a class grew by the 1970s (Vernon, 1977, p.246-7). The 1974 NIEO challenge to MNCs' entrenched legal rights from colonial times arose from developing countries' aspirations for economic independence (Kirkpatrick and Nixson, 1981, p.367). There were some nationalisations of assets which peaked in 1975 (Brewer-Thomas, 1991, p.4), but they were in decline by the time BITs were being signed in great numbers. Many MNCs' annual turnover exceeded their hosts' GDP. By 1974, twenty-one mining MNCs dominated in African mining activities and the hosts' earnings were based on the value of the output which could be manipulated by MNCs (Kirkpatrick and Nixson, 1981, p.380). The impact of MNCs on the world economy became powerful enough for the UN to set up a permanent intergovernmental Commission on Transnational Corporations - UNCTC (UN, 1972).

20. FDI was not a main feature of the 1970s' capital flows. Low interest rates led to increased availability of commercial bank loans (IMF 1991, p.39). Developing countries amassed a debt burden of approximately \$600 billion.

21. Sloan (1974, p.55, 60) suggests that MNCs might be responsible to more than one government whereas TNCs were not responsible to any government or international body. Most TNCs originated from a small number of economies in North America, Western Europe and Japan, and this trend continued in 2000 when less than 10% of world FDI originated outside this bloc (Amatori and Jones, 2003, p.363). In 1973, 45% of 9,481 TNCs had affiliates in only one foreign country, and under 4% had affiliates in more than twenty countries (Kirkpatrick and Nixson, 1981,

pp.369-370). When developing countries started to sign BITs, FDI and MNCs would have been largely understood by them in their traditional forms.

7.6 Corporations in the 1980s-1990s

22. During the 1980s, state actors focused on bilateral instruments to encourage FDI, but TNCs appeared to focus on regions –the US directed FDI to Latin America, Japan to Asian countries, and the EC to Central and Eastern Europe and a few African countries. The World Investment Report 1991 showed that FDI was rapidly increasing between 1980-89; 70% outflows were from the US, Britain and Japan. The US was also the largest recipient of FDI. The phenomenon of TNCs increasingly dominated the 1980s-1990s enjoying the competitive advantage offered by “the exploitation...of combinations of assets and locations” (Picciotto, 1992, p.761). Their growth relied on the opportunities offered by the organizational form more than on economies of scale of production (Williamson, 1985) and on the “arbitrage opportunities” arising out of the diverse currency exchange rates, markets and regulatory regimes (e.g. taxation) (Picciotto, 1992, p.761).

23. TNCs, according to Sloan (1974), have four main influences on host countries, namely, macroeconomic, cultural-ideological, political-legal, and social. General focus on attracting FDI in the 1980s did not consider the impact it would have at each of these levels. FDI may not bring increased capital or tax revenue where SCCs are used. FDI might bring sweatshops.⁸ Businesses might be operated on a short term basis. Cutting jobs to improve quarterly reports might have an adverse effect on workers. Using a company’s funds to buy-back its own shares might increase share-prices, but not add value to a company’s long-term interests in the business or in the host economy. Until the 1980s, buy-backs in the US amounted to 5% of share profits, but it rose to 90% in 2007 and 280% in 2008. GM spent \$20.4 billion in share buybacks between 1986 and 2002; at the rate 2.5% in a bank, the sum would have raised the \$35 billion that was needed for its bailout in 2009 (Chang, 2012).

24. TNCs’ business model based on short-term interests arrived on the global economic scene just before the developing countries were under pressure to liberalise their economies. State assets and enterprises were undervalued when privatised (Buckley and Arner, 2011, p.84). Despite their ability to exploit the loopholes in the regulations, TNCs were cossetted in developing countries (Sutherland 2010, p.284). Various incentives were given to attract TNCs’ investments (Picciotto, 2011, p.245). In the 1990s, a mono-causal approach prevailed when developing countries were being asked to improve their ‘investment climate’ to attract FDI. Yet, empirical research showed that financial incentives and concessions played little part in investors’ decisions; they were guided by the size of domestic and regional markets, host’s geographical location, and the quality of

labour-force (Szanyi, 1998, p.6).

25. Toporowski (2010, p.921) argues that a combination of two factors affected TNCs' investments: the lifting of capital controls at the end of the 1970s, and the inflation of the capital markets by the systematic inauguration of funded pension schemes. The overcapitalised TNCs with spare capital directed it to M&A that formed the major part of increased FDI in the 1990s (De la Torre and Schmukler, 2005, p.11). Large scale privatization schemes encouraged by IOs increased investment opportunities. FDI in the services sector went up from 20.1% in 1975 to 23.3% in 1982 (Brewer-Thomas, 1991, p.12). The US FDI outflows were increasingly in the financial services industry, and directed to SCCs during the period 1977-85 (Brewer-Thomas, 1991, p.12). By early 2000s, almost half of world's FDI was in the services sector (Amatori and Jones, 2003, p.368).

26. Accounting and legal firms promoted strategies to reduce TNCs' tax bills and manage risks (Palan et al 2010, p.203). Once the limitation on the maximum number of partners was relaxed by states, a few mega-firms emerged. Despite the increasing number of corporate entities that require tax, auditing, actuarial, and other advisory services, there are only four international accountancy firms that control over 90% of FTSE100 and FTSE250 companies (Christodoulou, 2011). These are, PricewaterhouseCoopers (PWC), Deloitte, Ernst and Young, and KPMG. Until the Enron scandal, Arthur Andersen was the fifth one. This concentration is similar to the bow-tie structure found by Vitali et al. (2011).

27. Despite the legal uncertainty surrounding their 'home' states, TNCs use governmental influence by claiming national allegiance when it suits them. GE is considered an American corporation regardless of how it is organised or where it pays tax. When the EU proposed a complete oil embargo on Nigeria in 1995, the British and Dutch governments' vetoes reflected Shell's interests (Frynas 2003, p.279-280). Yet, Shell, with several footholds in low/no tax SCCs (e.g. Switzerland, Bermuda) paid no corporation tax in Britain despite a profit of £19.87 billion in 2014.⁹ In *Generation Ukraine Inc.* (2009), the Canadian ambassador intervened in the dispute on behalf of the claimant but the case was brought before ICSID under the US-Ukraine BIT.

7.7 Financially enhanced TNCs

28. Strange (1997, p.12-13) described how TNCs, faced with volatile exchange rates, increased their short-term credit to hedge against that risk, but the inter-bank market operations connected the foreign exchange markets with the short-term credit market so that the result was a circle of ever-increasing transactions. In the post-1990s, financially enhanced corporations expanded quickly (Toporowski, 2010, p.920). Such growth appears to lead to inattention of real economies. A BIS study reported that financial growth, by "disproportionately benefiting high collateral/low

productivity projects”, reduces “total factor productivity growth.” (Cecchetti, and Kharroubi, 2015, p.3). This is pertinent to the kind of investments that should be eligible for BIT promotion and protection. The internalization of financial markets was a key feature of the post-1990s’ global economy, which also gave access to international capital markets to large investors from developing countries.

29. The 1990s saw an increase in the innovative financial products like securitisation. Rosenthal, and Ocampo (1988) wrote the first book on this topic; both worked for McKinsey. Securitisation enhanced the global financial integration (Holt, 1987). Offshore private bank deposits reached a trillion dollars and so did the amounts under management of the offshore-based mutual fund industry (Jones, 1994, p.26). TNCs could raise capital in any country. Alternative Investment Market (AIM) was launched in London in 1995 which facilitated this process; its regulations are less restrictive than those for the London Stock Exchange (LSE). About 35% companies listed on AIM in 2006 were from OFCs (the BVI, Bermuda, Ireland and the Cayman Islands) and majority were from India (Esse, 2007).

30. Many tax havens thrived because of the presence of foreign banks (Gordon, 1981). Offshore banking licences were used by IBCs to obtain freedom from all or some types of taxes (withholding, transfer, corporation, capital gains and so forth), and regulations or monitoring; the result was that there is an “extraordinary proliferation of banks” in tax havens or OFCs (Palan et al 2010, pp.94-95). The importance of banks to an economy is obvious in Britain, for example, with a banking business five times the size of its annual GDP (Vickers, 2013, p.4). The BVI are the largest supplier of IBCs (800,000), followed by Hong Kong, Panama and the Bahamas (Palan et al, 2010, p.57).

31. TNCs set up their own banks and captive insurance companies in SCCs, both reducing taxable income onshore and in the SCCs (which tended not to tax the income from interest or premium). By 2010, there were about 5,000 captive insurance companies (Palan et al, 2010, p.97). TNCs’ expansion in global markets took place without a commensurate increase in their worldwide taxes (Larkins, 1991, p.485).

32. As evidenced by Vitali’s (2011) bow-tie structure of network, institutional investors are some of the main actors in the global economy. The number of individuals owning equity has fallen in the US from 80% in the mid-1960s to nearly 40%. An OECD study in 2013 showed that nearly 70% of all listed equity in Britain was held by institutional investors. Conventional institutional investors were pension funds, banks, investment funds, and insurance companies. The list now includes equity and hedge funds, exchange traded funds, sovereign wealth funds (SWFs), closed-

end investment companies, proprietary trading desks of investment banks, foundations, endowments and asset managers, holding altogether \$ 84.8 trillion worth of equity in 2011 (Çelik S. and Isaksson, 2013). SWFs held only an estimated \$3 trillion. The influence of private institutional investors on the global economy is clearly enormous and growing.

33. An estimated 2,800 hedge funds managed \$2.8 billion in assets in 1995. Within a decade, there were 8,500 hedge funds with over a trillion dollars in assets (Ubide, 2006). By January 2006, 55% hedge funds were registered offshore, mainly in the Cayman Islands, the BVI and Bermuda. But, the business of hedge funds is run from London or New York (Palan et al, 2010, p.98). Despite the dominant role of IFIs in the tax havens' economy, the money is offshore only in theory (Workman, 1982, p.683). Some of these funds are taking an increasing role in funding third party ISA claims, a lucrative and growing industry charging between 20-50% of the arbitration award.¹⁰ The idea is apparently "to take the legal system and turn it into a stock market". This was attributed to John H. Beisner, a co-head of a dispute resolution team at a leading law firm.¹¹ The definitions of investments in most BITs are wide enough to allow the such institutional investments to be eligible for ISA protections (UNCTAD, 2005B).

34. According to one estimate, about 60% of the US TNCs' foreign-sourced earnings and profits are from countries in which they have little business activities (Hungerford, 2014). The profit-shifting and third-party funding practices have implications for what is meant by an investment, its impact on home and host economies and, above all, a justification for its *need* for ISA protection. TNCs use complex structures with SPEs that increases interdependence and contagion-risk, while decreasing transparency and potential preventive measures. In BIS's estimate, the Bahamas, Cayman Islands, the Netherlands Antilles, Hong Kong, and Singapore, accounted for 12% of all international bank liabilities in 2006 (more than the US's liabilities) (Roberts, 1995). BITs assume that states alone are responsible for their actions when they maybe driven by factors outside their control.

7.8 Special Purpose Entities (SPEs)

35. SPEs are the building blocks of the global economy. They were increasingly used in structured finance since the 1980s. SPEs provide TNCs with an alter ego to use for accounting, risk-limitation, or other regulatory purposes (Bratton and Levitin, 2012). The manipulation of SPEs was a common theme in the scandals of Milken's junk bonds, Enron, Parmalat, World Com and the subprime mortgages (e.g. ABACUS, Goldman Sach's SPE).

36. Holding companies ("holdcos") are SPEs that hold stock in other entities. As early as in 1932, the holdco was used to circumvent regulations or to amass power in an industry (Bonbright

and Means, 1932). By 1932, 16 holdcos controlled 75% of all electric power generation in the US (Irwin and Staley, 1974, p.396). They were being paid by operating companies with “watered stock, intracompany transactions, upstream loans, improvident dividend policies, and exorbitant equipment prices to inflated fees for technical, managerial, and financial services.” (Irwin and Stanley, 1974, p.397). These features tend to accompany the modern holdcos. They can be used to expand and manipulate businesses by concentrating benefits while isolating liabilities. Along with strategies of bankruptcy, disinvestment, intra-firm transactions and the SCC channels, TNCs’ options to direct and expand global businesses are countless.

37. Holdcos were a flexible and versatile tool for TNCs in the post-Bretton Woods world. TNC mergers in the 1970s involved, mainly for tax reasons, the establishment of one or more joint operating subsidiaries with the merging companies being converted into holdcos so that the business unit was single but the merging companies remained legally separate entities (Hadari 1974, p.18). Some companies appeared to be mere shells but were arguably “base companies” with a “legitimate business purpose” and a “genuine economic function” (Park, 1978, p.1639). TNCs were also integrating “backwards” often on a consortium basis so that, for example, oil companies could strengthen their control over sources of supply (UNCTC, 1978, p.58-9). Corporate inversion were used by the US corporations to become foreign corporations (Desai and Hines, 2002). For instance, Transocean shifted its headquarters to the Cayman Islands in 1999 and then onto Switzerland.

38. Sometimes investors used a trust as a vehicle as it allows the owner to control the trusts’ actions while avoiding liabilities associated with the investment. The advantages of confidentiality offered by SCCs include not only avoiding tax legislation but also other market regulations (against insider trading or takeover activities or antitrust, etc.) which activities became more widespread in the 1980s’ rising financial markets (Picciotto 2011, p.243).

39. The concentration of power using SCCs, holdcos and a multitude of operating companies is common among service firms. The big four media agencies – Omnicom Group and Interpublic Group of Companies, both of New York, WPP Group of Companies of London and Publicis Groupe of Paris – control most of the world’s advertising-budgets as well as hold significant shares of other marketing businesses in the \$500 billion a year industry.¹² In 2003, WPP formed GroupM to be a parent company making it the world’s largest group. GroupM’s CEO reportedly said in an interview in 2008 that in five to seven years, advertising agencies would not have to be transparent.¹³

40. TNCs use ‘orphan’ companies to issue and sell commercial paper collateralised by the (usually high-risk) assets purchased from the TNC. The ‘asset’ would be a loan given by the bank;

once the loans were removed off the bank's balance sheet, they were also beyond the prescribed-capital regulations. Some of these techniques were used by entities like Bear Stearns. Others using them needed substantial governmental bailouts after the 2008 financial crisis, e.g. the American International Group (AIG). Incorporated in Delaware, AIG was a 'holding' company. Its collapse in the financial crisis was caused mainly by the Credit Default Swap (CDS) transactions it had entered into through its various subsidiaries. The CDS market was estimated to be worth \$918.9 billion in 2001, and \$54.6 trillion by 2008 (Sjostrom, 2009, p.951). Insurance companies like AIG, investment companies, hedge funds and large banks used CDS transactions routinely by 2007. SCCs are commonly used in the CDS transactions. These examples highlight how TNCs' investments vary widely and do not all deserve the same level of ISA protection given their cost-benefits for states.

7.9 Tax manipulation using SPEs

41. One reason to welcome FDI is the added tax revenue. However, tax-minimisation is a basic tool used by TNCs. Their consolidated accounts do not have to disclose thousands of subsidiaries or affiliates. Intra-group transactions including transfer pricing need not be disclosed.¹⁴ It is difficult to say where an MNE trades, makes profit, keeps its assets and pays any tax (Palan et al 2010, p.246). For example, oil-drilling business can obtain a low effective tax rate using bare-boat charters or centralized leases, placing the formal ownership of rigs in SPEs located in SCCs, and keeping the lease rates to the TNC high (McClure, 2014, p.15).

42. The main techniques used by TNCs for minimising tax burdens include using: intermediary holdcos set up to minimise withholding taxes using a network of suitable DTTs, intra-firm transfer pricing, debt-financed acquisitions financed by an unrelated company which has a back-to-back loan from a non-resident affiliate, dual-resident companies whose accounts can be consolidated, as needed, with those of related firms in two jurisdictions, company acquisitions; Belgian coordination centres to finance other companies in a TNC group without paying tax on the interest income (Alberto 1992, p.358-361; Picciotto 1992, p.759 and 2011, p.228). Similar tools are used to deal with foreign exchange arbitrage. In most cases, investments are routed through more than one SCC enabling TNCs to reduce tax liabilities both at home and abroad. For example, Adobe Products claimed that no tax was due on their \$3 billion profit abroad, it being 'permanently reinvested' in 2014. It would have owed approximately \$900 million at 27% rate if the profits were repatriated (Gardner, 2015).

43. The late 1980s and the early 1990s brought an increase in asset-based lending. This included loans to obtain working capital, capital equipment, turnaround financing, acquisitions, leveraged

buy-outs, bankruptcy deals to debtor-in-possession financing (Drew, 1991, p.78). This was available to airlines and ship owners (using operating leases) or, indeed, any other business trying to grow beyond the capacity of its capital. TNCs used, with the knowledge of their bankers, lawyers and accountants, off-balance sheet financing vehicles that would enable them to conceal their true level of indebtedness. The International Accounting Standard Board (IASB) was informed by its then chairman Sir Tweedie in 2002 that almost no member of their audience had travelled on an aeroplane that appeared on an airline's balance sheet.¹⁵ Globally listed companies have \$3.3 trillion worth of lease commitments of which 85% are off-balance sheets.¹⁶

44. By 1988, securitisation was predictably rising on the basis of asset-based loans as the underlying security (Xavier 1988, p.38; Boemio and Edwards 1989, p.659; Jones 1994, p.32). The 1990s saw off-balance-sheet financing of publicly traded companies become widely acceptable (Jason, 1988, p.76). Off-balance-sheet vehicles widely used by Enron were not illegal. The Generally Accepted Accounting Principles comprise rules to govern them. Such vehicles were used by Electronic Data Systems (EDS), which supplied skilled data processing personnel and equipment. The client outsourced to EDS the operations. EDS did not want the debts caused by the purchase of the equipment to appear on its own balance sheet. This company, once owned by GM, became independent in 1996, and GM became its client. EDS would use a bank to create an SPE to buy the necessary equipment; the bank would pay for it using debt issued to large institutional investors (e.g. pension funds). EDS would pay the debt with proceeds from the outsourcing contracts. In 2001, it contended that others in the industry were doing the same thing, but there were criticisms of this view as the hiding of capital expenditure in this fashion makes it difficult for the analysts to work out a return on capital or to assess the long term performance of EDS.¹⁷ Hewlett-Packard purchased EDS in 2008 but EDS lost \$8.9 billion of its value rapidly by 2012.¹⁸

45. State regulators do not have the resources to monitor these kind of transactions. There is currently no theoretical justification to make ISA available to a variety of investors whose nationality or contribution to an economy is difficult to ascertain because of their use of SCCs. Ideally, such an exercise should be carried out for each investment based on some risk analysis.

7.10 Corporations as political actors

46. Privately owned TNCs are not all at the mercy of states' powers, particularly in the liberalised global economy. Most TNCs are, effectively, operating *above* national regulations using SCCs and SPEs. They are significant economic actors setting and driving the agenda for the transformation of international investment law. Chapter 4 showed the lead taken by Shell in promoting BITs and ISA. In 1990, Shell was keen to secure the involvement of the IFC or other

World Bank affiliates in its projects and to promote protection under the MIGA and ICSID.¹⁹ When BITs started to rise, corporations' status at international law as subjects was controversial. BITs skirted around the necessity to agree on this issue by making corporations the beneficiaries of BITs.

47. Political roles played by MNCs/TNCs are not unknown (Irogbe, 2013, p.229, 235) and some were quite controversial. For instance, in 1974, Overseas Private Investment Corporation (OPIC) refused to pay International Telegraph and Telecommunications Corporation (ITT) its \$92 million claim over the loss of its Chilean telephone company (Araskog, 1999 p.41). ITT was involved in the overthrow of the Chilean President Allende. OPIC argued that the expropriation of its company was the outcome of its illegal interference with politics. ITT took the matter to arbitration and won. OPIC had to pay \$90 million to ITT which it duly recouped from Chile (Fisse et al, 1983, p.131). There were also instances of MNCs' corrupt financial practices involving payments made secretly to accounts held in tax havens (Nehemkis, 1975). Some recent examples have been seen in ICSID arbitration (e.g. *World Duty Free Co. Ltd.*, 2000).

48. MNCs' overt role in hosts' politics declined by the 1970s (Turner, 1974, p.394). Perhaps this was a combination of market forces and authoritarian states (Picciotto 1988, p.58). In July 1972, ECOSOC resolved to appoint, a group of 'eminent persons' to study the role of MNCs and their impact on development of the developing countries.²⁰ The group found that the available data could not adequately measure the phenomenon of MNCs. The picture was distorted by the large incidence of inter-affiliate transactions, transfer pricing, other practices relating to capitalization, accounting procedures and the control of local resources. BITs tend not to factor in these distortions as they are drafted solely to 'protect' investors' interests but these considerations are relevant to blanket-availability of ISA for investors.

49. In the context of BITs, TNCs do not have to take responsibility for their subsidiaries' actions at international law (as they are separate legal personalities) as states do for their agencies under the draft Articles of State Responsibility. For example, Vodafone avoided a \$2.2 billion Indian tax bill by using SPEs in various SCCs. It had purchased, in 2007, a 67% interest in an Indian mobile phone business from Hong Kong based Hutchison Whampoa. The transaction was completed through Vodafone's Dutch subsidiary purchasing Hutchison's Cayman Islands subsidiary. The interest in India was held through an intermediary chain of Mauritius companies. India tried to amend its law with retrospective effect to apply to such indirect sales of Indian assets. The Indo-Dutch dispute is pending in ISA.

50. Where TNCs' objective is usually the maximisation of profits, states, in theory, are responsible to protect and promote overall public welfare. Yet, TNCs' actions (particularly the use

of SCCs to reduce their tax contribution to the host states) can have a direct and substantial effect on the socio-economic welfare of the host. Despite the capture of regulations by TNCs (Sutherland 2010, p.326), globalisation of capital has involved both political and economic processes (Picciotto, 1988, p.68). Developing states helped these processes (see Chapter 9).

7.11 Regulation of SCCs – difficulties

51. From time to time, governments attempt to regulate TNCs' use of SCCs. Given their fear of capital-flight, this is not easy. Any attempted regulation also carries some risk of ISA as shown by India's attempt to regulate Vodafone. After the Vodafone experience, India has been reviewing its BITs to try and disallow 'holdcos' but experts warn that this might create adverse perceptions of its investment climate. The co-head of KPMG's tax department suggested that it "could definitely discourage foreign investors."²¹ This was echoed by another expert - a consultant to the IMF and the World Bank.²²

52. Although the TNC rhetoric blames governments for arbitrary actions that make international business risky, particularly in developing countries, even states take risks in encouraging investments. For example, India's public sector banks wrote off \$17 billion in loans during 2012-2015 and were planning to write off further loans. Most of those were large loans made to private corporations.²³ Sometimes the developing countries' actions affecting TNCs are in response to those of capital-exporting countries. For example, after the global tax reform of the 1980s, capital-exporting countries reduced their statutory tax rates, and so did many capital-importing countries otherwise TNCs would have moved their deductible expenses to their home jurisdictions (Khalilzade-Shirazi and Shah, 1991, p.116).

53. TNCs and their lawyers lobbied for higher standards of protection for investors than those available under customary international law. The dissenting opinion of arbitrator Samuel Asante in *AAPL* (1987) case against Sri Lanka cited Denza and Brooks, both officials in the British Foreign Service, who acknowledged the input of the Confederation of British industry at the formative stage of the UK-Sri Lanka BIT. They also stated that the Foreign and Commonwealth Office would have found it difficult to persuade developing countries to accept standards that went beyond the customary international law. It was acknowledged by Asante that "the most politically sensitive provisions" including those on "nationality of individuals and corporations" were drafted so as not to go beyond "what was thought to reflect international law" (in *AAPL* award, p.911). ISA awards go beyond the traditional principles. The jurisdiction to make them was derived from generously wide interpretations of BITs as shown in Chapters 11-12.

7.12 Summary

54. Corporate law is a form of private law (Sutherland 2010, p.265) and TNCs are essential to globalisation. MNCs demanding protection against expropriation in the 1930s were a different creature from the TNC conglomerates of the post-1990s. The concept of residence has become meaningless and subject to manipulation for tax purposes (Omri, 2013). The same can be said about the investors' nationality under BITs. TNCs, especially the large ones, may not have a home state, or can be said to have more than one home.

55. Host states are limited in how they can regulate their economies because of (a) TNCs' power to manipulate organisational forms, and (b) the interdependence of the global economy. Yet, states' responsibilities under BITs remain wide-ranging. Global versus the national is at an interesting cross-roads currently, with the positives (e.g. growth and affluence) being shared globally, but any negatives (e.g. austerity) being constrained in the national sphere.

56. The provisions of BITs do not reflect the realities of the modern economies. TNCs' presence in a host country is, in some respects, similar to an Elizabethan "progress" - royal visits by the Tudor queen to an aristocrat's house that usually ended in a financial disaster for the nobleman whilst the Queen saved herself the expenditure of running her own household, got benefit of the progress, inspected her kingdom, and kept in touch with her citizens.

¹The World Investment Report 2012, UNCTAD, page iii.

²Some FDI is also undertaken by State Owned Undertakings (e.g. From China) and increasingly by Sovereign Wealth Funds.

³Retrieved from www.unctad.org.

⁴For example, according to the Citizens for Tax Justice, GE paid an average tax rate of 1.8% between 2002 and 2011 on its pre-tax profits; the US corporate rate is 35%. Apart from using the technique of deferring its taxes, GE also relies on lower tax rates on its foreign earnings, tax credits and so on (Hernandez, 2013).

⁵<https://www.chevron.com/documents/pdf/EcuadorBITEn.pdf>

⁶The difference is in the taxation; C is taxed separately from its owners but S is not taxed independently.

⁷Similar to NV in Belgium (naamloze vennootschap), SE in the EU (Societas Europaea), SA (Société anonyme) in France, or AG (Aktiengesellschaft) in Germany.

⁸On a rare occasion, Nestle admitted, on 24 November 2015, to have found forced labour being used in Thailand in its seafood business: <http://www.theguardian.com/global-development/2015/nov/24/nestle-admits-forced-labour-in-seafood-supply-chain>

⁹<http://www.independent.co.uk/news/uk/six-british-multinationals-including-shell-vodafone-lloyds-banking-group-did-not-paid-any-a6844676.html>

¹⁰ "Speculating on injustice: Third-party funding of investment disputes", International Trade 27 November 2012, Chapter 5.

¹¹*ibid*

¹² "Advertising's Big Four: It's Their World Now", *The New York Times, Business Day*, 31 March 2002.

¹³ "An Ad Man Tests the Limits", *Business Magazine Bloomberg*, 20 February 2008.

<http://www.bloomberg.com/bw/stories/2008-02-20/an-ad-man-tests-the-limits>

¹⁴Joint Committee on Taxation (JCT). 2010. *Present Law and Background Related to Possible Income Shifting and Transfer Pricing*. JCX-37-10

¹⁵ "On balance, companies would rather not show debt", *The Telegraph* 13 January 2016.

¹⁶ "On balance, companies would rather not show debt", *The Telegraph* 13 January 2016.

¹⁷ *The Asian Wall Street Journal*, 24 December 2001.

¹⁸ In fact, HP wrote off \$8.9 billion: <http://www.computerweekly.com/news/2240161906/How-did-EDS-lose-8bn-in-value-in-four-years>

¹⁹For example, see the keynote address given by Jennings, J.S., Managing Director of the Royal Dutch/Shell Group of Companies to the Cambridge Energy Research Associates Executive Conference, “The new era: energy, the environment and global strategies” in Houston Texas on 6-7 Feb 1990.

²⁰UN Document E/5500 report of the secretary-general to the ECOSOC, 14 June 1974, referring to the ECOSOC resolution 1721(LIII).

²¹“Holding Out on Holding Companies Self-Defeating: Analysts”, *Financial Express*, New Delhi, 10 March 2014.

²²*Ibid.*

²³“Write-offs a scam, small loans rarely in it, says former RBI Deputy Governor,” *The Indian Express*, 11 February 2016.

8. The US agency

8.1 Introduction

1. The American BIT program did not commence until after the European states had signed 200 BITs. The European countries might have got a foot-in-the-door with the developing countries, but the US involvement in BIT negotiations seemed to provide an impetus to a BIT-signing spree, albeit not necessarily with the US. The timing of the US BIT programme in 1981¹ appears to coincide with that of the introduction of the US international banking facilities (IBFs).² The US had a direct role in legitimising the use of SCCs, and an indirect one through its influence on IOs like the IMF and the World Bank. The US state-corporate bloc, and the legal framework influenced the forms of TNCs and FDI. This Chapter explores the influences of the US in its various roles as a capital-exporter, an aid-provider, a PRI-insurer, and briefly, as a promoter of oligopolistic TNCs.

8.2 A Major Source and Destination of FDI

2. The US is a major host and home country for FDI (Wilkins, 1989). Its FDI outflows in 1929 were \$7.5 billion (Salacuse, 1984-85, p.970), and in 1970 about \$7.59 billion (Table 5.1). In 1970, the US FDI inflows were just behind of those to Britain but its outflows were quite ahead of British FDI indicating that substantial amounts of FDI outflows were originating in the US.

3. On a historical-cost basis, FDI flow to the US in 2014 was \$2.9 trillion (US government, 2016). Despite the fact that the US share of worldwide investment decreased from 39% in 2000 to 21% in 2014, it remains one of the top destinations for FDI. It is one of the largest investors abroad, despite its position in 1914 as the world's largest debtor country (Amatori and Jones, 2003, p.364).

8.3 Oligopolistic firms - agenda for globalisation

4. The increasing concentration of corporate power was challenged in the US by the Sherman Act, 1890 – a law intended to promote competition. The interpretation of it led to the creation and legitimisation of oligopolistic firms in the form of a corporate group, i.e. TNCs (Picciotto 2011, p.454, 458). Samuel Dodd, Standard Oil Company's general solicitor created (a) in 1882, a trust, that allowed a nine-member board of trustees to manage forty operating companies and, (b) in 1899, a holding company in New Jersey to carry out integrated management functions for the business empire of Standard Oil. (Dobson, 2007, p.203).

5. TNCs would exercise considerable influence over American BITs as over other policies. Van Appeldoorn and de Graff refer to the “structurally determined openness of the US political

system to the ‘corporate community’ and its interests,” securing TNCs a dominant influence over the US policy. (2014, p.33). They contend that after the Cold War, a US-centred and a US-led globalisation was premised on an agenda of opening and expanding markets (pp.36-7). Their network analysis shows a relative dominance of the financial and legal sectors in the US administrations, and a general dominance of transnational capital - iconic TNCs and several prominent think-tanks (p.46). They argue that the global elite are dominated by the American corporate elite who owns and controls a substantial part of global, transnational, assets. (Van Apeldoorn and de Graaff, 2015, p.76). Lipson (1978) had also argued that the goal of private capital-accumulation was shared by the state-corporate bloc as evidenced by the weight given to corporate preferences in American policy.

6. Once the US ceased to be a leading debtor and became a leading exporter of capital, there was a possibility of world shortage of the US dollars unless American capital (both government and private) could be encouraged to be invested abroad (UK Cabinet Memorandum, 1949, p.176). The issue mattered as the US was the issuer of the international currency. The US is currently indebted but its debts are denominated in its own currency (Krugman 2007). Whether the dollar was weak or strong, its position as a privileged currency continues. The US has unparalleled military power and weight as a trading-partner – both useful to persuade other countries whether or not the powers are actually used. Trade tends to follow the flag (Keshk et al 2004).

8.4 The biggest SCC

7. As discussed in Chapter 5, the US offers several SCCs – all established before the 1990s’ BITs surge. The US corporate, insolvency, anti-trust, tax, and arbitration laws are corporate-friendly. American corporations are taxed on their worldwide income but the deferral rule allows them to avoid tax on unrepatriated foreign income. TNCs can avoid or delay payments by reinvesting capital abroad. After World War II, many of the US firms established foreign subsidiaries in low/no tax SCCs for captive insurance, to license IPR, and to collect and reinvest dividends from foreign subsidiaries (Park, 1978, p.1613-14). TNCs can rely on the US networks of over 150 DTTs with states including other SCCs such as Switzerland (from 1951), Britain, the Bahamas, the Netherlands, etc.

8. The US exercised capital controls until 1974 (Salacuse, 2013, p.85). The US investors borrowed abroad due to restrictions at home (Gordon, 1981). This helped to establish some offshore markets like the Bahamas, and assisted in the growth of the Euro-dollar market (Kendrick, 1980, 42-3). Interest rates were higher in Europe than in the US, leading to the escape of American capital abroad until the Interest Equalisation Tax in 1963.

9. American banks were allowed to set up ‘Nassau shell’ branches in 1969 in the Bahamas. Recycled petro-dollars could be lent to the developing countries via SCCs (Roberts, 1995, p.237). After the end of the fixed rates exchange system, significant real depreciation of the dollar moved the US to a position of equality in industrial capacity and trade, rather than dominance, among other developed countries. (Branson et al, 1980, p.186). The position of the US as a leader in outgoing FDI (Figure 5.3) indicates its dominance in respect of investments, but the use of SCCs based in entities might be responsible for this. This inference is drawn from the fact that the US was found to be home to only 3% of all MNCs; the total MNCs headquartered in the developed countries are 73% (Roach 2007, p.3).

10. The 1970s’ inflation led to the US innovation in junk bonds and leveraged buy-outs. Takeovers were financed with new debt, high-yield junk bonds, with the necessary consents coming from a complex web of SPEs set up for the purpose. The Securities and Exchange Commission (SEC) did not object (Strange 1998, p.34). The making of the new firms more profitable usually depended on cost-cutting (lay-offs) and led to asset-stripping. Cost-cutting was reinforced by McKinsey’s advice to its TNC clients in different sectors (McDonald, 2013). The growth of tax havens in the 1980s was affected by the rise of TNCs and SPEs, innovations in telecommunications, and the policies followed by the Reagan and Thatcher governments in the 1980s (Miller and Oats, 2016, p.339).

11. The World Bank encouraged an initiative to establish an offshore banking zone in New York so that the US could keep a closer eye on the dollar banking business (World Bank 1981, p.33). The US and the World Bank had converging ideas about the use of SCCs. TNCs were permitted to set up IBFs in 1981; they could accept deposits from foreign residents without reserve requirements or caps on interest rates. The IBFs brought offshore business onshore endorsing not only the use of the US SCCs but other SCCs too. The new IBFs in New York City, Miami, New Orleans, and San Francisco ensured rapid growth by December 1981.³ In 1999, 59% of the US firms with substantial foreign operations had affiliates in tax havens, performing better than the US-based companies. (Palan et al 2010, p.55).

12. In 1982, the year that the US signed its first BIT with Panama, money market deposit accounts were introduced that paid competitive interest rates without a ceiling. These competed with money market mutual funds and led to growth of “non-bank” banks (Strange, 1998, p.37). From 1984 onwards, the US abolished withholding tax on interest paid to foreign holders of bonds. TNCs relied on arbitrage of expected rates of return on assets denominated in different currencies with interest rate swaps, currency swaps, note issuance facilities etc. The US deregulation led to competitive rates of return to both domestic and foreign investors. Other industrial countries

followed suit facilitating the integration of international capital markets. The US began running a growing current account deficit moving from a large net creditor position to a net debtor position at the end of 1982 (IMF 1985B, p.32).

13. The US SCCs offer considerable secrecy to investors. Arguably, this is necessary for legitimate business reasons (Larkins, 1991, p.478-9). The US, along with other SCCs, made conscious choices to allow legitimate use of tax havens despite being aware of the extent of the use of tax havens (Gordon, 1981). In the context of FDI or BITs, the use of SCCs makes it difficult to trace the origin of an investment.

14. The dollar was strengthened by increased investment flows to the US (IMF 1985, p.31). From 4.9% of GDP in 1980, the US financial services industry grew to 8.3% of GDP in 2006, partly driven by the rise in asset financing and management activities, and partly by increased shadow banking (Greenwood and Scharfstein, 2012). Further growth in the financial services sector was caused by increased household credit, from 48% of GDP in 1980 to 99% in 2007 (Greenwood and Scharfstein 2012). The debt would later become part of the growing securitization business. Transportation, service and construction industries' use of tax havens grew significantly (Gordon, 1981, p.80). In the construction industry, an offshore SPE would sign the contract and execute the work after the initial preparation and promotion by a US corporation. If disputes arose, the SPE would commence an arbitration.

15. The US functioned as a tax haven in the 1980s (Palan et al, 2010, p.22). A decade later, an estimated 20% of total loans to the US-based enterprises were booked offshore (BIS 2009, p.50). The tax advantage depended on a combination of the deferral of taxation and the consolidation of worldwide foreign tax credits (Gordon, 1981). These policy choices might have been made to ensure American corporations remained competitive over the other OECD corporations (that could use SCCs).

16. In 2008, the US Government Accountability Office (GAO) examined foreign-controlled and the US-controlled corporations, and concluded that the majority of both kinds of corporations reported no tax liabilities for at least one year during the period 1989-2000 despite having reported substantial amounts of assets and pre-tax profits. Overall tax liabilities were found to be shifting to low-tax jurisdictions but transfer pricing practices made it difficult for GAO to determine the exact extent of this (US GAO 2008). Of the 83,642 foreign corporate entities reportedly controlled by the US corporations in 2008 – 19% were in tax haven countries (although this would almost certainly be higher, as it does not include countries like the Netherlands among the havens); 60% of the earnings and profits were in the tax havens (Hungerford, 2014). The pro-tax-haven bias of the US

investors is clear.

17. After the global financial crisis, Foreign Account Tax Compliance Act (FATCA) was enacted in 2010. The OECD agreed to Common Reporting Standards (CRS) in 2014.⁴ Despite 97 countries' agreement to CRS, signatures have been withheld by Bahrain, Nauru, Vanuatu and the US. The US alleges that the FATCA is sufficient. The US continues to be a tax-haven even though tax havens were acknowledged to have played a considerable role in the 2008 crisis. For example, Bear Stearns had incorporated in the Cayman Islands two subprime mortgage-backed funds that later collapsed (Keeler, 2009). A recent report suggests that there are advantages in moving money out of other SCCs, and that the US, despite its censure of Swiss banks, is becoming the "secrecy jurisdiction du jour" (Drucker 2016).

18. The US played a critical role in bringing about globalisation (Panitch and Gindin 2010, p.7) with the "institutional intertwining of the US Treasury and Federal Reserve with Wall Street," creating the global framework for the free movement of capital (p.10) The abandonment of the Bretton Woods system enhanced the US's structural power although this only became obvious in the 1990s (Panitch and Gindin 2010, 13). The use of SCCs was encouraged and tolerated by the US, and, therefore, by the IMF and the World Bank.

8.5 Foreign Aid – a tool of persuasion and compulsion

19. The Union of Soviet Socialist Republics (USSR) began to offer financial assistance to developing countries in the 1950s (e.g. the USSR gave a loan for economic development in India in 1955, Bowls, 1971, p.367). The US also encouraged capital flows to such countries by way of bilateral aid or through IOs' developmental assistance (Mazower, 2012, p.289, 294). The USAID sought to promote American interests and to mould the recipients' national policies. Before the establishment of the Overseas Private Investment Corporation (OPIC), it also handled political risk insurance (PRI). Usually, the aid was conditional and not always in the form of capital. Other OECD members also did not have much humanitarian motivation for giving aid. (De Mesquita et al, 2009).

20. The Official Development Assistance (ODA) target in 1970 was at 0.7% of donor's Gross National Income and this has since been re-endorsed.⁵ The US rarely meets the target rate although it tends to be the largest donor in dollar terms.⁶ From 1974 to the end of the Cold War, there was a rise in real terms in ODA, falling again in the 1990s. The aid to LDCs fell substantially in the 1990s, and that to other developing countries fell steadily since 1970 to 2010 by 40% (OECD 2011). The decline in the aid from the largest donor would have indirectly affected developing countries' willingness to change their policies. Further, developing countries' share of global FDI

(excluding China) was 29% in 1970, but fell to 10% by 1974 (OECD 2010). The debt crisis of the 1980s' affected developing countries' abilities to nurse their repayments.

21. The US has used its legislative power for the protection and promotion of American investments. The Hickenlooper Amendment to the Foreign Assistance Act, 1962, proposed cutting the US aid to a country that had expropriated American investment.⁷ This was invoked against Sri Lanka in 1963 after it nationalised the properties of two American oil companies.⁸ The provision was further strengthened in 1963. The US considered invoking the Hickenlooper Amendment against Peru in the 1970s. In 1974, Article 2(c) of the Resolution adopted by the UN General Assembly required that any compensation for expropriation had to take into account the relevant laws and regulations and all circumstances that the host states considered pertinent.⁹ This was different from the US-preferred Hull formula of guaranteed “prompt, adequate and effective compensation”. Interestingly, BITs rarely include the NIEO-preferred version from the 1974 UN Resolution.

22. The potential to use the Hickenlooper Amendment would have been effective even if it was infrequently invoked. The US also used, in thousands of cases, its Foreign Claims Settlement Commission to settle nationalisation claims. The US Department of State would negotiate a settlement with a host country, or, seek an authorisation of the Congress to use the host's assets in the US to pay compensation to American investors.¹⁰

23. American economic assistance declined worldwide from the mid-1970s. (Sussman, 1987, p.95). There were instances of using aid as a tool to bring pressure on countries that were alleged to have expropriated American property. *Compañía del Desarrollo de Santa Elena S.A.* (1996) involved a non-BIT case with a local entity acting as a claimant on behalf of the US investors. The US brought pressure on Costa Rica to take the case to ICSID by invoking the 1994 Helms Amendment.¹¹ A loan of \$175 million was delayed until this arbitration agreement was concluded.

24. Bolivia was at one time the single largest recipient of the US foreign aid, and is a good example of American persuasive power. The US aid was used to destroy the local unions (Mazower, 2012, p.295). It was also used, along with an IMF-implemented austerity programme, to open its hydrocarbons' sector to foreign investment (Achtenberg, 2013). The financial sector in Bolivia was deregulated in 1987. Bolivia enacted Investment Law, 1990 and joined the New York Convention in 1991. It also joined ICSID in May 1991 although it withdrew its membership in 2007. In March 1995, the US notified Bolivia that it would cut off aid, and oppose bank loans to it. That year, the Bolivian coalition government undertook a large privatization programme comprising the national airline, railway, electricity and phone companies – all mostly sold to American TNCs

without local partnerships (Klein, N. 2007, p.292). The Bolivian president had designed the new economic policy with the help of Harvard economist Jeffrey Sachs. The IMF was at first “somewhat sceptical”, but later encouraged it (Jenkins 1997, p.110-1). The US and Bolivia signed a BIT in April 1998. Bolivian laws were being written with the help of, if not by, American corporations and their lawyers. (Klein N., 2007, p.597) Apparently, such irreversible changes had to be done quickly “before the antibodies kick in” (Klein N., 2007, p.293). The privatised industries had been the source of 60% of the government revenue; the predicted 11% growth or thousands of new jobs did not materialise (Jenkins 1997).

25. The US can use aid in conjunction with the persuasive powers of the IMF and the World Bank. Mozambique joined the IMF and the World Bank in 1984 after a devastating drought so that it could receive food aid. Aid is not always in the form of food; it could be American “farm surpluses and unwanted equipment” (Mazower, 2012, p.298). In 1987, Mozambique needed further aid. A structural adjustment plan (SAP) was imposed which became more austere in 1990. Mozambique agreed to deregulate its economy and undertake privatization, having the World Bank as its only adviser (Potts et al, 2016). Its Law on Investment was enacted in 1993. Enron-Mozambique negotiated for the exploitation of gas fields in 1995. When disagreements arose, Enron threatened that the US would withhold aid to Mozambique if the agreement was not signed soon.¹² The threats were backed by the USAID (Abrahamsson and Nilsson, 1995, p.142). At that time, more than half of Mozambique’s public spending was financed by foreign aid (World Bank, 2000). The US and Mozambique signed a BIT in December 1998. Enron’s CEO similarly threatened in a 2001 interview that Enron could have the US government refuse aid to India as a result of its disputes in relation to the \$3 billion Dabhol power project.¹³

26. In 2014, the US threatened to withhold \$277 million in promised aid to El Salvador to meet the Millennium Goals unless its seed-purchases were from Monsanto and not from its local farmers’ cooperatives.¹⁴ The US thus obtained a commitment from El Salvador to make its future seed purchases under a mechanism that was transparent and compliant with CAFTA-DR.¹⁵ The US-El Salvador BIT has not entered into force but there is a veiled threat of ISA in the reference to CAFTA-DR. El Salvador has already had a brush with the ICSID arbitration, for example, over its refusal to grant mining permits (*Pac Rim Cayman LLC*, 2009).

27. Following the collapse of the communist bloc, the US changed its focus to bring about market reforms in the transition economies. The USAID established a Centre for Democracy and Governance and an Office of Transition Initiatives. The Centre’s website refers to one objective of the USAID as the fostering of private sector development. Privatisations in the transition economies did not all proceed smoothly. Some led to ICSID cases against Hungary (*ADC Affiliates*, 2003,

Electrabel, 2007), or Romania (*Noble Ventures*, 2001, *The Rompetrol Group NV* 2006), etc., and some non-ICSID cases against Romania,¹⁶ Poland,¹⁷ and the Czech Republic.¹⁸

28. The US had incentives and also sanctions at its disposal. For example, it could refuse a recalcitrant host the benefit of American resources, deny sugar sales, or veto its loans in IFIs etc. (Brookens 1978, p.48). There is the option of ICA, or OPIC arbitration. Awards can be enforced in the US courts by attaching any assets that are not subject to sovereign immunity including any third party payments that might pass through the US banking system.

8.6 No substantial BIT programme for the US

29. Despite being a leading exporter of capital, the US did not start its BIT programme with other OECD countries. Its FCNs did not provide for ISA. There was little “ownership of assets” of assets abroad from the US in 1947; this was not for lack of capital as the US had a “net export surplus” of \$1 billion (Branson et al, 1980, p.183-4.) In 1952, the US extraction sector’s problems were not so much profit-sharing with host states as with repatriation of earnings (Mason, 1952). BITs were clearly not a key factor influencing investors’ decisions; fewer than 25% of the US investors considered PRI essential to proceed with a project (Rowat, 1992, p.120).

30. American foreign investment in the 1970s was mainly in Europe and any disputes would have been within the jurisdiction of the hosts’ national courts or ICA. A US report suggested that the US had assumed leadership in the negotiations of BITs in the 1960s (US Government Document 1963, p.1067). But, the American BIT program did not start until the 1980s (Comeaux and Kinsella, 1994) although the US had joined ICSID in 1965.

31. OPIC was established in 1969 to provide both project finance and PRI on the recommendations of the International Private Investment Advisory Council which itself was advised by TNCs. In the 1970s, the US investors did not appear to consider the consent in BITs to be sufficient to commence an ISA; they tended to include an express arbitration agreement in their investment contracts. All eleven ICSID cases by the US claimants relied on investment agreements until its first BIT case *AMT* (1993).

8.7 The US BIT Programme

32. ICJ’s 1970 decision in *Barcelona Traction* (see Chapter 11) highlighted the issue of MNCs’ nationality (Vuyllseteke, 1974, p.352). Latin American countries were persuaded to sign the Convention as the US strongly favoured ICSID arbitration in its investment agreements (Sprague and Michael 1982-3, p.164, 178). In June 1981, the Reagan administration launched its BIT project believing that an “international credit war” was on.¹⁹ TNCs wanted assurances on issues like

repatriation, expropriation and national treatment.²⁰ Dispute resolution was not specifically identified.

33. At the 1983 Annual Meeting of the American Society for International Law (ASIL), Exxon's counsel David Gill identified BITs as the centrepiece of the US international investment policy (ASIL, 1983). Bruce Wilson from the Office of the US Trade Representative confirmed that the US had approached 35-40 countries with its draft. The whole approach and the content of the BIT was palatable probably only to the "small, perhaps poor, or medium-income, developing countries," and not to the newly industrialised countries (ASIL, 1983, p.294). Wilson alleged that the Europeans and most developing countries had looked at entering into BITs more as a "political, rather than an economic and legal, exercise" (ASIL 1983, p.295). The US negotiators were much constrained by the TNCs' input, having had periodic consultations with ASIL, various subcommittees of the American Bar Association and continued contact with the business community (ASIL, 1983, p.295).

34. James Hackney, an attorney from the US Department of State confirmed that about 2,000 lawyers and private industry had contributed to the US draft BIT over two and a half years (ASIL 1983, p.296); from the start of the US BIT programme in 1981 to 1983 when he spoke at the ASIL 1983 meeting. The US BIT covered an investment 'directly or indirectly owned or controlled' by the US nationals or companies in foreign states wherever located or incorporated. This was intended to overcome the limitation implied by the *Barcelona Traction* case (ASIL 1983, p.296). The same corporation could choose the US as a home state for its diplomatic protection, and other SCCs for tax purposes.

35. Further, Exxon's counsel confirmed that "no other group of negotiators" had been "quite so zealous and diligent in conferring with various representatives of the private sector." (ASIL 1983, p.295). Exxon had innumerable consultations and the negotiators had been "most responsive to comments made by the bar and business groups, perhaps too responsive". (ASIL 1983, p.295).

36. Scott Gudgeon, another attorney from the US Department of State, suggests that very little material was in the diplomatic archives on disputes under FCNs or non-US BITs. He assumed that this was the result of the effectiveness of the treaties in preventing disputes. From developing countries' points of view, this lack of case history would have blinded them to the potential enforceability of BITs. Even Gudgeon thought of BITs as, "providing, in the background of forces contributing to control and settlement of investment disputes, a little additional leverage for investors in stabilizing the rules of the game." (ASIL 1984, p.49).

37. BIT negotiations were not encouraging for the US. The US allegedly did not want investors

from other countries benefiting from its BIT simply by incorporating the investing company in the US (Salacuse, 1984-85, p.996). If this was true, the US did want to retain such a privilege for its own investors. British BITs relied on incorporation as the criterion for protection. Except in the BITs with Egypt, Russia²¹ and Poland, the US did not define the words “own” or “control” (Vandeveld, 1993, pp.681-2). Its negotiators believed FDI flows would depend on political stability, availability of natural resources, size of the market and legal climate; most of these issues were not addressed by BITs (Vandeveld, 1993, pp.626).

38. The number of BITs worldwide grew quickly in the 1990s (albeit not for the US). No developing country put in the amount of effort the Americans did into the drafting and negotiation of BITs. This was primarily because they, unlike the Americans, would not have seen BITs as enforceable legal instruments. The US managed to sign 47 BITs, six of which never entered into force. The BIT count for some other SCCs was as follows: Germany 155, France 109, the Netherlands and Britain 107 each, Italy 106, and Belgium 104. The US and the Netherlands did not sign a BIT, but entered into a DTT in 1994. The US program of BITs was believed to be more inflexible than its FCNs and the European BIT program which at that time did not insist on an arbitration clause in the BITs. The only successful US BITs were with countries that were “heavily dependent” on its foreign aid (Ruttenberg, 1987, p.125). A few years later, investment protection provisions were included in the US Free Trade Agreements (FTAs) with Mexico, Canada, South Korea, Australia, Colombia and Singapore.

39. Jose Alvarez, a US lawyer experienced in BIT negotiations, said that BIT partners turned to the US BITs “with the equivalent of an IMF gun pointed at their heads” or with a belief in the “inevitability of economic relations with the only remaining superpower”, and that for many states BITs were “hardly a voluntary, uncorked transaction” (ASIL, 1992 p.552). He also confirmed that in early days of BIT expansion, any reciprocity between signing BITs and entering the lucrative US market, was an illusion. The US insistence on promoting sanctity of contracts was followed by ISA arbitrators. Alvarez predicted that ISA would end up politicising disputes more than before. Some countries have withdrawn from ICSID, and some seek to renegotiate their BITs. Alvarez’s reference to the market-opening being an illusion is relevant to the fact that the US encouraged developing countries to liberalise their markets, but its own regulations were not entirely open to foreign investment.²² The US legislation Exon-Florio Amendment of 1988,²³ a reaction to an increase in the foreign takeovers of the US companies, empowered the US President to block foreign M&As or takeovers on national security grounds. Such formal action is rare; most applicants withdraw their request in the face of likely opposition.²⁴

40. As Alvarez suggested, a US-Argentina BIT was signed in November 1991 as the IMF was

engaged with the Argentine aftermath of the 1989's hyperinflation.²⁵ The IMF's convertibility plan from 1991,²⁶ and the dollarisation of the Argentine economy later caused trouble. Fifty or so ISA cases arose from the Argentine financial problems during the period 1998-2002. Until its BIT with the US, Argentina had never accepted unconditional ISA. It had accepted ISA only in two BITs (Britain and Germany) and that was subject to the investor first trying a local judicial remedy for a period of 18 months. In its BIT negotiations with Argentina, the US aimed to get its own companies "in on the ground floor".²⁷

41. In the US's first BIT with Panama in 1982, ICSID's Additional Facility was prescribed for arbitration as Panama had not signed the Convention. Gudgeon believed that the Additional Facility was ICSID's attempt to "expand its services in the face of the *obvious reluctance of a number of countries, particularly developing countries, to sign the convention.*" (ASIL, 1984, pp.48-9). (Emphasis added).

42. Most countries, even when in need of capital, did not seem to be overly enthusiastic to sign BITs with the US, as confirmed by its own negotiating lawyers at ASIL meetings and by the low number of BITs signed by the US compared to the other OECD countries. This reluctance does indicate that BITs were underpinned by *political bargains between* countries; states did not treat them as mere portals through which investments from any country could lead to ISAs. Wide-ranging ISA would not have been an easily acceptable political concept for many developing countries. The news coverage that has been prompted by Transatlantic Trade and Investment Partnership (TTIP) and Comprehensive Economic and Trade Agreement (CETA) negotiations is indicative of the larger public's reaction to the private adjudication of investor disputes even in developed countries.

43. The global SCC network that can be coupled with blocks of SPEs to hold and channel investments has greatly benefited the US investors. The US government appears to encourage its use. No BIT exists between Mauritius and the US; yet, the US recommends Mauritius as a launching platform for the region.²⁸ American treaties are but one part of a network of BITs around the globe that the US investors can access. ICSID data shows that the US investors started 59 ICSID cases under the US BITs and 21 under non-US BITs.

8.8 OPIC

44. Since 1969, OPIC provides project finance and PRI to American investors. US ownership and not control is the eligibility criterion. This was a "brainchild" of large MNCs (Lipson 1978, p.364). OPIC is not the only government sponsored insurer. Other national schemes exist, e.g. those in Canada or Britain. Investors can combine OPIC with private PRI (e.g. from Lloyd's, AIG). Both

private and public insurers enjoy rights of subrogation. PRI can potentially discourage investors from doing adequate homework before making an investment to ensure that it is commercially and politically feasible in a given market (e.g. not imposing an overly harsh price on essential services), and from mitigating their losses (e.g. by renegotiating a contract).

45. OPIC's coverage is offered for investments in 140 countries. The hosts have to approve OPIC insurance for each project (Comeaux and Kinsella, 1994, p.37). OPIC can deny insurance if the investment is likely to have a negative impact on the US employment or balance of payments. OPIC is guided by the extent to which hosts are "receptive to private enterprise."²⁹ Section 231(m) added in 1981 to the Foreign Assistance Act; it was described as "noxious" as OPIC must refuse to insure, reinsure, or finance any investment "which would reduce substantially the positive trade benefits likely to accrue" to the US (ASIL 1983, p.300). This clause confirms that developing countries' expectation of an opening in the US market (as a reciprocal advantage to welcoming American investments) was illusive.

46. Even if investments have been secured through inappropriate influence with the host's political authorities (e.g. in Indonesia during the Suharto reign), OPIC is not obliged to refuse to insure them. Without OPIC's support and the operative norms of international arbitration, many expensive and unfeasible projects would not have been undertaken or would have been renegotiated if unexpected difficulties arose (Wells and Ahmed, 2006). OPIC's refusal to insure might not cancel a project, but its support may convey to other financiers and the host that a project is feasible. OPIC accepts the use of SPEs set up in SCCs for the projects it insures or finances.

47. OPIC can exercise considerable influence over host countries in other ways (e.g. in settlement negotiations). OPIC sought to recover \$6 million from Petroleos de Venezuela SA (PdVSA). OPIC had paid this sum in 2004 to its insured entity, Science Applications International Corporation (SAIC), whose service contract was terminated by Venezuela. OPIC threatened not to support new investments in Venezuela unless it agreed to arbitration. OPIC's communications director said, "[w]e are generally a very important catalyst for investment ... and a bellwether for political risk in a country." (Luhnow, 2004). Despite the fact that OPIC's actions might not be a reliable indicator of country risk (Gero and Quintrell, 2013), such propaganda gives it significant power. The US is also a member of the multilateral investment guarantee agency (MIGA). Both OPIC and MIGA are more likely to accept the claims than an arbitration tribunal (Bekker and Ogawa, 2013, p.316–7). OPIC announced in 2011 that it would offer PRI cover to the fast growing private equity *fund* investments in emerging markets. The extension of PRI to portfolio investments reflects similar expansive developments in ISA.³⁰

8.9 The US pushed for the MAI

48. In the mid-1990s, the US used its considerable influence against a World Trade Organisation (WTO)-style investment agreement, and instead supported OECD's negotiations on Multilateral Agreement on Investment (MAI) (Beltz, 1995B). As discussed in Chapter 10, the MAI was not concluded. The advantage to the US was that it could manipulate the Europeans and Asians against each other as they competed for investments (Beltz, 1995A). It served as a "bridge and also as a catalyst" using the competition between the OECD and Asian Pacific Economic Cooperation (APEC) to facilitate the acceptance of the higher standards of protection for cross-border investments (Beltz 1995B, p.33).

49. The US then moved to "close the door on the home-front and increase investment discrimination" (Beltz 1995A, p.18). Its investors were able to take full benefit of those opened markets even if the US did not sign any treaties with host countries; all the investors had to do was set up SPEs in strategic SCCs. ISA arbitrators and academics may have construed BITs as a sign of capital-importing countries' competitiveness to attract FDI, but a fuller picture of the 1990s' must include the internal competing influences of the US and the fact that its capital sought higher return abroad. The US was promoting a conditional national treatment policy at home (Beltz 1995B, p.45), while arguing for a higher standard from other countries. American investors' capacity to borrow abroad increased with deregulation (Versluysen, 1988).

8.10 The US Influence in IOs

50. Using its power to direct, co-ordinate and influence IOs (the IMF, the World Bank), the US influence became a "force multiplier" (Weisbrot, 2013). During the 1980s-1990s, this joint power steered developing countries towards deregulation, privatization, and a general improvement of their investment climates.

51. Taking higher risks and lending heavily had ensured that by 1982, the nine largest US money-centre banks held Latin American debt amounting to 176% of their capital and their LDC debt was nearly 290% of capital.³¹ Mexico's threatened default on its \$80 billion debt was followed by 27 countries' wish to reschedule their debts. As the US led the organisation of 'an international lender of last resort,'³² the IMF and other official agencies agreed to lend to those LDC funds adequate to pay interest, not principal, of their loans on the condition of undertaking of structural reforms. The US influence led to the creation of the Structural Adjustment Facility in 1986 (Dash, 1999, p.889). With the enormous amounts at stake, it was no surprise that growth in developing countries appeared to be an attractive option to the creditors.

52. Debt, inflation and stagnation were not limited to Mexico. The aggregate long-term capital flows of developing countries (loans, FDI or aid) were at their lowest by 1987. The Mexican crisis continued even after the ‘reforms’. In March 1989, the Brady Plan was proposed for debt and debt-service reduction – conditional on further economic reforms. Upon agreement to implement certain reforms, a country’s loan was converted into new bonds with the support of extra funds obtained from the IMF and the World Bank. The US issued zero-coupon bonds that a country could buy and use as collateral for new securities to be issued to replace their bank loans.³³ Mexico was the first country to accept a Brady Plan. Its government contributed \$1.6 billion out of \$7.2 billion used as security for the new bonds (Unal et al., 1993, p.412). Other similar plans (e.g. Brazil, Venezuela and Argentina) followed.

53. Initially, creditor banks may have held the Brady bonds, but they sold them to non-bank institutions (e.g. hedge funds). The principal and interest were guaranteed, and there was a possibility of earning high returns (Johnson, 2013). Similar arrangements with Argentina later led to ISA started by thousands of Italian purchasers of bonds in the secondary market.

54. The list of the expected economic reforms included increased protection for property rights. The US wanted to end growth-stifling policies.³⁴ The assumption was that the growth (from reforms) would generate enough funds to pay capital and the high interest. BITs had similar aspirations. This could have worked if the host states retained enough of the wealth generated to reduce their indebtedness.

55. SAPs were prescribed to countries whether or not these helped them to repay their existing loans, or to achieve their developmental goals. Some led to more debt crises, requiring imposition of further adjustments and austerities. In most newly liberalised countries, TNCs (including the US investors) bought up struggling utilities, entering into 25-30 years’ concession contracts to build and operate infrastructure. Those gave rise to expensive ICA or ISA, or both. It was largely irrelevant in the legal setting that some projects were flawed in their design, or that loans were irresponsibly made. TNCs obtained guaranteed dollar prices in countries with a currency depreciating against (e.g. India) or pegged unrealistically to the dollar (e.g. Argentina). These projects were effectively to be subsidised by the host states. Most such investments were routed through SCCs, thus making it doubtful if any additional wealth was to be retained by the hosts. Indonesia paid over \$261 million in compensation for the OPIC-insured Karaha Bodas project (a 30 years’ “take or pay” contract) that was cancelled in the wake of the 1997 Asian crisis (Matthews et al, 2005, p.268-9). Nothing was built, no power generated; the arbitrators assumed, despite the Asian crisis, that debt financing would have been available for the project (Wells, 2003).

8.11 Trade and Investment Framework Agreements

56. The US has entered into over sixty trade and investment framework agreements (TIFAs). These provide annual fora to discuss trade and investment related matters. The US and the Philippines signed an agreement headed “Understanding,” in November 1989, a month before the coup against the Aquino government.³⁵ It sets out the need for policies that would promote and protect private investment (no reference to *direct*). Iraq and the US entered into one in July 2005 after which Iraq enacted its National Investment Law, 2006 to modernise legal protection for investors.

57. Although TIFAs are not BITs, they show that the US had a platform at which to discuss issues relating to investment. After a TIFA with ASEAN in 2006, the US made proposals for trade finance, environment, etc. that, if agreed, would apply to all ASEAN member countries. If agreements are made under TIFAs, they lead to an FTA or a BIT but not all of the TIFAs have done so.

8.12 The US preference for ISA continues

58. The US, Canada, and Mexico entered into the North American Free Trade Agreement (NAFTA) in 1994. Chapter 11 of NAFTA is an investment treaty. Article 1113 expressly provides for a denial of benefits cause. Article 1116 provides for claims by an investor of a Party on its own behalf and Article 1117 with claims on behalf of an Enterprise that the investor owns or controls, directly or indirectly. If an investor brings a NAFTA claim, say, on behalf of its subsidiary, it will do so under Article 1117. The treaty itself envisages beneficial ownership and control in a *separate* clause from the one providing for the investor’s own claim. This is different from most BITs. Both, the draft TTIP and the Trans Pacific Partnership (TPP) signed in 2016 (not entered into force) propose ISA as a dispute resolution mechanism. The US still prefers ISA.

59. The soft influence of Anglo-American law firms is increasing in arbitration cases and arbitral institutions (Alford, 2003, p.69). American legalistic attitude to contracts largely prevails in ISA. Contingency fees and third party funding are a growing features of ISA. Given the influence of the TNCs at the core of the bow-tie structure (see Chapter 7), coupled with the tightness of the elite arbitrators’ group, there is considerable potential for a convergence of ideas and an increase in the potential for conflicts of interest. In ISA this can only take away from, at least, the appearance of integrity. A TNC can spread work around mega-law firms in such a way that they are prevented by lawyer-client privilege from acting against that TNC. For example, a British law firm could not act for India in an ISA commenced by GE, Enron and Bechtel because its branch office had undertaken some unrelated work for GE, and GE refused to give a waiver.³⁶ It is difficult to measure the extent

of this practice.

8.13 Summary

60. The collapse of the USSR followed by the SAPs recommended to the transitional economies have had a significant effect on the global economy. Debt-ridden developing countries' options were reduced drastically. Not only was the US the only superpower left, but it also had the strongest vote in the IMF and the World Bank. It did not matter that American national debt was substantial and rising.

61. Before the entry of the US on the BIT scene, there were not quite as many BITs as exist today and they were treated more as expressions of political will than binding legal instruments. Despite the fact that only 41 of the US BITs ever entered into force, the US investors are big users of ICSID using both the US and non-US BITs. In light of this thesis, there appear to be three key contributions of the US.

- a) Its own role as an SCC legitimised the use of other SCCs and offshore SPEs. The US promoted and encouraged *indirect* investments. A Delaware corporation could work through SCCs like the Netherlands to make its investments. The US legal framework, especially the use of OPIC, endorses such use of BITs negotiated by other states.
- b) The US used its aid programme and influence in the IMF and the World Bank to promote various measures of deregulation, privatisation, and liberalisation of economies of developing countries. These were undertaken without particular emphasis on the channels used by capital flow, and regardless of their effect on the developing countries' ability to service, much less reduce, their overall debt. IOs promoted BITs (Chapter 10).
- c) The US created and nurtured the conditions that allowed oligopolistic TNCs to emerge, expand and thrive. This involves allowing TNCs a substantial say in US policy-making and implementation.

¹Letter from Reagan March 1986 to the Senate, Retrieved from www.state.gov.

²46 Fed. Reg. 32428 (June 23, 1981) amending 12 C.F.R. 204.2 et seq.

³"U.S. Offshore Banking", section 3, page 20, column 3; Financial Desk: *The New York Times*, January 10, 1982, Sunday, Late City Final Edition.

⁴ Retrieved from www.oecd.org.

⁵"The 0.7% ODA/GNI target - a history" – *OECD* Retrieved from www.oecd.org.

⁶US donated 0.1% of its GNP in 1998. Norway gave 1% of its GNP in 1998.

⁷*New York Times* 8 March 1962, p.14.

⁸48 Department State Bulletin 328-29 (1963).

⁹ United Nations Resolution 3281 (XXIX). Charter of Economic Rights and Duties of States. Retrieved from www.un-documents.net.

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- ¹⁰ The US Department of Justice. "About the Commission" Retrieved from www.justice.gov/fcsc
- ¹¹ 22 USC sec. 2378
- ¹² "Mozambique: Enron files for bankruptcy", *Mozambique News Agency* 12 January 2002.
- ¹³ "Energy giant piles pressure on India" 24 August 2001, *BBC News* Retrieved from www.news.bbc.co.uk
- ¹⁴ "Monsanto and foreign aid: forcing El Salvador's hand" 13 June 2014. *Foreign Policy Journal*. Retrieved from www.foreignpolicyjournal.com.
- ¹⁵ "Progress made on El Salvador deal" *Politico*. Retrieved from www.politico.com 1 July 2014.
- ¹⁶ *EDF v. Hungary* was an UNCITRAL arbitration; an award was made in 2006 but it is not yet public.
- ¹⁷ *Nordzucker AG v. Poland* ad hoc ISA started in 2006, and *Eureko BV v Poland* 2003.
- ¹⁸ *Saluka Investments BV v the Czech Republic*, 2001. UNCITRAL arbitration.
- ¹⁹ "Reagan initiative on foreign investment." *The Times* London, 25 June 1981, p.20 Issue 60963.
- ²⁰ *Ibid*
- ²¹ Not in force although it was signed in 1992.
- ²² This was a statement made by a former trade official from the Regan administration and a president of the Economic Strategy Institute. "Dubai Deal's Collapse Prompts Fears Abroad on Trade with US," *NY Times*, 10 March 2006.
- ²³ 50 USC, app.2170 (1988).
- ²⁴ This happened in 2006 in the cases of Dubai Ports World's potential acquisition of operations of six ports, and in 2005, with a Chinese SOE's attempted purchase of Unocal, an oil company. The US is, according to Credit Suisse's report, a country that imposes the highest number of protectionist measures (Shen, 2015).
- ²⁵ "The role of the IMF in Argentina: 1991-2002", *IMF Issue Paper* July 2003. Retrieved from www.imf.org.
- ²⁶ *Ibid* see Part II.
- ²⁷ See paragraph 33 of the award in *Camuzzi International SA*, 2003.
- ²⁸ "2012 Investment Climate Statement - Mauritius". Retrieved from www.state.gov.
- ²⁹ Subsection f, 22 U.S. Code § 2191 - Congressional statement of purpose; creation and functions of OPIC.
- ³⁰ Overseas Private Investment Corporation OPIC; "New OPIC Political Risk Insurance Will Cover Investments by Private Equity Funds" *Economics Week*, Jan 6, 2012, p.570.
- ³¹ Sims, J., "Latin American debt crisis of the 1980s" Retrieved from www.federalreservehistory.org.
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9. Developing Countries – reluctant partners in BITs?

9.1 Introduction

1. Developing countries played a critical, albeit passive, role in the proliferation of BITs in the 1980s-1990s. However, there is no evidence to show that they all understood and agreed to BITs as open-ended, enforceable arbitration offers that could be accepted by any investor, much less by one from a non-party, by giving an arbitration notice, *after* a dispute had crystallised. That interpretation is made in a legal framework that enables arbitrators to state authoritatively what the states' intentions were in their BITs.

2. The words in BITs (as drafted mainly by capital-exporters) were not of the standard that would indicate that ISA option was to “go without saying” for any and every kind of investment. Arbitrators appear to assume that (a) states signed BITs to give *enforceable* ISA rights to investors *without* an agreement between the state and the investor, and (b) indirect investments were intended to be covered by such options regardless of the origin of the capital, or the impact of an investment on a host's economy. Given the intentions expressed in most preambles, this may not be an accurate understanding of what the states intended.

3. To make ISA widely available, a large number of BITs did not need to be signed; just one adequately worded investment law could have sufficed. A possible alternative interpretation of BITs is shown in this thesis which could have been followed by arbitrators and which would have been in keeping with the objectives of BITs. To go beyond the states' intentions, ISA's expansion requires a normative justification which is currently lacking – the one repeatedly offered is *pacta sunt servanda*. This chapter briefly deals with its overreach.

4. This Chapter will summarise the historical background to explain how the sudden surge in signing BITs was out of character for developing countries. It will consider briefly the vulnerability of developing countries, and the history of nationalisations to examine if there was a need to assure investors against expropriations in the 1980s, and then analyse specific ‘gateway’ clauses in sample BITs signed by Sri Lanka, India and Britain. Unless otherwise specified, this thesis uses the expression ‘developing countries’ to include transition economies and the post-colonial countries.

9.2 More politics or more law?

5. The removal of politics from disputes was an early justification for ISA. A leading arbitrator asks rhetorically, “[m]ore politics or more law?” (Paulsson 2005, p.245). The question does not refer to fairness or justice. As assumed in this question, politics is not the domain of governments

alone. It touches upon all aspects of governance, and relates to all forms of power (Loughlin, 2003, p.38), including private power of TNCs and elite professional networks.

6. Borrowing money is an economic transaction, but debt-management is political (Strange, 1998, p.98). The same goes for FDI. Mining TNCs with an annual turnover surpassing that of the hosts' GDP (Kirkpatrick and Nixon, 1981, p.378) are powerful economic actors with real influence over political choices. It has been suggested that compared to the 1960s' conflict situations, there is a lot of cooperation between TNCs and state governments in the 1990s especially in industrial countries (Dunning, 1993, p.234). This may also exist between TNCs, the local elites and some sections of the host governments, but not among *all* stakeholders.

7. In the Post-1990s, capital has become transnational but labour is very much local (Picciotto, 1988, p.59). Problems of debt, unemployment, environmental damage, etc. are national too. For example, almost all the money borrowed by Greece from the IMF has been used to pay its debts off to European FIs; since 2010, Greece borrowed €252 billion and paid €232.9 billion on debt servicing; what was entirely owed to private banks has become mainly a debt owed to governments (Sheffield 2015). Private banks have had their debts nationalised regardless of whether the loans should have been made in the first place. It is, therefore, legitimate to question the grant of ISA privileges to investors that use SCCs to avoid contributing to an economy that they benefit from or where their commitment to the host country is short-term or purely speculative.

8. Out of the 463 ICSID cases analysed for this thesis, 129 (i.e. over a quarter of the cases) arose in the extractive sector involving natural resources; 121 of these cases involved the use of an SCC. The infrastructure and construction sector was involved in 117 cases (95 in the construction sector, and 22 in the waste management sector). Energy, an essential sector to any complex economy, gave rise to 52 ICSID cases, in 43 of which SCCs were known to be used. Financial services sector was involved in 36 cases (32 used SCCs); these included large stake disputes arising out of government debts (bonds), insurance or bank privatisations. The divisions between the sectors are not finely drawn as the energy sector may need to construct a plant and a construction company will need financial instruments. However, most of the large ICSID cases relate to matters of significance to the governance of a modern economy, and in many developing countries, these had been the domain of public enterprises until globalisation.

9. If a large dam is to be built to provide power to an urban or an industrial complex, the displacement of farmers from their land is a political decision. The environmental destruction caused by extractive operations also involves a political decision over who should bear its cost. It is naïve for TNCs to expect that they can be isolated from the political fallout of these decisions

especially if the project has been commenced without involving all stakeholders in the decisions. Insisting in the contracts that all the aggravation caused by a project to the local stakeholders is the responsibility of the host state may work in ISA by relying on *pacta sunt servanda*, but can lead to the kind of problems faced by Bechtel in Bolivia, Chevron in Ecuador, or Enron in India.

9.3 Overreach of *pacta sunt servanda*

10. *Pacta sunt servanda* is a potent principle, the power of which was and continues to be underestimated by many states. The principle *pacta sunt servanda* when stacked upon itself (as in the investment agreement coupled with a BIT), or with one or other international norms (state responsibility for government that was not made a party to the investment agreement), is a powerful tool for TNCs.

11. Brierly (1925) had rightly reflected on the temptation to forget the differences between treaties and contracts, and suggested a re-examination of the idea of applying contractual concepts from private law to the context of international affairs. One principle of international law that could ameliorate the rigours of *pacta sunt servanda* was the doctrine *rebus sic stantibus*. The harshness of a contract or treaty could be tempered, if there were a fundamental change in the applicable circumstances. Despite the potential for abuse of this condition, Oppenheim argued that it was as necessary as the rule *pacta sunt servanda* (Brierly, 1925, p.14). The argument was that a state could not be said to have consented to any such treaty as would hinder it in the fulfilment of its primary duties. *Rebus sic stantibus* was based on the presumed intention of parties somewhat similar to the doctrine of frustration in contract law (Brierly, 1925, p.15-16). The old advice to states was that “they should abstain from imposing conditions which, on any just and reasonable view of human affairs, cannot be expected to be kept. And they should conclude their treaties, as commercial treaties are usually concluded, only for a term of years.” (Mill, 1870, p.715). Developing countries did not take this counsel when entering into concessions and automatically renewable BITs.

12. Until the 1990s’ decisions in the *Asian Agricultural Produce Limited (AAPL)* and the *American Manufacturing and Trading Inc. (AMT)* cases (neither of which was widely published), the developing countries would not have been aware that their BITs effectively contained an open-ended, operative arbitration agreements, potentially with any unspecified investors. Their understanding is more likely to have been that BITs contained something akin to an invitation to treat, so that the investor could make an offer of an ICSID/UNCITRAL/ICC, etc. arbitration agreement in the bid for any investment, which, if accepted by the host, would lead to an arbitration agreement. This is why many BITs contain several options of which one might be specified in the investment agreement itself. The one principle most states would have been aware of (particularly

from their familiarity with the New York Convention), was that arbitration agreements had to be in writing between the parties to a dispute. BITs were between states.

13. Most BITs avoid using the expression ‘FDI’. Their definitions of protected ‘investments’ appear, *prima facie*, to include short-term portfolio investments. The difference between FDI and portfolio investments is significant in the balance of payment categories; portfolio investments can be withdrawn more speedily than FDI and present a different risk profile than FDI. For example, in November 2015, foreign investors withdrew over \$1.5 billion from India; the foreign portfolio inflow a month before had reached a seven-month high.¹ It would be an absurd interpretation to hold that hosts were agreeable to ISA in the case of disputes relating to all and any portfolio investors that might be dissatisfied with the states’ regulatory or policy decisions – all policies have the potential to hurt some legitimate expectations.

14. If, most BITs required, as is contended in this thesis, specific investment agreements containing ISA clauses, then the broad definitions in the BITs are reasonable; further details were to be clarified in the investment agreements; BITs would signal willingness to welcome all types of investments but ISA would be covered in specific negotiations. Most states tend not to make any open-ended agreements easily. In the case of early BITs, there is not much evidence of any *travaux préparatoires* approving the delegation of wide-ranging powers to ISA arbitrators to expand the scope of their jurisdiction.

15. BITs were interpreted as standing offers to arbitrate, to be accepted by any investor simply by giving an arbitration notice *after* a dispute had arisen, not at the time the investment was made. Developing countries had regarded BITs more as a political than a legal exercise. Many BITs required the investor to be “of” a Contracting Party so that indirect investors would have been outside the contemplation of developing countries. Most of these BITs were signed before any BIT arbitration took place under the Convention. In the 1960s, even the US lawyers believed that a consent to submit disputes to ICSID arbitration would suffice if it were included in an investment agreement.²

16. It is difficult to assess whether the extent of TNCs’ business through SCCs was known to the developing countries as they liberalised their economies. The debt and forex crunch in the 1980s and in the early 1990s would have meant that their focus was on fire-fighting rather than arbitration possibilities of BITs. Most discussions of potential FDI tended to be in glowing terms about: increased domestic employment, growth, technological and managerial knowhow, etc. Unless accompanied by sound domestic regulations, FDI might not bring these benefits. For example, a foreign monopoly might displace local businesses, and/or might not comply with local laws

(Nagaraj, 2003). In fact, studies into larger FDI flows leading to higher growth are unambiguous in their result; if Chinese growth was caused by large FDI flows, Brazil's experience with high FDI flows did not confirm it. (Nagaraj, 2003).

17. The early ICSID cases comprise states' objections to jurisdiction that indicate their understanding that ISA did not apply to *indirect* investments. Nor would they have realised that the government would be held responsible for the effect of (legislative, executive or judicial) actions or omissions in relation to contracts that had been entered into by autonomous public agencies using the principle of state responsibility – which took the ILC over 45 years to draft. When the draft Articles were completed under the chairmanship of James Crawford (now an ISA arbitrator), the UN was requested not to put the draft to vote. Yet, the draft is acknowledged as customary international law by most ISA arbitrators, and is relied upon in awards. Many developing countries are caught unaware of its effects in making their governments responsible for contracts they had no direct influence over.

18. BITs were not discussed openly, or their implications subjected to much public scrutiny. For example, despite the fact that India signed 84 BITs, there was rarely any discussion in the Indian Parliament about these, unlike the WTO agreements (Ranjan, 2014, p.437). India's finance ministry that negotiated most of the BITs continued to use broad wordings, as opposed to India's commerce ministry that negotiated the investment chapter in the FTA with Singapore in 2005 using narrower wording. Ranjan believes that this was to do with the commerce ministry's experience with WTO negotiations (2014, p.438-9). India's willingness to use broad wording in BITs might be due to the fact that India feels the pressure of being a net-capital importer. The Indian commerce ministry prepared a paper suggesting that BITs are neither necessary nor sufficient for promoting FDI and recommended a reconsideration of BIT policy (Ranjan 2014). This paper also recognised that India's BITs do not balance investment protections and its regulatory powers. This indicates that within a host state two departments of the same government might not share the same information or views.

19. Most BITs appeared to be slight modifications of a boilerplate model; China was an exception providing in its first generation BITs for ISA only in respect of the quantum of compensation and not the liability issues. BITs tended to be based on the home countries' terms (Allee and Peinhardt 2014). The South Africa-UK BIT, signed in 1994, was presented to the outgoing government in 1992-93 on the basis of the British model BIT. There was fear that the new government might expropriate the foreign investors' assets. A South African government official informed a parliamentary committee that there were no substantive obligations on the government under the BIT (Williams 2009). The British model, being drafted for a capital-exporter, was

inappropriate for South Africa which, at the time, was a capital-importer. Having lost a BIT case and settled another for an undisclosed sum, India suspended BIT negotiations in 2010 to review its model BIT. Since Ranjan's paper (2014), the commerce ministry has lost all power of negotiating FTAs to the finance ministry, and a new model BIT was issued in 2015 (Dahlquist and Peterson, 2016).

20. In India's new model BIT, published after the neoliberal Modi became the prime minister, the definition of an investment requires a "commitment of capital or other resources, certain duration, the expectation of gain or profit, the assumption of risk and a significance for the development of the Party in whose territory the investment is made." Portfolio investments and taxation disputes are specifically excluded.³ The model draft does not require that the investor would comply with human rights, consumer protection, and labour laws; the investor has to "endeavour voluntarily to incorporate" internationally recognised standards over these matters. The new model also includes a denial of benefits clause if an investor or investment is controlled or owned by persons of a "non-Party" or of "India", or where the investment or investor structure is set up primarily to gain access to an ISA mechanism so that treaty shopping would be potentially restricted (Article 35). These changes indicate that the Indian government appears to be making a conscious choice over the terms it is prepared to accept in its BITs. However, its first generation BITs did not undergo such scrutiny as at the time BITs were not believed to be enforceable in ISA.

9.4 Comparison of "investment" definitions in the BITs of the UK, Sri Lanka and India

21. BITs of three countries were analysed to examine how an indirect investment or an investor were dealt with. Britain was chosen as an industrial country that was a pioneer in the field. Sri Lanka was selected as a developing country that has signed the Convention. India is an example of a developing country that has not signed the Convention, and is now making a transition from capital-importing to being both an importing and a capital-exporting country. The definition sections for comparison were taken from the BITs available from UNCTAD's database.

22. Britain's 110 BITs did not use indirect control as a concept with the exception of Colombia-UK BIT (2010) which is not yet in force; it refers to an investment as being owned or controlled directly or indirectly. Shares and participation or interest in companies or their asset are included in several BITs as investments. The preambles of most BITs show that they expected to encourage business initiative, sometimes preceded by the word 'individual' and occasionally by 'private'. Promotion of mutual prosperity and greater economic cooperation appears in almost all the BITs. The prima facie inference from the definitions and the preambles is that Britain was promoting a *bilateral* investment climate. The encouragement is for investments *by* nationals and investors of

the signatory states – not by any investors routing investment through Britain.

23. Sri Lanka signed twenty-nine BITs of which four are not in force. The preambles refer to its intention to promote investments *by* the nationals and investors *of* its signatory states with the objective of promoting mutual benefit or prosperity. The word *indirect* does appear in a few BITs. For example, in its seventh BIT with Switzerland (1981), the word company is defined as one in which “Swiss nationals have a direct or indirect interest preponderant”. Although indirect ownership is included, the ultimate interest rests with Swiss nationals. The next time the word ‘indirect’ was used was in its BIT with the US (1991). Investment was defined to include those “owned or controlled directly or indirectly by nationals or companies of the other Party”. Thus, the ultimate ownership is the criterion for investment, indicating a *bilateral* focus. This is confirmed by the provision that reserves a right to deny benefits of the BIT. In its Australian BIT (2002), investment was defined widely to include one that could be made through a company “duly incorporated, set up or otherwise organised under the law of a non-Party;” it had to be owned or controlled by an investor from Australia and admitted by Sri Lanka. Australia was the second largest foreign investor in Sri Lanka with \$22 million worth projects being approved in the first eight months of 2002. The BIT followed the Australian model treaty closely.

24. Out of 84 Indian BITs, 73 are in force. The BITs include preambles that stress mutual prosperity, economic development, and the fact that an investment is expected to be made *by* the investors of the other state. Several BITs also refer to greater economic cooperation. The first reference to ‘indirect’ appears in the BIT with France (1997) – as “indirect and minority” shares or other participation in companies. Investments are defined to include directly and indirectly controlled assets in the BIT with Kuwait (2001); the control and ownership could be exercised through subsidiaries and affiliates wherever located. Despite the width of these definitions, there is an exception that the BIT would not apply to any indirect investments made through a company incorporated in a third state unless there is at least 51% ownership or control by investors of a signatory state. The ownership has to be *real* and control *effective*. This is the first express reference to and acknowledgment of, the use of SCCs in India’s BITs.

25. India, Sri Lanka and Britain rarely expected BITs to apply to investments of non-signatory states and when they did, they set it out in express terms. The BITs show a political calculation by reference to each capital-exporter of investments expected *from* that country, even if in the odd BIT they could be routed through SCCs. Most of these do not indicate the expectation that round tripping capital could be using the treaty to start an arbitration against the host. In the case of Britain, the expectation is probably that it would not be a respondent state; indeed, it has not yet been one in an ICSID case. There is no justification to imply that BITs that do not contain such

explicit references were intended to apply to investors who had no real connection with the home state. If anything, the bilateral bargains appear to be made to protect the investments that *originate* in the home countries that signed the BITs. The rest of this Chapter will briefly consider the historical position showing how developing countries were persuaded to sign BITs at all.

9.5 NIEO Years – “Return to the Law of the Jungle”

26. The “ability to provide capital and *appear* as the champions of national independence” was once advocated by Britain (UK Cabinet, 1960). It was important, during the Cold War, to entice the newly independent developing countries away from the Soviet faction. Few pertinent points about developing countries were:

27. Nationalism: Western powers were happy to tolerate supportive nationalism for developing countries (Srinivasan, 2006), but not NIEO – “the most serious challenge” to American leadership after 1945 (Mazower, 2012, p.304) or the Charter of Economic Rights and Duties of States (United Nations, 1974). NIEO was a collective attempt to endorse the use of sovereign power to control key industries, trades, and MNCs (Ogle, 2014).

28. TNCs had either long-established or nascent claims over natural resources (Carlston, 1959, p.429). Colonial long-term concession contracts clashed with the newly independent countries’ need for capital to support development; any changes to tax or royalty would be in breach of their contractual commitments.

29. In 1958, the UN Commission on Permanent Sovereignty over Natural Resources adopted a resolution 1314 (XIII) recognising the states’ rights over their natural resources. By 1962, the UN discussions led to a Resolution 1803 (XVII) to regulate foreign investments and TNCs in accordance with the host states’ national laws and recommended local remedies for dispute resolution. TNCs like Shell, BP and American Oil had begun mobilising against this as soon as the 1958 resolution was adopted (UK Foreign Office, 1961). Mobil International wrote to ECOSOC protesting about “a kind of return to the law of the jungle” at the prospect of states’ inalienable right to dispose of their natural resources. (Ogle, 2014, p.217).

30. Developing countries’ aspiration to economic self-determination was reflected in their policies of planned development (measured mostly by steel and energy consumption) and import-substitution, e.g. India prepared a comprehensive Industrial Policy Resolution in 1956. Even if some nationalisations took place, there was no competition among developing countries to sign BITs; their need for capital was no less intense than would be two decades later.

31. The post-Bretton Woods uncertainties and volatilities caused by increasing deregulation of

currencies and banking coincided with increased protectionist measures by developed countries such as import restrictions against manufactured exports under the Multi-fibre quota Arrangement of 1974 (UNCTC, 1978, p.16). These affected developing countries' export earnings. Subsidies offered by industrial countries worked against making a level field for host's domestic investors and foreign investors (World Bank, 1991A, p.52; and 1993, p.47).

32. Developing countries faced problems with balance of payments but their growth rates were respectable (see paragraph 9.4). Developing countries' share of global FDI fell from 29% in 1970 to 10% in 1974; it would reach 14% in 1980 (OECD 2010).

33. Most development in the pre-1960s was financed through the international bond markets which declined markedly after 1970 (Folkerts-Landau, 1985, p.320). In the case of defaults, which occurred regularly, further entry to the bond markets was barred for a defaulting country until it reached, at least, a partial settlement with its external creditors.

34. The developed countries had stagnation and a glut of petro-dollars during the 1970s (World Bank, 1997, p.12); the developing countries had growth-potential, and a cash-crisis (particularly if they were oil-importers). International banks were not "passive intermediaries" between supply and demand of dollars (World Bank 1981, p.11). Bankers used syndicated loans as they sought a higher return from the developing countries. This competition to lend is significant; states continued to borrow because credit was on offer.

9.6 Development debts pile up

35. The developing countries' debt billowed after 1973. As some of these countries developed, their attractiveness to TNCs increased (UNCTC, 1978, p.56). In a parallel development, MNCs' borrowed to fuel their expansion to developing countries thus adding to the overall debts. Between 1973 and 1980, developing countries' long term debt was growing annually at an average rate of 21.3% (of which the private debt was growing at 24% p.a.) (Krueger, 1987, p.168).

36. In the 1980s, Walter Wriston of Citibank started lending on the security, not of the asset itself, but its ability to generate cash in future, in the belief that countries do not go bankrupt (Krueger 2002). Banks increased their lending in diverse currencies, via branches in SCCs (World Bank 1981, pp.18-9).

37. The lending increased the activities of the private financial sectors in the industrial countries during the recession. The total outstanding debt of the developing countries to private and public lenders rose from \$75 billion in 1972 to \$180 billion in 1976 (Beek, 1977). Commercial debt began to replace ODA. Whether all the lending was responsible is another matter. For example, Brazil,

Argentina and Mexico accounted for half the developing countries' debts in 1984 (Deshpande, 1995), indicating a herd mentality among the lenders, not just the borrowers. It was possible in 1994 to borrow money in New York at 5 to 6% and to invest it in Mexico at 12-14% (Strange, 1998, p.102).

38. The "escalating need" of the developing countries coincided with the "escalating risk" of currencies (Strange, 1998, p.30). As MNCs' need for funds grew, the exchange risk multiplied. Derivatives were the answer to hedge the currency risks. The share of the financial services sector in FDI started growing (Brewer Thomas, 1991, p.12). The FDI in financial services, in turn, increased the need of SCCs and the interdependence of economies.

39. The developing countries lacked the sophistication, knowledge and experience to negotiate with foreign investors effectively. UNCTAD acknowledged that strengthening their capacity to bargain need not be at TNCs' expense (UNCTC, 1978, p.136). Developing countries borrowed funds, with IOs' blessings (Van Gelder et al 2002, p.149), for some 'white elephant' projects, e.g. the construction of large dams. The cost of large dams and other failed mega projects contributed to their debts (Ansar and Flyvbjerg 2014). The enormous hydro-electricity projects (e.g. Kariba, Akosombo, and Inga) of the 1950s-60s had cost far more, and produced less energy than expected; most benefits being for mining companies and aluminium smelters, and not the country's poor (Bosshard, 2013).

40. Before the 1990s, developing countries insisted on performance-oriented policies (e.g. a prescribed minimum local content, or advanced technology). This was not attractive for the investors' home countries, as the benefits of capital would shift from home to host countries (World Bank, 1979, p.20-21). With the debt crises, the developing countries could be persuaded to focus on FDI - bringing in non-debt financial resources.⁴

41. Harmonisation of the host states' policies was pursued by the developed countries by issuing their own political risk guarantee schemes (e.g. OPIC), and then entering into bilateral agreements to allow for subrogation. BITs and ISA in the 1990s were more steps in the same direction. Increasing FDI did not mean that the developing countries did not need to borrow. Their overall debts continued to increase with the liberalisations.

9.7 Were nationalisations or expropriations deterring investors?

42. Despite the Abs-Shawcross and Shell efforts, the Latin American investment climate was proclaimed to be "harmonious" in 1958 (Galvin, 1958, p.220). The 1970s brought nationalisations of petroleum companies in Saudi Arabia (ARAMCO in 1976), Ecuador (Texaco-Gulf 1977), Libya

(Exxon et al, 1977), and Kuwait (BP/Gulf, 1976) (UNCTC, 1978, p.314-5). By the 1970s, some host governments were not inclined to accept stabilisation clauses for 20-100 years when their economic stability was clearly unsustainable. (UNCTC, 1978, p.114). There were 1,369 instances of nationalisation between 1970-76 with the annual average nationalisations rising from 47 in 1960 to 140 in 1976; “this was still a very small portion of the total number of [foreign] affiliates” (UNCTC, 1978, p.65). These were focused on natural resources and utilities. Further, 170 contracts were renegotiated in 26 years as of 1946 (UNCTC, 1978, p.66).

43. The 1970s’ nationalisations were not caused just by the host countries’ political environment. The TNCs’ Anglo-American business culture of elaborate, one-sided contracts was not suited to the post-colonial times. Japanese firms, for instance, were less concerned than American firms over the 1970s’ nationalisations (UNCTC, 1978, p.68). Japanese companies tended to renegotiate more than litigate (Ramseyer, 1988). Only two Japanese claimants have brought ICSID cases as claimants and that was after 2015. However, despite the expropriations and renegotiations, any “evidence of refusals to invest” on grounds of political and commercial risks was scarce (UNCTC, 1978, p.67).

9.8 Nationalisations were not just a developing country phenomenon

44. The 1970s witnessed nationalisations by some industrial countries too - Canada’s Potash Corporation of Saskatchewan, British water utilities and 50% stake of BP, British Aerospace, and in the 1980s British Telecom, gas and coal corporations, and in France, the electricity and telephone utilities, and several banks in 1982.

45. FDI was not fully open in all sectors in either developed or developing countries. Defence and communication industries were commonly excluded. Public sector ownership was large in many developing countries; for example, in India this included the railways, power generation and distribution, oil exploration, water and sewage services, telephone and communications, etc. Some allowed minority foreign ownership while others opened certain sectors for a limited period to foreign ownership. Some (e.g. Korea) capped FDI in select sectors (UNCTC, 1978, p.24). Most incoming FDI would have needed some kind of approval from the governments in developing countries like India, and in developed countries like Canada.

46. Despite the privatisations undertaken by the OECD countries, their governments owned at the end of 2012, some 2,111 SOEs, with a combined value of \$2.2 trillion in telecoms, electricity, and transport.⁵ Developing countries were, however, advised in the 1980s that public enterprises were the reason for their problems.

9.9 Public sector involvement

47. Efficiency arguments may justify expanding private sectors (Amatori and Jones, 2003, p.375), but governmental involvement can lead to high growth rates (e.g. in Japan, or South Korea) (McCraw, 1997). A private sector is not always successful. Neoliberal policies failed in Africa albeit that the blame was left at the door of poor institutions, corruption, geography, culture, poor human resources, etc. (Chang, 2003).

48. Most developed countries regulated FDI and also used SOEs as it suited them (Chang, 2009). Yet, the 1980s' dominant paradigm was censuring state-led and nationalistic development policies (Chang, 2009, p.1) as evident in the US exhortation, at the 1981 Cancun summit, to embrace free market and private enterprise. Britain emphasised self-help (Ogle, 2014, p.225) within conditions to be circumscribed by the Western economies and TNCs.

49. Just as the developing countries' export earnings started to decline in the 1970s, their external borrowings increased (Rieffel, 1984-85, p.109). Interest rates soared. Governments, like TNCs, borrowed in the short-term credit market. Some preferred commercial borrowing to service their existing debts to avoid conditional borrowing from the IMF (Beek 1977). The World Bank, borrowing in the private markets, raised its interest rates in the late 1970s and the 1980s.

50. The debts were not excessive relative to the size of developing countries' export earnings or domestic production (Beek 1977). For over a decade before the oil crisis of 1973-4, the growth rate of the least developed countries was 6% per annum; after the oil crisis, it was average 5% per annum until 1980. This was a pretty strong growth rate indicating that the fears of wide-spread defaults were exaggerated (Beek 1977). However, servicing the interest payments became expensive for developing countries, and potentially risky for the lenders who faced liquidity crises. Various studies concluded that developing countries' debt problems could be solved, at least partially, if they could raise funds on a long-term basis (Strange, 1986, p.163), e.g. traditional FDI.

51. Around the same time as the debts piled up, SCCs enabled the unleashing of the financial markets' power (Strange, 1998, p.40). Innovative financial products started pulling away from the real economy. By 1995, the outstanding derivative contracts in twenty-six countries were worth \$47.5 trillion, twice the value of the world economic output (Strange, 1998, p.30). Only 5% of it represented banks' credit risk; banks could place bets both ways, or on behalf of their clients and themselves (Strange, 1998, p.31).

52. Argentina was a good example of how influential the debt crisis was in persuading a country to accept 'reforms'. In its BITs with the US, Argentina abandoned its reliance on the Calvo

Doctrine in 1992; six weeks later its ‘debt for development’ programme pegged the peso to the dollar. By the first quarter of 1995, Argentina was in crisis again. Its debt spiralled and its economic problems only got worse. Fifty-three ICSID cases were started against Argentina from 1998 onwards and most of them were the outcome of those difficult financial times.

9.10 Sovereign debt enforcement

53. The early 1980s’ brought concerns over developing countries’ debts. The reality of most crises is almost always to do with genuine inability to pay rather than reluctance to pay (Shonfield, 1976, p.400). No legal framework existed for sovereign defaults.⁶ This applied to the government borrowings and to amounts determined to be owed by them (under contracts, or under courts’ orders or arbitrators’ awards).

54. Defining debt as an investment is useful; most BITs include a variation of ‘claims to money’ as ‘investments.’ Litigation against states has increased since the immunity principle has weakened and vulture creditors have emerged (Das, et al, 2012, p.50). Vultures are investment funds that buy heavily discounted sovereign debt, and then recover the full debt from the debtor government. Third party funding along similar lines is available for ISA.

55. Argentina agreed in 2016 to settle a 2007 mass ICSID claim for \$2.5 billion (*Abaclat*). It arose out of Argentine bonds sold in Italy in the secondary market.⁷ Arbitration awards provide leverage for settlement. In terms of ease of enforcement abroad, an ICSID award ranks ahead of a New York Convention Award which itself ranks ahead of a national court’s decree. A national court cannot review or overturn an ICSID award; it must be enforced as if it were a decision of the host’s highest court.⁸ The principle of sovereign immunity applies in a diminished form.⁹ Under the 1988 amendment to the US Foreign Sovereign Immunities Act, there is no sovereign immunity if the enforcement of an award “would not be inconsistent with any provision in the arbitral agreement.” It is unnecessary to prove a connection between the property and the claim; arguably, it also means that the underlying investment does not have to be commercial as in the case of a New York Convention award.

56. The only other methods of sovereign debt recovery are described below to illustrate the value of ICSID as a mode of enforcement of sovereign debts. Government creditors’ loans are dealt with in the Paris Club – an ad hoc, and largely informal coordination of creditors.¹⁰ It first met in 1956. The Paris Club relies on burden-sharing by using a non-discrimination clause – the non-participating creditors have to provide similar relief (Rieffel 1984-85, p.88-89).

57. The London Club, which first met in 1976, deals with all other loans to governments. The

creditor governments wanted private banks to offer comparable relief to avoid the moral hazards of “bailing out the banks” (Rieffel, 1984-85, p.84, 89). Bailout could render high returns on investments risk-free at the expense of the international community (Gianviti, 1996, p.781). However, non-bank foreign investors could not look to their home governments to include their earnings in the Paris Club debt relief negotiations.

58. The London Club has more formality and structure in its proceedings than the Paris Club. Its first meeting took place in 1976. Almost 800 bankers participated in the case of Mexico’s debt in 1982. The London Club is a hard bargainer (Uppal and Van Hulle, 1997, p.742-3). Syndicated lending of the 1970s made it expensive for the borrower to default (Chowdhury, 1991); it was difficult for lenient lenders too (Uppal and Van Hulle, 1997, p.744).

59. Banks had participated in syndicated lending without much worry over defaults (Calhoun, 1977, p.1792). They also practised ‘complementary financing’ whereby private finances were joined with loans made by the World Bank or the IFC (Corse et al., 1977). Thus, much greater amounts were lent than before (Corse, et al 1977, p.36). Loans, in the form of FDI, would have been a lot easier to enforce; their returns were built into the projects in which banks would be stakeholders. The Convention awards have made sovereign debts relatively easy to enforce.

9.11 Privatisations under Pressure

60. The World Bank failed to bring about a multilateral investment insurance convention in 1974. By 1988, a Multilateral Investment Guarantee Agency (MIGA) was acceptable enough to enter into force. What changed in the intervening decade was the global move towards self-liquidating finances, liberalisations and privatisations.

61. Local elite investors and TNCs enriched themselves as they bought public enterprises cheaply (George, 2007). Recent examples include: (a) Queensland in Australia privatised Port of Brisbane in 2010 by offering a 99 year lease for just A\$2.1 billion; within three years, one of the buyers sold its 27% stake in the Port to a Canadian pension fund for more than A\$1 billion - at 33.33% annual rate of return. (b) Emma Delta, an equity fund, bought the Greek government’s 33% stake in Europe’s largest listed gambling company for €712 million; it had generated €505 million in net profits the year before.

62. According to the IFC and the Foreign Investment Advisory Service (FIAS), the developing countries’ onerous limitations on foreign investment discouraged FDI flows (World Bank 1997). However, caps on foreign ownership could be circumvented relatively easily. There were non-equity ways to control an entity. At times 1-4% of the ownership would nominally be in the hands

of a local owner but controlled by the foreign investor. When the host country lifted the ownership restrictions, the foreign owners officially purchased (e.g. under rights of pre-emption) the small bloc to obtain full ownership. In Poland's mobile phone industry, French TNC Vivendi challenged Deutsche Telekom's purchase of a minority shareholding of a Polish investor after Poland lifted the cap of 49% for foreign ownership of telecom companies; both the TNCs vied for the control of the Polish phone operator PTC, eventually settling their disputes in 2010.¹¹

63. Two approaches were advocated to the transition economies, namely, a gradual approach or, more commonly, a shock therapy (Hamm et al, 2012). IOs' advice that large scale privatisations would bring about efficiency and growth was not correct. There is considerable evidence of foreign firms doing better than domestic ones during transition. This does not mean that the whole country would benefit from a higher growth (Hamm et al, 2012; King, 2000). Less FDI penetration is better than more, and domestic rather than foreign investment is better for growth (Curwin and Mahutga, 2014). In fact, if foreign investment grows too quickly, it can lead to economic contraction (Curwin and Mahutga, 2014, p.1179). The shock therapy route was not good for the host countries; a gradual approach would have been better. Indeed, several early privatisations ended in expensive legal proceedings. Some were ill-conceived for countries with low levels of basic income. There was usually an incentive in the 'cost-plus profit' contracts for TNCs not to be frugal with costs or designs. For example, the Dabhol power project for 2184 MW power guaranteed a rate of return of 16% p.a. over twenty years in dollars; at a time when the US lending rate of interest was 6% p.a.¹² Similar projects were launched in other developing countries.

9.12 Reliance on IOs' Advice

64. IOs advised developing countries to improve their investment climates in the late 1980s and early 1990s (see Chapter 10). IOs are not entirely independent (Strange, 1986, p.170). The World Bank, the FIAS, the IFC and the IMF advised developing countries in the 1980s and 1990s to use similar tools; there is no evidence that they warned the countries about the effect SCCs would have on their development objectives. The advice was diagnostic (the FIAS charged for this service) as well as prescriptive in terms of treaties, laws and regulations. For example, the IFC helped to draft the mining codes of Ghana, Kazakhstan and Uzbekistan, and Uzbekistan's Bankruptcy law. The FIAS advised countries on policies, programmes and institution-building (World Bank 1997, p.24-26); since its inception to 1997, it had advised 100 countries.

65. There is not much evidence that the developing countries were advised to sign BITs in order to encourage round tripping of domestic capital. ISA arbitrators have decided over the years that the origin of capital does not matter in terms of ISA eligibility. Round tripping capital may involve a

questionable use of domestic tax laws. A state could theoretically offer to curb capital flight by offering incentives to retain it in its economy; such incentives are more likely to be offered in terms of tax immunity or credit, rather than in a BIT.

66. The real cost of FDI can be higher than that of pure debt. FDI may generate net positive resource transfers in rapidly growing countries or briefly, as it joins an economy. (Klein, 1990, p.36). After that, it is likely to result in negative net transfers. Not being advised to undertake liberalisations gradually, there was no expertise within many developing countries to protect their interests or to ensure that FDI did bring access to technology, new business practices, or export markets. TNCs' legitimate business interests could perhaps not be reconciled with the legitimate developmental concerns of the hosts (ASIL 1984, p.56).

9.13 The tax factor

67. Both developed and developing countries used taxes as incentives for investors (Hadari, 1990, p.122). That encouraged the distribution of dividends over reinvestment of profits; the latter was more likely with the support of subsidies (Hadari, 1990). There was no justification to allow foreign investors a special tax rate. Other solutions could have been used such as rights of repatriation, PRI, and a simplified bureaucracy (Hadari, 1990).

68. Vodafone's ISA against India (2013) arose from the investor's denial of tax liability for a 2007 transaction that allegedly took place outside India so that no capital asset was transferred. Only shares were transferred, not the assets held in India. The Indian Supreme Court agreed with Vodafone and upheld a distinction between an asset and mere shares in the company. Under India's BITs with Britain and the Netherlands, an investment includes all kinds of 'assets' including 'shares in' a company. However, for tax purposes, Vodafone argued that shares are not an asset. Vodafone's ISA under the Indo-Dutch BIT is in its early stages.¹³

9.14 Apprehension of arbitration

69. Developing countries' consent to ISA is inferred from BITs in most instances, not express investment agreements. The investors' tendency in the 1960s to overvalue an expropriated property¹⁴ made negotiated settlements difficult. Even today, the awarded amounts tend to be smaller than the claimed amounts in ISA indicating some overvaluation. In its early days, the developing countries did not rush to accept the Convention; they had no advantage other than that of avoiding formal diplomatic intervention from home countries. Iran, for example, had told AIOC that expropriation using its sovereign powers was not referable to arbitration.¹⁵ In 1978, ICSID introduced the Additional Facility Rules to allow an ISA against a non-signatory country.

70. The international arbitration scene was dominated in the 1970s by European and American arbitrators and expensive institutions like the ICC Court of Arbitration (which charged fees based on a percentage of the sum in dispute). Seats of arbitration tended to be Zurich, Paris, London or New York. Appearing at these seats for arbitration proceedings was expensive with the currency regulations in place in many developing countries. Trust in arbitration did not grow for various reasons including the confidentiality of proceedings, limited review by national courts, lack of diversity among arbitrators, and so on. Even the publications that would have informed public and private lawyers on the evolving arbitration practices were, and continue to be, incredibly expensive. Given their limited budgets, public agencies' perspectives did not form part of various discourses on arbitration.

71. Developing countries' courts tried to mitigate the perceived harshness of ICA awards and inflexible contracts by reviewing them; awards would be set aside on grounds such as an 'error of law manifest on face of the award,' or for being against 'the public policy' of the country. The 1985 UNCITRAL Model Arbitration Law limiting this kind of challenge to arbitration awards has formed the basis of the modern arbitration legislation of 72 countries.¹⁶ This has helped to harmonise the operative norms of international arbitration.

9.15 Summary

72. There was no pressing demand in the 1980s and 1990s to protect investors against expropriation, and there was no reasonable justification for states to have privatised and outsourced their disputes in BITs, particularly commercial disputes. BITs were part and parcel of the overall liberalisation, privatisations and deregulations imposed on developing countries and enabled back-door enforcement of sovereign debt. The developing countries do not appear to have done much negotiation of their terms at all. If BITs were negotiated freely and not imposed on the developing countries, this lack of attention to drafting a clear arbitration clause (rather than a list of possible options) shows that they did not understand that BITs could per se lead to arbitration cases with the investors.

73. A tool designed in the days when the stock of world FDI was \$66 billion¹⁷ is being manipulated, adopted and expanded to provide for the needs of the 21st century's global economy with \$1.7 trillion in FDI stocks. BITs appear to have become path-dependent; their interpretation took an expansive turn from which there was no turning back. Even with the problems they cause in interpretation, states or IOs do not take an initiative to address the very basic problem of SCCs underpinning this form. The list of ISA-eligible investments grows without any action from states; a bit like a guest who invited himself, and then proceeded to bring in extended family and friends to

eat one out of one's house and home. The underlying assumption behind ISA is that even emerging economies or the developed countries cannot be trusted to deliver the justice legitimately expected by (mainly) TNC investors, and that only privately trained sympathetic lawyers are able to do that in a unilaterally accessed setting.

¹“FPIs net outflow in November at \$1.5 billion”, *Economic Times*, India, 29 November 2015. Retrieved from www.economicstimes.com.

²“Avoiding Expropriation Loss”, *Harvard Law Review* Vol. 79, No. 8 June 1966, p.1669.

³“FPIs take out \$1billion from capital markets in November” *Economic Times* India. Retrieved from www.economicstimes.com, 22 November 2015.

⁴ India Brand Equity Foundation, a trust set up by the Government of India – retrieved from <http://www.ibef.org>.

⁵“Setting out the store”, *The Economist*, 11 January 2014. Retrieved from www.theeconomist.com.

⁶*Abaclat*, 2007. Paragraph 40.

⁷“Argentina settles Abaclat mass claim”. *Global Arbitration Review*, 2 February 2016. Retrieved from www.globalarbitrationreview.com.

⁸If a party fails to comply with the award, it can be enforced in the courts of other ICSID Member States (Article 54(1) of the ICSID Convention).

⁹*Mobil Cerro Negro Ltd.* (2015).

¹⁰Some debtor countries use consultants like Lazard Freres, Warburg & Co., Shearson Lehman or American Express at fees exceeding a million dollars to prepare their case (Rieffel, 1984-85, p.93).

¹¹“Vivendi, D. Telekom to settle Polish mobile dispute”, *Reuters* 15 December, 2010. Retrieved from www.reuters.com.

¹²<http://data.worldbank.org/indicator/FR.INR.LEND?locations=US&view=chart>

¹³“Vodafone moves ICJ over tax arbitration with India” *The Hindu*, 29 March 2016. Retrieved from www.thehindu.com

¹⁴ See for example, “Avoiding Expropriation Loss”, *Harvard Law Review* Vol. 79, No. 8 June 1966, pp.1666-1683.

¹⁵ Royal Institute of International Affairs, *Documents on International Affairs*, 484 (1951) May 20, 1951.

¹⁶ As confirmed on www.uncitral.org.

¹⁷From 1938; it had been \$15 billion in 1914. The World Bank, 1997, p.11-12.

10. International Organisations

10.1 Introduction

1. International organisations (IOs) like the IMF, the OECD, the World Bank, UNCTAD, the ICC, and the ECOSOC were instrumental in promoting BITs and, with them, ISA. Despite the creation of ICSID, their success was limited in the early years. The World Bank's advice to developing countries to improve their investment climate, and the IMF's SAPs both involved liberalisations, privatisations, enacting investment laws and/or agreeing to DTTs and/or BITs.

2. IOs failed or neglected to alert the developing countries about the risks of (a) BITs themselves amounting to an open, irrevocable offer of arbitration, and (b) including indirect investments in the BIT definitions without considering their effect on the objectives of BITs. Widely worded BITs offered the opportunity to transfer states' judicial authority over investments to private arbitrators. Arbitrators assumed free consent to BITs but IOs' role tends to be ignored in the making of BITs.

3. IOs were aware of the extensive use of SCCs. Yet, they provided legitimacy to the use of SPEs and SCCs. They bestowed 'developmental' framing on FDI as an alternative to debt. In fact, FDI coming through SCCs became another form of debt. In a highly financialised global economy, not all FDI had the potential to make a net positive contribution.

4. This Chapter draws on World Bank reports, IMF documents, and some contemporaneous research to explore the role IOs played with a focus on the World Bank as it had earned the trust of developing countries. Starting with the IOs' knowledge of SCCs and their encouragement of BITs, it shows that it was difficult for the OECD states to agree on the 'indirect investments' to be covered by the draft MAI. Similar discussions did not seem to take place with developing countries over the scope of BITs. This supports the view that BITs were mainly signed on the terms proposed by developed countries (Allee and Peinhardt, 2014). It also provides the essential backdrop for appreciating the origin of ISA as arbitration without privity.

10.2 The World Bank - trust of developing countries

5. The IMF and the World Bank tend to be influenced by the US (Oatley and Yackee 2004; Fleck and Kilby, 2006), and are not known to act in opposition to its interests. The IFC was close to commercial banking interests. The first five bankers appointed as advisers to the IFC by its

president Eugene Black included Abs,¹ who was a keen promoter of BITs.

6. With the intensifying Cold War rivalry in the 1950s, developmental finance became an important tool deployed by the US and the USSR. Developed countries had foreign aid departments. IOs set up various funds for developmental aid. Unlike commercial banks, the IFC was charged with 'responsible' lending. (Corse et al, 1977, p.48) to encourage the growth of productive private enterprises. The word productive was also used in the proposal for MIGA (Shiahata, 1985, p.367). The IFC encouraged, in the 1980s and 1990s, BITs, bi- and multi-lateral FIs and investment promotion programmes (World Bank 1997, p. 1). By then the role of productive investments was declining in the global economy. BITs did not comprise any incentives to encourage productive enterprises.

7. The developed countries used their aid for their own political and economic purposes. Black (1952, p.403) recognised that the developing countries financed major projects primarily out of their own resources. Therefore, under his leadership, the World Bank would not fund a project that was not relevant to the country's economy; they would not plant "steel mills in the desert" (Black, 1952, p.408). The World Bank missions in the 1950s went to developing countries like Turkey, Guatemala, etc. helping them to make plans to use their resources for development. The World Bank also would not lend more than what the borrowers could afford (Black, 1952, p.411). The World Bank thus earned the trust of developing countries early; it was seen more favourably than the IMF. The World Bank and the IMF have been called the good-cop and bad-cop duo (Krehm, 1999, p.18). Perhaps this trust meant that the developing countries did not sufficiently question the World Bank's advice on BITs.

10.3 IOs suggest pursuing FDI as an alternative to debt for development

8. 1979 brought declining ODA, the fall in commodity prices, a rise in oil prices, and a rise in real interest rates (Bhattacharyya, 2013, p.8). Each percentage point increase in the interest rate would cost the 33 largest borrowers from developing countries an additional \$1.8 billion per year (World Bank Report 1981, footnote 1). To put this increase into context, the World Bank's total lending in 1979 was \$7.2 billion, and the IFC's was \$354 million (Seiber, 2013, p.58). By 1980, only 13% of the "total disbursed debt" of the developing countries was owed to IOs (Seiber, 2013, p.59). The rest was private debt with short maturity periods. The World Bank estimated that the South had borrowed \$85 billion in 1983 in medium and long term loans, and paid its creditors \$96 billion in interest and capital repayments.²

9. The idea that FDI would be valuable to the development process was comprised in a UN Industrial Development Organisation resolution (ASIL 1983, p.311-2). UNCTAD and the OECD

claimed that debt affected the balance of payments but FDI, regardless of repatriation of profits, would be less oppressive; its servicing would be linked to its profitability (UNCTAD, 1984, p.6; OECD, 1982, p.9-10). The Joint Ministerial Committee of the Boards of Governors of the World Bank and the IMF on the Transfer of Real Resources to Developing Countries (Development Committee) urged in September 1987 to increase private direct investment to the indebted countries. All the initiatives seemed to propose ‘productive’ FDI. The justification for ISA would be that such investments were not being made because of political risks and ISA would encourage them.

10.4 FDI and additional debts

10. Most of the rise in FDI in 1988 comprised debt-equity swaps and other secondary market transactions. FDI can cost more than debt. For example, Chile paid an average of 7.8% p.a. rate of return during 1954-1987 to investors in Chile, when LIBOR rate was 3.6% p.a. (Klein, 1990). It would have been cheaper for Chile to borrow the money. FDI projects are financed heavily with debt (70% or more). Some FDI comprises intra-company loans (OECD 2014). Most tax policies favour debt-financing introducing inequities and distortions (De Mooij 2012).

11. Van Harten (2005) rightly treats the sovereign debt crisis of the 1980s as a structural factor leading to the growth of BITs. The World Bank treated the sovereign debt crisis of the 1980s as “more of a watershed” than the collapse of Bretton Woods (Callaghy 2002, p.3), but the intrepid lending of capital had its roots in the aftermath of the Bretton Woods system.³ FDI was perhaps believed to be less risky, at least for the banks; their regular payments would come from the projects’ earnings.

12. IOs did not discourage additional lending to debt-crippled economies. In the late 1970s, the World Bank even participated in complementary financing of projects. (Corse et al 1977, p.36). It headed a Consultative Groups of public and private lenders in the developing countries promoting foreign investment and private enterprise. Its lending ceased being principled. For example, after the declaration of martial law in the Philippines, it extended credit to the Marcos regime (Sussman, 1987, p.92).

10.5 Conditional loans and encouragement of financialisation

13. The World Bank’s loan conditions promoted privatisation. For example, in July 2001, a \$110 million loan for Ghana was subject to its undertaking water privatisation with specific increases of 95% in water and 96% in electricity tariffs respectively (Grusky, 2001). A 1999 World Bank loan to Mozambique was subject to the government undertaking water privatization (Barlow

and Clarke 2003). A 1998 loan from the World Bank to Bolivia was conditioned on the privatisation of its water utility in Cochabamba (Beltrán, 2004, p.4), which was duly undertaken and led to the ICSID case *Aguas del Tunari*. In 2003, Biwater Gauff obtained a water concession from Tanzania; the World Bank, the African Development Bank and the European Investment Bank had made a loan of \$140 million conditional on water privatization. This project went into a dispute and then to an ICSID arbitration in 2005. By the time 2,000 BITs were in force in 1999, the World Bank itself was not certain that the private sector had “lived up to its original promise”.⁴ The IMF’s SAPs included investor guarantees or changes to national laws (including arbitration) to make them more investor-friendly (Kalderimis, 2004, p.110-11). India had a balance of payment crisis in June 1991, having never defaulted on loans.⁵ Increased FDI would not have solved its foreign exchange problem (Dash, 1999, p.899). The IMF loan of \$1.8 billion was subject to undertaking liberalisation. India also pledged 46.9 tonnes of gold with banks in England and Switzerland to raise \$605 million.⁶ Simultaneously, foreign banks were permitted to own equity in Indian banks up to 74% and to open a certain number of branches each year (Panagariya, 2004, p.23). India’s BIT programme followed in March 1994.

14. By 1986, IOs were promoting FDI with suggested measures to the developing countries including: the elimination or reduction of restrictions to ease the entry, operation and exit by TNCs, deregulated markets, reduction of price controls and subsidies, privatisation of SOEs, etc. (World Bank, 1985, p.139; 1991A, p.53).

15. A World Bank background paper from 1988 recognised the securitized lenders’ use of excessive off-balance sheet risks, heightened financial volatility, and the increasing complexity of regulating a financialised economy (Versluysen 1988, p.1-2). IOs would, or should, have been aware of the developing countries’ lack of expertise to guard against the complex risks of wholesale and rapid liberalisation. The US influence, with its ambitions for globalisation might have hurried the process (see Chapter 8). At a 1990 seminar on debt, the World Bank recommended *inter alia* an intensification and extension of the process of adjustment, the improvement of tax rules, and the privatisations of natural resources and of SOEs (Klein, 1990, p.34). IOs promoted financialisation of economies. Countries were advised urgently to privatise banking, insurance and pension fund management (World Bank, 1993, p.191). This happened in the US too. By 2000, the Wall Street’s share of corporate profits was 40% (Weissman, 2013).

16. FDI flows to some developing countries slightly increased by 1994, and the privatisation of SOEs brought FDI inflows (World Bank, 1994, p.28), at least in the short term. Since the 1980s, SOEs worth a trillion dollars have been privatised by governments under pressure from the IMF (Brune et al, 2004). Documents relating to conditional loans of the IMF or the World Bank were

rarely publicly disclosed in the early 1990s (Grusky, 2001 p.21).

17. FDI in services grew from 20.1% in 1975 to 23.3% in 1982 which reflected, mainly, the growth in the financial services industry in OFCs, especially large amounts of the US investment in OFCs. Mexico was held out by IOs, in the early 1990s, as a success story (Edwards 1998, p.2, 5-8), based on its positive policy (Brewer Thomas, 1991). After signing NAFTA to bring growth and prosperity, for the “third time in 18 years Mexico’s currency ... collapsed” in December 1994 (Edwards, 1998, p.1). By 1995, the US Government, the IMF, the World Bank, and the BIS had lent \$40 billion to Mexico.

18. Despite increasing financialisation, IOs and the US discouraged capital controls with threats of exclusion from the IMF-led financing (Toporowski, 2010, p.923). TNCs were changing and using sophisticated business arrangements, giving rise to new centres and structures of political and economic power (Salacuse, 1984-85, p.972). Yet, IOs’ advice to the developing countries was not tailored to counter their effect on development or on long term debts (Salacuse, 1984-85, p.972).

10.6 Surge in DTTs

19. The belief that the developing countries had discouraged FDI was not entirely supported by evidence; fiscal policy was less stable in nineteen industrial countries as a group than in nineteen large developing countries (Brewer Thomas 1991, p.28). Investors’ decisions were more likely to be swayed by taxation than political risk. In 1979, UNCTAD and UNCTC encouraged DTTs between capital-exporting and capital-importing countries. (World Bank 1979A, p.34-5). DTTs signed by SCCs surged as shown in Table 10.1 below. Increasing DTTs encouraged use of SCCs.

Table 10.1: Number of DTTs - Select SCCs – data retrieved from www.unctad.org

SCCs	1970 DTTs	1990 DTTs	2011 DTTs
UK	30	70	129
Switzerland	28	58	113
France	26	84	132
US	15	99	154
Belgium	11	43	103
Germany	11	52	105
Ireland	10	21	71
The Netherlands	10	42	125
Trieste (Italy)	7	59	96

10.7 Expropriation or arbitration was not a pressing issue

20. Investors’ perceptions of political risks were not based on accurate information as explained

below. The momentum to change the legal framework of foreign investment was set in motion in the late 1950s; it carried on even when the political risks of expropriation were not that high. The overall trend showed a dramatic decline in expropriation after 1975 when the incidence of expropriations peaked (Brewer Thomas 1991, p.42-43; IBRD 1991). Even in the 1970s, the withdrawals caused by nationalisation or liquidation of MNEs were a minor fraction of TNCs' expansion (Vernon, 1981, p.523). This may be why the 1978-1983 World Development Reports do not even mention expropriation or unfair treatment, much less, as significant problems associated with the paucity of FDI in developing countries. Similarly, arbitration, or inadequacy thereof, did not find a mention therein. Thus, the legal infrastructure was not the reason for the low FDI flows to the developing countries. Empirical studies showed that a country's natural resources, recent growth performance, and political and economic stability were the factors that affected foreign investment (World Bank, 1987A, p.117).

21. The risk of expropriation along with the risks of blocked currency, war, etc. first appeared in the 1985 World Development Report (p.131). The World Bank suggested that many developing countries had embodied investor protections in their constitutions or laws to reassure investors. It referred to some 200 BITs and the investment guarantee schemes set up by 22 countries.

10.8 Shaping ideas

22. Competition among the FDI-seeking countries (Simmons et al, 2008, p.72) does not adequately explain the BIT-signing spree of the developed countries. There were, at the least, both push and pull forces at work. The push for liberalisation coincided with the specialist funds' attention towards the emerging markets (Folkerts-Landau and Ihno, 1997, p.88). Capital was competing to seek the best returns. Growth had slowed in the west. Debt reduction, the World Bank advised, would lead to increased probability of investments (World Bank 1989A, p.21). Debt reduction itself depended on increased capital inflow. The World Bank encouraged countries to project a confidence-building image. The IMF was also advocating that external financing was crucial for debt management (IMF, 1988, p.45).

23. MIGA was set up in 1988, as part of the World Bank group with 29 original members at least half of whom were SCCs. Its express mission was to promote *FDI* into developing countries to support economic growth, reduce poverty and improve people's lives. MIGA was to spread political risk among all members so that investors did not rely solely on national PRI, the largest of which was OPIC. The World Bank and the IFC set up the FIAS in 1985. The FIAS advice (including diagnostic) was available for a fee. By 1990, the demands for the World Bank's lending and advisory services increased (World Bank 1992A, p.15). In 2008, MIGA merged its technical

assistance services with the FIAS.

24. The FIAS published advice, supported by the Harvard Business School, on the marketing of countries using tools such as tax incentives, grants, simplification of bureaucracy, etc. (Wells and Wint, 1991). The developing countries were to create investor-friendly images and guarantee the repatriation of income. States were actively encouraged to indulge in competition for FDI.

25. MIGA was to be a ‘confidence-building’ framework for policy cooperation between the host and home governments, and private investors (World Bank 1985, p.132). The World Bank and the IFC helped to design policies to stimulate ‘productive’ private investment including the drafting or revision of laws governing investments and privatisation of SOEs. MIGA differentiated between portfolio investment and FDI and, in order to safeguard the host countries’ sovereignty, both the investment and the MIGA guarantee had to be approved by the hosts (World Bank, 1985, p.133). This emphasis on productive investments, sovereignty and express approval would have relaxed the developing countries’ guard in relation to the arbitration clauses in BITs.

26. UNCTAD used to help developing countries with their Paris Club negotiations. Its role widened to include FDI after the 1980s. It actively promoted BITs in the 1990s by facilitating meetings between interested countries for the negotiation and initialization of BITs. In January 1999, UNCTAD secretariat organised with the Group of Fifteen (G-15) and the UN Development Programme (UNDP), a meeting of BIT negotiators. Three BITs were concluded along with various consolidated texts reflecting consensus *ad referendum* on most issues. Similar efforts with G-15 focused on DTTs in Sri Lanka in 1999. Rounds of BIT negotiations were organised in 2000 in Geneva, Bangkok, Peru, and Japan, which led to 35 further BITs. LDCs were brought together in Geneva in 2001 for similar purposes. This facilitation included UNCTAD’s expert advice although it did not participate in the negotiations. These events were sponsored by contributions from the EC, and France, Germany, Japan, the Netherlands, Norway, Switzerland, and Britain, and, for the Peru event, by Canada (UNCTAD, 2000, p.3-4). This coordination may explain some similarities of most BITs. There is no evidence that the developing countries were warned that TNCs were increasingly relying on SCCs which would affect the bilateral political bargains reached in BITs, and the access to ISA.

27. There was often “pressure, advice or convenience” (e.g. withholding investment insurance until a BIT was signed) behind the making of BITs (Sornarajah 2010, p.173-4). BITs were signed without full understanding of their implications; some developing countries only found out what the words in BITs meant under international law once an ISA started, as stated by Pakistan’s former attorney general Makhdoom Ali Khan.⁷

28. IOs did not know how FDI would affect the non-OECD countries; most contemporaneous studies were inconclusive (Park, 1978). FDI had a different effect on non-OECD and the OECD countries (Figini and Gorg, 2006). FDI was attractive to investors. Simple loans (despite fixed repayment obligations) were risky, and would not be accompanied by a market share of hosts. FDI obligations could be paid out of the earnings of each project. Various projects funded by the World Bank in the 1990s had fixed tariffs that did not depend on the project's ability to raise the funds to pay for itself; they were fixed so as to earn an assured rate of return for the sponsors and lenders. Water or energy tariffs stretched beyond the paying capacity of the ultimate consumers (e.g. Bolivia). Contracts would be awarded to a foreign investor without much or any bidding so that the upfront capital cost could be very high. This was, partly, because of the lack of competition in some sectors because of M&As.

29. The FIAS's 1990 Occasional Paper I defined FDI in bilateral terms as "the establishment or purchase by residents of *one* country of a *substantial ownership or management* share – usually measured by a minimum equity stake of 10 percent – of a business in *another* country." (My emphasis). It excluded licensing, subcontracting, and portfolio investment from FDI. Most ISA awards include these activities in the definition of an ISA-eligible investment. There was a significant dissonance between IOs' advice to attract *FDI*, and the investment definitions in the BITs.

30. The Development Committee of the World Bank requested MIGA to prepare a legal framework to promote foreign investment in 1991. IOs could not make binding legal rules to govern the states' legitimate actions in regulating foreign investments. Any attempt on their part to draft a multilateral convention would have been "counterproductive" (World Bank, 1992B, vol. 1, p.6). At that time, there was no general consensus on what constituted the international law on all the issues that had been addressed in various drafts (Chapter 3).

31. MIGA held conferences in the early 1990s in Ghana, Hungary, Jamaica and Pakistan, executive development programs in Portugal, Angola, Hungary and the Czech and Slovak Republics, and a roundtable conference in Botswana on FDI policies to encourage governmental networking (MIGA 1992, p.6). By 1992, MIGA's signatories reached 115, but no claims had been made. MIGA worked, with the FIAS or other departments of the World Bank Group to help a number of countries to liberalize laws governing foreign investments including the facilitating of recourse to international arbitration. MIGA encouraged BITs and legal protection agreements (these would have benefited MIGA, 1992, p.21). In 1994, MIGA was still actively promoting BITs among members and continued to advise members also on draft investment legislation (World Bank, 1994A, p.165, 332-333).

32. BITs were not necessarily the most suitable tool for an improvement in the investment climate. Arbitrators would later associate BITs with assurances but for which foreign investments would not have been made and, they would attach particular significance to ISA as part of the ‘invitations’ by Argentina to invest in its privatisations. In reality, the decisions to invest could be based on many other factors. For example, existence of natural resources as in Brazil.

33. A World Bank paper suggested that states negotiate BITs and tax treaties with countries “from wherever investment might come” (Wells and Wint, 1991, p.1). This might have led to the acceptance of wide definitions of investments but not necessarily of ISA for all such investments. MIGA and the IFC advised the developing countries that FDI would bring external finance with “new technology, knowledge and access to markets.” (World Bank 1989B, p.13). The US lawyers, at the same time, were acknowledging that the access to markets would be illusory (see Chapter 8).

34. In the 1990 meeting of the World Bank Group, “direct” investment was stressed as a “powerful engine of growth.” (p.18). Developing countries were to attract private capital – whether foreign, domestic or flight capital (p.18). Not all investments would contribute to “flourishing, productive” economies which was the objective of the World Bank Group in 1986 (World Bank, 1986). Repatriation of flight capital suggested by the World Bank would provide a legitimising way for dubious sources of money. There was no justification to allow ISA for round-tripping investments.

35. FDI growth in the 1990s reached rates well above those of global economic growth or trade (IMF, 2003). In 1985, the IMF strongly encouraged the developing countries to undertake active promotion of non-debt creating capital flows, especially *direct* investment (IMF 1985A, p.117). Neither the IMF nor the World Bank appear to have advised developing countries to ensure that any BITs they signed should be worded so as to encourage FDI, much less *productive* FDI.

36. IOs supported the myth that the quantity of investments mattered and not the quality. The FIAS assumed that developing countries would seek FDI “only if enough officials believed that a substantial portion of this investment was either inherently beneficial to the economy or could be made beneficial through various types of government involvement.” (Wells and Wint, 1991 p.3). The reality was that once the economies liberalised, states did not retain such control. The developed countries, whilst preaching the gospel of liberalisation, themselves continued to have subsidies and protections in selected sectors.

37. In 1991, the FIAS carried out twenty one projects, half of which were diagnostic services. It provided specific investment-promotion advice to Kenya, Lesotho, Madagascar, Morocco, the Philippines, Uruguay and Venezuela. These countries have defended at least one or more ISAs,

with Venezuela having been a respondent in 36 ISAs just under the ICSID system. The FIAS worked with 32 developing countries in 1992. Acting on its advice, Poland and Papua New Guinea enacted new investment laws in 1992 (MIGA 1992, p.22). By 1997, the FIAS had conducted over 230 advisory assignments in 100 countries (World Bank, 1997, p.v). In the late 1980s, the World Bank Group and MIGA encouraged ICSID and other ISA clauses in investment agreements, national investment legislations of at least a dozen countries, and more than 150 BITs (World Bank, 1991A, p.53; 1994B, p.332-3). The FIAS offered specific advice on legal and regulatory framework (World Bank, 1991A, p.54). The IMF's technical assistance included reforms of company law. The World Bank Group and the IMF acted in harmony to promote the legal framework for FDI (World Bank, 1991A, p.95). This collective persuasive force should be part of the answer to the question why the developing countries signed BITs in large numbers around the same time and in similarly worded documents. As Poulsen (2015) argues the developing countries appeared to believe in the benefits of BITs helping to attract FDI but neglecting to take into account their risks. Poulsen (2015) believed that the developing countries considered BITs for their comfort factor more than as legally enforceable documents.

38. According to the FIAS and the IFC, globalisation would increasingly blur the distinction between foreign and domestically owned enterprises as well as the developed and the developing countries. This has certainly come true in respect of the socio-economic inequality and overall debts – both have risen globally. The IMF accepted that income inequality was rising rapidly over the last 30 years.⁸ If there is no distinction between domestic and foreign investors, there is no justification left to treat foreign investors in a privileged manner by offering ISA.

10.9 Knowledge of SCCs and interdependence

39. In 1991, the IMF promoted “greater capital market integration” having accepted that “globalization, innovation and integration of major financial markets” were important structural elements of the global economy (IMF 1991, p.37). It was expecting market-based hedging instruments and FDI to be the key elements of the global economy in the 1990s (IMF 1991, p.39). Both would extensively use SPEs and SCCs. The World Bank advocated liberalisation with full awareness of the increasing interdependence of economies (World Bank, 1981, p.1-2). Offshore banking was the most significant OFC activity in the 1990s (Hampton, 1996B, p.301). The IMF was aware of OFCs' importance as channels for cross-border portfolio investments (IMF 1998, p.134), and had reported in 1994 that “more than half of cross-border lending” was conducted through offshore jurisdictions (Palan et al, 2010, p.50-51). Yet, it was only in 2000 (after a majority of BITs had been signed) that the IMF undertook a review of OFCs; it concluded that the statistics were inadequate for monitoring and analysis (IMF 2001A, 2001B).

40. In 1997-98, the discrepancies recorded on portfolio investment transactions exceeded \$200 billion per year, and FDI inflows and outflows in 2000-01 showed discrepancies over \$100 billion (IMF, 2003, p.22). Inter-company debt transactions showed large discrepancies in 2000; FDI inflows of \$394 billion were double the level of recorded FDI outflows (IMF, 2003, p.23).

41. The OECD decided that it was futile to attempt a reconciliation of bilateral FDI data (IMF 2003, p.26). By 2015, the OECD accepted that SPEs could distort the FDI statistics by (a) inflating the FDI flows, and (b) confusing the geographic distribution of the data (OECD 2015). UNCTAD's 2014 report also reflects the distortions.

42. The IMF believed that round-tripping funds recorded in the statistics as FDI outflow and then inflow would not lead to an overstatement of FDI (IMF, 2003, p.33). However, these transactions can be complex. Nougayrède (2016) illustrates this with the \$55 billion Rosneft acquisition of the oil producer TNK-BP in 2013. TNK-BP was held through a BVI entity owned 50% each by BP and a consortium of BVI companies owned by individual Russian investors. It was reported in the official statistics as Russian FDI to the BVI \$82 billion, and a significant inflow from Britain to Russia (Nougayrède, 2016). Hong Kong excluded inward or outward FDI from or to non-operating companies set up in OFCs to remove round-tripping capital; it reduced its stock of inward and outward FDI by 32% and 38% (IMF, 2003, p.37).

43. The OECD considered TNCs' motivation to use tax havens as "an economic necessity." (OECD 1987, p.37). Some countries prepared specialist laws for globally-oriented businesses they were targeting such as shipping registers, cross-border leases of equipment, mining, and oil production and development (Jones, 1994, p.31). The BPM5 recommended that SPEs should be included in the FDI if they met certain criteria thus recognising them as an integral part of the investment network (IMF 2003, p.33). The discussion over BITs did not touch upon whether all or any of the SPEs ought to enjoy the right to start ISAs without an express arbitration agreement. For example, it is difficult to find a justification for offering ISA to purely financial transactions such as precision financing - arbitraging "often minute mis-pricing of financial assets around the globe." (IMF 1998, p.188).

44. The rational-choice literature on IOs neglects the possibility that IOs might give deceptive advice or mislead governments (Fang and Stone, 2012, p.538). In the 1980s and 1990s, the IMF either encouraged or demanded states to enter into BITs when they sought financial assistance from the IMF (Kaldermis, 2004), or the IMF loans were subject to conditions that overlapped with BIT obligations. Privatisation programmes were found to coincide with BITs (Simmons et al, 2008, p.252-3). Whether IOs actively misled developing countries on liberalisation or not, they failed to

alert them about the excessive use of tax havens by TNCs which would have had an adverse effect on their legitimate expectations from foreign investments; it would also affect investors' ISA eligibility.

45. The Development Committee of the World Bank identified, at its 1991 meeting, the need for an overall legal framework to promote FDI (IMF 1991, p.128-9). The World Bank published a Legal Framework for the Treatment of Foreign *Direct* Investment together with Guidelines to host states (emphasis added); the guidelines addressed the host states' (not investors') obligations (World Bank, 1992B, p.12). The norms were entirely voluntary but with the IFC's and MIGA's support, they gained "broad acceptance" (Sutherland, 2010, pp.304-5).

46. The IMF encouraged financial globalisation probably because its governance was dominated by the US and the other developed countries which had deregulated their own financial sectors. In the early 1980s, most of the external private debt of the developing countries got converted into public debt due to liquidity issues of foreign exchange (Folkerts-Landau, 1985, p.327). ICSID is showing the making of a regime for sovereign debt enforcement.

10.10 IOs and tax havens

47. IOs knew of the increase in the use of tax havens. The OECD knew in 1978 about massive increase in the bank deposits in tax havens (Hampton 1996B, p.295). The World Bank research showed that FDI in tax haven countries was growing rapidly, and that TNCs profitably used low-tax country subsidiaries and transfer pricing (Wells et al 2001, p.78, p.81). The OECD published a study of harmful tax competition in 1998, but delayed plans to take any action against tax havens.⁹ In 2011, the IMF did not support naming and shaming of tax havens (IMF 2011). By 2012, the OECD had only Nauru and Nieu left on its list of tax havens.¹⁰ IOs' relative inaction on tax havens can only be explained by their acceptance of SCCs in the developed countries that performed similar functions.

48. The World Bank had earned the trust of developing countries. It could have, but did not, advise them about the implications, on development or ISA eligibility, of investments routed through tax havens. The 1985 World Development Report did not feature any reference to BITs or offshore shell companies (which were growing apace); it focused on the contribution international capital could make to economic development. Certainly the scope of ISA was not discussed.

49. As the World Bank recommended a stable tax climate to attract FDI, the IFC was providing financial support to companies and banks using tax havens (Spies and Petruzzi, 2014, p.86). Development FIs supported intermediaries based in tax havens thus legitimising their use (Crisp

2014). For example, a British fund against poverty, Commonwealth Development Corporation (with 40 out of its 72 subsidiaries in tax havens),¹¹ made two-thirds of its investments of \$3.8 billion in tax havens between 2000-2013.¹² A Belgian Investment Company for Developing Countries used 42 investment funds, 30 of which were domiciled in tax havens (Crisp 2014). Qalaa, an Egypt-based development company (with 130 subsidiaries, of which one-third are in tax havens), partly funded by the World Bank, reportedly made returns of \$2.2 billion to its investors in six years, but paid €298,000 in corporation taxes.¹³

50. The World Bank Group was promoting the use of OFCs (Klein, 1990, p.117). For example, the IFC advertised the advantages of investing in Vanuatu.¹⁴ The World Bank assisted the creation of some SCCs, such as Bahrain in the mid-1970s (World Bank, 1978A, p. 52), Malta (World Bank, 1987B, p.139), Panama (World Bank 1979B, p. ix; the World Bank 1989B), and the Bahamas (World Bank 1978B, 1980).

51. IOs' acceptance of SCCs and TNCs' practices meant that they were focused inordinately on investors' needs when promoting BITs and DTTs. There was no evidence that FDI could be correlated to DTTs, but the World Bank's advice was to expand the scope of DTTs to make them "comprehensive" (1993, p.193). Even in 2007, the World Bank and PWC recommended the simplification of tax laws (World Bank and PriceWaterhouseCoopers, 2007, p.15).

52. Hampton's estimate of revenue loss for the British government was £1 billion p.a. from the late 1980s to 1996. Overall, an annual loss of \$250 billion is estimated globally and \$100 billion of which is in the developing countries.¹⁵ Hampton contends that the implications of tax evasion and the globalised financial system were not fully understood in 1996 because of the lack of data (1996B, p.293-4). They were not entirely unforeseeable, and should have been a reason to interpret BITs cautiously.

10.11 FDI benefit for hosts' economies

53. Economic growth was assumed to be the "cornerstone of successful development and poverty reduction" and "structural adjustment" the alleged prerequisite for growth (World Bank, 1991B, p.4). Growth did not necessarily result in development. For example, after India undertook partial liberalisation in the 1980s, there was growth but a crisis followed in 1991, mostly due to a "rapid accumulation of foreign debt" (Panagariya, 2004, p.7, 27). It is difficult to show empirically that FDI contributes to growth; it may have an immiserising effect. Its contribution varies from country to country, sector to sector, and project to project (De Mello, 1999). FDI may be beneficial in the long-run, lagged by five years but even this timing appeared to be a country-specific result (Fry 1997). Technology spill-over effects are strong in some countries and for some sectors, but not

necessarily universal (Markusen and Venables, 1998).

54. The IMF-recorded FDI in-flows grew on an average by 13% between 1900-1997, most of these comprised, not new equity, but cross-border M&As which reached a record level of \$1.1 trillion in 2000 (IMF, 2003, p.32, 35). FDI and liberalisation did not always deliver on their promises to host countries (Rodrik, 2001, p.59). But, no guarantees were made with liberalisation. Bonniticha (2012) has argued that BITs were more effective in attracting investments that are not associated with positive externalities than those that are. Overall, BITs and FDI have not been shown to be conducive to economic development (Sornarajah 2010, Bonniticha 2012). ISA arbitrators assume that investments are beneficial to hosts per se, or that their effect is an irrelevant question.

10.12 Promotion of ICSID

55. After the founding of ICSID in 1966, the World Bank naturally encouraged its use. In its submission to states for signature, it was specifically stated that “a larger flow of private international investment” was a “primary purpose of the Convention.” (ICSID 1965, p.4). In their early BITs, Germany and Switzerland (except for its BIT with Sri Lanka) did not include an ICSID clause. Given that ICSID was set up before NIEO’s advent, there was not an immediate universal acceptance. ICSID membership was a problem in the first two decades. It was “obscure”, and “seldom used” by the US MNCs (Baker, 1990, p.43). This situation would change after the decision in *AAPL* in 1990.

56. IOs worked hard to bring to pass a widely worded consent in a network of BITs. The ill-informed consent was used as a foundation for ISA’s growth. Developing countries signed BITs against their own interests and the expressly stated objectives of BITs. Either IOs knew that the wording in BITs could and would be construed as unilateral, open-ended arbitration agreements, or that was entirely to the credit of creative lawyers’ interpretation of poorly drafted treaties. Either way, ISA became path-dependent to grow in breadth and depth.

10.13 The MAI – diverse views on “indirect” investments

57. After the Annual Meeting of the OECD Council of Ministers’ in May 1995, work began on a draft MAI. The MAI negotiations were abandoned in December 1998. The US and the EU had disagreements over the provisions of the MAI.¹⁶ It is doubtful if the draft MAI would have led to a treaty regardless of public opposition. The negotiation highlighted the tension between the developed countries over the provisions that were heavily recommended to the developing countries; it would take another two decades before the developed countries would come around to

negotiating TTIP or CETA.

58. The definition of an investment in the MAI was discussed in October 1995 (OECD 2000). The two main approaches taken were: (a) “enterprise-based” - direct investment (excluding portfolio investment and real estate), or (b) “asset-based” - similar to those used in BITs (including portfolio investment and intangible assets such as intellectual property). The minutes of the OECD’s Negotiating Group meetings in January, April, May, and September 1977 indicate differences of opinion over indirect control of investments by non-MAI states’ investors or over investments routed through non-MAI states (OECD 2000). Numerous delegations were against applying the MAI to a subsidiary or a branch established in a non-member country. Further disagreement over the definition of an indirectly owned or controlled investment came to light in April 1998 (OECD 2000).

59. The OECD published its MAI database after removing the names of individuals and countries in February 2002. By this time, thousands of BITs were signed by other countries that included broadly worded definitions of ‘indirect investment’. Whenever the issue came up in ISA, most states have not been able to produce much documentation by way of *travaux préparatoires*. There is certainly not enough evidence of an active consent to ISA over investments routed through non-signatory SCCs.

10.14 Indirect investments and ISA protection

60. World Bank Guidelines recommended that there should not be any restrictions as to the nature of BIT-covered investments (including portfolio investments) (World Bank, 1992B, vol.2 pp.15-16). MIGA offered protection for any medium or long term investment (Article 12). The Convention did not define the term ‘investment’. The essence of arbitration being mutuality, the parties could, by consent, define the eligibility. As it was, the scope of the consent ended up being defined, in most cases, not by signatory states, but by arbitrators after a dispute had arisen.

61. Until the *AAPL* arbitration was decided in June 1990, it was not known that the arbitration clause in a BIT amounted to an effective consent to ISA. Similarly, until the *SPP* arbitration against Egypt was decided in 1993, it was not known that a binding arbitration could arise out of an investment legislation. The draft of the Convention was deliberately uncontroversial to encourage its acceptance. The ‘pro-arbitration’ climate acknowledged by the elite arbitrator Gaillard (2002, p.250) ensured that the interpretations of BITs in ISA were expansive. The phrase ‘arbitration without privity’ is attributed to another elite arbitrator, Paulsson (1995, p.232). This was not, at least openly, the system promoted at the time the Convention was first opened for signatures, nor when BITs were being signed.

62. The Convention sought to avoid overly restrictive criteria to determine nationality like those employed by the ICJ in *Barcelona Traction* case (Vuylsteke 1974, p.355). The ICJ had relied on the place of incorporation as the home state. The decision was not about an ISA. The claimant was incorporated in Canada by Belgian shareholders and had its operations in Spain. The ICJ rejected Belgium's claim to seek diplomatic protection on behalf of its investors. *Barcelona Traction* was like a tax haven company (Hadari, 1974, p.34). It is not that the investment in the form of shareholdings was left unprotected. The ICJ simply decided which state should offer diplomatic protection.

63. The World Bank Group did not advise the developing countries about the possibility of chains of intermediary SPEs that could be eligible for ISA offered under BITs, or that the same investment would potentially be covered under several BITs. There was no effort to ensure that BITs were tightly drafted to improve clarity in their provisions. It is possible that the World Bank experts themselves did not foresee these interpretations because they did not expect BITs to amount to arbitration agreements.

64. Cole (2013, p.7) argues that the Convention could not promote the security of private investment if tribunals accepted jurisdiction over a small range of cases that met a narrow definition of "investment". However, most private investments had security (e.g. under ICA) except in the rare cases of expropriation type risks for which ISA was originally designed.

10.15 Sovereign debt enforcement

65. One significant advantage offered by the Convention is to create a system for enforcing sovereign debts. The principle of sovereign immunity has gradually weakened since the 1950s (Das et al, 2012, p.50). Even a commercial arbitration award against a sovereign is not impossible to enforce under the New York Convention. In the case of an ICSID award, there is a simple registration process and no judicial review.

66. For some countries, such as Congo, and SaoTomè and Principe, the debt-claims under litigation correspond to about 15% of GDP (Das et al, 2012, p.50-1). Some litigation and arbitration is related to "unpaid energy bills or trade invoices," and most has been filed in New York or London since 2000 despite the fact that the number of sovereign defaults and restructurings has decreased in that period (Das et al, 2012, p.51). An ICSID claim can be used as a leverage to obtain early settlements of debts. Some Argentine debts have been settled with the help of the leverage provided by the ICSID awards against Argentina.

10.16 Encouragement of arbitration by strengthening the operative framework

67. IOs encouraged the building of the operative framework for arbitration, not just ICSID. Active in over 130 countries, the ICC enjoys the highest consultative status within the UN and its specialist agencies like the UNCITRAL. Various ICC commissions continue to work on projects in areas including arbitration, banking, competition, commercial law, taxation, environment, etc. The ICC documents are drafted after extensive consultation with member companies as acknowledged by the ICC on its website under the heading “Policy commissions”. A significant achievement of the ICC was the New York Convention.

68. Established in 1966 by the UN General Assembly,¹⁷ the UNCITRAL functions through working groups who produce the first drafts of rules and laws (e.g. the UNICTRAL Model Law on the International Commercial Arbitration, 1985.) Although the delegations to annual sessions and working groups are of states’ choice, they typically include experts and private sector lawyers (UNCITRAL 2007, p.6).

69. Over 2,000 changes in national FDI laws were brought about from 1991 to 2004, 93% of which were designed to welcome FDI (UNCTAD, 2005A); even Cuba joined in some level of liberalisation (Alvarez, 2008, p.957). IOs encouraged countries to modernise their arbitration legislations and the UNCITRAL Model Law was used to bring about uniformity in most modern arbitration laws.

70. The evolution of ISA and BITs paralleled the growth of financial globalisation, global governance, and privatizations. IOs actively promoted “new forms of statecraft that are much closer aligned to the private sector” so that parties find themselves bound by terms that “neither would have chosen freely”. (Quinot 2010, p.184, 191). An example of IOs’ pragmatic statecraft was in MIGA’s handling of its first PRI claim. In 1996, MIGA issued the initial guarantee to PT East, 50.1% owned by Enron (through its Delaware SPE)¹⁸ and 25% by Pasuruan Power Co. (its Indonesian owners included a son of President Suharto), and 24.95% by Prince Holdings Limited (an SPE in Hong Kong). A 20-year power purchase agreement was signed in 1996. The agreement was suspended by Indonesia, among other projects, in the 1997 Asian currency crisis. The World Bank’s Jakarta office had suggested that the project would place an enormous burden on Indonesia (Wells et al, 2006). There were questions of bribery involved; nothing was built, and yet MIGA paid out a claim to Enron. As MIGA could recover it from Indonesia, there was no incentive for it to be careful in the PRI offer or payment.

71. The World Bank advised bankers to use ICSID as an alternative to local courts (Delaume, 1983, 9). Traditionally, bankers did not use arbitration as much as other businesses (Park, 1998,

215). ISA cases involving banking and financial issues are increasing. In the 463 ICSID cases analysed for this thesis, 36 included banking and financial services related disputes; only two of which had not used an SCC.

10.17 Increasing inviolability of investment contracts - *pacta sunt servanda*

72. In the 1970s, many host governments contended that they could time the renegotiations of the long-term contracts by taking into consideration the investors' obligations to third parties and an agreed rate of return to the TNCs (UNCTC, 1978, p.115). Sanctity of contracts was not absolute under international law given that the maxim *clausula rebus sic stantibus* was as established as the maxim *pacta sunt servanda* (UNCTC, 1978, p.116). Investors were also willing to renegotiate a contract periodically (UNCTC, 1978, p.117).

73. Long-term contracts are increasingly enforced in ISA on the somewhat unrealistic expectation that the fundamental circumstances in which the agreement was made would not change. They tend to include flexibility for investors (e.g. price escalation clauses), but relative inflexibility for states (e.g. stabilisation clauses). The VCLT included the principle *pacta sunt servanda* (Article 26) but limited the applicability of *clausula rebus sic stantibus* to the circumstances set out in Article 62 which were thought to be so restrictive that they would hardly ever be found applicable.¹⁹

74. The coordinated advice of IOs was aligned to the TNCs' interests, rather than host states' goals, so that BITs conferred privileged treatment on TNCs that used offshore vehicles, without being assured a net benefit to the host states.

10.18 Summary

75. The World Bank, the IMF, and the UN agencies like UNCTAD played key roles in encouraging the liberalisation of developing country economies. Their considerable persuasive powers promoted networks of harmonised BITs and DTTs. Had their focus been on balancing the developing countries' and TNCs' interests, they could have advised the former against offering special concessions to investments made through tax havens or other SCCs. Instead, an exclusive focus on the investors' interests as first vocalised in the 1950s was applied to the drastically changed economies of the 1980s-1990s. The IOs' actions, loosely coordinated with those of other state and non-state actors, provided feedback loops to the path the early BITs and ISA awards took. A US lawyer-arbitrator has rightly called BITs a "one-way ratchet designed to benefit multinationals" and ill-suited to the concerns of the 1990s' global economy which did not face the NIEO or communism issues (Alvarez and Gunawardana, 1992, p.552).

¹ “Bankers To Advise I.F.C.” *Times* [London, England] 26 Feb. 1962: 15. The Times Digital Archive. Web. 26 Oct. 2015.

² “Beggaring the Poor”, *The Economist* Dated 18 February 1984, pp 15-16. Retrieved from www.economist.com.

³ After removal of the fixed exchange rate restraints, currency market speculation experienced explosive growth. In 1971, 90% of all foreign exchange transactions financed trade and long-term investments and 10% for speculation but these percentages were reversed by 1995 (Michie and Smith, 1995, p.277).

⁴ “Private goes public: World Bank continues to preach the privatisation gospel but is it the best way to improve the infrastructure of developing countries”, *The Banker*, Vol.149, No.884, October 1999, p.33.

⁵ “Economic Crisis Forcing Once Self-Reliant India to Seek Aid”, *The New York Times*, 29 June 1991.

⁶ Later, in 2009, the IMF sold 200 tonnes of gold to India for \$6.8 billion. *The Telegraph*, Calcutta, India 4 November 2009.

⁷ Canadian Council for International Cooperation, “Bilateral investment treaties: A Canadian primer”. Retrieved from www.ccic.ca, p.3

⁸ “IMF After Crisis”, *Indian Express* 3 July 2015. Retrieved from www.indianexpress.com.

⁹ *The Times Digital Archive*, Web, 24 April 2000, accessed on 10 December 2014.

¹⁰ “How Europe fuels tax haven deals in Africa”, *The Observer*, 2 November 2014.

¹¹ Retrieved from www.christianaid.org.uk Page 2.

¹² Retrieved from www.financialsecrecyindex.com

¹³ “How Europe fuels tax haven deals in Africa”, *The Observer*, 2 November 2014.

¹⁴ Retrieved from www.ifc.org.

¹⁵ “United Nations report urges greater coherence between international tax and investment policies” 24 June, Press Release by UNCTAD. Retrieved from www.unctad.org.

¹⁶ “US and Europe at odds over investment rules”, Guy, Jonquieres de *Financial Times*, UK 18 Feb 1998.

¹⁷ UN Resolution No. 2205(XXI) 17 December 1966.

¹⁸ As indicated in the SEC documents of US Exhibit 21, retrieved from www.sec.gov.

¹⁹ The Cypriot delegation made this statement in the ILC Report 1966, YBILC 1966 II 258, paragraph 6.

11. Arbitration without an agreement

11.1 Introduction

1. This Chapter has two objectives.

a) It describes the close association of private actors that expanded the scope of ICSID leading to a paradigm change in the concept of arbitration by permitting it to proceed without an express agreement between an investor and the host state. This set in motion the expansion of ICSID. But for this change, states would have negotiated an ICSID agreement specifically for each investment thus judging whether or not to allow ISA access to an investment made through SCC(s).

b) It outlines the extent of indirect investments in 463 ICSID arbitration cases, in terms of their complexity. The case studies selected from various SCCs show why a wholesale ISA access for indirect investments is contrary to the objectives of most BITs. All ICSID cases registered from the entry into force of the Convention in 1966, to December 2013 were analysed to examine how SCCs were involved in the routing of the investments. The phrase ‘tax haven’ was hardly ever expressly referred to in ISA awards. As will be shown in the next few chapters, ISA arbitrators do not criticise the use of tax havens regardless of their effect on the objectives of BITs and the ICSID Convention.

2. A reasonable, alternative interpretation of BITs was available to the arbitrators in the landmark ICSID cases. The assumption underpinning most jurisdictional awards was that they were founded on the consent of signatory states. This assumption is incorrect. Many BITs could be interpreted as invitations to treat and not standing offers. Even if they were drafted carelessly or deliberately deceptively, an open-ended arbitration offer to a laundry-list of all and sundry investments was contrary to the objectives of BITs.

3. This Chapter also briefly describes the role played by accountancy and other consultancy firms in encouraging convergence of ideas and practices relating to SCCs.

11.2 ICSID – a long, slow, and quiet start - 1966 to 1990

4. During ICSID’s first twenty-four years, only 26 cases were registered. Delaware was used in eight of these cases. All but one relied on express arbitration agreements for jurisdiction. There were some indirect investments in these cases, for example, *Holiday Inns* (1972) – a US investment via Switzerland to Morocco, and *Maritime International Nominees Establishment (MINE)* (1984) –

a Swiss investment to Guinea via Liechtenstein. The use of SCCs did not matter; these were no surprise skirmishes because the arbitration agreements with the hosts were express. In the very early days, tribunals exercised some caution as, for example, in *Holiday Inns*. The Moroccan subsidiaries of the US investors were held not to be foreign investors for the purpose of the Convention.

5. Over 1,800 BITs were signed by 1993, before the developing countries could (if they were following the ICSID developments) realise their potential interpretation as standing arbitration offers. This would have been after the jurisdictional determination in the *AMT* case in which consent derived from a BIT was challenged by Congo. Until then, states could have reasonably believed that an express arbitration agreement was required for an ICSID arbitration. After twenty years in force, ICSID had remained of marginal importance. This is obvious from Figure 11.1 which shows how actual consent was the cornerstone of early ICSID cases; it was soon overtaken by inferred consent from BITs. The chart also indicates the minimal use of investment laws to infer consent of states.

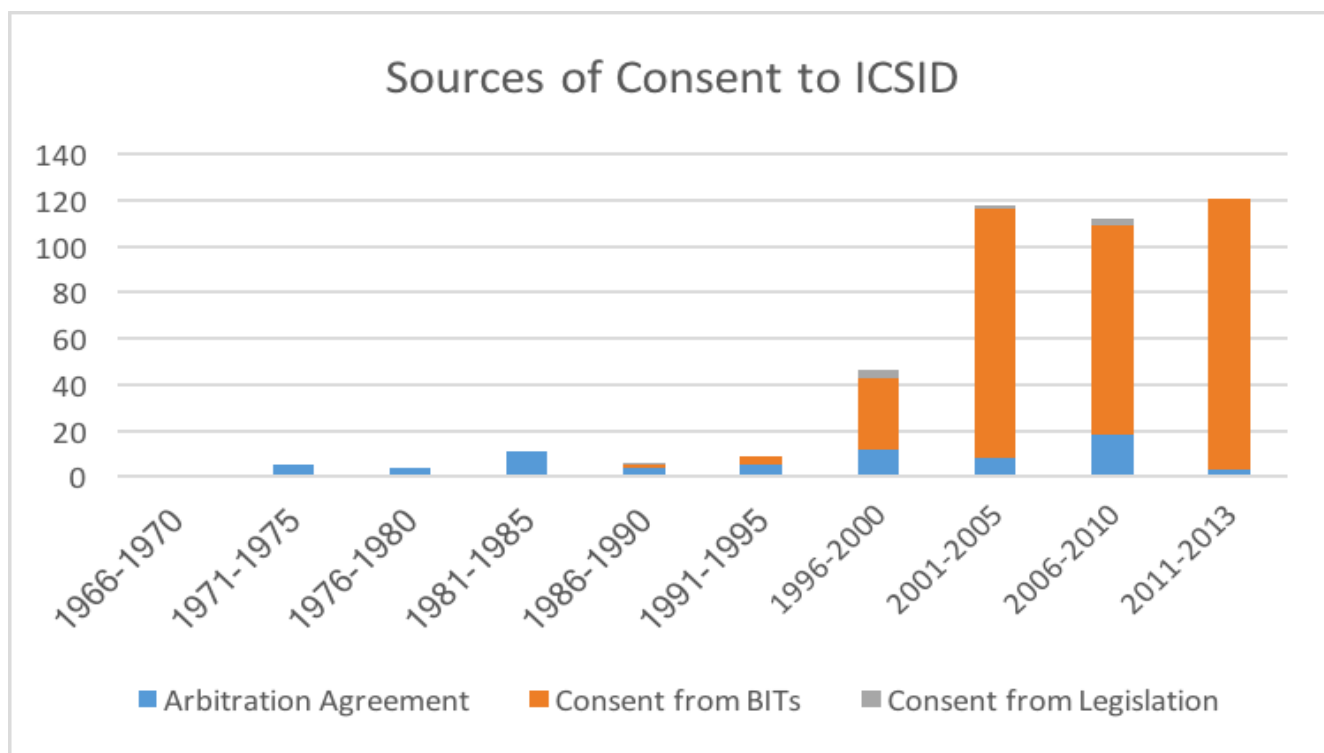


Figure 11.1: Stacked chart showing sources of consent for submission to ICSID.

11.3 Close association of non-state actors

6. Two landmark decisions - *Southern Pacific Properties (Middle East) Limited (1984) (SPP)*, and *Asian Agricultural Products Ltd (1987) (AAPL)* - derived an arbitration agreement from an investment law and a BIT respectively. The same law firm, Coudert Brothers, acted in both, but on behalf of the claimant in one (*SPP*) and the respondent (Sri Lanka) in the other. *SPP*'s lawyers included William Craig, Jan Paulsson, Paul Friedland, Jean-Claude Najjar, Harvey McGregor,

Mohammed Kamel, Charles Kaplan, Michael Polkinghorne, and Aron Broches (previously of the World Bank). Sri Lanka's team comprised Paul Friedland and Robert Hornick from the SPP team. In the *SPP* case, Emmanuel Gaillard and Rudolf Dolzer appeared on behalf of Egypt. Most of these lawyers went on to have careers as leading counsel and arbitrators in ISA. Paul Friedland who was involved in both the cases is currently the global head of the firm White and Case.

11.4 The First case to derive a consent to ISA from an investment legislation

7. Coudert commenced the *SPP* case on behalf of a Hong Kong incorporated investor. The arbitration agreement that arose from the investor's acceptance of an offer of arbitration in Egypt's 1974 Investment Law¹ was a bit of an after-thought even for the investor. The case was finally settled in 1993, but the determination on jurisdiction was made by majority (2:1) in 1988.

8. Canadian businessmen Munk and Gilmour (founders of Barrick Gold) controlled SPP, a Hong Kong Corporation set up to invest in luxury tourism resorts. SPP had invested \$5 million in Egypt before its project was cancelled. SPP first obtained an ICC arbitration award in favour of itself and its local subsidiary for \$12.5 million. A French court annulled the award for lack of jurisdiction. Paulsson, then at Coudert, commenced the first ICSID arbitration based on Egypt's 1974 Law. An ICSID award was made for \$27.6 million dismissing Egypt's contention that the cancellation of the project near the heritage site of the pyramids was required by the Egyptian and international laws. The decision is not available on the ICSID website; its excerpts were published a few years later in law journals. Broches was SPP's consultant on the case. He had been the World Bank's General Counsel and had helped to draft and promote the Convention.

9. The arbitration agreement was derived from the investor's notice of arbitration accepting the 'standing offer' in the Law. Article 8 of the Law stated, "Investment disputes in respect of the implementation of the provisions of this Law shall be settled *in a manner to be agreed upon* with the investor, or within the framework of the agreements in force between ... Egypt and the investor's home country, or within the framework of [the ICSID Convention], where it applies." (Emphasis supplied). It set out the details of an arbitration board. An Egyptian court was to select the tribunal's chairman from the members of Egyptian judiciary. Article 8 offered, *prima facie*, a choice of three-four possibilities and was more of an invitation to treat than a standing offer; the agreement would result from the investor making an offer choosing an option that upon acceptance by Egypt would have resulted in the arbitration agreement. The Report of the Executive Directors of IBRD (not the Convention) had suggested that a state might make an offer of ICSID arbitration in its "investment promotion legislation" which the investor might accept in writing (paragraph 24). The Report was silent on the timing of the investor's acceptance. It further specified that consent

alone would not be sufficient to refer a dispute to ICSID and that the nature of the dispute *and* the parties mattered “in keeping with the purpose of the Convention” (paragraph 25). An investment made through a tax haven is unlikely to be in keeping with the Convention’s objective.

a) SPP had approached the ICC. SPP did not believe that it had access to ICSID until Paulsson suggested that it did. It could not have made its investment on the assurance of the ICSID potential. The dissenting arbitrator had significant concerns about the nature of the investment; having applied for an investment to promote tourism (which the Law covered) the project was converted to an urban development one (which was unlikely to have been covered). The claim was assigned by one claimant entity to another without Egypt’s consent; the assignee’s capital was \$200. The investment was ‘indirect.’ Canada, the home of the controlling investors, was not an ICSID signatory. The investment contract was from December 1974, and the notice of arbitration was given in August 1983 by the assignee.

b) The 1974 law was published in June. The World Bank’s president Robert McNamara visited Egypt in February-March 1974. Just in that year, \$1.4 billion was owed by Egypt to its creditors (World Bank 1974, p.3). The World Bank’s note for the McNamara visit identified Egypt’s vast potential for tourism development. The Law was to signal an open door policy. It was designed to attract foreign exchange with projects like tourism. The US-Egypt business council even identified 35 potential projects that would have taken the form of a joint venture (pursuant to the Law). According to a contemporaneous note (Bushnell, 1981, p.313), a US lawyer advised investors to include an express arbitration agreement in their joint ventures to avoid Egyptian courts. He did not foresee an ICSID arbitration. An investor’s unauthorised assignee issuing an acceptance of an arbitration offer nine years after the original Heads of Agreement made for a surprise scrap more than a consensual arbitration.

10. After the *SPP* case, Egypt defended 28 ICSID cases; only one other case arose out of the 1974 Law, and 26 arose under various BITs. Egypt amended the Law in 1977 to clarify that it was not meant to give its consent to ICSID arbitration. States can legitimately expect to know how potential disputes arising out of any particular investment will be resolved. Not all investments will deserve the ISA privilege. Coudert’s innovative use of Egypt’s law created a legal fiction of a consent; a masterstroke in the use of what Katzenstein (2016) calls protean power; it was followed by a similar creative use of a BIT.

11.5 Consent to ISA derived from a BIT

11. Until the *AAPL* case, Sri Lanka is unlikely to have been aware of the potential for arbitration under its BIT. The IBRD Executive Directors’ Report did not refer to a BIT as a source of a consent

expressly. The *AAPL* tribunal comprised Professor Goldman, Dr Asante and Dr Ahmed El-Kosheri. Coudert, did not challenge the tribunal's jurisdiction on behalf of Sri Lanka. The dissenting arbitrator, Asante - a World Bank attorney between 1966-69 - did not discuss jurisdiction. El-Kosheri, the tribunal's chairman (nominated by ICSID) was Egypt's lawyer in the *SPP* case in the first commercial arbitration case before the ICC and a friend of Paulsson's (Paulsson 2012). He had been on the annulment committee of the first ICSID arbitration *Klöckner* (1981) in which Coudert had acted for Cameroon. These connections illustrate how small the network of ISA lawyers was. It did not take long for an innovative, potentially profitable idea to spread.

12. Article 8 in the UK-Sri Lanka BIT (1980) provided as follows: "Each Contracting Party hereby consents to submit to...[ICSID]...for...arbitration under the...Convention...any legal disputes arising between that Contracting Party and a...company of the other Contracting Party concerning an investment of the latter in the territory of the former." The words "Each Contracting Party...hereby consents" showed the willingness of the states to arbitrate the disputes described with each other. Article 8(3) provided for either party to make a reference to ICSID arbitration if "the...company affected has also consented in writing to submit the dispute to the Centre for conciliation or arbitration under the Convention." The words "has also consented" in Article 8(3) imply a pre-existing arbitration agreement presumably at the time the investment is made; if it meant a consent after the dispute arose, the wording was likely to be "if the investor also consents". It is not known whether Sri Lanka had a separate arbitration agreement with the investor pursuant to Article 8(3); if it did, it would explain why Coudert did not dispute jurisdiction. Even if there was no pre-existing agreement, Sri Lanka's acceptance of the reference to ICSID after *AAPL*'s arbitration notice would have been sufficient to derive an arbitration agreement.

13. The *AAPL* award in June 1990 quietly brought about a landmark change in law where a state's consent to ISA was derived from a BIT. The idea had been discussed right from the time of *Abs* and *Shawcross* albeit in the form of an arbitration agreement coupled with a BIT. Except for Sri Lanka, other developing states would not have known about the significant case as the jurisdiction issue was not even contested.

14. The second BIT case *American Manufacturing and Trading Inc* (1993) (*AMT*) against the Democratic Republic of Congo (DRC) led to a jurisdiction determination in 1997. *AAPL*'s counsel, Dr Golsong, was the claimant-nominated arbitrator in *AMT*. Golsong from Fulbright and Jaworski had been the general counsel and the vice-president of the World Bank between 1979-1982, and ICSID's Secretary-General between 1980-1983. He had helped to create MIGA and had taken a "great interest in the growing spread" of BITs (ICSID 2000, p.7). Both *AAPL* and *AMT* had disputes arising out of the looting of properties and the host states' failure to provide security. The DRC

challenged jurisdiction. The case settled.

15. The DRC's objection to jurisdiction was that the investor was locally incorporated; that AMT, owned 55% by the US shareholders, had not made a direct investment. The tribunal held that when AMT, in its arbitration notice, exercised the option available under the BIT, it validated the tribunal's jurisdiction. Until 1997, countries might have believed that ICSID arbitration was not a possibility if the investment had to be made through a local vehicle which they had not agreed to treat as being foreign-controlled under Article 25 of the Convention; however, the Convention and BITs would be held as two separate sources of jurisdiction (see Chapter 12). The BIT 'movement' was seen by some experts like Salacuse,² as part of an ongoing process to create new international law of foreign investment. (1990, p.675). There is no evidence of developing countries intending to create a new international law when they signed BITs with very little negotiation.

11.6 ICSID Cases 1991-1995

16. Out of the nine ICSID cases registered between 1991-1995, four arose out of BITs. As BITs were starting to increase in numbers, there was no mainstream discussion of these awards. Many cases would not be decided for several years after registration, and even then the decisions would only be published on the World Bank's website if *both* parties agreed to the disclosure. The arbitration community was well aware of the developments as they networked at conferences and subscribed to specialist publications. Most ICSID cases at this time still relied on specific investment agreements. Majority of investments leading to disputes were made from a home to the host state (even if they used SCCs).

11.7 ICSID cases – 1996 to 2000

17. Cases arising out of BITs or NAFTA rose in numbers. Out of 46 cases registered during this period, 31 relied on BITs and/or NAFTA's investment chapter, 12 relied on express agreements, and three relied on hosts' investment legislations.

18. Two BIT cases involved the use of a third party SCC (namely, *Mihaly International Corporation*, 2000, and *Generation Ukraine Inc.*, 2000), although six other non-BIT cases³ also involved indirect routing of investment. This was the period during which the incidence of cases arising out of BITs started to increase.

11.8 ICSID Cases – 2001 to 2005

19. Between 2001 to 2005, ICSID cases more than doubled from the previous five-years' period. Out of 118 cases, only ten were non-BIT cases. Eleven BIT cases⁴ involved using a third party SCC. Two cases involved round-tripping (*Gemplus*, 2004 and *Asset Recovery*, 2005). Four

non-BIT cases involved an indirect route between the ultimate investor and the host. It was in 2005 that the tribunal in *Aguas del Tunari*⁵ proclaimed that states were aware of portals being used to make investments.

20. There were 2,495 BITs in force by 2005 of which 1857 (74.5%) were concluded before 1990.⁶ Bolivia, the respondent in *Aguas del Tunari*, had entered into 23 BITs of which the last one was with Costa Rica in 2002, the same year that the *Aguas del Tunari* was registered. Ten of its BITs are terminated and two never entered into force. *Aguas del Tunari* relied on a BIT signed in 1992 which entered into force in 1994. It was signed before the *AMT* case was registered. Given the amount of input from IOs like the FIAS and UNCTAD, it should not have been readily assumed that states signing *bilateral* treaties were doing so to offer ISA to investments from *any* state. Most state negotiators were being herded in the BIT direction by IOs.

11.9 ICSID Cases - 2006-2010

21. Over the period 2006-2010, 112 cases were registered of which 21 were non-BIT (three arising out of investment legislation and 18 out of investment agreements); 91 cases arose out of BITs. From these 92, hosts' own investors used BITs in at least five cases,⁷ the ultimate home of at least one investor was difficult to establish from the data. A further sixteen cases⁸ involved investors using a third party BIT. In eleven non-BIT cases, indirect investment was involved between the ultimate investor and the host.

11.10 ICSID Cases - 2011 to 2013

22. Out of 131 cases registered during this period, only 13 were non-BIT. In two cases it was difficult to determine the controlling investors' nationality but in seven cases⁹ the controlling investor was from the host state itself. In 24 BIT cases,¹⁰ the controlling investor used an SCC's BIT. In seven non-BIT cases,¹¹ the investment was made through intermediaries in different SCCs.

11.11 Indirect investments – Examples showing how they worked

23. In 75% of all 463 cases at least one SCC was involved even if it was not always relied on for BIT jurisdiction. It is increasingly difficult to identify where the ultimate investor is from who claims to have invested on the basis of the host's assurances of ISA. The following sample examples of SCCs show how indirect investments work, why statistics cannot be accurate in respect of FDI, and why bilateral focus is no longer appropriate – either as a mode of attracting investments with incentives, of measuring the result of an incentive, or of justifying access to ISA.

24. In *Mobil and Venezuela Holdings B.V.*(2007), the Netherlands-Venezuela BIT was used by the claimants comprising two Bahamian entities (an Inc. and a limited company each), a US limited

company, a US corporation, a US holding Inc. and a Dutch BV. The ultimate investors were German and American.

25. In *Tidewater Investment SRL and Tidewater Caribe, C.A.* (2010), the arbitration was under the Barbados-Venezuela BIT over the investment made by five US LLCs and one Barbadian SRL.

26. In *LSF-KEB Holdings SCA* (2012), the Belgium-Luxembourg-Korea BIT was used. The Lone Star global capital management fund (US), made investments in financing through six Belgian SCAs, one Belgian SPRL, and one Luxembourg S.à.r.l. A Belgian holding entity with an equity of 5 million Euros can generate an annual tax deduction of more than 200,000 Euros.¹²

27. Six ICSID cases were registered by Cypriot and Panamanian claimants in each of which the controlling investor was non-Cypriot and non-Panamanian.

28. There are several ICSID disputes in which the British status was used at registration but the ultimate investor was probably not, or at least not solely, British. In chronological terms, the earlier BIT cases (1990s') had more connection of the investment with Britain than in the more recent ICSID cases. A few examples are set out below.

a) In *Wena Hotels Limited* (1998), the investor company was owned and controlled by Egyptian Mr El Faragy, and his South African wife. One of the Wena companies set up in the BVI was managed by a Guernsey trust. The couple's homes in Britain were purchased by a Jersey and a BVI company respectively. Wena won \$20.6 million award in ICSID which was deposited in *offshore* accounts. The ownership of the one of their British properties was claimed by a Sheik in the subsequent divorce proceedings of the El Faragys. Mr El Faragy moved the ICSID award funds to his own account in Switzerland claiming in the divorce that the money was spent to pay off his external investors.¹³ Although this investment was theoretically from Britain, it is clear that it mainly involved offshore sources and destination.

b) *Ridgepointe Overseas Developments, Ltd.* (2000) involved Ridgepointe, a British entity registered in the BVI in a non-BIT case. Ridgepointe was controlled by Zimbabwean born Rautenbach who was briefly appointed in 1998 as the chairman and the chief executive of the state-owned copper and cobalt producer in the DRC.¹⁴ He owned and controlled the Zimbabwean Ridgepointe Overseas Developments Ltd.

c) *Rusoro Mining Ltd.* (2012) involved an investor incorporated in Canada but controlled by Russian (UK domiciled) investor Vladimir Agapov. Rusoro Mining is a main mining asset of Agapov Group, an investment fund, controlled by Agapov.

d) Tullow's investment in Uganda for petroleum exploration was made through British and

Australian entities leading to the 2013 case *Tullow Uganda* (2013). Tullow, having started in Ireland, now manages 120 licences in 22 countries and is listed in London, Ireland, Dubai and Ghana.¹⁵ Despite owing 84% of its revenues to the African continent, only four of its 81 companies are registered in African countries. More than half (47) are registered in the BVI, St Lucia, the Channel Islands and the Netherlands.¹⁶ Uganda attempted to tax Tullow \$407 million in 2014 which led to the ICSID case. When Tullow sold 67% of its stake to CNOOC and TOTAL for \$2.9 billion, making it Uganda's largest transaction, Uganda settled for a tax bill of \$250million.¹⁷ The claim was suspended by parties' agreement.

29. With 91 BITs in force, the Netherlands is a major hub for FDI flows which peaked in 2007. Dutch claimants registered 40 cases, (one individual claimant). In most cases, the investment does not appear to have originated in the Netherlands except *Tulip Real Estate and Development Netherlands B.V.*(2011).

a) *Fedax N.V.* (1996) involved six promissory notes issued by Venezuela to a Venezuelan corporation which endorsed them to a Dutch Antilles company, Fedax. Venezuela argued that this was not FDI in Venezuela. The BIT included a rather broad definition of investments including 'titles to money' without any restriction. The tribunal held that the broad approach to the definition of investments was the standard policy of major economic groupings such as the EC and given the Netherlands' membership of the EC, it was no surprise that a similar approach was followed in its BITs. This is almost an acknowledgment of the lack of reciprocity in BITs as the tribunal referred to the preferences of the capital-exporting state. Venezuela had excluded non-direct investments in two other treaties, the Andean Group Regulation on Foreign Investments and the 1994 Mexico-Colombia-Venezuela FTA.¹⁸ This reference to other treaties is pertinent. Article 31 of the VCLT includes in the aids to be used for interpretation a state's treaties entered with the other signatory, but not with third parties.

b) *The Rompetrol Group N.V.* (2006) involved round-tripping to invest in Rompetrol. Most of the funds were Romanian in origin, or were not *invested* in Romania being used to pay off other investors. The tribunal refused to follow Prof Weil's view in *Tokios* case (that ICSID is not meant for round-tripping capital). His view, they said, had not been widely approved in academic and professional literature, or generally adopted by subsequent tribunals. The emphasis is not on what states would have intended but rather what other arbitrators find acceptable.

c) *Alapli Elektrik B.V.* (2008), decided in 2012, is interesting in the slight narrowing of the jurisdiction. It involved an investment that started with a Turkish company, First Project Company, whose rights were assigned, with the consent of Turkey, to a Dutch subsidiary company, which

itself was a subsidiary of a holding company in Curacao. First Project Company entered into a letter of intent with the American TNC, GE. However, the majority of the tribunal, with claimant's nominated arbitrator Lalonde dissenting (in an opinion that is not public), found that there was no jurisdiction under the ECT. Arbitrator Park held that there was no contribution from the claimants to create the status of an investor under the ECT or the BIT (the entirety of the financial contribution and technological know-how was to have come from GE). Arbitrator Stern held that there was no *bona fide* investment.¹⁹ The majority was keen that a tribunal should not “facilitate use of treaties by persons not intended to receive their benefits.”²⁰

d) In something of a rare occurrence, the majority expressly discussed the element of *reciprocity* in signing of BITs: “In signing the Netherlands-Turkey BIT and the ECT, Turkey could not have expected that treaty benefits would extend to just any Dutch company, regardless of its relationship to a Turkish investment. Nor could Turkey have expected that benefits would accrue to enterprises from the United States. Rather, Turkey agreed to arbitrate with Dutch entities that had actually made investments in Turkey. That jurisdictional principle must serve as the foundation in construing the notions of “investor” and “investment” in both Treaties, and the analogous provisions in the ICSID Convention.”²¹ If the company set up by the Turkish sponsors had taken a loan from the US, the conclusion might have been different but they merely provided a conduit for the investments without taking any risks. The majority suggested that BITs are not “intended as treaties with the world” but that they provide standards of treatment with relation to investments from designated nationals and even if economic contributions were made by nationals of the US, they were not “investments “of” a Dutch claimant”.²² Arbitrator Stern held that there was abuse of treaty in that the Dutch company was introduced after a legal dispute was crystallised. The case was decided after the financial crisis and the original decision was confirmed by the ad hoc tribunal in annulment proceedings. This majority’s view is not typical of arbitrators’ position in other cases.

30. Italian investors were claimants in 31 cases and particularly active in disputes in the construction sector; one corporation *Impregilo* was involved in five ICSID disputes by 2013. Italy has not been treated as an SCC for this thesis (it was not in the tax-haven list of Palan et al) but it appears to attract the construction sector. One significant contribution of Italian investors to the jurisprudence is the phenomenon of claims by multiple unrelated individual investors in relation to their portfolio investments *not* made *in* the host country. These claims were all started against Argentina, related to government bonds purchased in the secondary market and involved third party funding. Even if these cases did not lead to awards on merits yet, they have changed investment law in terms of their decisions on jurisdiction by expanding it. These are briefly described below:

a) *Giovanni Alemanni and others* (2007) was started by 183 Italian individual and legal entities

in respect of the debt instruments issued by Argentina. After some investors accepted Argentina's exchange offer in 2010, only 74 claimants remained. The claimants were recruited by a non-Italian entity called NASAM, and one of the claimants, a co-counsel, had a financial interest in NASAM. NASAM was a Monaco-based administrative company of a Swiss Trust, Guardian SA. The claimants had given over control of the arbitration to one individual by powers of attorney. NASAM had the right to recover proceeds from the arbitration. Some of the jurisdictional objections were dismissed by the tribunal despite these concerns and some joined to the claim on merit. Eight years later the claim was discontinued for the lack of payment of required advances.

b) *Abaclat* (2007) is currently suspended by parties' agreement amidst a news report of a settlement of \$1.35 billion (at 150% of the face value of the bonds).²³ This claim was started in the name of 180,000 individual investors, mostly between 60-80 years age who had invested in Argentina's government debt varying amounts between \$25,000 to \$50,000. It is not clear what advice, if any, they had received in Italy before buying Argentine bonds in the secondary market. Most sophisticated investors (like hedge funds, or other FIs) and the intermediaries that sold the debt to the pensioners would have been well aware of the risks. The majority of the tribunal upheld jurisdiction; the dissenting arbitrator relied on the absence of a *territorial* link with Argentina.

c) *Ambiente Ufficio S.p.A.* (2008) involved security entitlements of 55 different bond series commenced in the name of 90 individuals. The tribunal held that multi-party arbitration was a generally accepted practice in ICSID arbitration. The tribunal's majority decision was based on holding the issuance and the circulation of the bonds as an economic unity despite the numerous intermediaries being involved. Like in the *Alemanni* case, NASAM organised the claimants, claims, lawyers, and the finance for the arbitration, and exercised complete control over it. NASAM did not have Italian nationality as required by the Italian BIT so that it could not have brought the claim in its own name. The claim was discontinued for lack of ICSID payments in 2015.

31. Fourteen cases were registered by Luxembourg claimants; although as an SCC Luxembourg was involved in at least twenty cases. All the cases involved controlling investors outside Luxembourg. But one is important in its indication of the arbitrators' current thinking about 'holding' companies and the practice of using SCCs (although it does not use the expression SCC).

a) *Tenaris S.A. and Talta* (2011) was commenced under Venezuela's BITs with Belgium-Luxembourg and Portugal. The second claimant Talta was incorporated in Funchal, Madeira²⁴ (Portugal); it was a wholly-owned subsidiary of the first claimant set up in Luxembourg; another Luxembourg company Tenaris Investments S.a.r.l. was an intermediary. The claimants were part of Argentina's TNC Tenaris – a steel manufacturer operating in Argentina, and several other countries,

but headquartered in Luxembourg. Part of the investment in Venezuela was routed through Tenaris Global Services (B.V.I.) Limited, a wholly-owned subsidiary of Tenaris. Venezuela's Luxembourg BIT required a company to have *siège social* in Luxembourg, meaning that mere incorporation was not sufficient to establish jurisdiction. The Portuguese BIT required the investor to have a *sede* (seat) in the home country. Venezuela argued that the claimants were controlled and operated from Argentina, and relied on several authorities including UNCTAD²⁵ to show that the seat connoted the place of effective management.²⁶

b) The tribunal held that if “*siège social*” and “*sede*” were to have any meaning, each must imply something different to, or over and above, the address of a registered office or a statutory seat. Other meanings of both terms were effective management, or genuine corporate activity.²⁷ The Luxembourg BIT's preamble showed that the states desired to strengthen their economic cooperation and considered the BIT to have a “beneficial influence” on “reinforcing confidence.” The Portuguese BIT was to intensify economic cooperation “between the two States” because it would contribute to “economic prosperity”. The tribunal (which included Stern) concluded that there was a policy decision to promote bilateral economic cooperation as to the class of investors that each host wished to attract, and was willing to protect. Nothing in the BITs required a formal test of registered or statutory office.²⁸

c) The tribunal still recognised that a company's day-to-day management and physical links with its corporate seat will be very limited if it is a holding company, or a company with little or no day-to-day operational activities. It would be entirely unreasonable to expect a holding company to maintain offices or workforce, or to be able to provide evidence of extensive activities. But the tribunal concluded that holding companies have ‘management’, and were not excluded from the BITs. This was supported by Luxembourg and Portugal having considered it beneficial to attract holding companies, and to maintain a regulatory regime that allows for them. This might have been the reason why Venezuela had tried to exclude mere holding companies by demanding the extra conditions in the BITs. The tribunal applied a “flexible” test of actual or effective management.²⁹ Having effectively endorsed the tax-haven use as being acceptable, Venezuela's objection was dismissed.

d) Tenaris had over 25 subsidiaries but no operational activities; its only function was managing its portfolio of companies.³⁰ Tenaris's Articles prohibited it from engaging in industrial or commercial activities. Its annual shareholders' and board of directors' meetings were said to have taken place in Luxembourg; there were no board minutes. Out of its 27,000 worldwide employees, 7,000 were in Argentina. Under Luxembourg law, there was no requirement for the company to hold or rent an office in the country. Talta was a trading and holding company in Funchal. An

award was made in favour of the claimants for \$87.3 million plus compounded interest of \$85.5 million. This January 2016 award was made after Venezuela's withdrawal from ICSID. The same claimants started another ICSID arbitration in August 2012 against Venezuela arising out similar facts but in relation to two other Venezuelan investments.

32. Out of the 29 cases registered by Spanish investors 2013, at least eight were against Argentina, four each against Mexico and Venezuela, three against Ecuador, two against Chile, one each against El Salvador, Honduras, Guatemala, Costa Rica, Peru, Guinea, Spain and Egypt. They are overwhelmingly investment disputes in the same region. Spain was the second-largest source of FDI in Latin America in the 1990s, and also among the six largest recipients of FDI. In 2007, Spain had inward FDI stock of \$537 billion and outward FDI stock of \$637 billion.³¹ Spain was an SCC of choice for investors in Latin or South America. In five cases out of the 29, other SCCs were also involved (such as Liechtenstein or Panama).

33. Sixteen cases were registered by Swiss claimants (including two individuals). The very first ICSID claim by a Swiss claimant (non-BIT) was on behalf of the ultimate investor from the US claim. Except for the three cases brought by *SGS Société Générale de Surveillance S.A* against Pakistan, the Philippines and Paraguay, most other cases involved a non-Swiss controlling investor.

34. The US-based investors (including seven individual claimants) commenced 111 cases. Some US investors were not recorded as such by ICSID. For example, in a non-BIT case *Cambodia Power Company* (2009), the investor is recorded as being Cambodian, but it was a subsidiary of a Delaware based corporation called Beacon Hill Associates Inc. Its major financier was Hawaiian Electric Industries Inc.³² All the early cases started by the American investors included an express ICSID agreement until the *AMT* case. A few examples of the use of Delaware and other SCCs are discussed below.

a) *AIG Capital Partners, Inc.* (2001) was a claim under the US-Kazakhstan BIT. The first claimant was a Delaware corporation, AIG Capital Partners Inc. It was owned and controlled by its holding company American International Group Inc. also incorporated in Delaware. The latter was an investment company that used the claimant and AIG Silk Road Investors Inc. to provide worldwide financial services. Its joint venture in Kazakhstan was called Tema, (with a local company owning 34%); the rest was held by a Bermuda company called AIG Silk Road Investment I Ltd. (the Investment Company), a wholly-owned subsidiary of another Bermudan company called AIG Silk Road Fund Ltd (Fund). The Bermudan companies were controlled by the US AIG which indirectly controlled the Fund, the Investment Company, the Finance Company (yet another Bermudan company called Kazakhstan Housing Limited) and the Joint Venture. This level of

complexity was involved for a project to build a residential complex in Kazakhstan. The claimant succeeded in the claim.

b) *Azurix Corp.* (2001) was a BIT claim by an Enron-owned company against Argentina. Two companies of the Azurix group were registered in Argentina to bid for a water concession in Argentina: Azurix AGOSBA S.R.L. (AAS) and Operadora de Buenos Aires S.R.L. (OBA). AAS and OBA were indirect subsidiaries of Azurix. AAS was owned 0.1% by Azurix, and 99.9% by Azurix Argentina Holdings Inc. (a company incorporated in Delaware), which itself was 100% owned by Azurix. OBA was 100% owned by a Cayman entity Azurix Agosba Limited, and which, in turn, was 100% owned by another Cayman entity, Azurix Agosba Holdings Limited, 100% owned by Azurix. The Tribunal found (like OPIC) that the project was not financially sustainable. Azurix still won an award of \$165.2 million plus interest. This project was a good example of a company keeping its stock prices high by showing continuous growth in Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA). Enron had formed Azurix by purchasing a British water Company for \$2.8 billion to gain water industry expertise. Azurix then raised \$700 million in an IPO; later, Enron had to buy it back for \$325 million. That involved an elaborate arrangement with more holding companies and trusts, as described by Markham (2015, p.74).³³ A second BIT case, *Azurix Corp.* (2003) was discontinued for lack of payment of ICSID advances.

c) In *Aguas del Tunari, S.A.* (2002), the tribunal rejected Bolivia's argument that the US investor Bechtel's holding shell company in the Netherlands could not be said to control the claimant, thus allowing an American investor to make a claim under the Dutch BIT with Bolivia. The majority arbitrators pronounced, without supporting evidence, that their decision reflected "the growing web of treat-based referrals to arbitration ... 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 serve in many cases more broadly as portals through which investments are structured, organized, and most importantly encouraged, through the availability of a neutral forum." (para 332 of the Majority Award). The only award that later rejected this view was discussed above in *Alapli*.

35. The *Aguas Del Tunari* view was a remarkable generalisation of all states' knowledge and intentions when agreeing to BITs, whether they were signed under pressure from IOs, the US or the other developed countries or creditors. This view is indicative of TNCs' use of BITs and home states. The portals exist for the TNCs' convenience; their lawyers set them up, SCCs and IOs encourage and use them. Tax havens, especially, are not helpful to host states. Even if states may accept investments coming from any state, it is not necessarily true that ISA under BITs was offered to such investments.

a) *ConocoPhillips Petrozuata B.V.* (2007) arose from a Venezuelan investment made by the American energy conglomerate ConocoPhillips (headquartered in Houston but registered in Delaware). The claimants included ConocoPhillips Co. (Delaware). The claim was made under the Dutch-Venezuela BIT and the Venezuelan Investment Law. Three Dutch vehicles were used to make this investment. ConocoPhillips Hamaca B.V held its investment in Venezuela through a Delaware company called Hamaca Holding LLC, and a Bermudan company Phillips Petroleum Co. Venezuela Ltd. (this share was previously owned by the Delaware incorporated Phillips Petroleum Company Venezuela Ltd.). To ensure BIT coverage, ConocoPhillips routed its investments in the first claimant via the Netherlands (Paragraph 32 of the award on jurisdiction). Conoco Orinoco Inc. incorporated the first claimant ConocoPhillips Petrozuata B.V. in July 2005, and transferred its ownership in Conoven Holding Ltd. (place of incorporation not clear from the award) to the first claimant. The project had been approved for Conoco (as it was then) by its parent company E.I. du Pont de Nemours and Company in 1996. The tribunal found that it did not have jurisdiction under the Investment Law so that the claims by the US claimant ConocoPhillips Co. were dismissed. Some of the claims brought by the Dutch claimants in respect of extraction tax were found to be within jurisdiction under the BIT even if they were, in substance, American claims.

b) *Brandes Investment Partners, LP* (2008) was a telecommunications case commenced by a Delaware-based partnership. The claimant was an advisory firm managing assets worth over \$27 billion for institutional clients (e.g. pension funds) and high net worth individuals, but the award does not mention on whose behalf they controlled the investment in dispute. The claimant was listed in the 2011 *New Scientist* as one of the 147 “super-connected” companies “with disproportionate power over the global economy.” (Coghlan and MacKenzie 2011). The claim failed for lack of jurisdiction under Venezuelan Investment Law. Unlike the Egyptian law in *SPP* the wording of this legislation could not be used to support an open consent to arbitration.

c) *Pac Rim Cayman LLC* (2009) was a CAFTA-DR case brought by the Nevada incorporated claimant that was owned by a Canadian entity, Pacific Rim Mining Corporation. Canada was not a member of ICSID or CAFTA-DR so that a Canadian entity could not have commenced the case. The claimant was originally incorporated in the Cayman Islands but three years after its application for the necessary permits, its nationality was changed. El Salvador argued that this was an abuse of process. The tribunal refused to accept that a holding company could never amount to a company with substantial business activities. It held, “the commercial purpose of a holding company is to own shares in its group of companies, with attendant benefits as to control, taxation and risk-management for the holding company’s group of companies. It will usually have a board of directors, board minutes, a continuous physical presence and a bank account.”³⁴ This was not the

case with Pac Rim, especially after its change of nationality. Jurisdiction was upheld under El Salvador's Investment Law.³⁵

36. There was no reason for the developing states to offer ISA for investments that might not bring any benefit to their economies. The dissenting opinion of the ad hoc committee member *Malaysian Historical Salvors* (2005), referred to the ICSID preamble to suggest that hosts would not agree to apply the Convention to transactions that did not promote their economic development. The Convention was not meant to be just another arbitration institution (paragraph 62). However, another tribunal in *Victor Pey Casado* (1998) alleged that the reference to economic development was “as a consequence, not as a condition of the investment.”³⁶

11.12 Accountancy and other consultancy firms

37. The kind of complex investment structures illustrated above are set up with the expert advice of lawyers, tax consultants, and accountants. They also advise SCCs. For example, a team of US lawyers advised Nepal to promote itself as an OFC in the early 1990s (Picciotto, 2011, p.98). “Lawyer-arbitrators” easily accept that holding companies and shell SPEs have a genuine business function; the structures are legal under the SCCs’ regimes. The establishment of such structures leads to a conformity of practices by using law and accountancy firms that give similar advice. Accountancy firms have, over the last few decades, merged to form ever bigger entities reducing competition in the global market. The Big Eight³⁷ became the Big Five, and then the Big Four (Deloitte, PricewaterhouseCoopers (PWC), Ernst & Young and KPMG). They have offices in all SCCs. The fifth firm Arthur Andersen LLP ceased practice in 2002 after the Enron scandal. Its surviving part, Andersen Worldwide Société Coopérative, was based in Switzerland, and carries on consultancy as Accenture PLC, now based in Ireland. In 2014, it was one of the world’s largest consultancy outfits as measured by its revenues of \$31 billion.³⁸

38. A typical advice for the formation of an “optimal ownership structure” for say, a power project, included choices between a joint venture in the host state, a tax-haven holding company, direct ownership, or a hybrid entity (a corporation in the host to protect shareholders from liability, but a partnership for tax purposes at home).³⁹ An investment in an asset can be made by leasing it into the host country rather than owning it there.⁴⁰ The Big Four accounting firms (operating in 140 odd countries as advisers to most TNCs) are said to have “captured” some tax havens like Jersey writing their laws to suit the interests of their firms’ clients (Palan et al 2010, p.100).

39. There are some key consultancy firms like McKinsey & Company (McKinsey), and Boston Consulting Group, Bain & Company, and the Monitor Group (now part of Deloitte). They advise on every aspect of business such as management, organisation, operations, corporate growth and

development, innovation, and ICT, etc. McKinsey's quarterly reviews once pithily praised Enron in the following words: "Enron no longer produces oil and gas in the US, no longer owns an electric utility, and has never held a large investment in telecom networks. Yet it is a leading value creator in each of these industries."⁴¹ Former McKinsey consultant Skilling worked for Enron from 1990 (from leading its Finance Corporation to becoming president in 1997). Enron annually paid millions in fees to McKinsey. Several of Enron's large projects ended up in international arbitration and turned out to be very expensive for their hosts. Part of McKinsey's attraction was that TNCs using them were assured that they kept up with the business strategies being used by their rivals; this brought conformity to their behaviours; unpopular decisions (e.g. cost-cutting) could be justified by the outsider's 'independent' opinion (McDonald 2013).

40. India was advised by McKinsey in 2001 to accelerate economic growth to 10% p.a. by opening all sectors of the economy to foreign investors, and by rationalising taxes and privatising.⁴² Similar advice was given to other developing countries and it is said that virtually all of the Wall Street banks took McKinsey's advice in the credit boom that led to the 2008 crisis. McKinsey had a model for banks to use which helped converge their behaviour (McDonald, 2013, p.253). Consultancy or accountancy firms legitimised the actions of TNCs with their legitimacy being drawn from the perceptions of independence and expertise. The World Bank is also a McKinsey client. TNCs, consultancy and accountancy firms have revolving doors for experts. For example, the World Bank hired, in 2013, McKinsey director Keiko Honda to head MIGA.⁴³ The epistemic influence of such organisations as McKinsey percolates to TNCs, IOs, and states including SCCs.

11.13 Network of arbitrators

41. Developing countries did not have an active role in the conception, creation or promotion of ICSID. The Convention was a response to the TNCs' demands from the 1930s to 1950s. As NIEO threatened, the operative framework for ICSID and ISA was already in place. IOs and the developed countries needed to promote BITs. Lawyers urged the Latin American countries to sign the Convention in order to attract foreign capital (Sprague and Michael, 1982-83). One of the arguments used to promote ICSID was that host states would obtain the waiver of diplomatic intervention from the investor's home state. Host states were advised very early that they could insist that local administrative and judicial remedies took precedence over ICSID arbitration (Szasz, 1971). Unless BITs include a 'fork in the road' provision, commencing a local action is not a bar to an ISA; even where there is such a provision, rarely do arbitrators enforce it to exclude an arbitration.

42. The widening of ISA's scope came about because those implementing it mainly comprised a

small group of lawyers who were committed to the ICSID cause. Michaels (2014) has pithily summarised the kinds of roles and role perceptions of arbitrators, albeit in ICA but these are applicable to ISA, if for no other reason than the individual arbitrators that grace the elite roles in both. These roles include: a law dignitary, a professional or an entrepreneur, a scholar, a theorist (a philosopher of law), a visionary/dreamer. Networks are perhaps more important for arbitration lawyers than for other specialist lawyers, and systematic studies have been carried out on them (e.g. Van Harten 2012; Puig 2014). The impact of the epistemic community is not limited to the repeat appointments; it works to disseminate and consolidate information, converge practices and ideas, and to exclude people, practices, and ideas that are not approved by the power-brokers in Puig's analysis.

43. Curtin (2010, p.35) contends that the transfer of governmental decision-making authority takes place "along a continuum with a very loose coordination among stakeholders and other non-governmental actors at one end of the spectrum and a much closer association of non-state actors with the core political actors at the national, international or supranational level." The experts and expert-networks of non-state actors provide a source of legitimacy. This can be seen to have taken place in ISA with the close association of private actors when BITs were first conceived of (this was led by Abs-Shawcross), followed by a looser, broader coordination with IOs and states as ICSID was created. When ICSID did not have the expected uptake, there was another period of close association of actors when consent to ICSID was derived from a country's laws or BITs, even if some of them might have been lulled by the Convention's preamble⁴⁴ into thinking that a specific agreement would be required for an arbitration. The developing countries' role in that period is not entirely clear (as they comprised diverse countries with varying degrees of understanding and debt issues). Some then changed their laws (e.g. Egypt), some their BITs or even their commitment to ICSID itself. This does not validate the arbitrators' interpretations of at least some states' BITs.

11.14 Transnational law order

44. The phrase 'transnational law' was used in the US in 1956 (Jessup, 1956). It was being discussed, at least by some lawyers, as "a new body of law" (Fatouros, 1962, p.288), but it was not used in the Abs-Shawcross draft. For Paulsson, arbitrators' 'legal order' is distinct from the nation state; in his vision, arbitration functions "routinely without judicial assistance" (2013, p.45-6). He enthusiastically talks down national judiciaries because of their dysfunctional nature (2011).

45. The transnational legal order of ISA has a self-serving justification for its existence or growth – it is good because it exists, and would not exist if it were not good. Independent information about the field is not easily available, thus making it difficult for outsiders to get to

grips with ISA, either as users (e.g. civil servants) or as academics. Elite arbitrators' focus is, necessarily by their training, a narrow and legalistic. They owe no accountability to the stakeholders even if they have allowed *amicus* representations in the proceedings. Usually involved after a dispute is entrenched, they do not need to consider the overall circumstances in which the bargains might have been struck because of the operative framework of ISA. The very reason for the existence of BITs (to encourage economic development) on which states' consent was given has no space in this legal order that was founded such consent.

46. Some lawyers believe that a government needs a face-saving device of an arbitration award before paying a foreign investor. Libya, for instance, neither attended the arbitration proceedings commenced by oil companies like Texaco, BP and LIAMCO nor challenged the arbitration awards, and yet, paid the awards fully (Asken, 1983). Given how global governance has made private power prominent in various sectors, the face-saving explanation is not necessarily relevant to today's governments. Protectionism of a class of 'foreign investors' needs a more relevant explanation based on the realities of the global economy.

47. ISA awards have been the main feedback loop for the path-dependent process of expansion of ISA; some of these are examined through the lens of SCCs in Chapters 12 and 13. In more recent awards, arbitrators have shown a reluctance to uphold abuse of treaties where claimants' corporate restructuring is carried out to take advantage of a BIT *after* a dispute has crystallised. A few new model BITs suggest words that may tie an investor to the signatory country with a link of substantive business (albeit that in the case of holding companies such business would be easy to establish). If states should consider the possibility of a multilateral treaty (instead of a BIT) for investment protection without the 'mutual prosperity' considerations, it is quite likely that the projects to which ISA is applicable would be limited in their negotiations.

11.15 Summary

48. This Chapter used ICSID case studies to illustrate how investments are channelled to host countries along complex routes. A bilateral focus is no longer appropriate to forming policies to attract investments or to decide on their ISA eligibility. BITs have performed the function of propping up many arbitration proceedings but their objectives of bringing development or prosperity to a state are reduced to window-dressing as a result of the jurisdictional determinations of ISA. The governmental policy-making power over investments in its own territories was transferred to private judicial authority along a continuum (Curtin, 2010); it started with a close association between non-state actors at the outset, and once there was a foot-in-the-door, a wider, looser coordination between state and non-state actors confirmed the trends. The early ICSID cases

SPP, *AAPL*, and *AMT* provided the opportunities to a few arbitrators to steer the direction of ‘inferred’ consents. The inferred consents and the use of SCCs opened up the scope of ICSID to wide interpretations.

49. It has been suggested that the separation of powers, judicial independence, and impartiality is not always evident in some states, and that arbitration provides for independent and impartial judicial decisions, based on technical and legal grounds.⁴⁵ The allegations of lack of separation of powers and impartiality can be levelled at ISA as much as at any national legal systems; BITs themselves are hardly impartial codes providing as they do for TNCs’ interests alone. In fact, the draft Abs-Shawcross convention was described as “a statement of banker’s terms sought to be elevated to the dignity of law” for its lack of expressions of “mutuality” (Snyder, 1963, 1112).⁴⁶ Many disputes are avoidable by a transparent, give-and-take attitude at the time the investments are made with a focus on multiple parties’ needs rather than just the investors’ profits. Even after a dispute has arisen, such attitudes can bring about amicable solutions as for example in the case of the recent renegotiations of E.ON’s long-term gas supply contracts with Gazprom.⁴⁷ A laundry-list of all and sundry investments having ISA potential prevents non-litigious solutions from emerging to prevent or minimise disputes. For some disputes, national judiciary or ICA is appropriate, cost-effective and sufficient.

¹ Article 8 of Law No. 43 of 1974

²Salacuse published a book setting out “seven secrets” for negotiating with governments (2010). Apart from his association with Harvard Law School, he is also an independent director of several mutual funds, chairman of the India and Asia Tigers Funds, and a member of the Council on Foreign Relations. He was thus well placed to judge the path that BITs were taking.

³*International Trust Co. of Liberia* (1998); *Banro American Resources Inc* (1998); *Astaldi S.p.A.* (1999); *World Duty Free Co. Ltd.* (2000); *Ridgepointe Overseas Development Ltd.* (2000); and *Waste Management Inc.* (2000).

⁴*Fireman's Fund Corp.* (2002); *Aguas del Tunari* (2002); two cases filed by *Camuzzi International SA* (2003); *ADC* (2003); *Plama Bulgaria* (2003); *Cemex Asia* (2004); *Alstom* (2004); *ABCI Investments Ltd* (2004); *TSA Spectrum* (2005); and *African Holding Co. of America Inc.* (2005).

⁵Paragraph 332 of the decision on jurisdiction 21 October 2005.

⁶Of these, 385 had been signed before 1980. See Table 4.1.

⁷*Cementownia "Nowa Huta" S.A.* (2006); *Europe Cement Investment and Trade SA* (2007); *Alpali Elektrik BV* (2008); *KT Asia Investment Group BV* (2009); and *Border Timbers* (2010).

⁸*Rail World LLC* (2006); *Shell Brands International AG and Shell Nicaragua SA* (2006); *Eni Dación B.V.* (2007); *Bureau Veritas BV* (2007); *Ron Fuchs* (2007); *Shell Nigeria* (2007); *AES Summit Generation* (2007); *ConocoPhillips Petrozuata B.V.* (2007); *Itera International Energy LLC* (2008); *CEMEX* (2008); *Pac Rim Cayman LLC* (2009); *Swisslion* (2009); *Tidewater Investment Srl* (2010); *Pan American Energy LLC* (2010); and *Universal Compression International Holdings SLU* (2010).

⁹*Hortensia M. Shortt* (2011); *Gambrinus Corp.* (2011); *Accession Mezzanine Capital LP* (2012); *Société Industrielle*

des Boissons de Guinée (2012); *Venoklim Holding BV* (2012); *Sudapet* (2012); and *PNG Sustainable Development Program Ltd.* (2013).

¹⁰*Club Hotel* (2011); *The Williams Companies, International Holdings B.V.*, (2011); *Koch Minerals Sarl* (2011); *Ol European Group BV* (2011); *Tenaris SA* (2011); *Indorama International Finance Ltd.* (2011); *Tethyan Copper* (2012); *Emmis International Holding BV* (2012); *Slovak Gas Holding BV* (2012); *Ampal American* (2012); *Novera* (2012); *Ternium SA* (2012); *Rusora* (2012); *Blue Bank International & Trust (Barbados) Ltd.* (2012); *Fábrica de Vidrios Los Andes, C.A.* (2012); *Tenaris SA* (2012); *Transban Investments Corp* (2012); *Lao Holding* (2012); *Orascom TMT Investments S.à r.l.* (2012); *MNSS B.V. and Recupero Credito Acciaio N.V.* (2012); *LSF-KEB Holdings SCA* (2012); *Cervin Investissements S.A.*(2013); *Valores Mundiales, S.L.*(2013); and *Spentex Netherlands BV* (2013).

¹¹*AHS Niger and Menzies Middle East and Africa S.A.* (2011); *Diamond Fields* (2011); *Lundin Tunisia BV* (2012); *Guardian Fiduciary Trust* (2012); *Tullow Uganda* (2012); *Lundin Tunisia BV* (2013); and *Tullow Uganda* (2013).

¹²“Belgium – tax haven? Belgium, Tax candy store of Europe” from the website of tax lawyers. Retrieved from www.bespaarbelastingen.be.

¹³“*El Farargy v El Farargy & Ors* [2008] EWCA Civ 884” *Family Law Week* 2008. Retrieved from www.familylawweek.co.uk.

¹⁴ Retrieved from 20 November 1998 Infomine’s website at www.infomine.com.

¹⁵ Retrieved from <http://www.tulloil.com/>

¹⁶“UK’s top companies condemned for prolific use of tax havens”, *The Guardian, UK*, 12 May 2013.

¹⁷“Why government accepted less pay in Tullow case” *Daily Monitor* 28 June 2015. Retrieved from www.monitor.co.ug.

¹⁸ As the notes were issued by Venezuelan government they were assumed to involve a public interest and not merely commercial transactions.

¹⁹ An ad hoc tribunal concurred with the majority award. Most of the original award on the ICSID website is redacted.

²⁰ Para 335 of the Award.

²¹ Para 335 of the Award.

²² Paragraph 361.

²³“Argentina agrees to pay \$1.35 billion to Italian bondholders” Bloomberg 2 February 2002, retrieved from www.bloomberg.com.

²⁴ Madeira is a tax haven. Blankson, 2005, p.150.

²⁵ Scope and Definition, in UNCTAD Series on Issues in International Investment Agreements (1999), p.39

²⁶ It also relied on an UNCITRAL ISA *Alps Finance v Slovak Republic* which the tribunal believed did not help its case as the wording in the BIT expressly referred to both “seat” and “real economic activities”, thus implying that they were different criteria. <http://www.italaw.com/cases/74>.

²⁷ Paragraph 150 of the Award.

²⁸ Paragraph 153 of the Award.

²⁹ Paragraphs 199-200 of the Award.

³⁰ Paragraph 203 of the Award.

³¹ UNCTAD Stock database for 2007. WIR 2008.

³²“Arbitration court backs government in power deal with US firm” *Cambodia Daily* 29 April 2013. Retrieved from www.cambodiadaily.com.

³³ A holding company was formed - jointly owned by Enron and a Delaware business called Marlin Water Trust I which used as collateral the stock lent by Enron to another wholly owned trust. Enron then created a subsidiary from which it borrowed cash: Bristol Water Trust (which would also manage Azurix, which was performing poorly). Bristol's future debt payments were pledged from Enron to Marlin who raised finance from investors and issued debt. Enron swapped Azurix for 33% of Atlantic Water Trust, through Bristol and Marlin I bought 67% of the same, using the money it raised through the investors. The cash Enron borrowed from Bristol was raised by Marlin.

³⁴ Paragraph 4.72 of the determination on jurisdiction.

³⁵ Pac Rim was acquired by Canadian-Australian corporation called Oceanagold and it continued this claim. The tribunal dismissed it in its award in October 2016.

³⁶ Paragraph 232.

³⁷ Arthur Andersen, Coopers and Lybrand, Deloitte Haskins and Sells, Ernst and Whinney, Price Waterhouse, Peat Marwick Mitchell, Arthur Young and Touche Ross. Arthur Young & Co (later merged with Ernst & Whinney to become Ernst and Young). Touche Ross merged with Deloitte Haskins and Sells to become Deloitte & Touche. Price Waterhouse and Coopers and Lybrand merged to become PricewaterhouseCoopers

³⁸<http://fortune.com/global500/accnture-374/>

³⁹“How it works for project companies,”, *Independent Energy*, 24.9 (Nov 1994), 54.

⁴⁰*Ibid.*

⁴¹ <https://www.theguardian.com/business/2002/mar/24/enron.theobserver>

⁴² <http://news.bbc.co.uk/2/hi/business/1530163.stm>

⁴³ <http://www.worldbank.org/en/news/press-release/2013/03/27/world-bank-group-appoints-keiko-honda-head-miga>

⁴⁴ “Declaring that no Contracting State shall by the mere fact of its ratification, acceptance or approval of this Convention and without its consent be deemed to be under any obligation to submit any particular dispute to

conciliation or arbitration”

⁴⁵ “ISDS clause – a gateway to future trade deals” May 2014, *Business Europe* Retrieved from www.euractiv.com

⁴⁶ It was still considered to be less one-sided than the ICC draft, but not as balanced as the OECD draft.

⁴⁷ “Agreement reached with Gazprom on price adjustments to long-term gas supply contracts.” *E.ON. Press Release* of 29 March 2016 retrieved from www.eon.com.

12. Determination of ICSID-eligible investors

Diminishing role of states' consent

12.1 Introduction

1. TNCs' frequent use of SCCs and the jurisdictional determinations in ISA have led to an overall increase in ICSID's applicability. As the scope of ICSID widened, the importance of states' actual (not inferred) consent has diminished. Arbitrators' decisions carry persuasive value, particularly the higher up they are in their status in the arbitration community. This Chapter highlights the difficulties of drawing any basic, guiding norms from the fragmented developments in the case law. Clearly, BITs would have been more carefully drafted if developing countries believed that they would lead to ISA without independent arbitration agreements. At the least, BITs would have clarified their relationship with the Convention. While arbitrators don't take a uniform, homogenous view of SCCs, they usually accept SCCs and SPEs as being legitimate.

2. While states' BIT obligations are construed strictly using *pacta sunt servanda*, tribunals take a fairly flexible approach to jurisdiction. The tribunal in *Banro American Resources Inc.* (1998) acknowledged the flexibility and the fact that the ICSID tribunals do not accept that their competence is limited by formalities (paragraph 11 of the award). Most states may lose their jurisdictional challenges, but the flexibility introduces unnecessary uncertainty over the scope of arbitration, and of BITs. It gives the appearance of investment law being manipulated to suit investors. SCCs accentuate this perception by enabling the same corporate structures to be used for everything from outright fraud to treaty shopping.

3. This Chapter discusses briefly the consensual scheme of Article 25 of the Convention before illustrating how the Convention and BITs (or hosts' investment laws) have become distinct sources of potential consent. It examines whether ICSID access is given to formal or a beneficial owner of an investment, or to both. Each example below shows the tangle of facts that need to be unravelled given how investments are routed through SCCs; The economic reality of investments matters not just to TNCs, but to the host states, and to their developmental objectives.

12.2 The basic scheme of consent under the Convention

4. The Convention does not include a state's consent to ISA. There has to be a written agreement between a state and an investor to submit disputes to arbitration. This is clear from the model clause suggested by ICSID.¹ If an agreement with an investor includes such a clause, it would not matter that the investor was tax-privileged, or engaged in net wealth-extraction from the host state. Mutual consent would form the foundation of their arbitration and the parties to the arbitration would be clearly identified. The first twenty odd disputes under the Convention arose out of express arbitration agreements between investors and host states (Fig. 11.1). However, the uptake of ICSID facilities was not great. The Convention was not easy to promote in the 1960s and 1970s even though 153 states are now its signatories. The expansion of the Convention's scope was almost by stealth, being founded on inferences of consent.

5. The Preamble of the Convention recognises the role of private 'international' investment in promoting economic development. It clarifies that despite the ratification of the Convention, no state shall "without *its consent* be deemed to be under any obligation to submit any *particular* dispute to conciliation or arbitration." (Emphasis added). The word "particular" (reflecting an agreement which would identify it, a singular dispute) would not indicate to a state that unlimited number of disputes could be opened to ICSID by merely accepting the Convention. Pursuant to the Preamble, the Law in *SPP* should have fallen short of a commitment to submit a particular dispute to arbitration.

6. A mutual consent by the parties to a dispute to submit it to ICSID arbitration leads to a binding, irreversible agreement. The investors for whom the availability of ICSID is a deal-breaker would seek such an express agreement; it would increase certainty for them and the host states. Only in 78 (16.85%) ICSID cases from 1964-2013 was there a specific ICSID arbitration agreement between the state and the investor.

7. The relatively limited Article 25 is expanded, in practice, by allowing disputes in respect of which no written arbitration agreement existed save as one *derived* from BITs or from investment laws. The decisions in *AAPL* and *SPP* cases were discussed in Chapter 11. BITs and investment laws are documents issued by the host states, whose main objective is to set out the substantive obligations in respect of investments (e.g. fair and equitable treatment). They do not usually spell out that they contain an arbitration offer which can be accepted by giving a notice of arbitration by any of the investors who have made an eligible investment. Such a massive potential transfer of national courts' jurisdiction to private authority over an unlimited number and types of investments would have been accompanied by some contemporaneous discussions. This would particularly be

the case given how slow the ICSID uptake was in the first place.

8. BITs refer to investors and investments in broad terms. With multiple potential investment routes through a network of SCCs, a derived consent can lead to several potential claimants for the same investment. When interpreting treaties, their plain meaning is given effect to, unless it would lead to an absurd result. Article 32 of the VCLT allows for supplementary means of interpretation in such a case. ISA arbitrators usually choose the interpretation that keeps all of investors' options open right to the time of an arbitration notice, thus sacrificing reciprocity and certainty.

9. Article 25(1) uses the words "which *the parties to the dispute consent in writing* to submit to...". The emphasised words show that the consent is not by the state signatories to a BIT; the parties are the host and the investor. Investment laws are unilateral documents by their nature that may invite an investor to make an offer of arbitration. The early twenty odd ICSID cases show that perhaps most investors' reading of the ICSID scheme was along the above lines as they relied on express arbitration agreements.

10. After the *SPP* and *AAPL* decisions, the BIT route started to grow in breadth and depth. The small window of time in which the expansive interpretation could have been checked was closed. ISA is path-dependent unless all existing BITs are terminated or modified, or replaced by a multilateral instrument. The small pool of early arbitrators gave ISA an overall direction that states had not expressly chosen.

11. It is generally acknowledged that the Convention did not define eligible investments because its drafters could not agree on an acceptable definition. States and investors could have decided on a case by case basis what investments needed the protection of ISA. The consent to ISA is instead derived from documents to which much attention was not given at the drafting stage as instruments of jurisdiction. Instead of narrowing choices between BITs and the Convention, BITs are held to expand the eligibility of investments. This is particularly obvious in the case where an investment is made through a locally incorporated company in a host state. The Convention enables such investors to start an arbitration only if certain conditions are met. BITs do not follow this limitation and the Convention is circumvented using BITs to enable such companies to commence ICSID arbitration. When Lauterpacht first suggested a direct remedy for an investor against the state, the treaty and the investor-state agreement *together* founded the jurisdiction. Some issues with the Convention's and BITs' fitness for purpose arise out of the manipulation of BITs, investment laws and of SPEs and SCCs.

12.3 Direct shareholding as the basis of jurisdiction – Use of SCCs

12. Article 25(2)(b) of the Convention defines a “national” to mean any juridical person which had the nationality of an ICSID state *other than* the host state, and any juridical person which had the nationality of the host state, “*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).

13. In keeping with their developmental objectives, host countries tend to insist that a foreign investment be made through a local vehicle. Art.25(2)(b) gives such a vehicle an ICSID-option against, what is technically, its home state. For other purposes (e.g. taxation), the company remains a local entity. ICSID clearly purports to exclude host states’ investors from its use in all other circumstances. Such a tidy guidance cannot always be found in BITs. Even if an investor is not eligible (being a locally incorporated entity) under the Convention, the same entity can have ICSID access under a BIT. Once a consent is derived, the host state or its judiciary have no control on the dispute. Investors’ waiver of diplomatic protection is not much of a sacrifice. The developing countries would not have had any incentive to offer ISA to their own investors even under BITs.

14. For the purpose of foreign control under Article 25(2)(b), direct shareholding is assumed to confer voting rights, although it is not the sole criterion of control: *Autopista Concesionada de Venezuela, C.A.*(2000). Tribunals tend not to pierce the corporate veil so that formal ownership of an entity in an appropriate SCC is a simple way of founding jurisdiction. A dual citizen cannot make an ICSID claim against its own state,² but an enterprise owned by a dual citizen can do so (*H&H Enterprises Investments Inc.*, 2009). Even if a claimant is controlled by a national from a non-ICSID state, the formal ownership of a corporate entity can support ICSID jurisdiction: (*Swisslion Doo Skopje*, 2009).

15. Host states’ acquiescence in the use of SPEs is inferred from their (a) networks of DTTs and BITs with SCCs that are mainly known as tax-havens, and (b) acceptance of project-documentation with SPEs set up in such jurisdictions. Some of these investments may be offered on a ‘take it or leave it basis’. Some SPEs are introduced after an investment contract is signed as in the *Gold Reserve* (2009) case. Ever since a corporation was allowed to hold shares of another corporate entity, it made the corporate personality versatile, and SCCs are force-multipliers for such flexibility.

16. The claimant’s nationality is determined by reference to the law of the ‘home’ state, and not international law (Schreuer, 2001). In *AES Corporation* (2002) the claimant (headquartered in Virginia) submitted its Delaware incorporation certificate as a proof of nationality. Argentina was

not allowed to seek proof of actual control. It is easy to prove incorporation in an SCC. The host states may challenge the use of shell entities. Two examples are considered below:

a) *ADC Affiliate Limited* (2003): The Cypriot claimants were SPEs controlled by a Canadian (non-ICSID) investor. Hungary argued that they did not have a genuine connection with Cyprus.³ Hungary knew that Cypriot entities would be used in the airport project; management fees were payable to them. It contended that there was no fresh investment by the affiliates who also bore no risk. The Hungary-Cyprus BIT included in its ‘investments’, any approved re-investments and all income derived therefrom; management fees were, therefore, held to be a protected investment. The claimants were awarded \$83.8 million including costs of \$7.6 million; the investment in Hungary was \$16.765 million. Cyprus was used for its low-tax regime,⁴ and an extensive network of DTTs. ICSID jurisdiction was legitimised for a classic use of SPEs in a tax-haven. Hungary’s decision to accept investments through Cyprus (assuming it had a choice in dictating the investors’ corporate structure) led to a presumption that they also meant to accept the Cypriot nationality for the purpose of ICSID. The BIT included options of ICC Stockholm, ICC Paris or ICSID arbitration: it appears designed to be an invitation to treat. The airport project would have involved extensive documentation in which investors could have chosen express ICSID arbitration clause.

b) *Gold Reserve Inc.* (2009): The claimant incorporated a Canadian company for its tax advantages. Venezuela argued that the Canadian claimant was a shell controlled from the US. The absence of a ‘genuine link or a management’ test in the Canada-Venezuela BIT was used to uphold jurisdiction for the \$700 million award. Some financing was sourced from Canada and the Canadian government had intervened in the dispute.

12.4 Changing a corporation’s home state

17. Seats of corporations do not remain fixed. They can migrate, merge, mutate etc. Some examples are discussed below that illustrate such use of SCCs. Changes by assignment and succession are dealt with in a separate section (see Chapter 13).

18. *ABCI Investments Limited* (2004) arose out of an investment in a privatised Tunisian bank made through a Cayman Islands company by the same name. Its seat was then ‘transferred’ to Curacao in May 2003, eleven months before the registration of the ICSID arbitration, which itself was commenced twenty years after the original investment was approved. Jurisdiction was upheld under the Netherlands-Tunisia BIT. The origin of capital was unclear. The majority relied on the host’s approval of the investment. Arbitrator Stern’s dissenting opinion was that the consent in the approval given 20 years before was a bit far-fetched. The majority accepted both the migration of the seat and the irrelevance of the origin of the invested funds.

19. Corporations can change by M&A or simply by ‘absorbing’ another entity. Ecuador lost its jurisdictional objections to the Delaware incorporated Noble’s standing to bring a claim in *Noble Energy Inc.* (2005). This dispute settled allegedly for \$70 million after the determination of jurisdiction. The tribunal believed that, with two intermediate layers between the US entity Noble and the local corporation MachalaPower, no cut-off point (a possibility of which was flagged by the *Enron* tribunal, 2001) was reached. MachalaPower was wholly-owned by a Cayman Islands company, Noble Entergy International Ltd which, in turn, was owned by Delaware-incorporated Samedan of North Africa Inc. Under Delaware rules, Noble had absorbed Samedan and assumed all its rights and obligations. Ecuador was not informed of this merger and the claimant continued to use the Samedan letterhead in the project correspondence. Ecuadorian approval was not deemed necessary; the parent company having absorbed the subsidiary, no real change in the investor had taken place.

20. Frequently, corporations change their ownership structures by inserting another company or two in the chain for reasons of finance, tax or other advantages, as assumed by the tribunal in *Cervin Investissements S.A.* (2013). This case was commenced under the Swiss-Costa Rica BIT by the ultimate owners of the claimant, the Mexican Zeta group. Costa Rica argued that the transfer of the Dutch intermediaries to Swiss ownership involved treaty shopping. The tribunal upheld jurisdiction even though the dispute was foreseeable at the time of the restructuring; there was no evidence of bad faith. Costa Rica had renewed the claimants’ concessions *after* the restructuring. Host states’ actions were deemed to extend its acquiescence to ICSID jurisdiction. Whether the intermediary was a Dutch or a Swiss entity, the controlling investor remained Mexican.

21. If a claim is sold, the jurisdiction outcome can change. In *Vannessa Ventures Ltd.* (2004), the Canadian claimant Vannessa claimed \$1 billion for its shares in PDV, a copper and gold mining company in Venezuela, that it had bought for a nominal price of \$50. Canadian Placer Dome (PDI) had, after pre-qualification, secured a bid for the mine, and incorporated Placer B-V Limited in Barbados to channel its investment. PDI and a Venezuelan SOE (CVG), established a joint venture. With falling gold prices, PDI and Venezuela agreed to suspend the project. Hours before the expiry of the agreed period of suspension, PDI informed CVG that it had transferred its interest to Vannessa. Placer B-V and Vannessa agreed to share the proceeds of the arbitration. Vannessa had no experience of mining, no operating revenues or cash-flow, and it had made no preparations to resume mining. CVG had not consented to the transfer. The majority upheld jurisdiction on the basis that Vannessa was *prima facie* an investor under the BIT; Arbitrator Stern dissented on the basis that there was no *bona fide* investment. The majority tribunal believed that good faith did not need to be proved at the jurisdiction stage. Venezuela won on the merits. The tribunal believed that

the cost of \$20 million was regrettable.

22. An award of \$125 million in July 2008 in favour of Rumeli and Telsim was confirmed, on appeal, by the ad hoc committee in *Rumeli Telekom A.S.* (2005). The Kazakh government considered the claimants, shell companies, to be the investment vehicles of the Uzan family. There were allegations of fraud against the Uzans. Turkey's state agency TSDIF took over the claimant companies. The claimants might not have been successful had they not been under TSDIF's management. In *Libananco* (2006), another case involving the Uzans, bearer shares were not sufficient to establish eligibility as an investor. *Saba Fakes* (2007) was another case relating to Telsim that arose out of a banking fraud. The claimant's acquisition of shares in Telsim seemed to coincide with the dates for freezing the Uzans' assets by the US courts (*Rumeli Telekom*, 2005). The tribunal upheld jurisdiction to conclude later that the claimants had not made a genuine investment in Telsim having paid only \$3,800 for the shares that the claimant later valued at \$19 billion for the arbitration. The Uzans' cases show the use of a flexible test for jurisdiction.

12.5 A locally incorporated company under Article 25(2)(b)

23. An express agreement to treat a local company as a foreign one because of its control is surprisingly rare; it would be the easiest way to provide for ICSID jurisdiction. Although the Convention appears to require an express agreement, arbitrators tend to derive it from facts such as the approval of an investment with knowledge of the ultimate investor's identity. Given the wording of Article 25(2), an agreement for other purposes should not suffice. The Convention clearly indicated that the agreement was more important than actual or effective foreign control. The World Bank promotion of MIGA was on a similar basis that the hosts' approval would be required for both the investment and the MIGA guarantee (World Bank 1985, p.133). The developing countries might reasonably have believed that Art.25(2)(b) would require an ICSID-specific agreement wherever an investment was made through a locally incorporated entity. Most tribunals treat BITs as stand-alone arbitration offers leading to agreements (when they were not necessarily designed to work as such). Art. 25(2)(b) is largely diluted, and the scope of ICSID cases widened using BIT definitions of investors and investments in respect of locally incorporated companies.

24. A few case studies showing the use of Art. 25(2)(b) are considered below. A distinction is made between BIT and non-BIT cases in which the local company was held to be foreign-controlled. This is because arbitrators use BITs as an additional source of consent: (*Sempra Energy International* (2002); *Gas Natural SDG, S.A.* (2003)).

25. NON-BIT Cases

a) *Holiday Inns* (1972), the first ICSID case, arose from a joint venture to construct hotels in Morocco; the ultimate investors were the US companies, Holiday Inns and Occidental. Holiday Inns set up a Swiss company for tax reasons. Five out of the six claimants were registered in Morocco at the request of the Moroccan government which provided most of the loan to the local subsidiaries. In a fairly cautious decision, the tribunal held that it did not have jurisdiction in respect of the Moroccan subsidiaries. It was argued that the consent to treat the companies as foreign-controlled did not have to be in writing and could be implied.⁵

b) In *Amco Asia* (1981), Indonesia's objection to jurisdiction was dismissed. The reasoning was that (a) it would be illogical to grant the protection to the controlled entity (the locally incorporated PT Amco) and not to the controlling one (Amco Asia), and (b) Indonesia knew, from the investment application, that the investor would be Amco Asia (Delaware-incorporated), and (c) when Amco Asia assigned its right to a Hong Kong corporation, Indonesia had consented to the transfer. The ultimate investor was a Dutch citizen, Mr Tan, whose interest was allegedly known to Indonesia from the outset. The tribunal held that it could not take into account the legal nationality of the foreign juridical person who controlled a local investor as the control could go up the chain to the second, third, possibly xth degree. This was not in accordance with the Convention which required that the nationality would be satisfied by the incorporation test unless the place of incorporation was in the host state. The arbitrators cautiously veered towards certainty and not economic reality. Two out of the three arbitrators in this case, for whatever reasons, were not appointed to ICSID cases after this decision, and one was nominated in one other case by the claimant. Repeat appointments of these individuals might have led to a different direction of ICSID jurisprudence. Their argument was attractive in its simplicity and for the certainty it promoted.

c) In the *Société Ouest Africaine des Bétons Industriels* (SOABI) (1982) arbitration against Senegal, ICSID nominated Dr Broches, (formerly of the World Bank and a keen promoter of ICSID) as the chairman of the tribunal. The claimant SOABI was incorporated in Senegal but controlled directly by a company incorporated in Panama (at that time, a non-ICSID state), and headquartered in Geneva. The intermediary's shares were held by Belgian nationals (an ICSID state). If only the immediate control of the local corporation mattered for ICSID jurisdiction as in *Amco Asia*, the nationality of the investor was Panamanian (a non-ICSID state). The majority upheld jurisdiction on the basis that they were giving effect to the host state's wishes to ensure that foreign investments were made through local companies. Investors, they observed, could choose the legal form of the investment through intermediaries for their own reasons. The dissenting opinion relied on the *Amco Asia* award. Broches argued that Article 25(2) did not state that foreign control

had to be direct and that the *Amco Asia* tribunal was wrong. Senegal was aware in the negotiations that a Belgian national was representing the investor. The tribunal wrongly associated the reason for requiring an investment to be made through local companies with jurisdiction. The primary reason for attracting FDI was to make a contribution to the local economy by, for example, paying local taxes. It did not necessarily follow that ICSID arbitration was offered for all such entities. Deriving an agreement from the type or degree of control would not have been necessary if the Convention was interpreted to require an express agreement; it only became relevant when tribunals started to look for implied control when express agreements to treat the local companies as foreign-controlled were not available in several cases.

d) In *Liberian Eastern Timber Corporation* (1982), the French investor was required to set up a local company to obtain a concession to harvest of 400,000 acres of timber. In signing an agreement with the French company, Liberia was *deemed* to have agreed to treat the local company as a foreign-controlled entity for ICSID purposes. The agreement, it was held, did not need to spell that out. The tribunal was presided over by the well-known arbitrator Bernardo Cremades.

e) In the non-BIT dispute, *Maritime International Nominees Establishment* (1984), the claimant was a Liechtenstein corporation (i.e. non-ICSID) but its control by a Swiss corporation was sufficient to found ICSID jurisdiction.

26. The *SOABI* case decided in the late 1980s began an expansive phase of ICSID as regards chains of investment vehicles. Instead of stopping at one level as in *Amco Asia*, it opened the possibilities of various levels of investors making claims. Not much distinction was made between a specific agreement providing for ICSID arbitration, and a consent derived from a unilateral statement in a legislation or a BIT. The essential feature of BITs comprised reciprocity. The developing countries must have set some store by *bilateral* relationships. The requirement to set up a local corporation could have been interpreted as states' choice to *limit* the applicable remedies to the local ones, or to ICA, depending on the contract. The early decisions by the well-known arbitrators like Broches acted as juggernauts that pushed any other possible interpretations off the highway for good.

27. BIT cases

a) A local company claimed ICSID jurisdiction in the second BIT case - *AMT* (1993). The investment definition in the BIT with the US was broad, and included "every kind of investment, owned or controlled directly or indirectly" and investments made through subsidiaries of companies "wherever located" (Art. 1(c)). The US negotiators informed the Senate that they had obtained a statement from the DRC that this definition would cover investments made through subsidiaries in

third countries. This is a rare contemporaneous record of a BIT negotiation, even if a unilateral one. It shows that the US preferred to keep its investors' options open to invest through SCCs while retaining the right to intervene diplomatically as the home state. By relying on the consent derived from its BIT, the investor did not need to comply with Article 25(2)(b) to show foreign-control. Instead of using the BIT within the limitations of the Convention, it was used to expand the Convention.

b) In *AIG Capital Partners Inc.* (2001), the tribunal's jurisdiction was challenged on the basis that the local investment was made by a Kazakhstan joint stock company and a Bermudan company called CJSC Tema (the second claimant owned 34%) and the Bermudan entity AIG Silk Road Fund (the Fund) so that the US-Kazakhstan BIT would not apply. The first claimant, Delaware incorporated AIG Capital Partners Inc. (AIG) owned 5% of the Fund's 66% (i.e. 3.3%). This, Kazakhstan argued, was insufficient to consider the investment a US one. The tribunal held, after analysing a complex series of transactions, that AIG owned and indirectly controlled the investment that was routed through a chain of American and Bermudan companies. Jurisdiction was upheld leading to an award in favour of the claimants. The European Bank for Reconstruction and Development had invested in part of the Bermudan investment.

c) In *Pan American Energy LLC* (2003), PAE, the first claimant was incorporated in Delaware. The tribunal concluded that PAE was owned and controlled by two US companies, BP Argentina and BP America which had substantial business activities in the US. Argentina argued that allowing BP Argentina and BP America, the shareholders, a direct remedy would bring about a premature liquidation of the company giving any compensation to the shareholders and not the creditors of the company. The tribunal upheld jurisdiction although it agreed that foreign shareholders, in recovering their investment, might do so to the prejudice of other domestic or foreign shareholders, creditors and employees. The shares were not directly expropriated (also see, Chapter 13). Foreign creditors who invested in the corporation could also bring their own ICSID cases (if they routed their loans through SCCs that had a BIT with the host state), thus leaving the local creditors of the corporation unprotected. The *Pan American* tribunal referred to the US's argument in the non-ICSID case *Methanex v. USA* (1999) that investment treaties should be given a restrictive interpretation, resolving ambiguities in favour of maintaining state sovereignty.⁶ The *Methanex* tribunal instead preferred the ordinary meaning of treaties. In *SGS v. Philippines* (2002), another tribunal believed that any ambiguities should be resolved to favour the investors.

28. Jurisdiction was claimed for investments made through a locally incorporated company in the following cases *inter alia*, *Gemplus SA, SLP SA* (2004), *Noble Energy Inc.* (2005), *Daimler Financial Services AG* (2005),⁷ *LESI, S.p.A. and Astaldi, S.p.A.* (2005), *Siemens A.G.* (2008),

Convial Callao S.A. and CCI - Compañía de Concesiones de Infraestructura S.A. (2009), and *Tidewater Investment SRL and Tidewater Caribe CA* (2010). There was no express agreement to treat the local companies as foreign-controlled investments. They are cases where jurisdiction involved a skilful use of SCCs. Some of the key pronouncements from these cases are set out below.

a) Consent is the cornerstone of all international treaty commitments. (*Daimler Financial Services AG*, 2005). The tribunal referred to the successful global market for distressed debt in most jurisdictions that allow claims to be sold along with or reserved separately from the underlying assets from which they are derived. The tribunal contended that the severability of a damages claim from the underlying asset was even stronger in the case of ICSID claims; the Convention and many BITs accord standing only to the original investor and not to subsequent would-be purchasers of the underlying investment.⁸

b) In *Siemens A.G.* (2008) the tribunal held that the BIT did not require that there be no interposed companies between the investment and the ultimate owner of the company. If such companies were interposed, they could *each* have a right to arbitrate.

c) In *Tidewater Investment SRL* (2010), the tribunal upheld jurisdiction over the Venezuelan and Barbados companies' claims. Tidewater Caribe, the local company, was originally owned by a US investor through its Cayman Islands subsidiary. In March 2009, all of the shares in Tidewater Caribe were transferred to a Barbados company that Venezuela alleged was a corporation of convenience. The object of the BIT was to promote the economic development of Barbados and Venezuela, but the Barbados entity had no real economic activities in Barbados. The tribunal held that the restructuring was a perfectly legitimate goal so long as it was not done in relation to pre-existing disputes. Even without the restructuring, the tax benefits were already available to the US investor through the Cayman Island entity.

12.6 Local company not a foreign investor under Art 25(2)(b)

29. The possibility of not treating a locally incorporated company as foreign-controlled tends to arise in BIT cases. If jurisdiction is claimed under an investment agreement, it can always be held that the government acquiesced under Article 25(2)(b) (by its silence, if nothing more). A few examples of BIT cases are discussed below. Because the consent has to be inferred, questions arise as to whether the control has to be effective or nominal, and what evidence is sufficient to show control. In any case, most BITs include such wide definitions of investments that the Convention's conditions need not be met.

a) In *Caratube International Oil Company LLP* (2008) the claimant CIOC, a Kazakh oil company, was founded by Danish national Fadi Hussein to operate an oil concession. In 2004, Hussein and his distant cousin Hourani, a US citizen, agreed that Hourani would acquire 85% shareholding in CIOC for \$6,500. Kazakhstan argued that problems had started with the performance of the contract before Hourani acquired his shareholding. Dispute was thus foreseeable before CIOC could have become US-controlled. The price paid was nominal and some documents submitted by the claimant were withdrawn from evidence after allegations of forgery. There was no evidence of effective control of the claimant by Hourani although there was evidence of the potential to do so in CIOC's charter and incorporation agreement. The tribunal concluded that there was no control by Hourani as required by Art 25(2)(b), but that the BIT only required ownership *or* control. Jurisdiction was denied because the claimant did not establish that Hourani had made an investment.

b) In a similar case, *Alapli Elektrik BV* (2008), the tribunal (by majority, Stern and Park) denied jurisdiction to a Turkish citizen who had a foreseeable dispute with his own government and then established a Dutch entity. Park held that it was “a truism that investment treaties are country-specific, not intended to constitute treaties with the entire world.” (paragraph 361). This view is opposed to that of the *Aguas del Tunari* tribunal that BITs are mere portals. For Stern, the timing and *bona fides* were the key factors. Layers of Dutch companies were established including in Curaçao. The concession contract was transferred from one project company to another Turkish company which was owned by two Dutch shell companies whose owners were the Turkish sponsors of the project (and shareholders of the first Turkish company). Stern found that the whole transaction was a manipulation of corporate structures, not a real economic operation. Claimant's nominee arbitrator Lalonde dissented. Park found that the Turkish entities were just a conduit but it is difficult to differentiate between sham and acceptable shell SPEs. If there had been an investment in this case and say, it was round-tripping capital from Turkey, Park could have decided the matter differently. He has distinguished elsewhere between a tax haven company (as one collecting capital gains or reinsuring risks) and a base company which serves a legitimate business purpose for foreign operations; the former would lack significant activities in, or contact with the country of corporate residence, whilst the latter would provide services, make sales, or license IP and know-how (Park, 1978). The substantive difference between these is thin. The consequences of using such structures are significant for the host country. In 2010, Heritage Oil and Gas, a British company (registered in Jersey), shifted its ‘domicile’ from the Bahamas to Mauritius to take advantage of the DTT between Uganda and Mauritius, and saved \$400 million⁹ – more than 25% of Uganda's total healthcare budget for 2011 of \$1.4 billion or equal to a quarter of Uganda's total external debt in 2009.¹⁰

c) In *National Gas SAE* (2011), the dispute related to a 1999 concession agreement between the claimant, an Egyptian company, and the Egyptian General Petroleum Corporation (EGPC). X, a UAE company, owned 90% of the shares in the Egyptian company that held the concession agreement. It was wholly owned by Y (UAE), wholly owned by Z, an Egyptian and a Canadian dual national. The tribunal found that the choice of the corporate structure was made in good faith for legitimate fiscal reasons, and that X and Y were UAE-based shell, but not sham entities; again, the precise difference is not explained. Jurisdiction was denied under Art. 25(2). Given that Z was not a party to the arbitration, the tribunal could not derive jurisdiction from the Egypt-Canada BIT using his Canadian nationality. The tribunal refrained from the judging whether Z could have brought such proceedings.

d) In *Société Industrielle des Boissons de Guinée* (2012), Guinea argued that the claimant SIBG was a locally incorporated company that could not start an ICSID arbitration. SIBG alleged that its capital had come from Belgium and France, and that it was 60% foreign-owned and foreign-controlled. No evidence was provided of effective control by foreign partners or of the foreign source of capital. Jurisdiction was denied. However, another tribunal might not have considered either effective control or foreign source of capital relevant (see *The Rompetrol Group NV* 2006).

30. The ICSID *travaux préparatoires* indicate that the drafters found it impracticable to define foreign control. Most definitions would, they thought, be difficult to apply in practice, and could lead to protracted investigations of the ownership of shares, nominees, trusts, voting arrangements, etc. The parties were left with a wide discretion to decide under what circumstances a company could be treated as a national of another Contracting State because of foreign control (Broches, 1972). In a small minority of cases where states produced any *travaux préparatoires* of individual BITs, there is very little evidence of negotiation of this phrase, or of any other terms. Such difficulties of definitions indicate that it is best to make investors and states conclude express arbitration agreements.

12.7 Beneficial or formal ownership?

31. Given the extensive use of SCCs in routing investments, it is difficult to determine what arbitrators promote as the general basis of jurisdiction – beneficial or formal ownership of an investment. One tribunal believed that arbitrators generally prefer to work with economic (rather than purely legal) criteria for investment and investor (*Autopista Concesionada de Venezuela CA* (2000)). But, there is no clear answer in the case-law; partly because of the small variations in the terms of BITs, but mainly because of tribunals' flexible approach. The question is important. One ownership reflects the economic reality, and pragmatically that is the one the host states might wish

to focus on when trying to attract investments or when weighing their costs and benefits. But, the other view might promote certainty in resolving disputes. Even the certainty may be dependent on the criterion of formal ownership being limited to one link or two in the intermediaries making an investment.

12.8 Economic reality versus formal ownership

32. In the following eight decisions (two non-BIT) the tribunals chose to work with economic reality to uphold ICSID jurisdiction: *Alex Genin* (1999), *Waste Management Inc* (2000), *Duke Energy International Peru Investments No. 1 Ltd.* (2003), *Ron Fuchs and Ioannis Kardassopoulos* (2007), *M. Meerapfel Söhne AG* (2007), *Perenco Ecuador Limited* (2008), *Inmaris Perestroika Sailing Maritime Services GmbH* (2008), and *Niko Resources* case (2010). The formal ownership was ignored regardless of the initial choice of the investor to make to make the investment using a separate identity.

a) *Alex Genin* (1999) was a bank licence dispute under the US-Estonia BIT. The claimant's banking licence was cancelled when the requested information about the ultimate owner was not provided to Estonia. A main owner of the claimants was an Isle of Man corporation, Eurocapital Ltd., which would not have been eligible to claim under the US BIT. Somewhat belatedly, during cross-examination in the arbitration proceedings, the claimants alleged that Alex Genin, a US national, was the beneficial owner of Eurocapital's bearer shares. The beneficial ownership allowed him to proceed under the BIT; the claim was ultimately unsuccessful on the merits. The use of the SCC and secrecy did not come against the investor's right to commence the ISA.

b) In *Waste Management Inc.* (2000), Mexico challenged the standing of the claimant under NAFTA. Article 1117 of NAFTA allows claims to be brought on behalf of enterprises owned or controlled directly or indirectly. The tribunal held that the involvement of some US interests, if not the specific financial arrangements, was known to Mexico. The nationality of the intermediate Cayman Islands companies was held irrelevant. The tribunal further stated that where there was a breach of NAFTA Articles 1105 (fair and equitable treatment) or 1110 (expropriation), the state could not argue that it was not aware of the investor's identity or national character.¹¹

c) The ECT is for the benefit of the investors who are either EC nationals or in control of EC nationals. It also applies to non-EC states or regional organisations that have agreed to be bound by the ECT. The use of SCCs can lead to complex questions of jurisdiction in which tribunals may arrive at the right answer but not necessarily on the basis of SCC-using investors' eligibility. *Duke Energy International Peru Investments No. 1 Ltd.* (2003) was a non-BIT case relating to the privatisation of an electricity company, Egenor. Duke Energy, a US investor, acquired Egenor

through a series of transactions made by DEI Holdings US to maximise tax benefits. It incorporated DEI Bermuda and DEI Peru Holdings SRL, channelling its capital contribution of \$200 million via Bermuda. Peru signed tax stabilisation agreement for ten years with DEI Bermuda, but raised a tax assessment relating to the underpayment of tax by Egenor in the years prior to DEI's investment. The tribunal upheld the jurisdiction and made an award in favour of the claimant by majority. The dissenting arbitrator Pedro Nikken believed, consistently with the standard practice in privatisations, that an investor could not reasonably assume that an issue relating to the past taxes was approved by the state if the tax authority had not intervened in the approval, and if the period prescribed for the assessment was still open (paragraph 11, award). The sale and purchase agreement would usually include a clause that the seller assumed responsibility for any hidden tax liabilities. ICSID was used in this case to resolve what should have been part of the parties' negotiations at the time of making the investment.

d) In *Ron Fuchs and Ioannis Kardassopoulos (2007)*, the investment had been routed through a Panamanian trust. The tribunal pronounced, on the claimants' evidence, that the Georgians liked the idea of saying that an American company was investing in Georgia in order to encourage other Americans to invest, and that Georgia was aware all along that the beneficial investors were Greek and Israeli nationals. They had set up intermediate entities in the Channel Islands and the Dutch Antilles for tax purposes. When ICSID tribunals accept jurisdiction over such investments, they also legitimise the use of the tax haven SCCs.

e) In *M. Meerapfel Söhne AG (2007)* the government of the Central African Republic (CAR) did not have a direct relationship with the foreign investor who started the non-BIT dispute. The tribunal upheld jurisdiction. The award indicates that the Swiss government had refused to intervene diplomatically on behalf of the investor claiming that the dispute was between a local CAR company and the CAR government.

f) In *Perenco Ecuador Limited (2008)* the French beneficiaries of an intestate succession held an Ecuadorian investment *through* various Bahamian entities. The estate was yet to be distributed (giving formal title) at the time the claim was made. The dispute related to Ecuador's windfall oil tax. The claimant alleged that it was controlled by Mr. Perrodo's heirs, all French nationals. At the time of his death, Mr Perrodo had lived outside France for tax purposes, and the heirs were recorded as French nationals living in Britain. Disregarding the lack of formal title, jurisdiction was upheld for a Bahamian company to make the claim under a French-Ecuador BIT. Ecuador relied on the negotiating history of the BIT to show that the phrase "directly or indirectly" was deleted from the BIT's definition of "companies". The effect of this deletion was left to be decided with the merits.

g) An informal approach was taken to the jurisdiction issue in *Inmaris Perestroika Sailing Maritime Services GmbH* (2008). The claimants were various Inmaris companies. The dispute was about a bareboat charter, and financing for the reconstruction and operation of a vessel. The tribunal decided to consider the investments as components of one integrated investment, thus avoiding the examination of each transaction against the BIT definitions and the Convention. Ukraine unsuccessfully claimed that this allowed the claimants to create a new investment through sub-delegation when the claimants had chosen not to enter into a contract through a single entity.

h) Other tribunals have taken a similar approach of looking at an investment in its entirety. For example, in a non-BIT case, *Niko Resources* case (2010), the claimant was a Barbados entity, which migrated its headquarters to Cyprus. The tribunal looked at the investment as a coherent unit although it was implemented through a number of projects. It was held that the structure of the investments was within the power of the investor so long as no law was violated. The tribunal accepted that “distinct corporate identities serve a legitimate function” in cross-border investments. (paragraph 178). The respondent state knew that the Barbados entity was a subsidiary of the Canadian company Niko. The migration of this company to Cyprus did not change the fact that the claimant was a Barbados entity. It was not held to be a Canadian investor.¹²

12.9 Formal ownership – when not sufficient?

33. Sometimes host states do need an approval, as for example, in *Rafat Ali Rizvi* (2011). In that case the claimant’s investment in Indonesian banks was made through a company incorporated in the Bahamas. The Britain-Indonesia BIT required that investments were made in accordance with a specific Indonesia Law. Given that the IMF discouraged most developing countries from using licensing or approval regulations, such an issue does not arise frequently in ISA. Such laws could have provided the certainty that BITs and the Convention lack, even if TNCs lost the manoeuvrability for tax or other purposes.

34. Formal ownership has been adequate for jurisdiction in several ISA cases. States tend to overlook the manner of making the investment through SCCs or even tax havens. For example, in *Scimitar Exploration Ltd.* (1992), Bangladesh signed a production-sharing agreement with the Dutch-incorporated Scimitar that was variously thought to be of Pakistani, Lebanese or Canadian origin. A company called Scimitar Exploration SA is also registered in Panama.

35. A tribunal presided over by Weil denied jurisdiction to the claimant in *Banro American Resources Inc* (1998). This case (where a Canadian investment was unable to access ICSID) needs to be considered alongside *Plama Consortium Ltd* (2003) in which a mailbox company in the right SCC would have been able to access ICSID jurisdiction in less than salubrious circumstances but

for the tribunal's finding of deliberate concealment amounting to fraud.

a) In *Plama*, the tribunal upheld jurisdiction under Article 26 of ECT where the claimant PCL was admittedly a mailbox company. Bulgaria tried to deny PCL the benefit of ECT on the grounds that (a) Mr. O'Neill, a Canadian national, and a Bahamian company, Dolsamex International S.A. ("Dolsamex"), held PCL's bearer shares, (b) unknown non-residents of Cyprus held PCL's 1000 shares indirectly, (c) a non-ECT mailbox company held 4000 PCL shares, and (d) until after Bulgaria raised its objection under Article 17(1), PCL's directors were either mere nominees or non-ECT nationals, making it uncertain whether an ECT national was in control during the time period relevant to its claims. The claimant argued that the burden of showing that Article 17 applied was on Bulgaria (albeit that the facts proving their entitlement to make a claim would have been within the claimant's power). PCL was allegedly owned and controlled by a Mr Vautrin, a national of France (an ECT signatory). The claimant offered to produce bearer shares in an intermediary company in the BVI. Various intermediaries existed in Cyprus, the Bahamas, the BVI, Seychelles, Switzerland, and Norway.

b) Vautrin had acted, not on his own behalf, but as a representative of a Swiss entity Andrew & Cie. A Swiss litigation was pending over PCL's ownership. The tribunal rejected Bulgaria's objection. Its reasoning was that Article 17 could not be used to deny benefit with a retrospective effect; they accepted that Vautrin's role was largely unsupported by contemporaneous documents, and materially inconsistent with others. Bulgaria had not, and could not have, introduced cogent evidence as to who was in charge of PCL if not Vautrin. However, then the tribunal held that the ECT could not apply to investments that were made contrary to law and the principle of good faith. The claimant's conduct was found to be deliberate concealment amounting to fraud.

36. A German investment in a Philippines infrastructure (airport) failed in its jurisdictional claims in *Fraport AG* (2003). The claimant Fraport's formal ownership was within the permitted limit for foreigners, and no third party SCC was involved. But, Fraport had entered into confidential shareholders agreements to obtain control over the investment (e.g. \$400 million worth loans made to the project companies). This was in circumvention of the host's Anti-Dummy Law (ADL). The claimant argued that the Philippines authorities knew the details of their shareholding structure and had never challenged it. The investment was fully disclosed to the Philippines. The tribunal held, (with Cremades dissenting strongly), that there was no investment in accordance with the law and therefore, no jurisdiction *ratione materiae*. The ad hoc committee annulled the award for other reasons. In 2011, Fraport brought another case against Philippines, and again, lost on jurisdiction. Pointing out the inconsistent ways ISA creates law, Cremades reminded that if *Tokios* was within jurisdiction, Fraport's investment should be protected. The airport was nearly complete when the

government had claimed that the contract was invalid.

37. Similar questions arose in *Inceysa Vallisoletana S.L.* (2003) where the jurisdiction was challenged by El Salvador on grounds of fraud and misrepresentation by the claimant in the bidding process that evaluated the bidders' experience, expertise, and financial standing. Although the claimant was supposed to be Spanish, companies in Panama and the Dominican Republic were involved in the investment. The tribunal held that the claimant's investment was not made in good faith so that it did not have jurisdiction.

38. The majority declined jurisdiction in *TSA Spectrum de Argentina, S.A.* (2005). The award was made after the global financial crisis. The tribunal was willing to pierce the complex corporate veil to find that the Dutch company that had invested in the Argentine newly privatised radio spectrum, was owned and controlled by a German-Argentine national. Argentina argued that the company was owned ultimately, by the parent of the Dutch entities, a French company called Thales. This was not a case like *Tokios* with round-tripping capital. The majority held that the claimant could not take advantage of the BIT between Argentina and the Netherlands as it did not satisfy the requirements of Art. 25(2)(b). Other ICSID tribunals have not been consistent on this issue.¹³ The claimant argued that it only needed to show that it was controlled, directly or indirectly, by a national of the Netherlands, regardless of where it was located; this control was shown by over 49% voting power. The majority view can be contrasted with that of the majority in the *Tokios* case against Ukraine and the *Rompetrol* case against Romania (see Chapter 13).

39. It is usually difficult to determine the ultimate or beneficial investors. SCCs add to the difficulties. In *Brandes Investment Partners LP* (2008) the claimant was a US registered investment adviser who controlled a large number of American Depository Receipts and shares of a company in Venezuela, CANTV. It had acquired these on behalf of its undisclosed clients. The claimant's argument was that it was not necessary to be the economic or beneficial owner of the shares in question so long as it had control over them. Venezuela argued that the claimant was then an agent rather than an owner of the investment and, that it could not commence the arbitration as an investor. The tribunal declined jurisdiction but on the basis that Venezuelan Investment Law did not contain a consent for an ICSID arbitration. Had there been a BIT involved, the tribunal may well have come to a different decision on the investors' eligibility.

40. The difficulty of establishing the ultimate investor was also demonstrated in *Empresa Eléctrica del Ecuador Inc. (EMELEC)* (2005). The tribunal denied jurisdiction despite the formal appearance of the investor's American nationality. The ultimate owner might or might not have been Mr Aspiazu, an Ecuadorian national. He had created at least three Bahamian trusts, and had

been associated with a failed bank in 1999 with debts to the tune of \$893 million. Although the US Secretary of State raised the matter with the Ecuadorian government, the tribunal was not convinced on the evidence produced that the control was transferred to a US national to file the arbitration on behalf of EMELEC.

41. Another claim that failed for want of adequate proof of a formal title of an investor was *Libananco* (2006). Libananco was alleged to be the alter ego of Turkish nationals, the Uzans. The Uzan family's shares in the investment in Turkey were transferred to Libanco, the claimant; the possession of bearer share certificates was the evidence offered for the transfer. The tribunal held that there was no proof that the Instrument of Transfer was signed at any time before 2007, or that Libananco was licensed as an international business company. In *Cementownia "Nova Huta" SA* (2006) jurisdiction was reportedly denied where the investment was owned by the Uzan family in similar circumstances to the *Libananco* but the award is not public.¹⁴ The Uzans were also involved in *Europe Cement Investment and Trade SA* (2007) in which the tribunal condemned the fraud and abuse of process; the claimants produced backdated documents to prove a share transfer. Only one ICSID case succeeded which had had the Uzans' involvement (*Rumeli*).

42. Sometimes the issues of jurisdiction *ratione personae and ratione materiae* are closely bound; *ratione temporis* can be added to the mix. When restructurings are done to access ICSID by moving the seat of the investment, the current consensus appears to be that jurisdiction will be determined on the basis of the timing of the restructuring. A finding of abuse of treaty requires proof that a foreseeable dispute came before the restructuring. The timing is objectionable rather than the use of SPEs and SCCs in the restructurings.

43. In *Mobil Corporation* (2007) the claimants' corporate restructuring was for the main, if not the sole, purpose of gaining access to ICSID through the Dutch-Venezuela BIT. The investment vehicle was owned, in both instances, through Bahamian vehicles, to maximise the tax advantages to Mobil, but Mobil needed the Dutch company in the chain for the BIT-access. The restructuring was sufficient to uphold jurisdiction for future disputes; pre-existing disputes were not covered (also see the *Phoenix* case (2006)). The tribunal did not consider whether Dutch control was, in fact, exercised. What Venezuela called corporate abuse was legitimate corporate planning for the claimants. There was no contractual obligation for Venezuela to approve the restructuring. The tribunal observed that neither the BIT nor the international law expressly demanded that the capital invested be foreign.

44. The above case or *Duke Energy* (2003) show how incoming FDI may not be related initially with a BIT but may be restructured later to take advantage of one. They support the argument that

when investments are commonly channelled using SCCs, the relevance of a home state is diminished. In a recent non-ICSID arbitration under the Australia-Hong Kong BIT, the claim by Philip Morris Asia Limited was held to be outside the tribunal's jurisdiction; the restructuring was carried out for the dominant purpose of obtaining a BIT protection for the claim. However, there is flexibility over the timing issue as well, as seen in the case described next.

45. In a 2007 case, ConocoPhillips had restructured its investments to take advantage of the Dutch-Venezuela BIT. The Claimant entities were Dutch CPZ, CPH, CGP, and Delaware's ConocoPhillips. The Dutch entities were inserted in the chain of investors in Venezuelan Petrozuata Association. Venezuela argued that the claimants were corporations of convenience created in anticipation of litigation.

a) In 2006, Venezuela's new extraction tax law was approved. The claim for the loss of future tax credits was made under the Dutch BIT through the Dutch entities CPZ, CPH and CGP. The tribunal at the time – it has since undergone a complete change – noted that no claim was *made* by the time of restructuring; the claimants' witness admitted that the only purpose of the restructuring was to gain access to ICSID arbitration. After the restructuring, the claimants made a further investment of \$434 million (out of a total investment of \$5.3 billion) through the Dutch entities. The majority tribunal held that there was no abuse of the treaty. ConocoPhillips made claims in the region of \$30 billion (as well as having won two other ICC awards in its favour). The additional investment was, therefore, a small price to pay to gain access to ICSID.

b) One arbitrator Georges Abi-Saab resigned after giving a dissenting opinion on jurisdiction. The president of the original tribunal resigned a year later. One arbitrator was challenged as an arbitrator. This expensive ISA is still ongoing. It is indicative of how easy it is to claim ISA jurisdiction even as a dispute is starting to become foreseeable; the ultimate investor here was all along American, ConocoPhillips. It could simply move its pawns from one SCC to another SCC when it suited its purposes. Of course, the indirect route could have been used right from the outset.

46. Unlike the *Abaclat* decision, the tribunal in *Poštová banka, A.S. and Istrokapital SE* (2013) - took a narrow view of jurisdiction under the Greek BITs with Cyprus and the Czech Republic. The claimants found that the company that had the status as an investor could not show having made an investment. This decision highlights how EU membership complicates the status of some SCCs.

a) Poštová, a Slovak bank, owned Greek sovereign bonds that were subjected to a discount in the restructuring of the Greek sovereign debt. Istrokapital (a non-ICSID company organised under EU laws) owned Poštová. Istrokapital could be considered to be incorporated in Cyprus (where it was set up), or in any other EU member State, including Greece. Its 'Societas Europaea' (SE) status

allowed Istrokapital to move its seat from one EU state to another without dissolution or reincorporation; it lacked a genuine connection with Cyprus. Istrokapital argued that it was an indirect investor, through Poštová, so that its status as a claimant was not based on the shareholding in the company but on the bank's assets in Greece. However, it failed to establish that it had any right to Poštová's assets that could qualify for protection under the BIT.

b) The investment in bonds issued by the Greek government in five different series was subject to Greek laws and Greek courts' jurisdiction. Poštová was neither a participant nor a primary dealer. It had nothing to do with the original issuance of the bonds or their initial distribution to the secondary market. Its acquisition was made after that procedure completed. Jurisdiction was denied by the tribunal. While debentures would have been protected under the BIT as assets, sovereign bonds were held not to be eligible.

c) The decisions in *Abaclat* and *Poštová* do not make the evolution of the legal principles relating to sovereign bonds easy. The issues they address are too important to be left to haphazard law-making in ISA especially as the intermediaries' responsibilities were not a part of the discourse. The issues of investor nationality can be entangled with the issue of *who* provided the capital for the investment. Two cases below indicate the way they can be decided.

47. In *Standard Chartered Bank* (2010), the investment was made by the Standard Chartered Bank, Hong Kong in Tanzanian loans acquired from Malaysian FIs. There is no Hong Kong-Tanzania BIT. The Tanzanian BIT with Britain required that an investment was *made* by and not simply *held* by an investor. The tribunal held that the British claimant did not contribute to the investment; jurisdiction was denied. It stressed that it was not taking a position on whether jurisdiction would have existed had the claimant engaged in the process of funnelling funds through an intermediary. It is very likely jurisdiction would have been confirmed.

48. Not making any contribution did not stop the claimant in *Renée Rose Levy de Levi* (2010) from using ICSID jurisdiction. She had acquired from her father, for free, her minority interest in the Peruvian bank BNM five years after the facts giving rise to the dispute took place. Another case was commenced in the same matter by two claimants *Renée Rose Levy de Levi and Gremcitel SA* (2011) where the Peruvian company joined the claim. The claimant showed that she had acquired her direct shareholding in Gremcitel nine days before the disputed event. To this extent, the tribunal held that she had proven jurisdiction. The BIT did not require actual or effective control. The only reason for the transfer of shares to the claimant was her nationality. However, the claimant had asked a notary to backdate corporate resolutions by five years. Jurisdiction was therefore denied. The tribunal concluded that it is well-established that a company may legitimately organize or

reorganize its structure to enjoy benefits under BIT. If a specific future dispute is foreseeable as a very high probability, not just as a possible controversy, the reorganization may amount to abuse of process. The latter, in practice, will encourage an investor to negotiate with a state even as the restructuring is underway; by the time the negotiations fail and the dispute is arguably ‘highly probable’, the restructuring is already in place.

12.10 Summary

49. The dual scheme of consent illustrated by the case studies in this Chapter evolved from the original BIT design from the 1950s and the ICSID framework of the 1960s to protect an obsolescing bargain. It has been tweaked here and there by the ISA arbitrators’ decisions to make international investment law on complex transactions. The case studies in this Chapter are some of the decisions that were the feedback loops to confirm the path of ISA as expansive, based on mainly inferred consents. This Chapter also shows how difficult it is to say whether a formal or a beneficial ownership is needed to acquire ICSID eligibility. The easier it is to claim ICSID jurisdiction under BITs (whether by using the right SCC from the beginning, or by restructuring an investment through an SCC or two), the less incentive there is to negotiate express ICSID arbitration agreements at the time of making of an investment; such agreements would reflect the actual consent of the parties to the dispute and reflect who the parties to the arbitration should be regardless of the use of SCCs. If ISA is supposed to promote the rule of law, it should aim to promote certainty and transparency in terms of jurisdiction. If transparency is promoted right from the stage of making investments, jurisdiction would not rely on the smell test as it appears currently to do.

¹<https://icsid.worldbank.org/ICSID/StaticFiles/model-clauses-en/7.htm>

² Although Article 25 of the Convention is clear on this issue, there is not necessarily a bar to non-ICSID ISA being raised by a host’s own national. This will depend on the terms of the BIT. For example, see *Serafin García Armas and Karina García Gruber v. The Bolivarian Republic of Venezuela*, UNCITRAL, Caso CPA No. 2013-3 retrieved from www.italaw.com.

³ Paragraph 339. Hungary relied on *Oppenheim’s International Law*, 9th ed., volume I, p.861 to contend that it is permissible to look behind the formal nationality of a company (e.g. the location of the control and ownership of the company).

⁴ *Cyprus Business and Investment Opportunities Yearbook*, by USA International Business Publications, ed 2009 Page 73.

⁵ According to the tribunal in *Vacuum Salt* case in the early ICSID cases arising out of specific arbitration agreements, the issues of consent and foreign-control were intertwined; in *Amco Asia* and *LETCO* cases there was 100% foreign ownership and in *Klöckner* there was 51% shareholding. These were non-BIT cases.

⁶ Paragraph 103.

⁷ Jurisdiction was denied on a different ground.

⁸ Paragraph 144.

⁹ “Panama Papers: How Jersey-based oil firm avoided taxes in Uganda”, *BBC news*, 8 April 2016. Retrieved from www.bbc.com.

¹⁰ “UGANDA - Joint IMF/World Bank Debt Sustainability Analysis I” Prepared by the Staffs of the IMF and the International Development Association, 27 April 2010. Retrieved from www.imf.org.

¹¹ Paragraph 79 of the Award.

¹² The case was a non-BIT matter, arising out of an investment agreement.

¹³Paragraph 148.

¹⁴“Cementownia claim against Turkey found to be “manifestly ill-founded” *Investment Treaty News*, 1 November 2009. Retrieved from www.iisd.org.

13. Round trippers, assignees, and minority shareholders

13.1 Introduction

1. The Chapter analyses ICSID decisions, through the lens of SCCs, on the issues of round-tripping investors, shareholders (including minority) claiming in their own names (derivative claims), and assignees as claimants.

2. All these issues are relevant to who can make ICSID claims given the purpose of the Convention and BITs (i.e. to encourage the flow of foreign investment to host countries). They all have the potential to change the nationality of the claimants in respect of the same investment after disputes have arisen.

13.2 Round tripping capital

3. Art. 25 of the Convention specifically forbids a host's own investors from using the Convention. However, arbitrators ignore this prohibition if jurisdiction can be derived from a BIT. SCCs make it easy to use ISA for round-tripping capital. Most BITs contain wide definitions that do not address round-tripping. Many do not contain a denial of benefits clause. BITs' silence on these is used to support an inference of a consent. This approach avoids arbitrators having to consider if the assets might have left the host country by circumventing its tax laws.

4. NAFTA specifically forbids round-tripping investments from being eligible for ISA. Some tribunals recognise, as for example, in *Phoenix Action Ltd.* (2006), that the purpose of ICSID is not to protect nationals of a host against their own state. The matter is not as straightforward as that to all ICSID tribunals. Egypt argued, in *Wena Hotels Limited* (1998), that the investor was really an Egyptian company, and not a foreign-controlled company; the tribunal rejected the argument. It did not consider which of the various claimant's affiliates had made the investment, although there were various offshore corporate entities involved in this investment ostensibly made by a couple resident in Britain.

5. *Tokios Tokelès* (2002) was an important case that dealt with the issue of round-tripping capital in which the majority upheld the use of ICSID. The Lithuanian claimant set up a wholly owned subsidiary in Ukraine, Taki Spravy, with an investment of \$170,000 in 1994. By 2002, it alleged that it had invested \$6.5 million. Ukraine argued that Taki Spravy was not Lithuanian; 99% shares, two-thirds management, and the corporate seat of Taki Spravy were Ukrainian. It had no substantial business activity in Lithuania. The majority (which included a former US BIT negotiator Daniel Price) relied on the facts that the BIT included the place of incorporation as a test of

nationality, and did not include a denial of benefits clause. It was assumed that the absence of such a clause in the BIT was deliberate. The majority quoted Broches' belief that Art. 25(2)(b) was intended to *expand* the jurisdiction of ICSID.

6. Prosper Weil, the tribunal's chairman, resigned after writing a strong dissenting opinion. He believed that the majority's approach contradicted the object and purpose of the Convention. Weil concluded that the arbitration mechanism was meant for international disputes, not for disputes between states and their own nationals. He said that the majority wrongly assumed that the origin of the capital was not relevant. Weil believed that it would be an unwarranted extension of ICSID jurisdiction to allow domestic corporations to evade the application of their national law and the jurisdiction of their national tribunals. The silence of the Convention on the determination of corporate nationality, he stated, ought not to mean that the BIT signatories had complete discretion over allowing round trippers' claims.

7. Taki Spravy lost its claim on the merits as it failed to prove expropriation. However, the trend was set for the Convention and BITs to be interpreted in expansive terms. These cases create two classes of local investors. The ones that pay taxes and use local courts, and the others, usually richer, investors that are treated as foreign investors who end up in a highly privileged position both in terms of taxes they pay (or not), and the law and jurisdiction they access for their disputes.

8. In *The Rompetrol Group NV* (2006), the tribunal went further than the *Tokios* majority to state that the corporate control, the effective seat, or the origin of capital had no part to play in the determination of the claimant's nationality under the Romania-Netherlands BIT. This approach renders the investor's nationality a mere matter of form, albeit that it is supposedly based on the parties' intentions. The Netherlands might have so intended; it is a transit SCC for capital flows. Whether Romania intended the same is doubtful as the preamble of the BIT referred to 'economic development' as a goal. The BIT, like several others, appears to be drafted with three options of dispute resolution (one of which was ICSID), and could have been treated as an invitation to treat.

a) The tribunal upheld the jurisdiction. The claim was eventually rejected as no loss was proven. When the refinery Rompetrol, was first privatised in 1999, two Romanian citizens, Messrs Patriciu and Marin, each bought 32.15% shares. Patriciu formed a Dutch company, Waverton BV, which was owned by a Luxembourg company called ROGI, which, in turn, was owned by a closed-end private equity fund, Romania and Moldova Direct Fund LP (RMDF). Waverton changed its name to The Rompetrol Group BV (TRG), and later changed its form to NV (from a private to a public limited liability company).

b) In 2000, TRG BV (owned by Luxembourg ROGI) became a majority owner of Rompetrol.

Marin and Patriciu each held 37% of ROGI. By 2002, RMDF was removed from the chain, Marin's holding was bought out, and ROGI was instead owned by Rompetrol Holding, a Swiss company set up by Patriciu. Patriciu was left with 80% ownership in TRG with the 20% of the Swiss company being held by one Mr Stephenson. Romania argued that Libya was the most important source of TRG's funds but the claimants alleged that their funding was from multiple sources, and that they routed their investment through the Netherlands because of its corporate governance laws, a favourable tax treaty, and infrastructure. The tribunal allowed latitude to the investor because the states did not forbid round-tripping in the BIT.

9. ICSID Jurisdiction expanded to occupy the space left vacant by the states' omission to regulate. The potential for abuse of local laws increases with such interpretations of BITs. In *Fondel Metal Participations BV* (2007), the Azerbaijan nationals incorporated the claimant companies in the Netherlands. The same beneficial owners also owned Azpetrol and had commenced another ICSID case which contained an admission of bribery (*Azpetrol*, 2007. Award paragraph 49). *Fondel Metal* settled on undisclosed terms. No determination was made on jurisdiction.

10. *KT Asia Investment Group BV* (2009) demonstrates the use of SCCs to evade or circumvent the local laws. The claimant, a shell company, was incorporated in the Netherlands by Mr Ablayzov, a Kazakhstan national. Ablayzov did not disclose his ownership to the Kazakhstan authorities. Foreign ownership in excess of 10% in the Kazakh banking business required an approval. The investment was held in tranches of less than 10% each, through several companies incorporated in various jurisdictions using trusted associates as nominee directors. The Dutch claimant was incorporated a few months after the Dutch BIT entered into force. Fraud allegations were made in related English proceedings, at least eleven of which were pending at the time of the arbitration. Under the English court's orders, Ablayzov's shares were frozen in 637 companies (set up in SCCs like in Cyprus, the BVI, the Seychelles and Luxembourg). For Ablayzov's failure to disclose his assets to the court, a 22 months' custodial sentence was pronounced; he fled England before it was handed down. The ICSID arbitration was funded by third parties, initially Wintop and Fitcherly, and later, Green Life. The rights under the agreements with the third party funders were not included in the freezing order. The tribunal concluded that the place of incorporation was a test chosen in the BIT, and that the claimant was thus a Dutch investor despite Kazakhstan's objections to the "ephemeral corporation of convenience" (Award, p.19).

11. The round tripping objection sometimes succeeds as in *Burimi SRL and Eagle Games SHA* (2011) where the claimant Eagle Games was an Albanian company owned by Albanian nationals. Jurisdiction was also denied in *Venoklim Holding BV* (2012) in which the tribunal concluded that the Dutch-incorporated claimant was not an international investor thus giving relevance to the

ultimate owner of the investment. The claimant's sole shareholder was a Swedish corporation whose shares were wholly owned by a company in Venezuela, whose majority shares were, in turn, owned by another Venezuelan corporation.

12. Thus, *Tokios* (2002), *The Rompetrol* (2006), *KT Asia* (2009) allowed round-tripping investors to make ICSID claims but in *Burimi* (2011) and *Venoklim* (2012) the tribunals denied jurisdiction to similar claimants. Although one could attempt to distinguish these cases on the nuances that may exist in different BITs, the Convention and ISA awards together do not give clear guidance and certainty to either investors establishing these routes for their capital or to the host states.

13.3 Derivative claims by shareholders

13. In most BITs, the definitions of investment cover 'shares in and stock and debentures of a company and any other similar forms of interest in a company', occasionally followed by words such as an 'enterprise, corporation, firm, association or other legal entity' clarifying the drafters' intention to make the definition as broad as possible. Under most domestic laws, shareholders cannot bring an action in the name of a corporation unless it has (unreasonably) refused to sue. Such derivative action is uncommon. No equivalent exists in international law. The Convention did not foresee the possibility of such an action unless it was in the context of an express arbitration agreement. In the case of a BIT, both corporations' investments and investors' investment in corporations are promised substantive protections. Many actions are commenced by shareholders directly even if their shares are indirectly affected by the states' actions against the corporation. Given the indirect routes of most investments through various SCCs, there could be potentially layer upon layer of such an action; each layer of shareholding company could claim at least indirect ownership or control of the ultimate investment.

14. Early in the ICSID history, states unsuccessfully tried the objection that the local company, a separate entity could sue and be sued in its own name, and that meant that the foreign investor could not sue in respect of the same subject matter (*Tradex Hellas SA*, 1994). Argentina, for example, has raised the objection many times arguing about impermissible derivative actions, and lost each time.

15. The ICJ in *Barcelona Traction* was asked the question: could Belgium act against Spain on behalf of its nationals who were the majority shareholders in a Canadian incorporated company with Spanish subsidiaries? The ICJ answered in the negative in 1970, but it has been heavily criticised by the ISA arbitrators. Park, a well-known arbitrator, a tax and banking lawyer, has said that the ICJ took a narrow view of the question in an attempt to avoid creating confusion and

insecurity in international economic relations by allowing the shareholders' state to grant diplomatic protection to the corporate entity set up in another state (Park, 1978, p.1639). The same logic applies to ICSID arbitration claims. What Park did accept was that the principles of public international law for determining the nationality of a corporate entity were "anything but settled" with different countries using the country of incorporation, location of registered headquarters, nationality of ownership, and place of control of management (1978, p.1638). The tribunal in *Enron Creditors Recovery Corporation* (2001) held that the ICJ was aware when it decided the *Barcelona* case that the Convention would offer new trends in investment protection. It referred to the *Elettronica Sicula* decision of the ICJ (1989) in which a claim for the shareholders' protection was upheld.

16. In *ADC Affiliate Limited* (2003), Hungary unsuccessfully relied on the *Barcelona Traction* to try and pierce the corporate veil in order to prevent the misuse of legal personality set up in two SCCs (Cyprus and the BVI).

17. In *Suez, Sociedad General de Aguas de Barcelona S.A.* (2003), Suez, a French TNC, held 51.69% shares in an Argentine entity – the water concession holder. It was allowed to bring a claim in its own name. Similar decisions were reached in the second *Suez* case (2003), *Telefónica S.A.* (2003), *Total SA* (2004), and *Impregilo SA* (2007). In *Daimler Financial Services AG* (2005), the tribunal dismissed Argentina's objection to the derivative action, referring to the two-dozen previous tribunals' decisions.

13.4 Minority Shareholders

18. Assuming that states signed BITs to attract FDI (in the conventional sense of a minimum 10% ownership/control), it is worth looking at the ICSID arbitrators' approach to minority shareholders' claims. Minority shareholdings can be akin to portfolio investments. They may not even be known to the government until the dispute arises. Most countries' corporate laws contain provisions to address minority shareholders' grievances with their own companies; providing protection against oppression of, or mismanagement by, the majority; these actions are resolved by the purchase of the minority stake by the majority at a fair value or, in the worst case, by dissolution of the company. It is rare for a minority shareholder to start an action against a third party in the name of the corporation. In some countries this would require a certain prescribed minimum shares.¹ In fact, continental legal systems rarely see derivative actions. The question is whether any or some minimum level of minority shareholding can be sufficient to amount to control under Art. 25(2)(b)?

19. In *Vacuum Salt* (1992), 20% shareholding held by a Greek national resident in Ghana was

not found to be sufficient, without some kind of alliance with other shareholders, to give foreign control. In most BIT cases, any shareholding, including minority holding, is included in the definition of investments so that arbitrators allow a *direct* action to be started in case of any loss or diminution in value of the shares by the host state's actions affecting the company. Usually, the shares themselves are not affected directly.

20. Two or more shareholders can start separate actions in respect of the same dispute under separate BITs. The claimants in *Sempra Energy International* (2002) argued that 43.09% holding in the gas distribution entity Sodigas allowed them to exercise a negative control; another investor, Camuzzi, began an arbitration (2003) relating to the same facts, claiming to exercise a positive control with its 56.91% shareholding. In *Camuzzi*, the claimant was a Luxembourg entity. The companies' joint control was based on a Shareholders' Agreement between Sempra and Camuzzi, and the By-Laws of Sodigas. Sempra used Argentina's BIT with the US, and Camuzzi used one with Belgium-Luxembourg. Argentina argued that the theory of joint control was incompatible with the consent manifested individually in each BIT. The tribunal referred to the *Lucchetti* case (2003)² in which *Empresas Lucchetti, S.A.*, petitioned as a foreign investor, and *Lucchetti Perú, S.A.*, did so as a company incorporated in Peru, and controlled by the same foreign investor. Both situations were held valid. The *Sempra* tribunal concluded that Article 25(2)(b) and the BIT provided optional alternatives. This meant that they also avoided having to make a decision on the messy joint-control issue. This decision was confirmed by the ad hoc committee. The matter is under resubmission as the \$128 million award was annulled by the ad hoc committee on another ground. The *Camuzzi* tribunal also upheld jurisdiction.

21. Argentina objected, in *CMS Gas Transmission* (2001), to the Delaware-incorporated minority shareholder's right to make a claim for the loss of its investment. But the tribunal upheld the claimant's right, stating that the *lex specialis* was so prevalent that it could be considered to be the general rule. Thus, investment was not defined in the Convention because of lack of agreement of states; yet, inexplicably, most state signatories to BITs included very widely framed definitions of investments.

22. The decisions in respect of the minority shareholders' standing to bring direct ICSID actions renders Art. 25(2)(b) redundant. The dispute may substantially involve an underlying action that could and should be brought by the company in which the shareholding is held. The chain of the minority shareholders could be quite long, depending on the number of SCCs involved, leading to multiple potential claimants. The danger of remoteness of the 'consent' to ICSID increases with the degrees by which the minority shareholding is removed.

23. In *Compañía de Aguas del Aconquija and Vivendi Universal SA* (1997), the dispute related to the privatisation of a water company. The claim was made by CGE, a French investor with 36% shareholding.³ On appeal, the ad hoc committee held that the investment was made regardless of whether CGE had control of the concession holder or not.⁴ The France-Argentina BIT specifically included ‘minority and indirect’ shareholding or participation in companies among investments. If jurisdiction was based on this BIT, it was held that there was no need to show control under Art. 25(2)(b). Argentina’s BIT programme started in May 1990 and all but three of its BITs were signed before 1999. The IMF had been involved in Argentina from at least 1991 onwards. A number of public enterprises were privatised; shares in local gas distribution companies were sold to foreign investors in the spate of privatizations after the IMF-induced reforms. The water concession contract did not refer to the Convention or any BITs; it provided for the jurisdiction of the Tucuman court in Argentina. There were also other claimants in the case that relied on the Spanish and British BITs with Argentina, neither of which comprised an investment definition by reference to minority shareholding. The *Compañía de Aguas del Aconquija* decision on jurisdiction could not be said to have been just based on the express reference to minority shareholding in the French BIT.

24. The ISA determinations rely on the *absence* of an exclusion of derivative actions in BITs; domestic corporate law expressly provides for such actions (paragraph 49, the 2006 determination on jurisdiction in the *Suez and Vivendi* case 2003). Argentina’s reliance on *Barcelona Traction* (1970) did not help its cause. The ICJ acknowledged the growth of foreign investments and of TNCs before noting that surprisingly no generally accepted international norms had crystallized. According to the *Suez and Vivendi* tribunal, this crystallization took place in the form of 2,200 BITs (at the time) and a growing jurisprudence of awards interpreting treaty provisions that did not exist in 1970 (paragraph 50, determination on jurisdiction). This supports the view taken in this thesis that the growth of investment law has taken place through arbitration awards. If BITs had been designed as arbitration agreements or standing offers, they might have addressed the issue of derivative actions.

25. In *Lanco International Inc.* (1997), Lanco’s 18.3% shareholding was sufficient to give it standing as the US-Argentina BIT included investments controlled directly or indirectly by the investor; Art. 25(2)(b) did not need to be satisfied. In *Enron Creditors Recovery Corporation* (2001) the claimant held, through three wholly-owned or controlled Argentine companies, 35.263% of investment in Argentine TGS (involved in gas transportation and distribution) which, in turn, was controlled by another Argentine company CIESA, not by the claimants. Argentina argued that its BIT with the US did not apply to such claims by a minority investor. The tribunal upheld the minority and non-controlling shareholders’ right to claim independently of a separate corporate

entity.

26. Whether the locally incorporated company may make a claim on its own does not affect the minority shareholders' right to make a BIT claim. The *Enron Recovery* arbitrators accepted that there was a need to establish a "cut-off point beyond which claims would not be permissible as they would have only a remote connection to the affected company" (Paragraph 51 of the award). This necessitated establishing of the *extent* of consent. It was sufficient that the claimants had been invited to invest in Argentina in relation to the privatization of TGS. This argument was found persuasive also by the tribunal in *CMS Gas Transmission Company* (2001). Argentina had invited claimants to participate in the privatization of the gas industry and had required the licensees to be locally incorporated companies. The invitations expressly referred to the protection granted in the BITs. The invitations were held incompatible with its arguments in the arbitration. Argentina unsuccessfully argued that if its measures affected the shares, they could be included in the BIT investments, but not where damage has been suffered by the corporate entity – what it called 'indirect damage'.

27. In *LG&E Energy Corp.* (2002), Argentina argued that privatization was carried out by invitation to national and international bidders, but that no investors were specifically targeted because of their nationality. The tribunal included elite arbitrator Van den Berg who was also nominated by the claimant in the *Enron Recovery* case. Argentina believed that a local company would qualify as a foreign investment only if it was owned, or directly or indirectly controlled by a foreign company, and LG&E was only an indirect shareholder. It lost the challenge to the jurisdiction. The tribunal referred to the *CMS* tribunal's view that control was not a central tenet of ICSID jurisdiction, only an alternative for a very specific purpose. Here, the BIT used by the investors was between the US and Argentina, but the ultimate investors belonged to a German entity, E.ON.

28. The majority tribunal upheld jurisdiction for the minority shareholders' right to commence ISA in *Teinver* (2009). The dissenting arbitrator, Dr Hossain, pointed out that the participation of the minority shareholders was not *specifically* sought by the host state. Hossain was concerned that minority shareholders claiming independently from the investor company could potentially start an endless chain of claims because any shareholder making an investment in a company that makes an investment in another company, and so on could make a claim affecting the corporation at the end of the chain. His concern is justified. The minority investments could all take indirect routes through more than one SCC. The difficulty of applying BITs to such claims actually arises from the fact that BITs were not designed for this purpose. *Total SA* (2004) also rejected Argentine objections to claims by a minority shareholder. Total's claim for just under \$1 billion was made in

relation to its 19.21% stake (held indirectly) in a gas distribution company in Argentina. The award is not available on the ICSID database – the online list of cases published by ICSID.

29. As large projects involve investments by separate entities taking on a variety of specialist roles, the dispute resolution clauses ought to be negotiated carefully to reflect the contracting parties' intentions in these respects. Generic and broad-brush BITs are not an appropriate tool for them. The more complex an investment structure, and the more remote the investors' interest, the greater should be the expectation of a directly expressed mutual consent to ICSID arbitration. Such an express consent would have largely prevented the repeated jurisdictional issues raised by, say, Argentina.

30. Construction cases are likely to lead to this issue of joint control,⁵ or a consortium without legal personality⁶ wishing to make a claim. Amarsinghe (2003, p.667-8) has suggested that special circumstances may exist where an association or a group of entities ought to be treated as within the scope of a qualified investor. But these solutions foisted by the arbitrators should be replaced by more workable solutions that the parties negotiate at the time of making of the specific investments. In the *Azurix* case (2001), the water concession agreement was entered into by Azurix's subsidiary; it required a submission to the local court's jurisdiction and the waiver of other jurisdictional fora. Argentina argued that Azurix was breaking its contractual commitment to use local courts by relying on the separability of its subsidiary's legal personality, but at the same time, it was also trying to make a claim for loss allegedly suffered by such an entity. The Ad Hoc committee held that Azurix's claims were in relation to the breaches of the BIT, and, therefore, admissible under the Convention. Even if the underlying facts are the same, there is a legal distinction between framing claims as breaches of contract or of BITs.

31. Where a company, Hochtief, owned 26% shares in the investment vehicle in Argentina and it had made loans to the locally incorporated company, the loan related claims were held inadmissible by another tribunal. The claims relating to its 26% stake in the same company were found to be within the tribunal's jurisdiction in *Hochtief Aktiengesellschaft* (2007). Under a differently worded BIT, the loan could have been held to be an investment too.

13.5 Assignment and succession

32. A key advantage of a corporate structure is the continuity of identity or perpetuation of its existence. A 1999 ICSID tribunal proclaimed that the "absence of beneficial ownership by a claimant in a claim or the transfer of the economic risk in the outcome of a dispute should not and has not been deemed to affect the standing of a claimant in an ICSID proceeding" (*Československa obchodní banka, a.s.* 1997, paragraph 32 of the jurisdiction award). SCCs have different rules for

the proceedings carried on in the name of, or to recover the claims of, a dissolved corporation. In *Amco Asia Corporation* (1981), the Delaware-incorporated claimant was dissolved. Delaware's general corporation law allows a dissolved corporation a continued existence as a juridical entity, for the purpose of proceedings it commences within three years of its dissolution. After Enron's 2001 bankruptcy, its affairs were administered by Enron Creditors' Recovery Corporation which could also bring ICSID claims (e.g. against Argentina, 2001).

33. Most corporations provide in their investment agreements for the possibilities of changes in the corporate identities with a boilerplate clause that the successors and assignees (often with consent of the other party) will take over the rights and obligations of a corporation. For the purpose of the Convention, these lead to questions of nationality that have to be decided as of the date of registration of the request for arbitration (*Banro American* 1998). Investors can assign rights or claims so as to take advantage of a BIT. For example, a Luxembourg claimant León commenced an ICSID arbitration under the France-Argentina BIT as an assignee of a French Bank (*EDF International S.A.*, 2003).

34. Investors have to be careful that the assignor has a right to assign. In *Mihaly* (2000), Sri Lanka challenged the assignment of a claim by a Canadian Company to its US affiliate. At the time the claim was commenced, Canada was not an ICSID state. *Mihaly* (USA) and *Mihaly* (Canada) were not partners, and did not form a juridical entity. As *Mihaly* (Canada) did not have a right to begin an ICSID claim, it could not assign it to *Mihaly* (USA) although *Mihaly* (USA) could bring a claim in its own name in respect of its own rights in the project. The timing of the assignment can lead to the rejection of jurisdiction as in *Phoenix Action Ltd.* (2006).

35. Even arbitration awards can be assigned. An award, especially one as enforceable as an ICSID award, is a valuable, tradable debt. *CMS Gas Transmission* (2001) award against Argentina for \$133.2 million was purchased by, and assigned to, Blue Ridge Investments LLC (Delaware) - a wholly owned subsidiary of Bank of America. Blue Ridge successfully applied to the US court to enforce the award.⁷

36. African Holding, incorporated in New Jersey, made an investment in a Congolese company, Safricas. It was controlled at the time by Belgian investors and then became the property of New Biz Congo, incorporated in the Cayman Islands. Congo challenged the right of Safricas to bring a claim using US nationality on the basis that its only connection to the US was that it had sold a debt to a US entity. The assignment was held to be successful. The tribunal held that African Holding was a majority shareholder in Safricas, through the Cayman company. (*African Holding Company of America, Inc.* 2005). Jurisdiction was denied on the basis of the timing of the investment rather

than for the indirect route taken.

37. An award for \$1.8 billion against Ecuador included compensation for the 40% economic interest that had been assigned by Occidental, the claimant, to a non-party, without the consent of Ecuador (and in breach of Occidental's investment agreement). The majority award (Stern dissented) applied a 25% discount to reflect the lack of consent to the assignment. (*Occidental Petroleum*, 2006). Occidental had transferred a substantial interest to Andes,⁸ a Chinese entity, but the claim was made under a US-Ecuador BIT. At an intermediate stage the assignment was made to a Bermuda-based subsidiary of Canadian EnCana Corporation, but the beneficial interest belonged to Andes at the time of the award. The ad hoc committee, on appeal, annulled the award to the extent of the Andes-owned investment. Although the mistake was set right, ISA's shortcoming is clear from the fact that the first stage tribunal could uphold jurisdiction to make an award towards a non-party's interest. It shows why the jurisdiction stage of ICSID arbitration needs to be revised to fit the realities of modern day investments so that it is transparent and fair, particularly for host states.

38. The US BITs and NAFTA have had a considerable legal impact on international investment law, but their provisions cannot always be said to lead to a just and reasonable results. A case which reflects this situation was *The Loewen Group Inc and Raymond L Loewen* (1998). It also showed how SCCs do not work for all investors. The tribunal agreed that there was unfairness towards the foreign investor, but declined jurisdiction on the basis that the claimant group had lost its Canadian nationality. The claimant was restructured after filing for Chapter 11 protection thus ceasing to comply with the nationality requirement of NAFTA. The claimant group had both the ownership and the control of its investment at the time of breach; the change of control thereafter came at the behest of their creditors (in whose power they were put by the original injustice they suffered in Mississippi – the reason for their claim). The tribunal did not approve of the assignment of the claim to the newly created holding company, Nafanco, as the claim was the only asset of this company and its only business. It was owned and controlled by a US corporation. The Canadian nationality of the claimants did not remain continuous in this case, as required by NAFTA.

39. The respondent states may not always know when there is a third party behind a claim. As the Argentinian cases showed, ICSID can be used by investors who bought sovereign bonds in a secondary market; all of those could, in theory, assign or sell these claims forward several times. Thus, the investors' ability to change their nationality for the purpose of the claim can take various forms.

13.6 Summary

40. This Chapter has highlighted the role of the arbitrators in the expansion of ISA jurisdiction to include indirect claims by focusing on round tripping, assignments, and minority shareholders' claims. The jurisdiction issues discussed in the case studies arise frequently and rely on inferred consents. BITs' objectives should be taken to provide reasons to construe the ISA options as narrowly as possible, not liberally. An investment in a locally incorporated company – whether a minority shareholding or otherwise – should have led to ISA claims against the host state only where the parties had agreed *for the purpose of the Convention* that the local entity was foreign-controlled (Art. 25(2)(b)). Any other shareholding-related claims could have been allowed in ISA only where the state's sovereign (rather than commercial) actions *directly* affected the shareholding (e.g. by expropriation). Currently, an investor can enjoy independent legal personality (e.g. liability remains at the corporate level or tax decisions are made in reliance of it) and also circumvent it for ISA, if it suits the investor by framing its arbitration as a shareholder's action. The round-tripping prohibition in the Convention should not be circumvented by relying on BITs instead. SCCs enable the investors to keep multiple arbitration options open. ISA awards legitimise the use of SCCs when they uphold jurisdiction for indirect investments that do not take a home-host states route. If SCCs are used purely for tax minimisation, evasion or avoidance, relying on them for ISA jurisdiction would in most cases be against the preambles of the BITs.

41. Not all the post-1990s' investments leading to ICSID arbitration were indirect holdings. For example, in *IBM World Trade Corp.* (2010), the investment in IBM Ecuador was direct. In *Metal par SA and Buen Aire SA* (2003) the Chilean investors made their investment in Argentina, so that the flow of the investment was from the home to the host state.⁹ However, very few cases include an express ICSID arbitration clause. The reason for not agreeing on an express ICSID arbitration for complex transactions must be that investors like to keep all their options open to restructure their investments in the most-tax friendly options.

42. As the first generation BITs did not address the complexity of investments through SCCs, they did not provide a complete foundation for the next generations of BITs and regional treaties. The 1990s was the period when international investment law became path-dependent. Decisions in ICSID awards from that time are assumed to have become customary international law.

43. Despite the FDI-related discourse when promoting BITs, most arbitrators do not refer to FDI as an objective of investments; they refer simply to 'investments'. This enables them to accept jurisdiction for the rounder-trippers', assignees' and shareholders' indirect or minority claims even if they might be outside the hosts' legitimate expectations. Again, the arbitrators could have implied

a term that BITs applied to FDI, thus bringing some restraint on the meaning of investors and investments. In *Continental Casualty Company* (2003),¹⁰ one tribunal did acknowledge the role of FDI from an UNCTAD report: “[t]raditionally, home countries have relied on BITs as a mechanism to ensure protection for their investments in developing countries, while developing countries have entered into BITs as part of their strategies to attract ... [FDI].”¹¹ The former did the drafting of BITs and the latter appear wrongly to have believed that FDI was obviously implied in the BITs’ objectives. They were certainly not *ad idem*.

¹For example, Germany requires shareholder(s) bringing a derivative action to own at least 1% of the statutory capital or shares with a par value of €100,000. See Eisen 2012.

² Later known as *Industria Nacional de Alimentos*.

³The original tribunal upheld jurisdiction but the claimant lost on the merits.

⁴ The claim was started in February 1997, and after going through an original award, annulment proceedings, and then resubmission of the partially annulled claim and award, it was 2010 when the last decision was rendered.

⁵In *Impregilo SpA* (2003), the five parties to the joint venture in Pakistan included an Italian leader and an entity from each of Pakistan, Italy, Switzerland and France. Their unincorporated entity GBC – set up in Switzerland - did not have a legal personality under Swiss or Pakistani law. The tribunal agreed that Impregilo could not make a claim on behalf of GBC; nor could it advance, under the Italy-Pakistan BIT the claims of other partners in GBC that were not protected investors under the BIT. The only claims that Impregilo could advance were for its own alleged loss. Similar decision was made later against representative claims in *Tulip Real Estate and Development Netherlands BV*, 2011.

⁶In *Consortium Groupement L.E.S.I. - DIPENTA* (2003) the tribunal held inadmissible a claim by a consortium of companies that was formed after the contract was signed. The companies should have filed separate claims but one of them had ceased to exist and was removed from the register of companies. The Italian 'external' consortium was thought to be difficult for the Algerian state to understand. The two companies Astaldi and LESI started separate ICSID arbitration cases later.

⁷This was confirmed by the United States Court of Appeals for the Second Circuit 19 August 2013.

⁸Andes is a joint-venture between two Chinese government oil companies, China National Petroleum Corp. and China Petroleum & Chemical Corp., known as Sinopec.

⁹Even in such cases, Argentina has consistently objected to derivative claims by shareholders.

¹⁰ However, portfolio investments were not excluded from the US-Argentina BIT. The tribunal, therefore, decided that it had jurisdiction over the disputes relating to the claimant’s investment in an Argentine insurance company that maintained a portfolio of investment securities.

¹¹Paragraph 81 of the determination on jurisdiction 22 February 2006.

14. SCCs and the Host States' Expectations

14.1 Introduction

1. The host and home states' economies are affected by (a) how and from where the funds originate that make up the investment, and (b) where and how profits are repatriated. Much foreign investment does not replace debt; it is accompanied by debt, both local and international, and subsidies from the host states. Local investors and host governments do not always earn the same level of high returns that the foreign investors earn.

2. This Chapter focuses on arbitrators' decisions on (a) tax havens, (b) the origin and destination of funds, (c) the effect of FDI on the host state, and briefly, (d) third party funding. It shows that ISA awards (using the broad-brush definitions of investors and investments in most BITs) legitimise the use of SCCs (including tax havens) regardless of the original objectives of BITs and the Convention.

14.2 Tax, tax havens and Single Purpose Entities (SPEs) (the building block of the global economy)

3. A majority of investments leading to ICSID disputes are made via SCCs for tax reasons. Yet, very rarely do ICSID tribunals deal with the concept of tax havens. Occasionally, a respondent state unsuccessfully objects to the use of corporations of convenience as, for example, Venezuela did in *Tidewater Investment SRL and Tidewater Caribe* (2010).

4. It is worth noting the non-ICSID *Yukos* (2006) award for the international arbitrators' perception of tax havens; the tax issue was not an accidental reference, but formed a key part of Yukos's dispute with Russia. The award was for \$50.020 billion. Yukos's law firm Shearman & Sterling's fee (ordered to be reimbursed by Russia) was in the sum of \$60 million. Russia also had to bear the arbitration cost of €4.2 million.¹ The claimants alleged that other oil companies were indulging in similar transactions using tax havens.

a) The UNCITRAL tribunal discounted the overall compensation awarded to the *Yukos* claimants by 25%, but their language shows that they did not find Yukos's scheme egregious in its use of tax planning. In the tribunal's view, "it may well be that, while Yukos was *vulnerable* on *some aspect* of its *tax optimization* scheme, and *possibly* even would have faced 'substantial tax

claims' that might have resulted in 'significant losses' principally because of the *sham-like* nature of *some* elements of its operations in at least *some* of the *low-tax* regions ..." (emphasis added, p.174). The language is mild in its censure, if at all. The description of Russia's conduct in pursuing Yukos for a \$27 billion tax bill, there is a censure in the following words, "... the State apparatus decided to *take advantage of that vulnerability* by launching a *full assault* on Yukos and its beneficial owners in order to bankrupt Yukos and *appropriate* its assets while, at the same time, removing Mr. Khodorkovsky from the political arena." (emphasis added, p.174). The tribunal did not refer to 'tax havens'. The phrase appears only seven times in the 600+ page final award, mostly when quoting someone other than the tribunal. 'Low tax regions' has much less negative connotation than 'tax havens'.

b) Russia's skeleton argument relied on a European Court of Human Rights' (ECHR) unanimous rejection of Yukos's challenge to the tax assessments that were the subject matter of the arbitration. The ECHR found that the tax burden was shifted from Yukos to letter-box companies in domestic tax havens in Russia. The letter-box companies were purchasing oil and oil products from Yukos at below-market prices, which would be sold in transactions that maximised profits while saving taxes; some of the profits would find their way to Yukos as sham loans.

c) Complex offshore structures² were used to take Yukos's profits out of the Russian tax authorities' and possibly of the minority shareholders' reach; massive transfer pricing was alleged. The chart attached to the award shows 86 entities in a complex web of interrelations. The companies were not just in Russia. There were various entities in other SCCs like Switzerland, Britain and the Netherlands, etc. Some of the offshore entities were controlled by Yukos with call options. Yukos's auditors PWC withdrew all of their Yukos audit opinions in June 2007 after refusing to continue to audit the company's US GAAP financial statements in 2003. The company president testified that he had no knowledge that Yukos was using offshore structures that it did not own (p.559 of the award).

d) The tribunal "could not exclude the possibility" (p.559) that the offshore scheme would have continued to be used and would have decreased the dividends paid by Yukos. Russia contended that Yukos was given a windfall as it had already earned unreasonable returns due to tax evasion and asset stripping. The tribunal held that any such benefits were not relevant to the compensation for losses caused by Russia's breaches of the ECT.

e) The Hague District Court set aside the *Yukos* award in 2016 on the ground that Russia had never ratified the ECT so the tribunal did not have jurisdiction to make the award. This does not necessarily mean that the award cannot be enforced in any of the other 150 odd signatories to the

New York Convention.³

5. ICSID cases have yet to see such dazzling numbers. The effect of tax havens on the host states' economies can be severe depending on the size of the country's economy. For example, the Switzerland-based claimant in *Alimenta SA* (1999) was alleged to have indulged in money laundering; the Gambian government seized Alimenta's plant. Gambia settled the claim for \$11.4 million which was large enough to have an adverse effect on Gambia's quarterly budget and foreign-exchange reserve.⁴

6. Tax claims are usually found to be within the ICSID tribunals' jurisdiction although in *Amco Asia Corporation* (1981) the government's claim for unpaid taxes was held to be outside the tribunal's jurisdiction. The Delaware corporation had proposed various tax concessions in its investment application for a \$4 million investment. Indonesia argued that PT Amco had not paid corporate taxes from 1973 and that there was a systematic course of tax evasion. It contended that the tax concessions were given as a core part of the investment programme. The ad hoc Committee held "The obligation not to engage in tax fraud is clearly a general obligation of law in Indonesia. It was not specially contracted for in the investment agreement and does not arise directly out of the investment." (paragraph 126-7).

7. The claimant in *Marvin Roy Feldman Karpa* (1999) asked for a refund of excise tax on its export of tobacco products to Honduras, a low-tax jurisdiction. The tribunal decided the case without having to address the low tax aspect of the transaction.

8. In *Patrick Mitchell* (1999), the American claimant (who ran a law firm) was alleged to have sheltered his income from local taxation, thus acting against the DRC's developmental interests. The argument about tax havens was not raised before the original tribunal; therefore, the ad hoc committee would not deal with it on appeal. The ad hoc committee held that tax avoidance, however shocking, would have related to the merits of the case and not to the existence of the investment (i.e. jurisdiction). The award was set aside on the ground that the firm's activities did not constitute an investment, not because of its use of tax havens.

9. In *Autopista Concesionada de Venezuela, C.A.* (2000) the claimant was a Venezuelan company owned by a US corporation, but the controlling entity, in Mexico, had given a guarantee of its US subsidiary's performance. The tribunal held that the US was not considered a tax or a regulatory haven. No American person served as an officer or director of the claimant. The BIT did not require effective control from the US; it used the criterion of majority shareholding for qualifying investors. The Convention did not require effective control either. Broches (1972), who was involved in the preparation of the Convention, argued that the concept of foreign control was

meant to be broad and flexible. The tribunals have, therefore, refused to adopt a restrictive definition. The *Autopista* tribunal held, “Although [respondent’s] views [that the corporation said to control the claimant] was a mere formality, this formality is the fundamental building block of the global economy.” (Paragraph 67, decision on jurisdiction).

10. If investments could not be defined in the 1960s for the Convention, they have only become more complex to define with the multitude of corporate forms in existence and the types of SCCs. Yet, in case after case, ICSID tribunals are claiming to enforce the states’ choices in BITs even where the states have not left any, or any clear, pointers for the direction they should take; the tribunals are making entirely new and often unexpected trails. As shown below, sometimes the state tries unsuccessfully to avoid ISA in its contract with the investor.

14.3 A case study – SCCs can help an investor overcome a host’s attempt to avoid ISA

11. The building blocks of the global economy were also referred to in *Aguas del Tunari SA* (2002). Bechtel (US) established a Bolivian company, AdT, to make its investment in the Bolivian water sector. Its wholly-owned British subsidiary, International Water Ltd., negotiated the concession. AdT was 55% owned by a Cayman company, International Water (Tunari) Ltd., itself 100% owned by Bechtel Holdings Inc. through Ben IWL Holdings (U.S.), Inc (De Gramont 2006). A minority stake was owned by a company from Uruguay owned in turn by Spanish Abengoa. There was no option to use a Uruguay or a UK BIT; the Cayman Islands were not covered by a BIT. In November 1999, Bechtel announced a merger with Italian Edison SpA; the merged entity was to be incorporated in the Netherlands.

12. Bechtel asked the Bolivian authorities for approval, stating that it related to tax requirements outside of Bolivia and that AdT would be under the same control as before. Three Dutch entities, called Baywater Holdings BV, International Water Holdings BV, and International Water (Tunari) BV were incorporated in the Netherlands in November 1999. Bolivia granted its approval in December 1999. Bechtel decided that the Cayman Islands entity would instead ‘migrate’ to Luxembourg to be called International Water (Tunari) S.a.r.l., owned by International Water (Tunari) BV. shareholding.

13. AdT was then owned by three Dutch companies and a Luxembourg one. One of the Dutch companies was a joint venture of Bechtel and Edison. Bolivia described the Dutch entities as mere shells. The Netherlands, but not Bolivia, was a signatory to the VCLT, but the parties’ counsel agreed that the provisions of the VCLT relating to the interpretation of treaties reflected customary international law.⁵

14. Bolivia alleged that it had structured the concession so as to avoid foreign ownership that might bring it within the coverage of a BIT. The structure put in place by the claimants was not the same ownership structure as provided for in the concession. Article 37.1 of the concession required every ‘founding stockholder’ to keep more than 50% of the original equity percentage in voting shares of the concessionaire for at least the first seven years of the concession.

15. The tribunal held that the concession allowed for some changes in the organisational ownership *upstream* without Bolivia’s consent; the restriction in Art 37.1 applied only to founding and not ultimate shareholders. It was undisputed that AdT’s Cayman owner had transferred all its rights and obligations to the Luxembourg entity. The claimants argued that the Cayman entity had migrated, thus remaining the same entity in Luxembourg as it was in the Caymans. Expert legal evidence was introduced by both parties. Bolivia’s expert was a US lawyer, Fox, who gave evidence that every corporation is unique and distinct because of two factors: its name and its incorporating jurisdiction. The claimants disputed this general comparative law view.

16. The tribunal accepted the migration to hold that AdT’s ownership had not changed. Bolivia argued that under the Bolivia-Netherlands BIT, the shell companies could not be said to be controlling AdT; the controlling entity was Bechtel. The tribunal concluded that the BIT referred to the power to control, not its actual exercise.

17. The tribunal, like others, believed that holding companies are a common and legal device although the corporate form might also be abused. The holding company formality was a “fundamental building block” of the global economy (paragraph 245). The majority observed that it would be difficult to create a test of actual control; it could include, for example, day-to-day operations, strategic meetings, delegation to a consulting firm of part or all of the management, and so on. The test was not provided in the BIT because it would be impractical and the resulting uncertainty would defeat the object of the BIT. If the investor could not determine whether their investment vehicle would qualify for BIT protection or not, the object and purpose of the BIT to stimulate investment would be defeated.

18. The tribunal did not seem too concerned about Bolivia’s legitimate expectations to try and avoid the risk of ISA in the concession. Bolivia, relying on Schreuer (2001, p. 286), asked the tribunal to interpret the BIT definitions as co-extensive with the ICSID definition for foreign control. Bechtel relied on a commentary by Broches that the Convention was designed to give the greatest possible latitude for states to decide under what circumstances a company could be treated as a ‘national of another Contracting State’. (1972, p.360). The tribunal cited Dutch sources that the BITs were supposed to give a guarantee of neutral arbitration, unlike national laws which can be

changed quickly.⁶ In the Dutch Model BIT, the definition of “national” included entities “wherever located.” This is not surprising given that the Netherlands is known as a transit SCC. The Bolivian BIT with Argentina included a specific reference to what “effectively controlled” would mean but this was not reflected in its Dutch BIT. The former was signed in 1994, two years after the Dutch one. The tribunal decided that the BIT practice of the two countries was of limited probative value in interpreting the Dutch-Bolivian BIT.

19. The Bechtel-Edison joint venture held a portfolio of eight contracts and with its consolidated subsidiaries employed 55 employees, generating an income of €8.6 million. If the joint venture controlled the investment, Bechtel was in breach of the concession; if it did not, then the intermediary was a shell. The tribunal did not address this; the condition was in Art. 37.1 of the concession, and the claims before the tribunal (albeit arising from the concession) were framed as breaches of BIT claims.

20. The tribunal pronounced that it was not uncommon or illegal to locate an investor’s operations in an SCC to take advantage of taxation, or even the availability of a BIT. (paragraph 331). It concluded that the language of many BITs evidences that such national routing of investment is entirely in keeping with the purpose of the instruments and the motivations of signatory states. Most tribunals inferred the consent to arbitration from BITs so that they could rely on these wide definitions as the logical basis of the conclusion that states expected investments to use SCCs.

21. The case settled despite both the parties having spent a substantial amount on costs. The water industry, as other essential utilities, tends to rely on subsidies or other concessions due to the heavy costs of infrastructure-building or updating. Bechtel’s initial interest in this concession was preceded by a 1998 IMF loan of \$138 million to Bolivia. Around the late 1990s, the provision of water as a public good was replaced by the idea of water as an economic good (Dinar and Maria, 1998). The World Bank promoted the idea (1994D). Over the next few years, over a hundred water-related M&As took place so that only three or four TNCs⁷ or their subsidiaries and affiliates would have been at the top tier of water TNCs that could invest in the large privatisations. Even in the developed countries, government has to support water infrastructure projects. For example, in the US many water projects are debt-financed with municipal bonds followed by governmental grants or loans. Public Private Partnerships (PPPs) tend to be used for the operation and maintenance with a limited role in capital-financing.⁸

22. The forty-years’ Bechtel concession was concluded after direct negotiations, not open tenders. The first attempt at inviting private companies to bid had not led to much interest. Riots on

Bolivian streets in protest against the hike in water charges led to the termination of the concession. This case involved the kind of issues that developing countries have to grapple with domestically while keeping the long-term promises made (and drafted by the) TNCs. The effective prioritising of foreign investors' interests above those of the public interests can only be justified if the investment makes a net positive contribution to the host's economy. Otherwise, it is difficult to contend that the use of SCCs is compliant with BITs' and states' objectives. If the host states did not mind where the investment flows came from, they would not have entered into many bilateral arrangements; one BIT with some place like the Netherlands or one adequately worded investment law would have sufficed.

23. That TNCs use tax advantages as much as possible is clear in several cases as, for example, *PSEG Global Inc. (2002)*. Tax policy can be excluded from the ambit of a carefully drafted BIT. In *Nations Energy Inc. (2006)*, the US-Panama BIT excluded claims relating to tax policy. The claim was based on Panama's refusal to allow the claimant to transfer its tax credits to a third party. The majority held that such a right was not a true attribute of property ownership, but the claimant-nominated arbitrator held the claim to be within the jurisdiction of the BIT in his dissenting opinion. The exclusion of any types of claims from ISA requires to have been made in a BIT, before the dispute arises and be drafted carefully so that it cannot be defeated by a corporate restructuring.

14.4 Host states' contributions to investors' profits

24. When considering the effect of SCCs and their tax consequences on the host states' legitimate expectations, arbitrators need to consider that the hosts themselves contribute to these projects. Black recognised this in the early projects supported by the World Bank. It is a myth that FDI in infrastructure projects replaces debt. Host governments also provide attractive conditions for foreign investors even before factoring in the investors' use of SCCs to minimise their tax burdens. These may take the form of in-kind contributions (e.g. land, cheap power/water), loans, partial contribution to the capital, concessions from taxation or other duties, guaranteed uptake of power/gas/oil at fixed prices, and many times a stabilisation clause providing a guarantee against changes in the taxes or duties applicable to the investment for decades. Some of these examples are set out below from the ICSID cases to illustrate the kind of contributions governments agree to make for foreign investors.

a) In *Holiday Inns (1972)* the Moroccan government gave substantial loans to the US investors' project. In *S.A.R.L. Benvenuti et Bonfant (1977)*, the Congolese government guaranteed funding and promised to establish a special tax regime for its joint-venture with an Italian investor for the manufacture of plastic bottles of mineral water. In *Reynolds Jamaica Mines Limited (1974)*

Jamaica agreed to a tax stabilisation clause. By the time of the arbitration arising out of a change in the tax regime, the companies had enjoyed the benefit of the stabilisation clause for over twenty years. *Kaiser Bauxite Company* (1974) and *Alcoa Minerals of Jamaica Inc.* (1974) included similar deals.

b) In *Cable Television of Nevis Ltd.* (1995), the St. Kitts' government gave a 100% ten-year tax holiday, subject to renewal and other privileges. In *Duke Energy* (2003), there was a long legal stability agreement between Peru and Duke Energy's Bermudan SPE. Yemen offered tax and customs incentives to foreign investors in *Desert Line Projects LLC* (2005). Romania gave tax concessions for investing in disfavoured regions but then repealed some of these in order to comply with the EU accession requirements in *Ioan Micula*, (2005). The claimant in *Metal-Tech Limited* (2010) obtained from Uzbekistan a five-years' exemption from customs duties, and an exemption from consular fees or state duty. The income of its non-resident personnel was exempt from tax.

c) In *Lao Holdings NV* (2012), Lao agreed to a flat-rate tax for five years of the 50 year concession and the claimant alleged that this was to be renewed by another flat-rate tax agreement for the remainder of the term. In *Société des Mines de Loulo S.A.* (2013) British mining investor claimed from Mali \$46.5 million in a tax dispute relating to the salaries of foreign employees over 2008-2010 period.

d) *Antoine Goetz* (1995) arose out of Belgian nationals' investment in a company incorporated in Burundi for the production and marketing of gold and silver. The benefits granted by Burundi included a certificate of tax free zone. Burundi did not raise an objection to the tribunal's jurisdiction. The same case led to further disputes and another award in favour of the claimants in 2012.

25. The claimant with a minority shareholding in a joint venture in Sri Lanka in *AAPL* (1987) recovered more than its equity investment; the Sri Lankan agencies and individuals (that provided 60% financing of the shrimp farm) did not receive any compensation. It is not usual for the awards to indicate the amounts involved in the benefits that foreign investors gain in terms of tax concessions. In some cases, the numbers give a hint of the scale of the issue.

a) In *PSEG Global Inc.* (2002), PSEG's proposal of a branch office, Turkey believed, would offer it a windfall of \$256 million. The claimant argued that if they had to bear the burden, the tariff would increase. Turkey argued that the heavier burden was already offset by the changes made to the domestic legislation. The tribunal commented that the claimant should have proceeded with greater transparency.

b) In *Tokios Tokelès* (2002), the tribunal, by majority, upheld the jurisdiction of a Ukrainian owned and controlled Lithuanian vehicle in its claim for \$65 million. The government was concerned with money-laundering and tax-evasion issues using fictitious enterprises, recording spurious loans, circular transactions using different exchanges, etc. The government launched tax evasion enquiries against the claimant's investment SPE. The bulk of the claimant's assets were transferred to another SPE and were not harmed by the government's actions. Having upheld jurisdiction, the claim was dismissed on the merits by the tribunal majority, with the claimant's nominee dissenting.

c) In *Suez, and others* (2003), a water concession dispute, just under half the investment made in Argentina was from multilateral lending institutions, and only about \$120 million out of \$1.7 billion was the initial capital of the foreign investors.

d) In *Plama Consortium Limited* (2003), the claimant wanted a modification of the tax laws to eliminate a potential tax liability which it duly obtained; it blamed the delay for its difficulty in raising funds. It was advised by Ernst & Young and should have been aware of the tax consequences of the debt settlement agreement. Bulgaria had not even sought to collect the taxes due. The difficulty of obtaining financing was not caused by the potential tax.

e) In *Newmont USA Limited* (2006), the claimant had worked a mine for thirteen years before Uzbekistan claimed \$49 million in back taxes. The dispute was settled without disclosing the amount, but the reported sum was in the region of \$80 million.⁹ When a claimant obtains an award under the Convention, it tends to receive the compensation net of the local taxes (*Mobil Corporation*, 2007).

14.5 Origin of investments

26. Given the expectation of ongoing *bilateral* relationships delineated in the preambles of BITs, and the supposed role of incentives to promote *mutual* prosperity, the origin of the investment capital ought to be of relevance in a BIT. However, ISA jurisprudence is heavily weighted in favour of ignoring it. Given that TNCs use SCCs generously, there is no investors' demand to change the current norms; if anything, TNCs would like to strengthen the current norms.¹⁰ Arbitrators appear to

ignore from and how capital got to the host country, so long as outright corruption is not shown.

27. This direction was given to ICSID jurisprudence very early. In *SOABI* (1982), the tribunal, including Broches, held, by majority that the nationality criteria did not say anything about the origin of the resources. It upheld jurisdiction over the Belgian investor's claims where the investment was routed through Panama, a non-ICSID country.

28. The investment does not have to be made *by* the investor entity claiming protection. In *Tradex Hellas S.A.* (1994), Albania alleged that the investment was financed either by an unspecified offshore company, or by Greek state banks, and the EC. The tribunal held that the Albanian law did not require that the foreign investors had to finance the investment from their own resources. It also defined investment very broadly to include direct and indirect investments (paragraphs 108-111).

29. In *Wena Hotels Limited* (1998), the tribunal was not persuaded by the relevance of Egypt's argument that much of the claimant's investment came from Wena's affiliates rather than from Wena. Instead, the tribunal was persuaded that it was a widely established practice for hotel enterprises to adopt "allocation measures" to spread the profits from the group operations into various jurisdictions according to the tax advantages (paragraph 126). Subsequently, in English divorce proceedings between Wena's shareholders, the husband claimed that the investment was not all his own.

30. In *Tokios Tokelès* (2002), Ukraine challenged that there was no non-Ukrainian capital. The majority tribunal held that an origin-of-capital requirement could not be implied and that it would be inconsistent with the object and purpose of the BIT. Even assuming, the majority further commented, that the claimant's capital was Ukrainian, the claimant made the investment when it decided to deploy it in Ukraine instead of investing it elsewhere. The majority referred with approval to *Tradex Hellas S.A.* The Convention appears to envisage *foreign* investors' disputes with host states, but using a BIT as an optional source of jurisdiction means that the Convention's scope can be widened. The dissenting arbitrator Weil believed that the majority's decision was against the Convention's objective. The jeopardy to the ICSID institution itself that he foresaw did not come true. ICSID has survived and prospered. Most arbitrators followed the majority. *Joseph C. Lemire* (2006) also held the origin of funds into Ukraine to be irrelevant. The BIT provided that the reinvested earnings would qualify as investment; these would necessarily originate in the host country. This was a slightly misleading argument; defining the reinvested earnings as foreign did not mean that the original funds did not have to be foreign.¹¹

31. In *ADC Affiliate Limited* (2003), Hungary argued that the origin of the capital must be

considered by the tribunal; it relied on the dissenting opinion of Weil in *Tokios*. The origin of the capital in *ADC* was Canadian, i.e. non-ICSID at the time. However, the BIT between Cyprus and Hungary defined the investor by reference to the place of incorporation. The tribunal held, “[C]onsiderations of whence comes the company’s capital and whose nationals, if not Cypriot, control it are irrelevant.” (paragraph 357 of the award). Early in the ICSID jurisprudence, much was made by arbitrators of the investor’s waiver of the home state’s diplomatic protection in consideration of ISA, but the *ADC* tribunal found it irrelevant that the claimant used the Canadian Government’s diplomacy in the dispute. The BIT could not be made “to disapply” because, “rightly or wrongly, the claimants’ shareholders appealed for help to Canada.” (Paragraph 361). *Generation Ukraine Inc.* (2009) also held a Canadian diplomatic intervention immaterial for jurisdiction.

32. The ILC adopted a draft text of Articles on Diplomatic Protection with commentaries.¹² Article 9 of the ILC’s draft provides, “For the purposes of the diplomatic protection of a corporation, the State of nationality means the State under whose law the corporation was incorporated. However, when 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.” The commentary suggests, probably because of the use of the word ‘both’, that if the seat of management and the place of financial control are located in *different* States, the State of incorporation remains the State entitled to exercise diplomatic protection. Even where BITs require a connection with a home state by including a denial of benefits clause, it applies with prospective effect (*Plama Consortium Limited*, 2003).

33. In *Saipem S.p.A.* (2005), Bangladesh raised an argument, which is not frequently made (but could be), that infrastructure projects need substantial injection of funds by the host state and bring relatively little equity from the foreign investor. Bangladesh argued that the claimant, Saipem, never was a net creditor in respect of the pipeline contract. Saipem responded that this fact was never given any relevance in the case law. Thus, many projects qualify as investments for the Convention or BITs even if the host state has not received any new capital and has, in many instances, undertaken a net liability. The award referred to Broches’ view that the Convention could not make a distinction based on the origin of funds (paragraph 107). Given the multilateral ICSID context, Broches’ view is understandable. ICSID was simply an enabling framework to plug into for dispute resolution, by express agreement of the disputing parties, and for particular disputes. For *bilateral* treaties it does not logically follow that the origin of funds should be irrelevant; it is in the very essence of a bilateral relationship that the origin of funds being protected is implied to be from the other signatory to the BIT.

34. Some restraint is shown by tribunals in the cases decided after the financial crisis. The tribunal in *Caratube International Oil Company LLP* (2008) agreed that subject to *express* provisions to the contrary, the origin of capital is immaterial for jurisdiction purposes, but it needed some economic link between that capital and the purported investor to show that the investment was *of* a particular investor. In *Alapli Elektrik B.V.* (2008), a US-funded Turkish investor was denied jurisdiction on the ground that there was no investment *by* the Turkish investor. The claimant argued on appeal that this meant that a new qualitative criterion was introduced for the origin of capital. The ad hoc committee did not agree.

35. The US treaties tend to provide for an express connection with the home state. In *Generation Ukraine Inc. v* (2009), Ukraine alleged that the claimant could not rely on the US-Ukraine BIT as it had no substantial business activity in the US. The investment was allegedly controlled by a Canadian entity. The tribunal held that a US national owned 100% share capital so that it was unnecessary to consider the question of substantial business activity in the US.

36. Venezuela challenged the origin of funds in *Flughafen Zürich A.G.* (2010), a case involving a concession to manage an airport. The funds, it argued, were not investor's own; they came from the operation of the airport. The tribunal held that the relevant question was not the source, but the contribution of the investor. As a result of their activity the investors generated profits, and their contribution was their experience, know-how, and money.

37. The restraint in the *Alapli* and *Caratube* did not last long. Poland contended in *David Minnotte and Robert Lewis* (2010) that the claimants' shares did not represent an injection of cash, but the churning of the company's funds back into it. The US claimant made wire transfers to Poland via an account in Guernsey held by ZAN trust - a British company owned by one Mr Niziol. The investment vehicle was charged with invoices from Australian and American corporations for the prepayment of royalties and fixed upfront fees. These were paid into a Swiss bank account. Another invoice was raised by a Dutch concern for the supply of equipment that was never delivered. The tribunal held that, for the purposes of jurisdiction, the monies which were not invested in Poland but paid to Niziol were not investments. The questions about the reality and validity of several other transactions were not critical at the jurisdiction stage. Jurisdiction was upheld even though the tribunal found the details of the money transfers curious.¹³ Later, the claims were dismissed on the merits and Poland awarded \$1.2 million towards its costs.

38. *Flughafen Zürich AG and Gestión e Ingeniería IDC SA* (2010) confirmed that the investor did not have to contribute its own funds. *Franck Charles Arif* (2011) was another tribunal that confirmed that whether investments are made from imported capital, profits made locally, payments

received locally or from loans raised locally, etc. made no difference to the degree of protection enjoyed. Similarly, in *OI European Group B.V.* (2011) the unwithdrawn profits of the claimant were sufficient to constitute an investment.

39. In *KT Asia Investment Group BV* (2009), and *Hassan Awdi* (2010) jurisdiction was denied on the ground that there was no evidence of the claimant having made any contribution to the alleged investment. The *KT Asia* tribunal refused to pass judgment on the legality of the practice of using hundreds of “companies as pockets,” shifting assets from one to the other solely to suit the investor’s purposes. *KT Asia* had no resources. It financed its acquisition of equity through a loan that it had no means of repaying without a resale of the same shares.

40. The claimant’s lack of contribution was held irrelevant for jurisdiction purposes in *H&H Enterprises Investments Inc.* (2009). Egypt argued that an option to buy, exercised at the claimant’s discretion and involving a one-time lump sum payment, did not contribute to Egypt’s economic development in any significant manner when there was no transfer of know-how, technology or equipment. Egypt prevailed in the award but for a different reason.¹⁴

41. Sometimes the question of an investor’s contribution arises because of a corporate restructuring. In *Gold Reserve Inc* (2009), a previous holding company became a subsidiary, and the subsidiary company became a holding company after the restructuring. No transfer of funds to Venezuela took place. The tribunal upheld jurisdiction as there was an initial investment in the mining concession. (also see, *Renée Rose Levy de Levi*, 2010)

42. Where the concessionaire intended to bear the project financing (whether with own resources, or through third party funding) received a capital contribution to its incorporation, that contribution was sufficient to be considered a qualified investment: *Convial Callao SA and CCI* (2010). Contribution was also upheld as investment in the form of equipment and activities leading to the creation and development of a saw mill in *Antoine Abou Lahoud* (2010). A commitment to contribute funds in the future after delivery of goods is not sufficient to constitute an investment (*Nova Scotia Power Incorporated*, 2011). This may not always be the case, as in *Malicorp* (2008), where the tribunal believed that an undertaking of a commitment was enough.

14.6 Destination of capital – is there a contribution to the host’s economy?

43. If the origin of capital is irrelevant, what about the destination? The bilateral promotion and protection for economic development or mutual prosperity must mean that some contribution is expected to the host state. TNCs’ frequent use of SCCs has been enabled, at least partly, by ISA arbitrators’ construction of a jurisdictional matrix that takes the wider definitions of BITs and mixes

them with the multilateral ICSID; leaving out the restrictions from both – the idea of reciprocity from the BITs, and the concept that an explicit agreement was required for a local company to be deemed to be under *foreign control* in ICSID. Allowing protection for investments that never reached the host states but were made in another SCC defeats BITs’ developmental objectives. The following cases illustrate the extent of the expanding ICSID jurisprudence by way of a summary.

44. The tribunals in *Fedax* (1997) and *Salini Costruttori SpA* (2000) set out some criteria for determining the existence of an investment. These were expanded in *Phoenix Action* (2006). They include: contribution (money or assets, etc.), duration, risk, potential to develop an economic activity in the host state, bona fide investment, compliance with the host state’s laws. The element of bona fides was also used in *Alapli Elektrik BV* (2008). Stern was on the tribunals in the *Alapli* and *Phoenix* cases. Tax haven SCCs are usually implicated when some of these elements do not apply. The contribution element is increasingly held to be of less relevance than the origin of funds.

45. These elements of an investment were held to be interdependent by the *Consortium RFCC* (2000) tribunal. If they are to be considered at all, ISA tribunals usually take a holistic view. However, this concept of essential characteristics of an investment does not find favour with all tribunals. Some tribunals have moved away from these criteria (*LESI SpA and ASTALDI SpA* 2005); one claimant argued that it introduced “non-textual jurisdictional limitations” to ICSID (*Phoenix*, 2006, paragraph 81).

46. The development element does not need precise computation. In *Kaiser Bauxite Company* (1974), the claimant’s alleged that it was the single highest tax-payer in Jamaica, which was its contribution to Jamaican economy from bauxite extraction. The contribution element is the most problematic one. This may be a function of the arbitrators’ over-familiarity with just commercial law. The *Phoenix* tribunal held that the contribution to development was impossible to ascertain, especially given the divergent views on what constitutes ‘development’. It preferred the less ambitious approach of focusing on the contribution to the *economy* of the host state. The contribution was held to be inherent in the very concept of investment and was, in principle, be assumed. This was also the view of the Stockholm arbitration tribunal in the non-ICSID *Franz Sedelmayer* (1998) that investments, in principle, create economic value.

47. ICSID cases (95 construction cases, 52 energy related and 22 water/waste management out of the 463 analysed in this thesis) highlight the problem with infrastructure construction contracts where one could always argue that capital (debt or equity) has reached the host state, and if the capital were not foreign, at least that the foreign investor’s (technical) contribution has made a difference. However, in these projects many countries struggle to support the high rate of return on

the investment that foreign investors expect. In *PSEG* (2002), a build, operate and transfer (BOT)¹⁵ project was planned for the generation of electricity in Turkey. The regulations in force would have capped its rate of return at a generous 16% p.a. The alternatives discussed with the ministry ended up in lower figures. The EC and the World Bank were opposed to the uncompetitive BOTs guaranteeing the profitability of a project artificially using government guarantees and a subsidized tariff. (Paragraph 85 of the determination on jurisdiction). The \$9 million award in favour of the claimants for a project that had not reached a financial closure, and on which no work had been undertaken in Turkey, involved arbitration costs of \$20.85 million, 65% of which were borne by Turkey.

48. Some of these projects are simply white elephants that end up in wealth-extraction rather than creation. The IMF's advice to privatise enterprises led to a number ill-advised and hurriedly agreed privatisations, and when these turned out to be unsustainable without further debt, several of them ended up in ISA. At times, capital seems to move from the Washington bank account of the World Bank to that of the contracting TNC (particularly on a turnkey project designed by the TNC); the host state becomes liable for the debt without having had complete control on the upfront cost of such projects. The current state of the ICSID jurisprudence is such that investments that have not been made *in* the host country still qualify for ISA protection.

49. In *ABCI Investments Limited* (2004), the tribunal held banking activities to amount to an economic contribution. Pre-shipment inspection claims have been challenged on the basis that no investment was made in the host states, and in each such case, the host state lost its challenges (*Société Générale de Surveillance S.A. (SGS) cases* against Pakistan (2001), the Philippines (2002), and *Paraguay* (2007), and *Bureau Veritas, Inspection, Valuation, Assessment and Control, BIVAC BV* (2007). The *SGS Pakistan* stated that ICSID (i.e. TNC investors and arbitrators) was moving away from traditional notions of investment. In a similar case by SGS, the agreement was so structured as to minimise the activities of the liaison office in the Philippines for the objective of ensuring that no tax liability arose within Philippines. The agreement specifically provided that the income earned abroad by the claimant would not be subject to any Philippines tax. Although the claimant accepted that the investment was made abroad, and would not be taxed in the Philippines, there was still an eligible investment in the Philippines for ISA purpose. The tribunal concluded that the tax treatment of investments was a distinct regime from that of the BIT.

50. In *Abaclat* (2007), the tribunal decided that the investment made in a secondary market in Argentine bonds in Italy would be deemed to be an investment *in* Argentina even if the Government in Argentina did not receive the funds paid to various intermediaries. For a purely financial matter as that, the tribunal's view was that the relevant criteria could not be the same as those applicable to

an investment comprising business operations, manpower or property. The criteria, the majority used were, where and/or for the benefit of whom the funds are ultimately used. The bonds and the securities purchased by the claimants were held to be part of one economic operation. The logic being that the underwriters would not have committed to pay to Argentina if they could not rely on future payments of individual investors buying the securities. This meant that the funds generated later served Argentina's economic development regardless of whether they ever reached Argentina.

51. In *Abalaclat*, the claims related to Argentina's debt-restructuring in which sovereign bonds – normally considered to be securities with fixed income. There were like the Brady Bonds which did not remove the debt; they simply augmented and rebranded it. The dissenting arbitrator believed that there was no territorial link with Argentina as required by the BIT; the claimants had bought their securities in Italy. In his opinion, with a variety of off-the shelf products traded in the financial markets electronically, there is no involvement or knowledge of the debtor country. This, he contended, was “worlds apart” from FDI. (paragraph 57). He alleged that the majority's strategy disregarded the host state's legitimate interests (paragraph 261). He was concerned about the ICSID jurisprudence expanding to cover standardised financial transactions unknown at the time the Convention was drafted. He flagged the issue as one of international public policy about the workability of future sovereign debt restructuring.

52. In *Ambiente Ufficio SpA* (2008), the tribunal held that buying of Argentina's bonds in the securities market in Italy contributed to Argentina's economic development. The dissenting opinion of the arbitrator was that the bonds could not be a protected investment under the Convention because there was no intent to perform an economic activity in the host country. There were Italian intermediaries involved in selling these bonds to the Italian individual investors so that Argentina alone did not benefit from the secondary market. Perhaps the intermediaries too had some duty of care towards their customers.

53. In *Poštová banka* (2013), the Greece-Slovakia BIT defined investment very broadly to include “loans, claims to money or to any performance under contract having a financial value”. The claimant had acquired Greek sovereign bonds under a contract with a company called Clearstream, and sold them back through Clearstream under assignment agreements, in some cases in matter of hours without even informing Greece. The bonds were freely negotiable, high-risk and short-term. The investment risk was held to be a commercial (not sovereign) risk. The majority of the tribunal (Stern and Zuleta) believed that there was no investment. If the claimant had made a loan to Greece it would have had a direct contractual relationship with Greece and the conclusion would have been different.

54. If payments were outside the host country but for its benefit, they are accepted as investment. (*Alpha Projektholding GmbH* 2007, *Inmaris Perestroika Sailing Maritime Services GmbH* 2008, and *Saipem SpA*, 2005). Claimants have even tried, not always with success, to show that a settlement agreement or a repayment agreement, or an ICC arbitration award constitute investments (*GEA Group Aktiengesellschaft* 2008). The attempt to treat an ICC award as an investment would be to allow using ICSID as a forum to enforce and execute an agreement (*Nova Scotia Power Incorporated*, 2011).

55. ICSID jurisdiction is certainly not dependent on the amount actually spent by an investor (*RSM Production Corporation*, 2005). Even a two years' hedging contract was held to be an investment in Sri Lanka by the tribunal in *Deutsche Bank AG* (2009). The benefit to Sri Lanka was reducing its exposure to volatile oil prices and improving the predictability of their cash-flow.

56. The construction of a highway, dam or a similar infrastructure is assumed to serve the public interest in the host state. Host states do not necessarily look at a construction contract with the understanding that it is an investment protected under BITs (*Consortium RFCC* 2000, and *LESI SpA and Astaldi SpA* 2005). For example, in *Toto Construzioni Generali SpA* (2007), Lebanon argued that an investment for the purpose of the Convention required a specific risk that the operation might not be profitable, not just that some contractual obligation will not be honoured. The tribunal disagreed on the basis that there is not always a full coverage of the profits and costs and that an unforeseen event might occur. This flexibility should, but tends not to be, afforded to host states when they undertake projects that are marginally feasible and later become impossible to perform.

57. Other tribunals have also tended to consider construction contracts as investments, as for example, in the *Salini* (2000) or in *Convial Callao SA and CCI* (2010). In *Bayindir Insaat Turizim Ticaret Ve Sanayi AS* (2003), the interest paid on bank guarantees by the construction contractor was held to be part of the investment. Pakistan argued that in order to qualify as an investment, there should be an element of risk. Bayindir had received a substantial mobilisation advance which it alleged involved risk because they had to provide a first demand bank guarantee. In *Antoine Abou Lahoud* (2010), a guarantee to cover a \$1.5 million loan to a French bank was the risk taken by the claimant justifying its entitlement to ICSID protection.

58. In *Joy Mining* (2003) case, bank guarantees to the value of £9.6 million were not held to be a contribution to the economy of the host state. The guarantee itself was money that the investor would receive back from the bank if there was no breach of contract.

59. Even if an investment failed, and made no contribution at all to the host's economy, it would not mean that there was no investment (*KT Asia Investment Group BV*, 2009). However, BITs are

not an insurance policy against bad business decisions, as was held in *Robert Azinian and others* (1997), *Emilio Augustín Maffezini* (1997), *Waste Management* (2000), and a few other cases.

60. The host country risk is usually balanced by a high rate of return that the investor can expect should the investment be successful. In many infrastructure contracts the tariff, for example, includes a premium for the country risk, and there may well be other protections for the investor either in the agreement or allowed by the tribunal in an award (as, for example, a guarantee of tariff adjustment in the case of a changed parity of Argentine peso with the dollar in *Enron Creditors Recovery Corporation*, 2001). The returns are even higher if the claimants have used SCCs that grant tax advantages. When difficulties do arise, like for the claimants in *CMS Gas*, investors do not always mitigate their losses, or when other things are in even balance, they choose an option that is to the detriment of the host state. In *Azurix Corporation* (2001), the claimants decided to make the company insolvent to the detriment, Argentina argued, of its creditors such as the Province; the creditors' receivables were pesified but the Azurix claim was in US dollars.

14.7 Corruption/misrepresentation

61. As in any other sector of the global economy, issues of corruption and misrepresentation arise in ISA. In a BIT arbitration, one could assume that state signatories would not have wished to grant a privilege of a direct international arbitration on an investor who misrepresented the benefit of such an investment to the host state or indulged in bribery over it. At times, the ISA arbitrators' legalistic approach leads to upholding jurisdiction (instead of requiring *bona fide* investments, as arbitrator Stern has done in a few cases). The use of SCCs is often implicated in cases involving allegations of corruption.

62. In *Malicorp Limited* (2008), the claimant's investment was not made at the time the contract was rescinded. Malicorp, a UK-registered company, with issued share capital of £1,000 but authorised capital of £100 million, made a bid for the construction of an airport on a BOT basis. After the bid was successful, Malicorp's board cancelled the resolution that had increased its authorised capital (not issued or subscribed) to £100 million, and replaced it with a resolution approving £1,000 capital. When Egypt cancelled the concession contract, the claimant had failed to take any requisite steps under the contract (e.g. setting up an Egyptian company, providing guarantees, etc.). In a commercial arbitration under the concession contract, the claimant won an award of \$14 million for the cancellation –including \$10 million for loss of profit; it was held that the contract was awarded by mistake. The finance and specialist engineering companies that Malicorp had contacted were from Norway, Guernsey, and a holding company of an international investment group from Luxembourg. This commitment to perform the contract in future was held to

constitute an investment even if there were indications that Malicorp might not have had a capacity to fulfil its contractual obligations. The tribunal stated, “the protection here extends to deprivation of the revenue the investor had a right to expect in consideration for contributions that it had not yet made, but which it had contractually committed to make subsequently.” (p.34). On the merits, and after considerable expenditure on costs, the tribunal held that Egypt’s rescission was well-founded. The claimant’s annulment application was rejected. The commercial arbitration award for \$14 million was refused enforcement in France and in Britain,¹⁶ and set aside in Egypt. From the fact that the claimant was represented in ICSID by a French law firm, it could be inferred that the ultimate investor behind Malicorp was not British; Britain was simply a convenient seat. This case can be usefully contrasted with the decision in *Alapli Elektrik BV* (2008).

63. *World Duty Free Company Limited* (2000) was a non-BIT arbitration started by a British company incorporated in the Isle of Man, resident and headquartered in the UAE (where the ultimate investor family was), and operating in Kenya. It admitted paying a bribe of \$2 million; the tribunal refused to allow the claimant to use the ICSID forum as a matter of international public policy. However, as no evidence or argument was submitted by either of the parties to the effect that the bribe specifically procured Article 9 of the investment contract (to submit disputes to ICSID arbitration), the arbitration agreement was held to remain subsisting, valid and effective to make the award.

14.8 Third party funding of ISA

64. It is arguable that third party funding is similar to insurance contracts in that an insurer can step into the shoes of the insured entity (subrogation). However, if PRI is involved, the host state tends to know of its existence, if it is through OPIC or MIGA. PRI insurance is different from outright third party funding of claims; there is a global market in claims. Various funds have been set up in SCCs enabling such funding to be given. This willingness to invest capital indicates the confidence of potential for a good rate of return by recovering the ISA claims, or by selling them forward to other (perhaps unsuspecting) investors.

65. The tribunal in *Phoenix Action Ltd.* (2006) held that if the sole purpose of an economic transaction is to pursue an ICSID claim, without any intent to perform any economic activity in the host country, such a transaction cannot be considered as a protected investment. However, the purchase of a claim by a holding company was held to be an investment in *African Holding Company of America Inc.* (2005).

66. In *Abaclat* (2007), an entity called Task Force Argentina (TFA) started the arbitration involving thousands of individual claimants. Argentina unsuccessfully objected on the basis of a

conflict of interest between TFA and the claimants. After the determination of jurisdiction and various other procedural steps, Argentina agreed to pay \$1.35 billion to the claimants in February 2016 by way of settlement.¹⁷ *Giovanni Alemanni and Others* (2007) and *Ambiente Ufficio SpA* (2008) were cases with multiple claimants against Argentina. Their funding was from NASAM, incorporated in Monaco and owned by a Swiss trust. The tribunal ignored NASAM's standing as irrelevant and focused on whether the named claimants were Italians. Invoking the get-out-of-difficult-situation concept of the general unity of an investment, the tribunal looked at the 'economic substance' of the transaction in a holistic manner. In their opinions, there was nothing for the states to lose in terms of defining the investment broadly to include sovereign bonds or security entitlements.

14.9 *Travaux préparatoires*

67. Whether these kind of secondary market transactions made outside the host countries should be investments under BITs is an interesting issue. When Americans purchase, in US shops, consumer goods manufactured in China, they are helping the Chinese economy, but that is not the same thing as an investment *in* China.

68. Usually, the hosts have no documentation about the negotiations as seen in *Generation Ukraine Inc.* (2000). In *Perenco Ecuador Limited* (2008), Ecuador put forward evidence to show that the words 'directly or indirectly' were removed in relation to control so the tribunal invited the French authorities to submit any *travaux* to help understand the process through which the phrase was deleted. In *Tidewater Investment SRL and Tidewater Caribe CA* (2010), the claimants relied on the statements prepared by Ambassador Corrales, Venezuela's Permanent Representative at the WTO, Geneva, to the effect that a regime applicable to foreign investments must leave open the possibility of resort to ICSID arbitration which, he said, was almost universally accepted. He had been involved in the drafting of Venezuela's Investment Law. However, the tribunal refused to impute his statements to the Venezuelan legislature especially as the Law was ambiguous, and could not be interpreted as an open offer by Venezuela to arbitrate investment disputes under the Convention.

69. Out of the 463 cases analysed for the purpose of this thesis, *travaux préparatoires* or some other type of state-negotiating document was sought or referred to in about fifteen cases – that is in less than 5% cases, and in those cases the *travaux* was not much use for the interpretation. The solution is then to assume that the parties delegated the power to make norms to the arbitrators. However, there is no evidence of this either.

14.10 Summary

70. The tribunal in *PSEG Global Inc. (2002)* acknowledged part of the argument in this thesis that the Convention expected express agreements between the investors and states. The tribunal stated, “at the time the Convention was negotiated it was envisaged that the Contracting States would normally express their consent in investment agreements concluded with the private investors, which were later supplemented by the massive network [of BITs].” (paragraph 138). The BIT supplementation referred to by the tribunal occurred only because of the interpretation of the BITs in ISA, not because of the states’ understanding that this would be so. This explains why, in most of the early ICSID arbitration cases, jurisdiction was routinely challenged by respondent states.

71. Consent to arbitration has become an ever-expanding phenomenon because arbitrators have used BITs and the Convention together, as if the deal is to provide for arbitration on the best terms out of the two. Instead of limiting ICSID arbitration to the rare cases of egregious use of sovereign power by states acting to the investors’ detriment, tribunals overlook the origin of capital, its destination, and its wider effect on the host state’s economy – all of these elements are affected by the use of SCCs. ISA has recently come under increasing criticism as public awareness about it has increased. The current generation of BITs and regional treaties are attracting more attention than was ever accorded to the original BITs. The path on which ISA has been set by the ICSID cases encourages, or at any rate, does nothing to discourage the use of SCCs and thus of tax havens.

¹ Shearman & Sterling, Yukos’s law firm also secured for Dow Chemical Company the second biggest arbitration award of \$2.1 billion in an ICC arbitral award in May 2012. See the news dated 23 October 2012 on the firm’s website. Retrieved from www.shearman.com.

² Russia relied on internal messages of the company management that a disclosure of its scheme would “result in substantial tax claims against the Company.” (p.35 of the Award).

³ The French Cour de cassation decisions dated 23 March 1994 in *Société Hilmarton Ltd v Société Omnium de traitement et de valorisation (OTV) / 92-15.137*, and dated 29 juin 2007 in *Société PT Putrabali Adyamulia v Société Rena Holding et Société Moguntia Est Epices / 05-18.053*. The position is not necessarily the same in other jurisdictions.

⁴ *IMF Staff Report - The Gambia: 2001 Article IV Consultation-Staff Report; Public Information Notice on the Executive Board Discussion; and Statement by the Authorities of The Gambia. 2001*

⁵ This was similar to Indonesia’s consent in *Rafat Ali Rizvi (2011)*.

⁶ “Investeringsbeschermingsovereenkomst” (Note on Investment Protection Agreement), Netherlands Ministry of Economic Affairs at www.minez.nl quoted and translated in Expert Opinion- Dutch Practice, Professor Nico J. Schrijver, para. 10.

⁷ Top two TNCs at that time were : Vivendi (in 1998 had revenues of €31.7 billion), Suez Lyonnaise des Eaux (1998 revenues of €31.36 billion).

⁸ “Water infrastructure financing: The water infrastructure finance and innovation Act (WIFIA) Progroam” *Congressional Research Service*, 9 February 2016.

⁹ Retrieved from www.mining-technology.com/projects/zarafshan/.

¹⁰ In a NAFTA case against Canada, the claimant Mobil Corporation claimed that the compensation awarded should be increased by 38% as it would be likely-taxed in US at that rate. The companies operating in Canada were owned and controlled by Mobil, Delaware. However, the tribunal could not find a justification in this argument for why the compensation had to flow to US when the damage was suffered in Canada. The tribunal held that it was not part of international law to gross up compensation as a result of such considerations.

¹¹ Here part of the funds could be shown to have originated abroad. The dispute was settled after the determination on jurisdiction and the award is not public.

¹²The text was adopted by ILC at its 58th session in 2006, and was submitted to the General Assembly (A/61/10).

¹³Paragraph 155.

¹⁴On the basis that the claimant could not invoke the MFN clause to avoid the fork-in-the-road provision in the BIT.

¹⁵“In a BOT Project the project company or operator generally obtains its revenues through a fee charged to the utility/government rather than tariffs charged to consumers.”: “Concessions, Build-Operate-Transfer (BOT) and Design-Build-Operate (DBO) Projects” – retrieved from www.ppp.worldbank.org.

¹⁶*Malicorp Limited* [2015] EWHC 361 (Comm), UK decided on 19 February 2015.

¹⁷*ibid*

15. Conclusions

15.1 Dispensing with an express arbitration agreement

1. In answer to the Research Question framed in Chapter 1, this thesis has shown that ISA in BITs is being used for indirect investments, routed via SCCs, disregarding the objectives of BITs to encourage investments *from a home state to a host state*. It has also shown that the concept of FDI is irrelevant to ISA. Chapters 3 to 4 summarised the circumstances in which ISA was first demanded; the economies of the states were less interdependent then than they would become in the 1990s. Those Chapters also showed how difficult it was for the states to agree to a multilateral convention on the protection of investors' rights. Neither the Convention nor the BITs were designed to dispense with an express arbitration agreement between an investor and a state. Consent to ISA is mostly inferred from unilateral documents regardless of the investments having been routed via SCCs. ISA was promoted on the basis that it would help the developing countries to attract foreign non-debt finance. However, for ICSID jurisdiction, it is not always necessary that any funds originate in the home state or be destined for the host; investments do not even need to be foreign or direct; they need not make a net contribution to the host's economy. There is no consideration for the host states' promises to protect investments under BITs or to agree to ISA. Given the ease of corporate restructuring through the SCCs, the original justification that the bitter pill of ISA would attract FDI no longer holds true, if it ever did. Lawyers tend to oppose arguments about regulatory chill. However, there must be a reason that ISA continues to find a place in the current regional treaties like the TTIP or the TPP. This thesis has highlighted the need for a current justification for ISA that is not based on bilateral or even regional deals. What it highlights is the need for the investors and states to negotiate specific ICSID or ISA agreements for specific investments.

2. In answer to the Research Question (a), Chapter 5 explained the concept of SCCs and described the characteristics of a few typical SCCs. Tax havens might have started off being used by individuals of high net worth or the odd oil company in the 1950s, but by 1990 they became part of the mainstream economies – accepted by the OECD states, IOs and even the EU. Chapters 6 and 7 described the crucial changes that took place in the global economy after the Convention and BITs were designed. Where BITs were perceived to be necessary in the NIEO times of highly regulated economies of developing countries, their *raison d'être* has disappeared with largescale liberalisations, privatisations and deregulations. Ironically, just around that time, the number of BITs surged along with the use of SCCs. FDI ceased to be associated with control or minimum 10%

ownership; in fact, it now includes ‘indirectly held direct investments’. As MNCs turned into TNC conglomerates, their businesses also changed radically. Production was no longer the main focus of businesses as financialisation became prominent. Corporate residence became a meaningless concept.

3. In part answer to the Research Question (b), Chapter 8 showed that BITs’ growth went hand in hand with the spread of globalisation and the growth of oligopolistic TNCs – both of which were actively encouraged by the US government and US based TNCs. The US might not have signed many BITs, but its starting a BIT programme gave an impetus to many countries to sign BITs and DTTs. The US investors use SCCs and SPEs prolifically, and take advantage of other countries’ BITs. There is no political incentive for the US to change the current system. It is not clear whether the other developed countries and IOs that encouraged the signing of BITs (on terms designed mainly by capital-rich countries) were aware that BITs would, without express arbitration agreements, serve as the foundations of ISA jurisdiction. If they were aware, there is no evidence that this understanding was shared with the developing countries.

4. In part answer to Research Question (b), Chapter 9 confirms the developing countries’ debt crunch but also that they appeared to have had very little negotiations over the terms of their BITs. There is no indication that they believed that BITs themselves could lead to an arbitration between investors and states. Most BITs were signed before the key ICSID cases derived a consent. Chapter 10 showed how the World Bank, the FIAS, MIGA, the IFC, the IMF, and UNCTAD all advised the developing countries to improve their investment climates and specifically to make investment laws and treaties. Particularly, no IOs appear to have focused on the effect of the SCCs or tax havens on the developmental objectives of BITs and especially on the jurisdiction of ISA.

5. In part answer to Research Question (b), Chapters 11 to 14 dealt with the most important role in the process of expansion of ISA to indirectly made claims. Chapter 11 demonstrated the possible alternative and narrow interpretation of BITs and investment laws that would have restricted the effect of the SCCs and limited ISA jurisdiction to the investments for which ISA was specifically agreed. Instead, arbitrators’ key decisions acted as wedges to open new ways of inferring consent to arbitration. Chapters 12 and 13 case-studies showed how these gaps were then used to expand ISA’s scope to apply to instances where jurisdiction was derived by arbitrators and manipulated by the TNCs’ clever use of SCCs with little attention to the objectives of BITs or to the legitimate expectations of the host states. It was not the BITs, but the arbitrators’ decisions that rendered BITs as mere portals. It was the arbitrators’ expansive decisions that discouraged TNC investors from entering into specific arbitration agreements.

6. This thesis examined the governance of international investments by focusing on one part of the process by which private authority has grown, namely the drafting and interpretation of the gateway clauses in the Convention and BITs in the light of the use of SCCs. The direction of these interpretations was not a matter of chance, but a deliberate choice by arbitrators. Lawyers, in their interchangeable roles as arbitrators and counsel, have taken their interpretations of the Convention and BITs beyond those foreseen by the signatories. Thus, the roles of the changing economy and the states and IOs were important in the process, but it was the arbitrators' interpretations that helped to expand the applicability of ISA jurisdiction to indirect claims routed via SCCs.

15.2 Historical influences on norm-making

7. TNCs' influence on norm-making is not a new phenomenon. Their influence led to the operative framework of the New York Convention (Chapter 3) – its effectiveness was the main reason for the growth in arbitration. All law has its roots in the past to some extent. Anghie described the colonial origins of international law and the problems posed by the new states' intentions to regain control over their natural resources from foreign corporations (2005, p.224). Fidler (2001) drew parallels between BITs and the capitulation agreements from the 19th century.¹ Alvarez cautions against this comparison as there exist BITs between the developing countries themselves and some south-to-south agreements (2008, p.960). However, those were signed after BITs were well established as part of global governance.

8. International investment law, described as “new and largely experimental” in the early 1960s (Friedman, 1962, p.1148), is no longer new, but continues to be experimental in pushing its boundaries (for example, its use in enforcing sovereign bonds). One can speculate whether there will be some reining in of the extensive principles given that some of the western states are now capital-importing states and likely to be respondents in ISA.² Further, a EU-proposed investment court may or may not function as a slightly improved version of ISA. It still assumes that treaty law is, in principle, required to resolve every investment dispute.

9. When the wording of BITs, based on the realities of the pre-1950s' world economy (with growth based on traditional capitalism and *direct* investments in productive ventures), encountered the conditions of the 1990s' global economy (with growth based on financial innovation that generously used SCCs), they encouraged the *indirect* mode of investments. Despite the recent rhetoric of most states and international organisations against tax havens, BITs and their interpretations in ISA have encouraged, or at least not discouraged, the use of SCCs, a large number of which function as tax havens.

10. When an investment is routed through one or more SCCs minimising the financial and

regulatory burden on the investor, the potential for benefits to either host or home economy is obscured in a complexity of connections between cross-border corporate entities. Investors may rely on a formal title to an investment or a beneficial one, and sometimes they have simply purchased the title to a claim. Sometimes the host is aware of the identities of the ultimate investors and sometimes it becomes aware of them during ISA proceedings. Analysing how ISA came to apply to indirect investments (as analysed in this thesis) is essential before further incremental improvements are carried out to try and fix some of ISA's fundamental problems.

15.3 Interpretation defeating the objectives of the Convention and BITs

11. Investment protection (whether under the Convention or BITs) was intended to be a means to achieve the objective of investment promotion for economic development. SCCs, particularly, tax havens, defeat such an objective. TNCs' usage of SPEs set up in SCCs derives legitimacy from ISA decisions, which in turn, purport to derive legitimacy from the wording of BITs.

12. The Convention was a facilitating agreement that needed a "consent in writing" as the basis of the arbitrators' jurisdiction (Article 25). It clearly prohibited an arbitration by a national against its own state, unless the host and the investor agreed that the local company should be treated as a national of "another Contracting State for the purpose of this Convention." It did not provide for indirectly routed investments with a possibility of having multiple home states.

13. BITs comprise widely worded definitions of investors and investments. However, in most cases, their prima facie purpose appears to be to set out the substantive protections that the investments would be entitled to (e.g. against expropriation). The arbitration clauses in BITs appear to be invitations to treat that should have led to the need for an express arbitration agreement with the investors. It would have been unreasonable and unnecessary to permit access to an expensive international tribunal to investments that would have defeated the whole point of entering into BITs (as for example, loans and short term portfolio investments). Any other interpretation allows almost an indefinite number of investments to be removed from the national courts' realm to the international treaty realm. Many of those are probably in the realm of ICA anyway; ISA simply gives further leverage to those investors to enforce ICA awards.

15.4 Problems with an inferred consent

14. The inferred consent to ISA coincided with the crucial changes that took place in the global economy around the 1990s as discussed in Chapters 6 and 7. MNCs metamorphosed into TNCs that started to create thousands of SPEs strategically placed or moved in key SCCs. TNCs themselves no longer owed allegiance to one home state; their businesses became multi-layered and

multilocal. Most of their investment decisions did not need to be driven by the existence of a dispute resolution scheme. Financialisation, and not production, became the staple of economic transactions. Hence, one cannot assume that investments *per se* create economic value for the hosts. BITs were not designed for these conditions. The developing countries, suffering from the 1980s' debt crises, did not have much of a free choice over the terms of BITs. This disadvantage was magnified by the interpretations of BITs by arbitrators.

15. Most investment laws and BITs were treated by arbitrators as standing offers of arbitration that could be accepted any time even after many years of making the investment. The risk of multiple claims in relation to the same dispute could not arise when an arbitration agreement relating to specific investments was made between a state and an investor; the umbrella of an investment law or a BIT would have given it added protection. The use of SCCs or SPEs, and the bargaining between states and investors over issues of taxation as well as arbitration would have all taken place transparently, without relying on an element of surprise. A specially negotiated arbitration agreement would have helped to avoid complicated jurisdictional issues. These include, the correct forum for a host state's counterclaim, whether the parties to an investment contract (e.g. state agency that signed the contract) should be parties to ISA,³ mass arbitrations by people of whose existence or investment the host state has no knowledge,⁴ etc. The main responsibility for the direction of ISA towards expansion and uncertainty thus has to be laid at the door of arbitrators, particularly those who issued some landmark decisions. Not only has this led to some expensive disputes over jurisdiction but they have not encouraged states and investors to negotiate ISA-specific arbitration agreements.

16. BITs worked to provide a foot-in-the-door as explained in Chapter 4. Once a dispute is decided by arbitrators (with even a majority of 2:1), there is little reconsideration of the issues, particularly in the national courts or legislature. BITs cannot be modified without the consent of the other signatory state. ICSID coupled with BITs thus contained the potential to grow the scope of ISA so long as the arbitrators' group was predominantly convinced of the project. The very nature of the small pool of arbitrators in the field ensured this.

17. Right from that stage of creating a possibility of ISA, each time there was a landmark change, the push appears to have come from a small group of persons with similar ideas (e.g. the teams involved in the *SPP*, *AAPL* and *AMT* cases, or more recently in the Argentine disputes arising out of the Italian bonds). ISA progress soon became path-dependent, with ISA awards and legal commentators providing feedback loops. The latest feedback loops are being provided by the new generation BITs that were signed by emerging powers like India with less powerful countries, and the regionals treaties signed or being negotiated by and between developed countries (e.g. the TTIP

or the CETA). Ironically, and despite the arbitrators' claim that BITs and awards are making new customary international law, there is still no movement for a multilateral investment protection treaty. Thus, international law has become part of the armoury of private global governance techniques.

18. SCCs have become highly relevant to international investment law because of their prolific use in channelling of investments around the globe. ISA awards dealing with SCCs and SPEs have blurred the distinctions between FDI and other investments. TNCs are the main beneficiaries of the way ISA has developed. They can now make an investment in any country by choosing the route to get the best of taxation and other regulatory provisions. If they get it wrong, they can, as easily, modify the route. A negotiated ISA agreement would not provide this flexibility.

19. The US, being an SCC in itself, has not discouraged the TNCs' way of investing through other SCCs. The oligopolistic TNCs emerged in the US and thrived because of the conditions of the US political economy. The US assisted in the spread of indirect investments around the globe with its investors making their investments abroad by taking advantage of the DTTs and BITs made by other countries. IOs did not discourage the use of SCCs; in fact, some like the World Bank assisted in the making of a few SCCs. IOs' focus on the investors' demands meant that they did not provide for the legitimate expectations of host states when promoting ISA or BITs.

20. Chapter 11 showed examples of *indirect* routes taken by investments that ended up in ICSID disputes, and Chapter 12 showed how arbitrators expanded the consent further. Chapters 13 and 14 showed the implications of such expansion. The original objectives of BITs are neglected. Thus, the authority of national courts over the investments made in their jurisdiction has been transferred to private judicial authority of arbitrators along a continuum since the 1950s with each new broadening being introduced by the arbitrators' decisions, albeit helped by states' choice of words.

21. Simply providing for a formal title, the place of incorporation of the investor, as the basis of jurisdiction will not resolve the difficulties of defining ISA eligibility. That place of incorporation can be changed by migration or affected by a merger upstream. Making the use of ICSID dependent on a clear and express agreement would be better than relying on a derived consent.

22. If a legal tool is created, inevitably lawyers will try and expand the scope for its use. This is, of course, not a justification for it. Some atypical aspects of investments found to be eligible for ISA include the kinds of disputes which have worked well with ICA, as for example the rebuilding of a vessel and its operation under a bareboat charter (*Inmaris Perestroika Sailing Maritime Services GmbH 2008*); or a salvage contract which is normally on the basis of 'no find, no pay'. (*Malaysian Historical Salvors SDN, BHD*). Due to the way the Convention and BITs are drafted,

construed and applied, the term ‘investment’ can amount to a broad range of activities quite distinct from the common understanding of the meaning of this word. For example, in *Atlantic Triton* (1984), the Government of Guinea (Guinea) entered into a management agreement with Norwegian company Atlantic Triton (AT) under which AT would convert, equip and operate three shipping vessels *owned* by Guinea, *at Guinea’s cost*, in order to establish a fishing industry in Guinea. The agreement was to last two years. The repair and conversion work was done in Norway, so that under the commonly understood definition of an investment, Guinea made an investment in its own fishing industry and possibly in Norway’s shipyards. However, the management agreement was held to be an ‘investment’ by AT in Guinea so as to enable AT to start an ICSID arbitration. The first few months’ operation showed that the ships were unsuitable for fishing in the local Guinean waters, too large, expensive (leading to several mechanical and electrical breakdowns from having used technology unsuitable for tropical waters) and complicated to operate, the Norwegian nets were unsuitable and the ships needed further work including an overhaul. Further work was undertaken in Norway before the parties’ dispute led to AT terminating the contract for non-payment by Guinea. The ICSID tribunal comprising two Dutch and one French arbitrators awarded AT its claim for conversion costs but denied Guinea’s counterclaim. Regardless of the merits of that case, there is no reason to think that Guinea and AT could not have resolved this dispute in ICA. There was no reason to invoke the specialist ISA jurisdiction; this was a commercial dispute not one related to the exercise of sovereign power by Guinea. The investor secured a huge advantage in not having to rely upon the New York Convention for the enforcement of its award against Guinea. This case illustrates how foreign investment (if AT’s *expertise* in ship-outfitting could be called that) may actually be inappropriate for a host state, an expensive mistake which would have an adverse effect on social welfare and development.

23. One of the concepts frequently used by arbitrators is that of “legitimate expectations” - primarily of investors to make profit. One arbitration tribunal clearly set out its expected standard of state behaviour in the words, “The foreign investors expects the host State to act in a consistent manner, free from ambiguity and totally transparently in its relations with the foreign investor, so that it may know beforehand any and all rules and regulations that will govern its investments as well as the goals of the relevant policies and administrative practices and directives, to be able to plan its investment and comply with such regulations.” (*Tecnicas Medioambientales TECMED S.A.*, 2000, paragraph 154). It would be only fair to expect investors to act equally transparently with their host states.

24. The *Suez* (2003) tribunal relied upon Max Weber’s idea of making economic life “more calculable,” and that capitalism arose in Europe because its law demonstrated a high degree of

“calculability” (Weber, 1922, p.855). The tribunal held that the investors’ expectations are in effect calculations about the future (paragraph 222, decision on liability). Quite apart from ignoring the equally calculable legitimate expectations of the states, this perspective also neglects the difference between a European country making its laws calculable to *all* its nationals in the 1920s, and countries doing this for TNCs in the globalised economy. The European laws aimed at their own capitalists formed part of their national social systems; the global economy is not yet at a stage to be called a unified social system. As soon as a country suffers an economic or other kind of emergency (e.g. a natural disaster), foreign investors are keen to depart with their profits intact or increased. Even in the absence of an emergency, most TNCs are keen not to contribute to the local economy, going to great lengths to avoid or minimise tax payments that would contribute to the common goods. But for the efforts of TNCs and high net worth individuals to avoid taxation in the host countries, the host countries could potentially have more funds to pay for improving the infrastructure as well as social and economic conditions of their country, thus making their investment climates attractive.

25. There were a few early attempts to consider that economic benefit to the host state was a requirement of an ISA-eligible investment, but increasingly arbitrators shy away from this view. Some do not consider it a feasible or practical matter to determine, while others think that it is beyond their legal remit. Either way, this helps to promote a privileged position for TNCs. Historically, English law was not always this favourable to corporations. For example, according to the Oxford Illustrated History of Tudor and Stuart Britain, English judges declared, in the case brought by the Merchant Tailors of Ipswich in 1615, that, within limits, “the common law right of every man to earn his own living outweighed claims of corporate privilege.” (Morrill, p.145). This was the time when crown-grants of monopolies and copyrights had started to emerge. “It was widely held amongst the lawyers that the Elizabethan and early Stuart practice of granting patents of monopoly, which allowed favoured individuals to profit from the regulation of named trades, was an abuse.” (Morrill, p.145). Thus, the common law in England was that the public interest should override private interests.

26. International investment treaty law is acknowledged to be akin to international common law or what the *Mondev* (1999) tribunal called concordant practice. Lawyers, whether acting as counsel or arbitrators or indeed as advisers to states drafting treaties, have moved ISA from one possible alternative mechanism for dispute resolution to *the* accepted mode of changing international law. Cole (2013, p.xvi) suggests that a structure has been created in which the jurisprudence of arbitral tribunals is the “central means by which investment law is developed.” While this may be the acknowledgement of the exercise of such private power, its foundation is still without justification

as it is founded on states' inferred consent.

27. In common with the international arbitrators of today, the early English litigation was based on using the might of law to enforce debts and agreements. Creditworthiness was terribly important; debt defaulters had to go to prison where they had to pay for their keep. Yet, without any means to earn while in the prisons, many had to stay there indefinitely. Promises made by state or public agencies are strictly enforced in ISA, a little like the old English debts. The burden of the debt used to fall on the family of the debtor; with today's investments, it falls on the taxpayers who might have had no control over the making or managing of the debt.

15.5 Were signatories to BITs *ad idem* about the eligibility of investments?

28. Given that most BITs proclaim their intention to encourage the flow of investment *between* the signatory countries and define the concepts of 'investor' and 'investment' by reference to nationality and citizenship, the idea – at least in the beginning – was that a *bilateral* relationship was promoted. This also makes sense in the context of the *political* risk that was the main target of the protection offered in the BITs, and not ordinary commercial risks. Only a minority of BITs specifically referred to investments routed via 'third' parties – non-signatory states; these still needed control from home state. The US BITs or multilateral treaties (e.g. the ECT) tend to include a 'denial of benefits' clause.

29. The denial of benefits clauses may become increasingly difficult to apply with the recent decisions that holding companies do not have to do much to qualify as eligible investors. In *Pac Rim Cayman LLC* (2009), the claimant PRC was established in Nevada, but owned by Canadian Pacific Rim Corporation. Originally, the investment had been routed through the Cayman Islands. Canada was neither a member of ICSID nor CAFTA at that time. Holding companies can have a board of directors, board minutes, a continuous physical presence and a bank account. That was not the case with the claimant in this dispute; its activities were equally insubstantial, whether in the Cayman Islands or later in Nevada. A majority of Pacific Rim's shareholders were natural or legal persons residing or at least having postal addresses in the US, but there was not enough evidence of them controlling the claimant. The denial of benefits of CAFTA to the claimant was therefore upheld. However, the El Salvador government had treated the claimant as a foreign investor, and, therefore, the claimant was held to have made an eligible investment. The tribunal did not want to conclude that a holding company could never meet the CAFTA condition of having 'substantial business activities' in a country. Usually, the holding company's business is merely that – to hold shares. Such companies, the tribunal assumed, have attendant benefits (e.g. taxation and risk-management). Also, this decision or the one in *Cervin Investissements S.A.* (2013) shows that it is

not difficult to provide a paper trail for holding companies.

30. If the signatory states envisaged that more than one entity would be entitled to bring the same claim under a BIT or sets of BITs, they would have provided a clarification of their intentions; the lack of such a clarification indicates that they did not envisage such a possibility. ISA tribunals assume that states have, by using broad language, permitted all the entities in a chain to bring a claim in respect of the same subject matter despite the risk of potentially contradictory decisions over the same issues, or the risk of double-dipping for compensation. The time taken to negotiate a convention like the VCLT shows how much care states used to take in agreeing to any change of international law. It took twenty odd years from 1949 to 1969 for the ILC to draft the VCLT and a further eleven years before it entered into force. This was merely a convention to be used when interpreting other treaties and the US has yet to ratify it. Lauterpacht was one of its Special Rapporteurs in the early part of the Convention's drafting. He was not an enthusiast of 'state sovereignty'⁵ but there is no evidence that the developing countries necessarily shared that view as they signed BITs or the Convention.

15.6 'cui bono?'

31. ISA arbitrators' authority is specialist private judicial authority. Strange's question '*cui bono?*' is pertinent in relation to it (1988, p. 132). ISA appears to benefit private investors, bankers, third party funders, the ICSID Centre, and the arbitration industry. While, some states may win some actions or issues in some actions, ISA does not exist for their benefit.

32. 'Rule of law' in its various manifestations is the oft-cited justification for the existence and promotion of international arbitration relating to investment treaty or purely commercial disputes (Schultz and Dupont, 2014, Van Harten, 2010, and Zekos, 2008). The concept of rule of law is multidimensional (Haggard and Tiede, 2011). However, within the narrow confines of international commercial and investment disputes, it is now assumed that arbitrators, rather than national courts, are the vanguards of rule of law (not necessarily of justice or overall social welfare). One common justification for ISA is a gap in the public governance of FDI, as indicated by dysfunctional public judiciary (Paulsson, 2011). This kind of an over-generalised argument may make a good rhetoric, but does not provide a justification for private authority either. Arbitration, of both commercial and investment treaty types, still relies upon the structure of states and their consent to BITs for its legitimacy; it also depends on the operative frameworks set up by other treaties for enforcement.

33. If rule of law is defined simply as "the restriction of the arbitrary exercise of power by subordinating it to well-defined and established laws,"⁶ there should exist such "well-defined and established laws" in place for private investment matters including on jurisdictional issues. As they

do not, only arbitrariness of states is to be provided against, not that of other important actors like TNCs or IOs. For instance, the IMF or the World Bank cannot be made a respondent in international arbitration for wrong or negligent advice to countries.

34. Rule of law is not usually an end in itself; it should be a means to justice or fairness. The qualified fairness promoted by the way ISA expands the eligibility of investors and investments is a ‘new legality’, using Sassen’s wording (Hall and Biersteker, 2002, p.94). Jurisdiction is power, as aptly put by Mr Justice Holmes (1913).⁷ This thesis has shown how the concepts of ‘investor’ and ‘investment’ have been stretched to include the kinds of investors and investments that were not within many developing countries’ contemplation as being subject to ISA. The concept of a ‘home’ country of an investor has lost a large part of its meaning. This loss is not simply a matter of form as it affects justice and fairness; if states’ obligations must be construed strictly, so should be the TNCs’ obligations. An investment being given a higher protection could be fair and justified on grounds of the extra revenues created in a local economy but not if the investment is so structured that the net effect to the host country is of wealth extraction rather than wealth creation. As Montt (2009, p.75) suggests, the BITs themselves are not objectionable per se, but the ISA jurisprudence poses a threat to developing countries’ sovereignty and has the potential to lead to either equality or inequality. The increased private authority over investments as analysed in this thesis has significance over that ultimate outcome of ISA; it encourages investors not to bother with negotiating specific ISA agreements with their host states.

35. Romano (1985, p.226) demonstrated how legal counsel assisted in raising the market-share of Delaware in the corporate charter competition. Similarly, lawyers have promoted ISA, not just in their practice, but also in their writing as for example, Schwebel (2008) and Paulsson (2005). The arbitration community has generated “a competitive market for legal products and judicial services” (Watt, 2010, p.9). BIT law now grows and develops in what Koskenniemi would call a “world ruled by lawyers” – “Lauterpacht’s utopia” (Koskenniemi, 2001, 404, 406), or what Fergusson might call “the rule of lawyers” (2014, p.109).

36. TNCs, for whose benefit BITs mainly function, are not meek creatures subject to arbitrary powers of states. Non-state actors’ activities are growing increasingly authoritative (Cutler 2003) and invisible (e.g. when the flag followed commerce, private power was visible). ISA arbitrators’ private authority in the judicial field cannot easily fit into the typology as ‘market’ authority. It requires its own category.

15.7 Changes on the horizon?

37. The recent bailing out of private businesses and the widespread nationalisation of private

debt mainly in the US and Europe were examples of states favouring the national over international entities, implementing exactly the kind of policies that the BIT framework was designed to prevent in the developing countries. For most countries, policy areas that require delicate balancing of interests are as wide-ranging as natural resource extraction, environmental harm caused by big businesses, health, intellectual property, land grabs, food production and distribution, water, and energy. For example, almost half of the pending Canadian NAFTA cases relate to energy policies. Regulation affecting multiple conflicting interests in these sensitive areas should, ideally, be left to the decision of states as they are the only actors that currently have political accountability.

38. Brown and Miles (2011) focus on the state of flux in investment treaty law. There are indications of some state actors taking a position away from the bandwagon: for example, the recent withdrawal from ICSID by Ecuador, Bolivia, etc. Spears (2010) and Born (2012) point to a new generation of BITs but it is clear that ISA still draws heavily from the earlier phases. ISA has been steadily carrying on business as usual. BITs are “here to stay” (Joubin-Bret and Kalicki, 2014, p.2) thus leaving open the possibility of tinkering with the system, but not drastically changing or replacing it.

39. The EU is a relatively new actor on the scene since the entering into force of the Treaty of Lisbon in December 2009, and has appeared in some ISAs as *amicus curiae* (Brown and Miles, 2011, p.8). The CETA proposes a definition of investment which, detracts from the *Salini* criteria, but still refers to characteristics such as the commitment of capital or other resources, the expectation of gain or profit, or the assumption of risk, or a certain duration. It also proposes that shell companies are not protected so that a qualified ‘investor’ would have substantive business operations in the territory of one of the Parties. The EU has proposed an investment court so as to address the unfairness in the way arbitrators are appointed. The EU is the first entity that carried out a public consultation over ISA. The report of the public enquiry showed a fundamental lack of trust in ISA. The EU promises to make it difficult to do forum-shopping. Ironically, the most progressive position on ISA is taken by the EU, a super-state type of entity that faces challenges of its own democratic legitimacy.

40. With the growth in ISA has also come a view that opposes the “democracy” thesis by relying upon the legitimacy in the “merits of the decision-makers” (Smit, 2010, p.22). This is on the basis that private law should be understood “more as an organism than as a product of explicit design” making it clear that “democratic input in this area of law can only have a limited impact” (Smit 2010, p.26). This is, at least partly, a boot-strapping argument. As the ambit of private justice has grown by ever-widening interpretation of international law and treaties, clearly, there is a growth in the number of private arbitration experts. Unlike an expert, say in forensic pathology,

arbitrators' job can be done by elite judges in most countries or by non-legal expert technocrats (for example, engineers for construction disputes, or accountants to unravel the economic pros and cons of an investments). The assumption of legitimacy of expert lawyers' authority ignores that the question is not of individuals' integrity, but of setting up a system with legitimacy, and checks and balances. The private judicial power needs to be founded on something more than a myth based on outdated BITs.

41. The creation of a satisfactory investment climate was being talked about in the late 1950s, but there were some sceptics about achieving this merely by drafting an investment code (Rubin, 1956). That objection remains valid today, in fact, more so given the prolific use of SCCs and SPEs. This research has highlighted the theoretical problem with inferring a 'consent' as the basis of the ISA edifice. If BITs were not about attracting FDI from one signatory state to another, they would have been replaced by a multilateral treaty.

42. The debate over whether corporations should be subjects of international law has been rendered somewhat otiose in relation to ISA by the development of BITs. TNCs are *de facto* subjects of international law and "significant actors on the world stage" (Milner 2014, p.2). International arbitrators accept that private parties, to a greater or lesser degree, are participants in the international legal process (Paulsson, 2005, p.55). There is no reason why investors who are keen on ISA cannot negotiate an upfront ISA agreement for their investments instead of relying on BITs.

43. It is clear that in a globalised economy with frequent crises such as the Argentine one or the more recent Greek one, debt and its aftermath tends to be the responsibility of states and indirectly of their tax-paying nationals; external finance, be it from private investors or banks, is a fair-weather companion (Rodrik, 2011). If the risks of such economies are not shared equitably by investors, there appears to be no basis for the privileged treatment of such investors. Further, making law on an ad hoc basis is an inefficient and unfair way of going about making international norms. For instance, Germany's decision to phase out nuclear power plants after Fukushima, or Canadian court's decisions on patents, do not have to be part of confidential ISA. Just the average legal cost of each such dispute is over \$8 million, sometimes reaching as high as \$30 million or more.⁸

44. Cole (2013, p.4) suggests that because ICSID is a power-conferring treaty, states' intentions are not terribly relevant despite the provisions of the VCLT. This argument still requires that the signatories to the Convention intended to confer such a power on arbitrators. The Convention expressly expected written arbitration agreements between states and investors, and without such

agreements, the power-conferring part is also inferred.

45. BITs promised increased FDI, growth and prosperity, and alternative sources of finance to debt. Whether they brought about a regulatory chill is difficult to prove either way (Bonnitcha, 2011, p.134). Tienhaara (2011, p.606, 619) sets out a few examples including three from Canada that might have had a regulatory chill as a result of a threatened NAFTA ISA and suggests that investigating regulatory chill requires methods and approaches more familiar to political scientists than to lawyers. The important point is that there is *potential* for a regulatory chill with ISA.

46. Currently, ISA power is truly private and tries to draw its legitimacy from a myth of consent by states. Given that the system is here to stay, for now capital-importing states need to put in a lot of work at the stage when each investment is made, and also in publishing unilateral reservations, provisos and exclusions from the general access to ISA. They need to carry out independent cost-benefit analyses of particularly large projects. They could try and draft creative safeguards for their contracts to minimise their risk exposure under international law. They could start demanding that TNCs undertake some basic obligations including tax paying; they could turn down, as their contracting partners, shell entities in SCCs. Most foreign investors' attitude to host countries' waters, paraphrasing Arthur Stringer's view of society, is that they are good to swim in, but not to swallow.

47. This thesis has looked into ICSID jurisprudence to consider the effect of SCCs on international investment law. This was a gap in the literature that needed to be addressed, especially in light of the states' and IOs' current rhetoric against the use of tax havens. The ambiguous wordings of BITs (for which both the developed and developing states bear varying degree of responsibility), the TNCs' frequent use of SCCs (mainly for their tax advantages), the changes to the essential natures of FDI and TNCs, IOs' advice to states to improve their investment climates, etc. all have enabled BITs to be applied to indirect investments. The most significant role was played in the process by the arbitration lawyers. This thesis has demonstrated why, in an interdependent global economy, both home and host states need to consider whether they should carry on using the pretence of a bilateral system designed for a radically different economy. The thesis advances the current scholarship on private authority's expansion by tracing the process by which this happened in ISA. The strategies of a foot-in-the-door, and a creative use of operative norms of the tools of arbitration and interpretation, have enabled ISA jurisdiction to expand. If ISA and SCCs are here to stay, this thesis has shown that the solution most commensurate with the rule of law would be for the host states and investors to negotiate specific ISA agreements on a case by case basis rather than trying to use outdated BITs as generic foundations of arbitration. The initiative for this will have to come from host states.

15.8 Further research

48. Research into the specific advice given to countries by the World Bank Group (particularly, by the FIAS) and UNCTAD should throw further light on IOs' role in the promotion of BITs. The developing countries' archives are unlikely to contain information about how and why they began their BIT programmes. The developed countries' archives (particularly, the European countries that pioneered the BIT programme) may indicate how they approached the developing countries with the initial draft BITs.

49. ISA is being shaped as a regime to enforce sovereign debts. Further research should focus on this aspect. Another area of potential research is the efficacy of the 'denial of benefits' clauses if holding companies are assumed to be legitimate business. Corporate forms used in ISA from various SCCs and the convenience of the separate identity of corporate personality should be further investigated in FDI.

50. Like TNCs, states need to monitor and manage disputes before they crystallise to the stage of ISA. Sector specific research into the effect of investment law will also help states to determine how tax havens or SCCs affects their contractually negotiated frameworks for infrastructure contracts or extraction concessions. Particularly, the use of specific SCCs by certain sectors need to be investigated further as also the differences between the SCCs (some are closer to tax havens than others). States should analyse the origin of funds on a sector wise basis and attempt to minimise potential damage in their investment contracts for high-risk projects; for example, accepting SPEs based in tax havens as counterparties simply encourages treaty shopping.

51. This thesis illustrates that there is a need for a new theoretical justification for ISA in the global, interdependent economy in which states are not as powerful actors as they once might have been. Such a justification will also need to consider the status of TNCs as significant actors on the international stage. They should be capable of taking on direct contractual commitments rather than having to rely on benefits under BITs as non-signatories. Rights could then be related to responsibilities.

52. A multilateral effort towards tax harmonisation and codification of investors' rights and obligations could improve overall global governance and investment climate. Bilateralism of investor protection or taxation does not answer the needs of a global economy. For most investments, expensive ICSID arbitration may work but whether it should be encouraged is another matter. An expensive drug for cancer might work on the common cold, but that is no reason to prescribe it regularly in place of rest and vitamins. The kind of medicine required for developing countries is not an expensive theriac, but a preventive prescription of fair and flexible contracts,

good feasibility studies before large investments are undertaken, and expert cost-benefit analyses of foreign investments and loans.

¹Capitulations exempted foreigners from the civil and criminal jurisdiction of the local tribunals, subjecting them instead to the laws and authorities of the contracting states: Fidler, 2000, p.390.

² The first of these South-North ICSID cases was started by a Chinese insurance company against Belgium. *Ping An Life Insurance Company of China, Limited* (2012) arose out of a bail-out in the 2008 financial crisis and was dismissed in April 2015 for lack of jurisdiction. The original BIT of China did not include access to ISA for a wide variety of disputes (only compensation amount in case of expropriation); the dispute did not come within the new 2009 treaty with Belgium and Luxembourg.

³This has practical disadvantages to a state defending an ISA as the autonomous state agencies may not be under any obligation under domestic law to assist the state in its defence.

⁴This is important because risk is usually allocated in a contract to the party that is best able to control it; for this such a party should know of the risk.

⁵He even wrote an “indictment of sovereignty into his drafts of the opening and closing statements of the British prosecutor at Nuremberg, Sir Hartley Shawcross.” These parts were deleted by Shawcross. (Koskenniemi, 2012, 8).

⁶Oxford English Dictionary, retrieved from www.en.oxforddictionaries.com.

⁷*Michigan Trust Co. v. Ferry*, 228 US 346, 356 (1913).

⁸OECD (2012) Investor-State Dispute Settlement. Public Consultation: 16 May – 23 July 2012, p.19.

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