



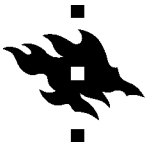
HELSINGIN YLIOPISTO  
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# **TREATY SHOPPING IN INTERNATIONAL INVESTMENT LAW**

Setting Limits on Corporate Restructuring to Gain Access to  
Investment Protection

**UNIVERSITY OF HELSINKI  
FACULTY OF LAW**

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<p>This study systematically examines the practice of treaty shopping in international investment law and related arbitral awards. In this context the term "treaty shopping" connotes a strategic change of the investor's nationality for the purpose of accessing more favourable investment treaty provisions and dispute settlement mechanisms. The focus is solely on corporate investors, as the overwhelming majority of international investments are made by legal entities. In addition, the nationality of legal entities is generally much easier to manipulate as they can be relatively freely established, modified and dissolved.</p> <p>In recent years, international investment law has witnessed a rapidly growing number of treaty shopping cases, which has also raised certain concerns regarding the practice. At present, these concerns are strikingly unsettled as investment tribunals have adopted diverging attitudes towards treaty shopping, thus rendering decisions inconsistent with regard to the permissibility of it. Corporate nationality planning or treaty shopping is not illegal or unethical in principle, although many states perceive it as undesirable and have increasingly taken measures against such practices. What separates legitimate nationality planning from treaty abuse? The uncertainty about the limits of treaty shopping is unsatisfactory for both states and investors, not to mention the functionality of the investment protection system in general. This is the principal problem this study attempts to resolve.</p> <p>The study approaches the topic through three separate research questions. The first question seeks to place investment treaty shopping in the wider context. In this regard, the study will endeavour to establish a working definition of treaty shopping. In addition, the study will analyse the reasons for the occurrence of treaty shopping and introduce the most common ways to carry it out. Most importantly, the study explores in detail the benefits of treaty shopping and the main objections against it. Following the examination, the study concludes that despite extensive criticism, treaty shopping may actually enhance the underlying objectives of the investment regime: fair treatment of investors regardless their origin and helping states attract foreign capital to further stimulate financial growth.</p> <p>The second research question encompasses the legal limits to treaty shopping via corporate restructuring. The main purpose is to clarify the dividing line between legitimate nationality planning and abusive treaty shopping. To answer this question, the study analyses the most influential case law related to treaty shopping and discusses the different ways investment tribunals have reviewed the distinction between objectionable and acceptable treaty shopping. Further, the study attempts to systematise the main elements of the arbitral decisions with the goal of formulating general rules for assessing the permissibility of treaty shopping. These rules are useful guidelines for maintaining stability and predictability in investment treaty arbitration, which benefits both investors and states wishing to attract foreign capital. In this respect, the study suggests that the decisive factor is the timing of the investment <i>vis-à-vis</i> the timing of the dispute. The timing element, however, raises its own questions, each of which are further explained in the study.</p> <p>The third and final research question addresses the practical aspects of treaty shopping. While the previous research questions relate to defining the boundaries of treaty shopping, this part of the study focuses solely on the pragmatic and political implications. To this end, the study will introduce certain state reactions to treaty shopping. Further, the study will explore solutions and make recommendations <i>de lege ferenda</i> on how states can safeguard themselves against abusive treaty shopping. It also highlights that the power to curb the practice lies mostly with states who conclude investment treaties. The study suggests that the most effective methods are including narrower definitions and denial of benefits clauses to the treaties. From the foreign investor's perspective, the study will propose a "shopping list" that contains points to consider before undertaking any restructuring measures.</p> <p>This study is not meant as a comprehensive empirical review of treaty shopping, nor does it claim to supply any definitive answers to the questions it raises. Rather, the goal is to elaborate the legal issues arising from the ambiguous boundaries of treaty shopping and to make proposals as to how to assess these issues. For the time being, treaty shopping will remain not only possible, but also a highly attractive option for a prudent investor wishing to improve investment protection.</p>			
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## List of Abbreviations

<b>BIT</b>	Bilateral Investment Treaty
<b>CAFTA</b>	The Dominican Republic–Central America Free Trade Agreement
<b>ECJ</b>	European Court of Justice
<b>ECT</b>	Energy Charter Treaty
<b>EPA</b>	Economic Partnership
<b>FCN</b>	Treaty of Friendship, Commerce and Navigation
<b>FDI</b>	Foreign Direct Investment
<b>FET</b>	Fair and Equitable Treatment
<b>FTA</b>	Free Trade Agreement
<b>ICC</b>	International Chamber of Commerce
<b>ICJ</b>	The International Court of Justice
<b>ICSID</b>	International Centre for Settlement of Investment Disputes
<b>ICSID Convention</b>	Convention on the Settlement of Investment Disputes between States and Nationals of Other States (1965)
<b>IIA</b>	International Investment Agreement
<b>ILC</b>	International Law Commission
<b>ISDS</b>	Investor-State Dispute Settlement
<b>LCIA</b>	The London Court of International Arbitration
<b>MFN</b>	Most Favoured Nation
<b>MIT</b>	Multilateral Investment Agreement
<b>NAFTA</b>	North American Free Trade Agreement
<b>NYC</b>	The Convention on the Recognition and Enforcement of Foreign Arbitral Awards (“The New York Convention”)
<b>OECD</b>	The Organisation for Economic Co-operation and Development
<b>PCA</b>	Permanent Court of Arbitration

<b>SCC</b>	Stockholm Chamber of Commerce
<b>SOMO</b>	The Centre for Research on Multinational Corporations
<b>TIP</b>	Treaty with Investment Provision
<b>TTIP</b>	The Transatlantic Trade and Investment Partnership
<b>UNCED</b>	United Nations Conference on Environment and Development
<b>UNCITRAL</b>	United Nations Commission on International Trade Law
<b>UNCTAD</b>	United Nations Conference on Trade and Development
<b>UNTS</b>	The United Nations Treaty Series
<b>WTO</b>	World Trade Organization

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## Keywords

*Abuse of Rights, Abuse of Process, Bilateral Investment Treaty, BIT, Corporate Restructuring, Denial of Benefits, Foreseeability, Good Faith, ICSID, Incorporation, International Investment Agreement, IIA, Investment Arbitration, Investment law, Investor-State Dispute Settlement, ISDS, Mailbox Company, Multilateral Investment Treaty, Nationality of Investor, Nationality Planning, Rationale of Investment Law, Reciprocity, Round-Tripping, Sustainable Development, State Consent*

# 1. INTRODUCTION

## 1.1. Policy Perspectives

The world today is more integrated than ever before in the field of international investment and trade. Investment in particular has become an important tool in shaping the international economic landscape, and along with this development the significance of the international law and policy of foreign investment (hereafter FDI) has grown too. Capital no longer flows exclusively from developed countries towards the less developed but also vice versa. Inter-governmental treaties establishing safeguards for the protection of aliens and their property abroad have a long history, but in the framework of international investment agreements (hereafter IIA) it was as late as in the second half of the 20<sup>th</sup> century when the number of IIAs grew exponentially.<sup>1</sup>

Regardless of the fact that IIAs have been adopted almost universally, there is no global investment treaty or rule of customary international law that would obligate States to grant identical rights to investors irrespective of their country of origin. As a consequence, investors' legal stance relative to the State can vary. To obtain the most favourable investment protection in the patchwork of IIAs, a growing number of investors have resorted to treaty shopping, through which they restructure their business or investment in order to gain access to desirable treaty provisions and dispute settlement mechanisms, for which they would not be qualified otherwise.<sup>2</sup> This practice is at the core of this Study.

While treaty shopping is not a new phenomenon, it remains as controversial as ever.<sup>3</sup> This practice has provoked debate on many levels; some find it perfectly acceptable, while others perceive it as exploitation and abuse of the investment protection system. For States, the stakes are high as they are on the respondent side of investment disputes. Have States

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<sup>1</sup> See e.g. Vandevelde Kenneth, 'A Brief History of International Investment Agreements' [2005] 12(1) UC Davis Journal of International Law and Policy 157–194. According to United Nations Conference on Trade and Development (UNCTAD) a total of 2951 bilateral investment treaties have been concluded as of the end of 2017, 2363 of which were in force. In addition to these, a total of 373 other types of treaties (for example free–trade agreements) contained investment provisions, 310 of them in force. See UNCTAD, 'International Investment Agreements Navigator' (*Investment Policy Hub*).

Available at: <http://investmentpolicyhub.unctad.org/IIA> (accessed 26 January 2018).

<sup>2</sup> The same practice is often times also called "nationality planning" but, for the sake of clarity, I will use the term treaty shopping throughout this Study. See more about the different definitions regarding treaty shopping in Subsection 3.6.1.

<sup>3</sup> Avi-Yonah, Reuven S., 'Rethinking Treaty Shopping: Lessons for the European Union' C. H. Panay (co-author) in *Tax Treaties: Building Bridges between Law and Economics* (IBDF 2010) 21.

truly signed up for the consequences treaty shopping entails? They certainly seem dissatisfied.<sup>4</sup>

The question of whether or not treaty shopping is permissible has reached arbitral tribunals on a few occasions. The case law has not clarified on the issue but, on the contrary, has created even more doubt regarding how to approach the treaty shopping phenomenon. Although arbitrators have expressed some discomfort towards the practice, in many cases they have approved treaty shopping based on the permissive wording of the relevant IIA. States have drafted the treaties and thus chosen to allow investors to shop in their jurisdiction. Meanwhile, a number of tribunals have employed teleological interpretations to resort to considerations beyond the treaty text. The outcomes of these cases have led to the emerging notion of abuse of process<sup>5</sup> in the jurisprudence of investment treaty arbitration, which looks deeper into the true motives of changing nationalities to obtain treaty protection. This development of external standards has the potential to offer immediate relief by preventing the most questionable forms of treaty shopping.<sup>6</sup> However, what separates legitimate nationality planning from *mala fide* restructuring? Should the tribunal stay within the limits of the treaty wording or does it have the authority to scrutinise the investor's intentions? A grey area remains. Timing of the restructuring seems to stand out as the decisive factor, but so far it remains unclear how it should be assessed. The uncertainty about the limits of treaty shopping is unsatisfactory for both States and investors – not to mention the functionality of the investment system in general. The combination of rather permissive terms of IIAs and the relatively low costs of incorporating a subsidiary abroad or moving to another jurisdiction is what enables some corporations to push the boundaries of legitimate

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<sup>4</sup> However, as Judge Schwebel, the former president of the ICJ, said: "Can it really be supposed that States of North and South, East and West, developed and developing, of virtually all political complexions and economic models, some 180 countries, have been misguided in concluding some 3,000 investment treaties?" Schwebel Stephen, 'Keynote Address: In Defence of Bilateral Investment Treaties' (*International Council on Commercial Arbitration*, 6 April 2014).

Available at: <http://www.sccinstitute.com/media/49810/iccamiamicpeechfinalrendering.pdf> (accessed 9 April 2018).

<sup>5</sup> Following the miscellaneous terminology of the case law, the terms "good faith" and "abuse of process" are used interchangeably in this Study. The doctrine of abuse of process is particularly tricky in the context of treaty shopping as it denotes to a conduct that is not *prima facie* illegal (it does not violate any established rule of procedure). Investors increasingly adopt creative litigation strategies, and hence identifying the true instances of abuse of process poses a significant challenge for arbitrators. Gaillard Emmanuel, 'Abuse of Process in International Arbitration' [2017] 32(1) ICSID Review 18. For recent commentary on abuse of process principle in international investment arbitration see De Brabandere Eric, 'Good Faith', 'Abuse of Process' and the Initiation of Investment Treaty Claims' [2012] 3(3) Journal of International Dispute Settlement 609–636.

<sup>6</sup> Lee John, 'Resolving Concerns of Treaty Shopping in International Investment Arbitration' [2015] 5(2) Journal of International Dispute Settlement 374–375

investment protection in the event of a dispute with a host State.<sup>7</sup> While the treaty shopping phenomenon has definitely hit a nerve, is it really in contradiction with the primary objectives and fundamental nature of international investment law?

## 1.2. Sources of Law

International investment law, the framework of this Study, is a field of public international law. Primarily, investment law deals with the standards and rules governing commercial activities that multinational enterprises have undertaken in a foreign State.<sup>8</sup> The international investment law regime is comprised of various legal sources such as an extensive network of IIAs, customary international law, general principles of law and the decisions of arbitral tribunals. Although these sources have many substantive similarities, there are also considerable differences, which make investment law a rather dynamic and challenging area of law. However, it also means that the regime governing international investment is highly fragmented, difficult to describe, and sometimes complicated to navigate. Investment law has also been characterised by instances of inconsistent law making and application. Moreover, it is in constant flux (which underlines the challenges).<sup>9</sup>

The norms of investment law can be accepted under public international law only if they are based on an acknowledged source.<sup>10</sup> The most authoritative and widely acknowledged source of international law is the recognised list of sources of general international law according to Article 38(1) of the Statute of the International Court of Justice (hereafter ICJ).<sup>11</sup> Scholars typically focus on four main sources of international law: treaties, customary international law, general principles of law and juridical decisions. In the following, I will briefly introduce each of them in the context of investment law.

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<sup>7</sup> Gaillard Emmanuel, 'Abuse of Process in International Arbitration' [2017] 32(1) ICSID Review 19.

<sup>8</sup> Collins David, *An Introduction to International Investment Law* (Cambridge University Press 2017) 1.

<sup>9</sup> Sauvart Karl, *The International Investment Law and Policy Regime: Challenges and Options*, E15Initiative (International Centre for Trade and Sustainable Development (ICTSD) and World Economic Forum 2015) 9.

<sup>10</sup> Sornarajah Muthucumaraswamy, *The International Law on Foreign Investment* (Cambridge University Press 2004) 98. See also Koskenniemi Martti, *The Sources of International Law* (Ashgate/Dartmouth 2000).

<sup>11</sup> United Nations, *Statute of the International Court of Justice*, Annex to the Charter of the United Nations 26 June 1945 (in force 25 October 1945). This reference was also made by the Executive Directors of the ICSID Convention. See ICSID, *Report of the Executive Directors on the Convention on the Settlement of Investment Disputes between States and Nationals of Other States* (1965). The article states that the sources of international law include international conventions, international custom, and general principles of law recognised by civilised nations, and as subsidiary sources, the judicial decisions and teachings of the most highly qualified publicists can be used.



One of the exceptional features of investment law is the major role of investment treaties (particularly bilateral ones) in investment relations; with regard to foreign investment, treaties are by far the most important source of law. Accordingly their provisions are, in most cases, the centrepiece of the law applied by investment tribunals.<sup>12</sup> IIAs, however, can only cover investor-State relationships so far. They do not even aim to exhaustively define all possible aspects, but instead need to be supplemented with other sources of law.<sup>13</sup>

In cases of *lacunae*, international customary law (such as the rules included in the 2001 ILC Articles on Responsibility of States) plays a significant role in complementing the treaty rules.<sup>14</sup> Some IIAs may even explicitly refer to international customary law as a supplementary source of law. Even if a specific legal question is addressed by the provisions of the IIA in question, those provisions are frequently subject to divergent interpretations.<sup>15</sup> In such situations, investment tribunals must constantly interpret the ambiguous language in light of international customary law.<sup>16</sup> Further, general principles of law are also used to fill in the remaining gaps, although they are not considered as authoritative as treaties or custom.<sup>17</sup> In the context of this Study, the general principle of good faith has great importance when evaluating the permissibility of treaty shopping practice.<sup>18</sup>

Finally, it should be noted that even though there is no doctrine of precedent in international investment law and investment tribunals are not, in principle, bound by awards rendered by other tribunals, case law nevertheless has value. Investment tribunals have been inclined to follow previous rulings on the same subject matter (in somewhat similar circumstances) and

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<sup>12</sup> Grisel Florian, 'The Sources of Foreign Investment Law' in Douglas Zachary, Pauwelyn Joost and Viñuales Jorge E. (eds), *The Foundations of International Investment Law: Bringing Theory into Practice* (Oxford University Press 2014) 217–219. The phenomenon of numerous IIAs is also called the "treatification" of investment law. See more in Salacuse Jeswald, 'The Treatification of International Investment Law' [2007] 13(1) *Law and Business Review of the Americas* 155–166.

<sup>13</sup> Newcombe Andrew and Paradell Lluís, *Law and Practice of Investment Treaties Standards of Treatment* (Kluwer Law International 2009) 92.

<sup>14</sup> Hirsch Moshe, 'Sources of International Investment Law' in Bjorklund Andrea and Reinisch August (eds), *International Investment Law and Soft Law* (Edward Elgar Publishing Ltd 2012) 16.

<sup>15</sup> Gazzini Tarcisio, 'The Role of Customary International Law in the Field of Foreign Investment' [2007] 8(5) *The Journal of World Investment and Trade* 710–712.

<sup>16</sup> See, for example, the *Phoenix* case (this case is analysed in greater detail in Subection 4.3.1): "It is evident to the Tribunal that the same holds true in international investment law and that the ICSID Convention's jurisdictional requirements – as well as those of the BIT – *cannot be read and interpreted in isolation from public international law, and its general principles. Phoenix Action, Ltd. v. The Czech Republic*, ICSID Case No. ARB/06/5, Award (15 April 2009) para 78.

<sup>17</sup> Lowe Vaughan, *International Law* (Oxford University Press 2007) 87. See also Tolonen Hannu, *Oikeuslähdeoppi* (WSOY 2003) 134–137.

<sup>18</sup> Specifically its particularization, the abuse of process doctrine. See more how these principles have been applied by investment tribunals in Chapter 4. For a deeper analysis of the status of good faith principle in investment arbitration see Ponce José and Cevallos Ricardo, 'Good Faith in Investment Arbitration' [2016] 13(5) *Transnational Dispute Management*.

to develop a pattern of *jurisprudence constant* to enhance the predictability and stability of foreign investment.<sup>19</sup> Therefore, *de facto* practice of precedent does exist in international investment law, and the majority of tribunals conscientiously examine earlier awards and accept their reasoning as authoritative in most cases.<sup>20</sup> This tendency is also visible in the case law dealing with treaty shopping. However, despite the aspiration to coherence, the tribunals often reach divergent conclusions, which is also illustrated by the arbitral awards analysed in Chapter 4 of this Study.

All the above mentioned sources of law are employed in this Study to properly characterise the treaty shopping phenomenon and assess its limits in light of the current case law. In addition, scholarly writings are an important source for organising and analysing the structure and content of treaty shopping. Domestic laws fall outside the scope of the research because, albeit relevant in many cases,<sup>21</sup> they tend to differ greatly from country to country, particularly between different legal families and traditions. The aim of the Study is to provide an overall picture of treaty shopping practice in an international setting and, therefore, focusing too much on individual domestic legislation would lead to incomplete findings.

### 1.3. Scope of the Study and Methodology

The research questions of this Study revolve around one specific theme: the practice of treaty shopping in international investment law. My research focuses solely on the nationality changes of *corporate* investors because the overwhelming majority of international investments are made by legal entities rather than natural persons. In addition, the nationality

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<sup>19</sup> Bjorklund Andrea, 'Investment Treaty Arbitral Decisions as Jurisprudence Constante' in Picker Colin, Bunn Isabella, Arner Douglas (eds), *International Economic Law The State and Future of the Discipline* (Hart Publishing 2008) 265. See also the reasoning of the *Impreglio* tribunal: "Nevertheless, the Arbitral Tribunal finds it unfortunate if the assessment of these issues would in each case be dependent on the personal opinions of individual arbitrators. *The best way to avoid such a result is to make the determination on the basis of case law whenever a clear case law can be discerned.*" (emphasis added). *Impregilo S.p.A. v. Argentine Republic*, ICSID Case No. ARB/07/17, Award (21 June 2011) para 108.

<sup>20</sup> Weiniger Matthew and Schreuer Christoph, 'A Doctrine of Precedent?' in Muchlinski, Ortino and Schreuer (eds), *The Oxford Handbook of International Investment Law* (Oxford University Press 2008) 1188.

<sup>21</sup> For example, IIAs often include a requirement for covered investments to be made in accordance with the law of the host State, an obligation on States to admit investments in accordance with its laws and regulations, and a requirement that an expropriation has to be carried out in accordance with domestic legal procedures. Even when domestic law is not expressly mentioned in the IIA, it is still likely to play some kind of a role in the proceedings. In addition, the law of the place of arbitration is a relevant source of procedural law in non-ICSID Convention cases. Finally, investors are subject to all of the laws and regulations of the host State. In this regard, corporate law, tax law, administrative law and practice, labour law, and numerous other areas of law will apply to the foreign investor and to the investment. UNCTAD, 'Investor-State Dispute Settlement, A sequel' in UNCTAD Series on Issues in International Investment Agreements II (United Nations Publication 2014) 127–134. For further discussion see Hepburn Jarrod, *Domestic Law in International Investment Arbitration* (Oxford University Press 2017).

of natural persons is generally much more difficult to manipulate for purposes of gaining access to a specific IIA whereas diversity of nationality is rather easy to achieve in the case of legal entities, as they are a creation of law and can be (relatively simply) established, modified and dissolved.

I will approach the topic from different angles, through three separate research questions, each of which require slightly divergent usage of methodology. As a primary method throughout this research, I employ legal dogmatism from a practical point of view.<sup>22</sup> That is, interpreting and systemising of formally valid legal rules, and weighing and balancing of international principles as well as other standards that enjoy adequate institutional support and societal approval.<sup>23</sup> My aim is to clarify the jurisprudence related to investment treaty shopping, which is currently strikingly unsettled. The clarification is done by comprehensive and systematic examination of customary international law, international investment law and arbitral jurisprudence dealing with the practice of treaty shopping. Below, I will further elaborate on the structure of this Study, particularly each of the three research questions to be examined.

To begin with, I lay the groundwork by introducing some basic concepts that are necessary to understand the thematics of treaty shopping. Chapter 2 describes the basic structure of international investment regime and depicts the vast extent of the global IIA network. Furthermore, it will explain the significance of investment dispute settlement mechanisms, which have had a great impact on the development of the treaty shopping phenomenon. In this section of the Study, I interpret the rationale behind the evolution of the investment system as it is today, and analyse the benefits and shortcomings of the regime from a policy-oriented perspective.<sup>24</sup>

The first research question concerns the very essence of treaty shopping: what it is, how is it carried out and what are the reasons behind it. In Chapter 3, I will first establish a working definition for treaty shopping. Thereafter, I will examine the question as to what causes

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<sup>22</sup> Van Hoecke Mark, *Title: Methodologies of Legal Research: Which Kind of Method for What Kind of Discipline?* (Hart Publishing 2011) chapter 1, part III: Which Methodology for Legal Research.

<sup>23</sup> Siltala Raimo, *Oikeustieteen tieteenteoria* (Suomalainen Lakimiesyhdistys 2003) 945–946. See also Aarnio Aulis, *Reason and Authority, A Treatise on the Dynamic Paradigm of Legal Dogmatics* (1997) 75 and Aarnio Aulis, 'Oikeussäännösten systematisointi ja tulkinta' in Häyhä Juha (ed), *Minun metodini* (Werner Söderström Lakitieto Oy 1997).

<sup>24</sup> Ratner Steven and Slaughter Anne-Marie, *The Methods of International Law* (The American Society of International Law 2004) 6 and McDougal Myres, 'Law as a Process of Decision: A Policy-Oriented Approach to Legal Study' [1956] Paper No. 2464 Yale Law School Legal Scholarship Series 53–72.

investors to treaty shop and illustrate the most common ways to do treaty shopping by the means of corporate restructuring. Furthermore, I will weigh the pros and cons of treaty shopping. I elaborate on the possible benefits of the treaty shopping practice mainly by viewing it through the lens of *raison d'être*<sup>25</sup> of investment law, and explain why it has nevertheless gained such a controversial reputation. For this purpose I will discuss some of the central arguments against treaty shopping and analyse their plausibility in a critical manner. Finally, at the end of Chapter 3, I will shed light on the significance of the concept of nationality for treaty shopping. To describe the methodology for the first research question, I approach the issues on a conceptual level. That is, I explain the characteristics and the enabling factors of the phenomenon without evaluating its legitimacy.

The second research question is more concrete, asking where the decisive line should be drawn. In other words, under which circumstances does treaty shopping turn from diligent corporate management into misuse of the investment system? In Chapter 4, I use various case studies to answer this question. First, I will describe the basic principles of treaty interpretation in international law, which provides useful guidance for the case analyses. The cases examined in this study are systematised in two main categories: literal and teleological interpretation of the treaty. The methodology of this part of the study represents a more traditional method of legal dogmatics that focuses on the evaluation and systematisation of rules and doctrines developed by the case law.<sup>26</sup> I will interpret the *ratio decidendi* of the leading arbitral awards concerning treaty shopping and consequently formulate some general rules as to how the legality of treaty shopping should be evaluated. For the time being, the relevant legal praxis is strongly divided, which generates insecurity for both States and investors. However, certain common standards have emerged, and these can be used as guidelines when assessing future treaty shopping cases.

The third and final research question addresses the practical aspects of treaty shopping. While the previous research questions relate to defining the boundaries of treaty shopping, Chapter 5 focuses solely on the pragmatic and political implications of it. In this part of the Study, I will examine the consequences of treaty shopping and the ways to control it: from both State's and investor's perspective. In Chapter 5, I will elaborate on State reactions to the treaty shopping phenomenon through two examples. Given that States give away part of

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<sup>25</sup> Reason for being; the sole or ultimate purpose of something.

<sup>26</sup> Aarnio Aulis, *Oikeudellisen ajattelun perusteista* (Suomalainen Lakimiesyhdistys 1971) 50 and Hirvonen Ari, *Mitkä metodit? Opas oikeustieteen metodologiaan* (Yleisen oikeustieteen julkaisuja 2011) 25–26.

their sovereign power when they enter an investment treaty, the problematics of treaty shopping also often boil down to question of States' powers. That is why Chapter 5 will look to the future and asks what States can do to prevent investors from shopping into investment treaties which originally did not cover them. At this point, I will list ways to control treaty shopping. The purpose of this is not to take a normative position on whether States should adopt counter measures against treaty shopping or to what extent, rather, to analytically assess the challenges and opportunities afforded by various strategies that could be implemented by States who share negative perception of treaty shopping. With this regard, I will make recommendations on how States could make themselves less susceptible to the practice of treaty shopping.

At the end of Chapter 5, I will review treaty shopping from investor's point of view and present a "shopping list" for foreign investors who are planning to engage in treaty shopping. With regards to the last part of the Study, my methodology focuses on *de lege ferenda* analysis and proposals considering also law and economics perspectives by reflecting the most efficient stance towards treaty shopping.<sup>27</sup> However, it is impossible to deliver a definite solution regarding general acceptability of treaty shopping. As explained later in this Study, investors engage in treaty shopping for various reasons, in various manners and in circumstances. Thus, it would be impossible to provide a simple yes-or-no answer regarding the legitimacy of this practice. Finally, Chapter 6 recapitulates the main findings of the Study – is treaty shopping an enemy or an ally (if either) to investment law? And more importantly, where do we draw the line?

The Study does not aim to be a comprehensive empirical review on treaty shopping nor does it claim to provide definitive answers to the questions it raises. Rather, the goal is to elaborate the main concerns about the practice of treaty shopping and, in this manner, encourage discussion of the phenomenon which, as I argue, requires clearer limits.

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<sup>27</sup> See Cooter Robert and Ulen Thomas, *Law and Economics: Pearson New International Edition* (Pearson Education 2013) Chapter 1: An Introduction to Law and Economics.

## 2. INVESTMENT TREATY PROTECTION

Before beginning to analyse the research questions set out above, it is necessary to present the underlying characteristics of the international investment regime. In this Chapter, I will introduce the global system of investment agreement, focusing primarily on bilateral treaties (hereafter BIT). Then I will examine the purpose and rationale of the investment regime from the perspective of customary international law. In addition, I will present the characteristics of investor-State dispute settlement mechanism (hereafter ISDS) which is a unique feature of investment law. The aim of this Chapter is to provide the framework in which treaty shopping appears in order to fully analyse the phenomenon.

### 2.1. Global Reach of Investment Agreements

The development of the investment regime we know today has been eventful and driven by many factors. This Section contains a brief overview of the evolution of IIAs into a world-wide BIT network. Understanding the historical background is essential to evaluate the phenomenon of treaty shopping, why it occurs and what one should make of it.

The proliferation of treaties concluded to protect and liberalise foreign investment is said to be one of the most significant phenomena in international law during the past few decades.<sup>28</sup> The year 1959 is commonly acknowledged as the year when the first modern BIT was signed between Germany and Pakistan.<sup>29</sup> Since then, other States have followed suit, and the number of BITs climbed steadily for some 30 years until around 1990, after which the figures began to increase exponentially.<sup>30</sup> Today, almost every country in the world has signed at

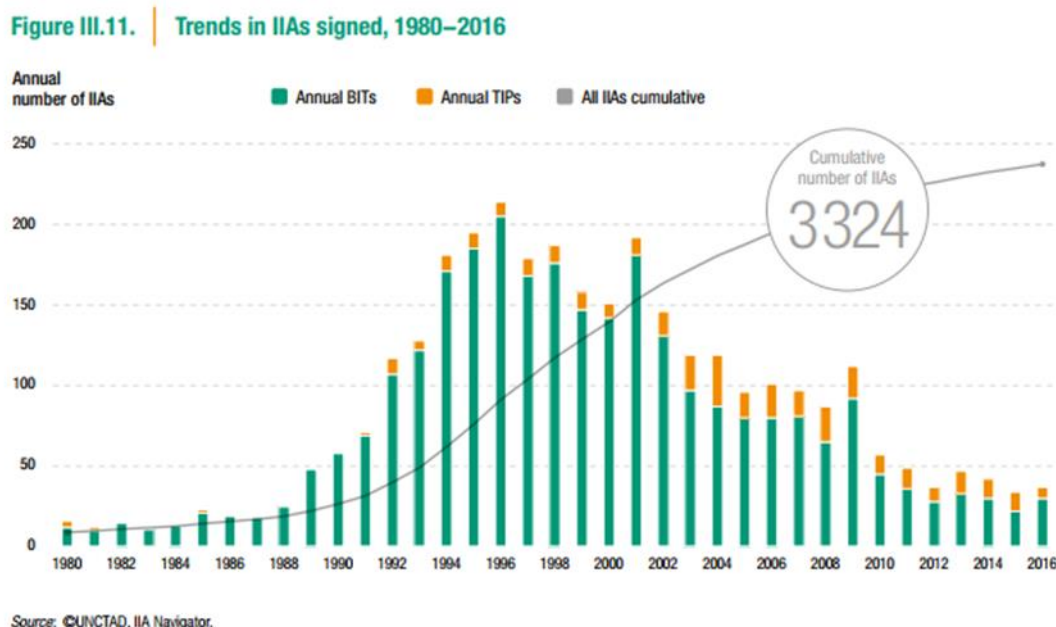
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<sup>28</sup> Vandevelde Kenneth, 'A Brief History of International Investment Agreements' [2005] 12(1) UC Davis Journal of International Law and Policy 157–161. However, similar agreements relating to investment protection of property abroad have been concluded as early as in the 18<sup>th</sup> century. At that time States concluded so-called treaties on friendship, commerce and navigation (hereafter FCN), whose contents were strikingly similar to those of the early BITs despite the fact that they mainly addressed trade issues. Especially the United States was active in concluding such treaties. See Sornarajah M., *The International Law on Foreign Investment* (4<sup>th</sup> edn, Cambridge University Press 2014) 180. <sup>28</sup> For more information about the history of IIAs prior 1959 see Vandevelde Kenneth, *Bilateral Investment Treaties: History, Policy, and Interpretation* (Oxford University Press 2010) Chapter 2.

<sup>29</sup> Treaty between the Federal Republic of Germany and Pakistan for the Promotion and Protection of Investments (Germany–Pakistan BIT), 25 November 1959 (entered into force 28 April). A replacing treaty was signed 1 December 2009 but it is not in force to this day.

<sup>30</sup> In 1959 there was one BIT, at the end of 1969 there were 72, by the end of 1979 this number had about doubled to 165 and by the end of 1989 it had doubled again, to 385. At that time the figures began to increase explosively, and over the next ten years the number of BITs grew to 1,857, which means a four-fold increase. At the end of 2005, the total number was approximately 2,500 so the rate of growth had slowed down notably. Gimblett Jonathan and Johnson Thomas, 'From Gunboats to BITs: The evolution of modern international investment law' in Sauvant Karl (ed), *Yearbook on International Investment Law & Policy 2010-2011* (Oxford University Press 2012) 685.

least one BIT, and there are nearly 3,000 BITs in force accompanied by over 300 trade agreements with investment provisions.<sup>31</sup> The bar chart below illustrates the proliferation of IIAs from 1980 to 2016.



**Figure 1.** The boom in the number of IIAs<sup>32</sup>

While navigating through the extensive number of IIAs, it is common and rather helpful to group them into three different generations: treaties concluded between 1959 and the mid-1980s are referred as the first generation, and those concluded between the mid-1980s and mid-1990s as the second generation. Agreements signed after 1995 belong to the third generation.<sup>33</sup>

The first generation of BITs was characterised by asymmetrical economic and political relationships between capital exporting countries and capital importing countries; seemingly reciprocal agreements were in reality a tool for developed capital exporting countries to

<sup>31</sup> UNCTAD, 'International Investment Agreements Navigator' (*Investment Policy Hub*) Available at: <http://investmentpolicyhub.unctad.org/IIA>. The explosion in IIA practice had two primary causes: first, there was an increased political commitment by governments in both developed and developing countries to economic liberalism and the freer international flow of goods, services and investment. Second was the lack of developing countries' alternatives to FDI as international lending and aid, both important sources of development financing in the 1970s and early 1980s, became increasingly scarce. Consequently, the competition for FDI coupled with an increasing acceptance of liberal economic policies provided the fertile ground for the conclusion of investment treaties. See Newcombe and Paradell (n 34) 48–49.

<sup>32</sup> UNCTAD, *World Investment Report 2017* (United Nations Publication 2017) 111.

<sup>33</sup> Van Os Roos and Knottnerus Roeline, 'Dutch Bilateral Investment Treaties: A gateway to 'treaty shopping' for investment protection by multinational companies' (*Centre for Research on Multinational Corporations (SOMO)*, 2011) 8.

protect the financial interests of their nationals abroad.<sup>34</sup> With the second generation came the trend of BITs concluded between non-industrialised States, giving its contribution to the upswing of the BIT network.<sup>35</sup> More importantly, during the first two generations, IIAs saw a significant upgrade in the level of investment protection, especially owing to the inclusion of ISDS mechanisms. The innovation of ISDS meant that for the first time, foreign investors had an effective remedy for unlawful actions by host States that was not dependent on the willingness of their home State to pursue their claim. Therefore, these BIT provisions depoliticised investment disputes and "placed investment protection in the realm of law rather than politics".<sup>36</sup> Nevertheless, until early 1990s there was no significant case law in the field of international investments. In the past 25 years, as a direct consequence of the availability of investment-State arbitration, the situation has changed dramatically.<sup>37</sup>

According to the United Nations Conference on Trade and Development (UNCTAD), the newest generation of BITs involves a few distinguishable trends that aspire to greater certainty regarding the scope and extent of State's treaty obligations.<sup>38</sup> For example, BITs seem to cover broader sets of issues, especially some of the key public policy objectives where more room for host State regulation is needed. The protection of safety, health, labour rights and the environment etc. now stand side-by-side with the economic aspects of investment. In addition, new patterns of BIT formulation have emerged as the wording of various substantive provisions, such as indirect expropriation, has been revised to ensure an unambiguous interpretation of these protection standards. Further, modern BITs deviate from traditional definitions of investment and investor. Contracting States have attempted to find ways to formulate definitions that would be sufficiently comprehensive (i.e. not so strict that they would hinder foreign investment), but that would not to cover assets or investors

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<sup>34</sup> Newcombe Andrew and Paradell Lluís, *Law and Practice of Investment Treaties Standards of Treatment* (Kluwer Law International 2009) 43. Until 1968, when the Indonesia-Netherlands BIT expressly provided for investor-State arbitration, BITs only contained State-State dispute resolution through arbitration or the ICJ. For a long time the Iraq-Kuwait BIT (signed 1964) was the only BIT not falling within the developed-developed State pattern. It should be also noted that some major developing countries, such as India and China, did not conclude BITs until at the turn of 1<sup>st</sup> and 2<sup>nd</sup> generation.

<sup>35</sup> In the period between 2003 and 2006, treaties between two developing nations outnumbered those between developed and developing countries. Dolzer Rudolf and Schreuer Christoph, *Principles of International Investment Law* (2<sup>nd</sup> edn Oxford University Press 2012) 7.

<sup>36</sup> Vandevelde (n 1) 175. ISDS mechanisms are dealt with in greater detail in Section 2.3 of this Study.

<sup>37</sup> Dolzer and Schreuer (n 35) 11. The number of investor-State disputes inflated from 6 known cases in 1995 to 226 in 2005, and up to 444 by the end of 2015. The year 2013 saw the second largest number of known investment arbitrations filed in a single year (56), bringing the total number of known cases to 568. So far majority of cases are resolved in favour of the State. It should be noted that these figures do not include ad hoc arbitrations which are mainly conducted in secrecy, away from the public eye. UNCTAD, *Investor-State Dispute Settlement: Review of Developments in 2015*, IIA Issues Note No. 2 (United Nations Publication 2016).

<sup>38</sup> van Os and Knottnerus (n 33) 9.



that the contracting States did not really mean to protect.<sup>39</sup> The latter trend is relevant for the research questions of this Study because treaty formulations are the main enabler of treaty shopping and revising the language could also serve as one of the methods for States to take control over treaty shopping practice.<sup>40</sup>

## 2.2. Objective and Purpose of the Investment Regime

As described above, almost every country in the world has concluded IIAs, thereby committing themselves to observe specific standards on the treatment of foreign investments within their territory. BITs have become the dominant mechanism for international regulation of foreign investment, and therefore they form the core of the investment regime.

Through IIAs, States offer enhanced security to foreign investors by guaranteeing an additional layer of protection beyond that provided by domestic laws. Thus, from a policy perspective, the host State deliberately renounces an element of its sovereignty in return for a certain new opportunity: the possibility to better attract new foreign investments that it would not have achieved without an IIA.<sup>41</sup> This is necessary because making foreign investment differs from engaging in trade transactions. Whereas a typical trade deal consists of a one-time exchange of goods and money, the decision to invest in a foreign country initiates a long-term relationship between the investor and the host State.<sup>42</sup>

So, what are States looking for when they sign an IIA? According to Professors Schreuer and Dolzer, the leading scholars in the field of investment law, "the objective and purpose

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<sup>39</sup> United Nations Conference on Trade and Development, *Recent Developments in International Investment Agreements* (2005) IIA MONITOR No. 2: International Investment Agreements 4–6.

<sup>40</sup> See Section 5.2.2 of this Study.

<sup>41</sup> Chaisse Julien, 'The Treaty Shopping Practice: Corporate Structuring and Restructuring to Gain Access to Investment Treaties and Arbitration' [2015] 11(2) *Hastings Business Law Journal* 236; Dolzer and Scheuer (n 35) 22. In addition, Professor Andrew Kerner argues that BITs enhance States credibility in the eyes of a foreign investor on two levels: ex-ante costs (signals), and ex-post costs (commitments). Signalling, in the case of IIAs, may be defined as "sending a broadly received 'signal' that a country is trustworthy." With regards to the latter one, Professor Kerner suggests that BITs are effective because they "present significant ex-post costs to signatory states that violate the agreement." From this point of view, a BIT is a commitment device. Kerner Andrew, 'Why Should I Believe You? The Costs and Consequences of Bilateral Investment Treaties' [2009] 53(1) *International Studies Quarterly* 74.

<sup>42</sup> Moreover, the investor is most likely required to sink substantial resources into the investment in the outset of it, and the expectation is to recoup this amount added with an adequate rate of return during the lifetime of the investment (sometimes up to 30 years or more). Foreign investments take place in different forms, *inter alia* committing capital directly or indirectly through portfolio investment or by licensing the use of technology. The investors who, for example, enter into joint ventures or purchase land or other immovable property from a foreign State cannot break loose from that engagement that easily. Thus, investors are vulnerable to sudden and unwanted changes in the political or legal scheme of the State. That is why BITs must be long in duration, usually 10 to 20 years with certain continuing coverage after its termination. See more in Subedi (n 44) 108 and Schreuer Christoph, 'Investments, International Protection' in Wolfrum Rüdiger (ed), *The Max Planck Encyclopedia of Public International Law* (Oxford University Press 2010) paras 1–2.

of investment treaties is closely tied to the desirability and to the nature of foreign investments, to the benefits for the host state and for the investor, to the conditions necessary for the promotion of foreign investment, and, conversely, to the removal of obstacles that may stand in the way of allowing and channelling more foreign investment into the host states."<sup>43</sup> Foreign investment is often deemed an engine of financial growth, a stimulator of the local economy, and a source of foreign currency income, new skills, information and know-how.<sup>44</sup> IIAs are a purposeful tool to guarantee a stable investment framework as, unlike domestic laws, a State cannot unilaterally change the treaty provisions when it suits them.

Consequently, the underlying purpose of the investment system is to attract FDI by addressing typical risks of foreign investment, thereby creating a level playing field and a stable, investment-friendly climate.<sup>45</sup> However, understanding the objectives and nature of the investment regime would not be complete without addressing subject of investment arbitration. ISDS is a fundamental part of comprehensive investment protection and thus it is necessary to understand the main aspects of the ISDS system, to which we now turn.

### **2.3. The Significance of the ISDS and the 1965 ICSID Convention**

Access to a dispute settlement mechanism normally ranks very high on the purported Treaty Shopper's list of requirements. The substantive safeguards provided in IIAs are of no use unless they can be efficiently enforced in case of a violation. That is why ISDS mechanisms

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<sup>43</sup> Dolzer Rudolf and Schreuer Christoph, *Principles of International Investment Law* (2nd edn Oxford University Press 2012) 22.

<sup>44</sup> Subedi Surya, *International Investment Law: Reconciling Policy and Principle* (3rd edn, Hart Publishing 2016) 107–108.

<sup>45</sup> However, the question whether IIAs actually succeed in their mission to bring in foreign capital is, at best, controversial. In fact, several empirical studies have found little or no positive connection between the conclusion of IIAs and increase in foreign investment flow. Van Harten Gus, 'Five Justifications for Investment Treaties: A Critical Discussion' [2010] 2(1) *Trade, Law and Development* 30–31. For researches with different findings see UNCTAD, *Bilateral Investment Treaties in the Mid-1990s*, UN Doc. UNCTAD/ITE/IIT/7 (1998); Hallward-Dreimeier Mary, *Do Bilateral Investment Treaties Attract Foreign Direct Investment? Only a Bit and They Could Bite* (World Bank Policy Research Working Paper 2003); Tobin Jennifer and Rose-Ackerman Susan, *Foreign Direct Investment and the Business Environment in Developing Countries: The Impact of Bilateral Investment Treaties*, Yale Law and Economics Research Paper No. 293 (2004); Salacuse Jeswald and Sullivan Nicholas, 'Do BITs Really Work? An Evaluation of Bilateral Investment Treaties and Their Grand Bargain' [2005] 46(1) *Harvard International Law Journal* 67–120; Neumayer Eric and Spess Laura, *Do bilateral investment treaties increase foreign direct investment to developing countries?* LSE Research Online (2005). Available at: [http://eprints.lse.ac.uk/627/1/World\\_Dev\\_\(BITs\).pdf](http://eprints.lse.ac.uk/627/1/World_Dev_(BITs).pdf) (accessed 23 March 2018); Yackee Jason, *Sacrificing Sovereignty: Bilateral Investment Treaties, International Arbitration, and the Quest for Capital*, USC Center in Law, Economics and Organization Research Paper No C06-15 (2006) and Poulsen L.S., 'The Importance of BITs for Foreign Direct Investment and Political Risk Insurance: Revisiting the Evidence' in Sauvart Karl (ed), *Yearbook on International Investment Law and Policy 2009/2010* (Oxford University Press 2010).

play a major role in the investment regime; basically the possibility to initiate arbitration against the State gives "teeth" to the substantive obligations of an IIA. Therefore, it is understandable that the ISDS provision is a great incentive to engage in treaty shopping.

The ISDS mechanism was designed to overcome the clumsy institution of diplomatic protection that made investors dependent on the political discretion of their governments.<sup>46</sup> Before the development of ISDS, a foreign investor only had two avenues to pursue if the host state interfered with its investment: (i) to seek relief before the local courts of the host State; or (ii) to request diplomatic protection from its own State. Both options have limited appeal for a foreign investor, as in local courts there is a possibility of partiality and/or bias, whereas diplomatic protection provides no guarantee that the investor's home State would espouse the claim, which leaves the investor completely at the mercy of the State and its politics.<sup>47</sup> Conversely, modern BITs have equipped investors with a direct and independent standing to assert their own rights under international law without the barrier of the requirement to exhaust local remedies first.<sup>48</sup> Namely, the BIT system re-allocates powers from States to investors and thus plays a crucial role in the investment regime.<sup>49</sup>

The most relevant international agreement for the law and practice of ISDS is the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (hereafter the ICSID Convention).<sup>50</sup> It provides a procedural framework for settling disputes between host States and foreign investors from other contracting States through arbitration and conciliation.<sup>51</sup> The ICSID Convention, which established the International Centre for

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<sup>46</sup> Under the system of diplomatic protection a State overtakes the claim of its national and pursues it in its own name. The government may refuse to take up the claim, it may discontinue diplomatic protection at any time. It may also waive the national's claim or agree to a reduced settlement. As soon as the national State has taken up the claim, it becomes part of the foreign policy process with all the consequent political risks. See Schreuer Christoph, 'Investment Protection and International Relations' in Reinisch August and Kriebaum Ursula (eds), *The Law of International Relations, Liber amicorum Hanspeter Neuhold* (Eleven International Publishing 2007) 345.

<sup>47</sup> Nadakavukaren Schefer Krista, *International Investment Law Text, Cases and Materials* (2nd edn, Edward Elgar Publishing Ltd 2016) 364; UNCTAD, 'Investor-State Dispute Settlement 2014 (n 21) 23.

<sup>48</sup> The Working Group of the International Law Association (ILA) German Branch Sub-Committee on Investment Law, 'The Determination of the Nationality of Investors Under Investment Protection Treaties' (2011) Transnational International Law Research Centre, Online report. 11.

<sup>49</sup> See more about the relation between diplomatic protection and investor's rights in Kulick Andreas, *Global Interest in International Investment Law* (Cambridge University Press 2012) 10–38. There is an interesting debate about whether investor's rights under BIT are independent or merely a derivative from State's rights. With this regard see also Wälde Thomas, *New Aspects of International Investment Law* (Centre d'Etude et de Recherche de Droit 2004) discussing the multiple asymmetries of investment arbitration.

<sup>50</sup> Convention on the Settlement of Investment Disputes between States and Nationals of Other States, International Centre for Settlement of Investment Disputes (ICSID) 575 UNTS 159, Washington 18 March 1965 (entered into force 14 October 1966). ICSID Convention is also known as the Washington Convention.

<sup>51</sup> Dolzer and Schreuer have described the ICSID Convention as "the boldest innovative step in the modern history of international cooperation concerning the role and protection of foreign investment". Dolzer and

Settlement of Investment Disputes (ICSID or the Centre), was created by the World Bank<sup>52</sup> primarily to fill the gap that had long existed in international law due to the fact that private parties could not bring claims against States if States breached their international obligations.<sup>53</sup> Nowadays, the majority of IIAs provide ICSID as the main arbitration forum.<sup>54</sup>

Unlike IIAs that guarantee standards for substantive investment protection, the ICSID Convention contains procedural and jurisdictional remedies.<sup>55</sup> The system is exclusively designed for international disputes, and its objective is to offer foreign investors a neutral and independent body to settle disputes with host States in a speedy manner so that investors are better protected and that, in turn, would attract more investments to the Contracting States.<sup>56</sup> In this regard, ICSID facilitates depoliticisation of investment disputes in the sense that a confrontation between home State and host State can be avoided.<sup>57</sup> Furthermore, the availability of a flexible and fair hearing in a neutral forum facilitates foreign investments as investors do not have to worry about national courts being biased towards the State.<sup>58</sup>

The ICSID arbitration is only accessible to investors that are nationals of ICSID Convention Member States, and only against other Member States. For a Treaty Shopper, the ICSID system is desirable because the Convention contains stricter grounds for annulment and refusal of enforcement of the award than what is provided in the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (hereafter New York Convention), which commonly governs non-ICSID arbitrations.<sup>59</sup> Further, ICSID proceedings are mostly public and the awards of ICSID tribunals are published, which gives

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Schreuer (n 43) 9. See also Franck Susan, 'The ICSID Effect? Considering Potential Variations in Arbitration Awards' [2011] 51(4) *Virginia Journal of International Law*.

<sup>52</sup> The World Bank pays the running costs of ICSID and the Administrative Council of ICSID is composed largely of the representatives of World Bank member states. Further, the President of the World Bank is *ex officio* the Chairman of the ICSID Administrative Council.

<sup>53</sup> Collins (n 8) 233.

<sup>54</sup> United Nations Conference on Trade and Development, 'Scope and Definition' (*UNCTAD Series on Issues in International Investment Agreements II*, 2011) 1.

<sup>55</sup> Badia Albert, *Piercing the Veil of State Enterprises in International Arbitration* (Kluwer Law International 2014) 141.

<sup>56</sup> García-Bolívar Omar e, 'The Issue of a Foreign Company Wholly Owned by National Shareholders in the Context of ICSID Arbitration' [2006] 2(5) *Transnational Dispute Management* 7; Collins (n 8) 233–234.

<sup>57</sup> Bhagnani Preeti, 'Revisiting the Countermeasures Defense in Investor–State Disputes: Approach and Analogies', in Bjorklund Andrea (ed), *Yearbook on International Investment Law & Policy, 2013–2014* (Oxford University Press 2015) 452–453.

<sup>58</sup> As an Irish writer Humphrey O'Sullivan expressed in 1979: "There is little use in going to law with the devil while the court is in hell". See. H. O'Sullivan, *Cí n Lae Amhlaoibh, The Diary of an Irish Countryman 1827–1835* (T de Bhaldráithe trans, 1979 edn).

<sup>59</sup> Reinisch August, 'Methods of Dispute Resolution' in Muchlinski, Ortino and Schreuer (eds), *The Oxford Handbook of International Investment Law* (Oxford University Press 2008) 700–701; Skinner Matthew, Miles Cameron and Luttrell Sam, 'Access and advantage in investor-state arbitration: The law and practice of treaty shopping' [2010] 3(3) *Journal of World Energy Law & Business* 265–266.

States a notable incentive to settle investment disputes instead of risking potential adverse publicity that may result from an open hearing and possibly unfavourable award.<sup>60</sup> Thus, if the IIA in question does not contain an ICSID clause, an investor may be tempted to shop into a treaty that secures availability to the ICSID mechanism by relocating to a Contracting State. In other words, dispute settlement provisions, especially an ICSID clause is a valuable item on the "sophisticated Treaty Shopper's list".<sup>61</sup>

To conclude, the principal goals of ISDS are: avoidance of direct State confrontation in the event of a dispute (namely depoliticising of an investment dispute) and avoiding the possibility of corrupt, dysfunctional and/or biased local courts and a weak legal system in the host State.<sup>62</sup>

### **3. PLACING TREATY SHOPPING IN CONTEXT**

Having introduced the cornerstones of the investment regime and investment arbitration, in this Chapter, I advance to elaborate on the concept of treaty shopping. First, I will define what the term means and analyse the reasons for the occurrence of treaty shopping. Then I will discuss the principal ways to execute it in practice. Placing treaty shopping in the context of its philosophical background is useful not only for examining the phenomenon on a practical level, but also for evaluating its nature, and later analysing arbitral decisions relating to it. Further, I will examine the possible pros and cons of the phenomenon and, subsequently, list the most common objections presented by States. I aim to evaluate these objections critically and clarify whether treaty shopping is the root of the problem or not. Understanding the arguments for and against the phenomenon is also helpful to understand the issues underlined in the case law, which is dealt with in Chapter 4. Finally, I will explain the significance of investor's nationality in relation to the topic of this Study.

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<sup>60</sup> *ibid* 267; Mellwrath Michael and Savage John, *International Arbitration and Mediation: A Practical Guide* (Kluwer Law International 2010) 391.

<sup>61</sup> Skinner *et.al.* (n 59) 267. See Section 5.3 of this Study.

<sup>62</sup> Schultz Thomas and Dupont Cédric, 'Investment Arbitration: Promoting the Rule of Law or Over-empowering Investors? A Quantitative Empirical Study' [2015] 25(4) *The European Journal of International Law* 1147–1168; Primec Jan, *Enemy of the State: Is Treaty Shopping in Contradiction with the Rationale of Investment Law?* (University of Amsterdam 2015) 32. The advantages of ISDS also include speediness, flexibility, effectiveness and a high level of expert input. In addition the parties have higher level of control over the procedure (for example the possibility of selecting arbitrators, negotiating procedural rules, applicable law, seat of arbitration etc.)

### 3.1. What Is Treaty Shopping?

In light of the overall controversy surrounding the legitimacy of treaty shopping, it should be noted that even the meaning of the term "treaty shopping" does not enjoy universal consensus.<sup>63</sup> This overall uncertainty is also reflected by the variety of names used to describe the phenomenon. "Treaty planning", "nationality planning", "corporate restructuring", "corporate manoeuvring" and even "treaty abuse" have all been used to characterise similar situations. The terminological choice often uncovers the writer's attitude towards the practice. Even without such a striking choice of words, the notion of treaty shopping tends to be charged with more negative than positive nuance.<sup>64</sup>

As a starting point, it is important to note that despite the bad publicity and increasingly expressed dissatisfaction among States, treaty shopping is not *per se* prohibited or even improper under international investment law.<sup>65</sup> However, numerous States have regarded corporate restructuring or related measures carried out for the purpose of obtaining better treaty benefits as undesirable and have taken some measures against it.<sup>66</sup> In addition, the legal practice demonstrates that there are some limits to treaty shopping. These limits are examined further in Chapter 5.

Returning to definition of treaty shopping, the term most often refers to the conduct of foreign investors who deliberately shop for a "home country of convenience" that has favourable IIAs with the host country where their investments are or will be made.<sup>67</sup> The shopping is carried out by altering corporate structures or routing investments through the country/countries necessary to gain access to an IIA even if there is none in place between

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<sup>63</sup> Chaisse Julien, 'The Treaty Shopping Practice: Corporate Structuring and Restructuring to Gain Access to Investment Treaties and Arbitration' [2015] 11(2) *Hastings Business Law Journal* 228; Baumgartner Jorun, *Treaty Shopping in International Investment Law* (Oxford University Press 2016) 7–9.

<sup>64</sup> The negative connotation attached to treaty shopping activities may be due to the association with the debatable problem in international tax law where corporate structures are established in "tax havens" with the sole purpose of gaining advantages from more favourable tax treaties. See more in Baumgartner, 'Treaty Shopping' (n 63) 7–8.

<sup>65</sup> Chaisse (n 63) 228; Van Os and Knottnerus (n 33) 10–11. Skinner *et al.* have suggested that the lack of outright ban of treaty shopping can be attributed to e.g. the absence of uniform barriers to this practice in the express provisions of BITs and the absence of the common law doctrine of precedent in international investment law. See more in Skinner *et al.* (n 59) 261.

<sup>66</sup> See State reactions in Section 5.1 and Dolzer and Schreuer (n 51) 52.

<sup>67</sup> United Nations Conference on Trade and Development, 'Investor–State Disputes Arising from Investment Treaties: A Review' in *UNCTAD Series on International Investment Policies for Development* (United Nations Publication, 2005) 21–22.

the host State and investor's actual home State. Alternatively, if such IIA exists, investors may "shop" to acquire the benefits of a more favourable IIA.<sup>68</sup>

An example will suffice to explain this practice: a Norwegian investor plans to make a considerable investment in Serbia. After looking into the BITs Norway has concluded, the investor notices that its home State does not have an agreement with Serbia. The next step is to look around for BITs between Serbia and other States. The investor happens to own a shell company in Finland, a State that does have a BIT with Serbia. However, the Finland-Serbia BIT<sup>69</sup> requires that the investor, besides being incorporated in Finland, has "its registered office or central administration or principal place of business within the jurisdiction of that Contracting Party." Since our Norwegian investor does not pursue any economic activities in Finland, it will not qualify as an investor under that BIT. Then again, the Netherlands-Serbia BIT<sup>70</sup> merely requires incorporation. The Norwegian investor therefore decides to establish another shell company, this time in the Netherlands, and that way route its investment through an intermediate company. The investor thus "planned" its nationality in order to gain the highest level of protection available.

To summarise, the Treaty Shopper aims for maximum protection of the investment under the operative treaties. The means of carrying out treaty shopping are considered in greater detail in Section 3.3, but first it is necessary to understand the causes of the phenomenon and the function of nationality in this setting. In the next Section, we move on to discuss the question as to where treaty shopping phenomenon stems from and why are investors inclined to take the trouble to reorganise their investments or even their whole business just to be qualified under a certain IIA.

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<sup>68</sup> Muchlinski Peter, 'Corporations and the Uses of Law: International Investment Arbitration as a 'Multilateral Legal Order' [2011] 1(4) *Oñati Socio-Legal Series* 1; Chaisse (n 63) 228.

<sup>69</sup> Agreement Between the republic of Finland and Serbia and Montenegro on the Promotion and Protection of Investments (Finland-Serbia BIT) 23 May 2005 (entered into force 29 October 2005). See Article 1(3)(b).

<sup>70</sup> Agreement on encouragement and reciprocal protection of investments between the Kingdom of the Netherlands and the Federal Republic of Yugoslavia (Netherlands-Serbia BIT) 29 January 2002 (entered into force 1 March 2004). See Article 1(b)(ii).

### 3.2. Seeds of Treaty Shopping Phenomenon

Restructuring corporate chains and investment projects always requires some level of planning, time and effort from the foreign investor. The benefits are obvious if the investor manages to gain protections it was not entitled to before treaty shopping. But which factors motivate investors to carry out such operations? And what are the circumstances that allow it?

Before the turn of the last century, the concept of treaty shopping was nearly unknown, or at least very insignificant, in investment arbitration.<sup>71</sup> In fact, the first explicit mention of the practice of treaty shopping can be found in the *Maffezini* decision from 2000.<sup>72</sup> Since then foreign investors have discovered the advantages of treaty shopping and increasingly used it to secure maximum treaty protection for their investments. But where does the phenomenon of treaty shopping stem from? Three main factors are essentially responsible for the occurrence and expansion of treaty shopping: proliferation of the BIT network, development of investors' self-standing rights instead of diplomatic protection, and the fact that diversity of corporate nationality is relatively easy to create by incorporating legal entities in countries other than the investor's principal place of business.<sup>73</sup>

The most important explanation for the occurrence of treaty shopping is the sheer number of IIAs. Such a plethora of treaties distributed worldwide is a unique characteristic of investment law. In theory, a dense network of treaties provides as many possibilities to treaty shop as there are IIAs in force.<sup>74</sup> The often used "spaghetti-bowl" metaphor is illustrative.

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<sup>71</sup> Baumgartner Jorun, *Treaty Shopping in International Investment Law* (Oxford University Press 2016) 19–20.

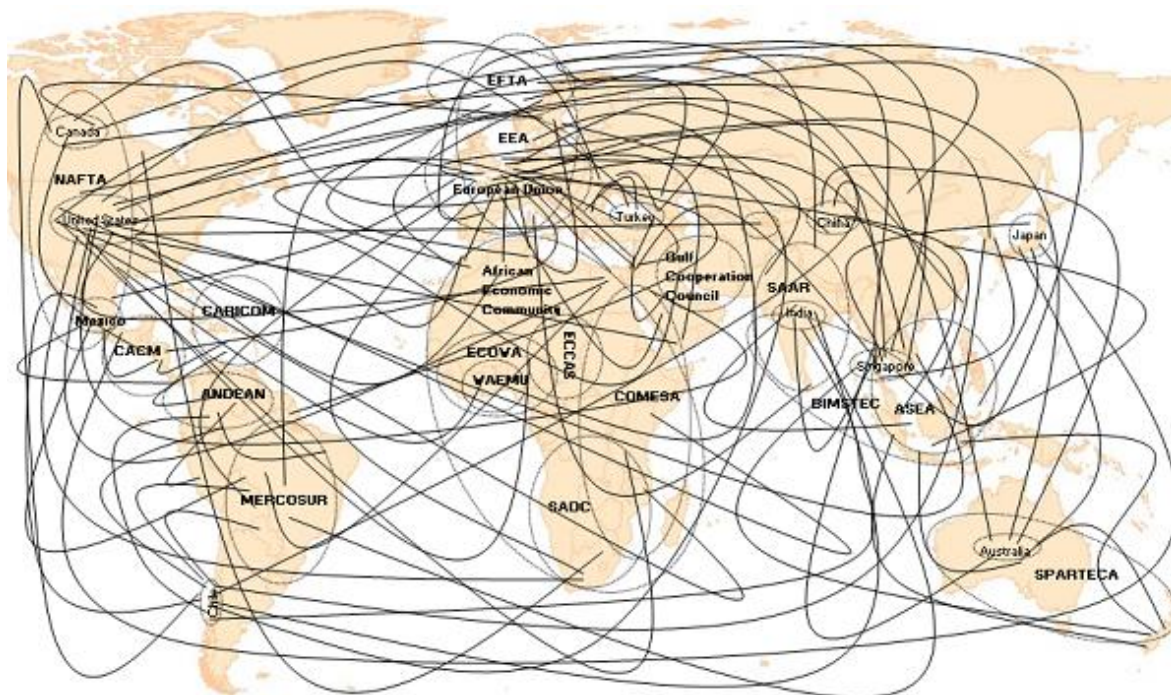
<sup>72</sup> *Emilio Agustín Maffezini v. The Kingdom of Spain*, ICSID Case No. ARB/97/7, Decision of the Tribunal on Objections to Jurisdiction (25 January 2000) para 63: "*It is clear, in any event, that a distinction has to be made between the legitimate extension of rights and benefits by means of the operation of the clause, on the one hand, and disruptive treaty-shopping that would play havoc with the policy objectives of underlying specific treaty provisions, on the other hand.*"

<sup>73</sup> Some scholars have also added the absence of a doctrine of precedent in international investment law on the list. Although not specific to treaty shopping, but the whole investment regime as a whole, the lack of precedents might create an incentive to bring claims based on treaty shopping on grounds of often widely diverging jurisprudence. See *e.g.* Skinner *et. al.* (n 59) 261.

<sup>74</sup> Accordingly, some scholars have submitted that treaty shopping would be greatly reduced (and useless) if there was one far-reaching multilateral agreement on investment. See *e.g.* Bekker Pieter, 'Is Arbitration Based on "Treaty Shopping" In Jeopardy?' (Kluwer Arbitration Blog, 17 June 2009). Available at: <http://arbitrationblog.kluwerarbitration.com/2009/06/17/is-arbitration-based-on-treaty-shopping-in-jeopardy/> (accessed 19 March 2018) and Leal-Arcas Rafael, 'The Multilateralization of International Investment Law' [2009] 10(6) *Journal of World Investment and Trade* 865, 919. For more information about global investment treaty as a way to curb treaty shopping, see Subsection 5.2.3 of this Study.



The figure below depicts the multi-layered nature of the global IIA system and the intertwined network of bilateral and multilateral investment treaties.



**Figure 2.** The "spaghetti bowl" of IIAs portrays the supply of treaties available to a potential Treaty Shopper.<sup>75</sup>

Despite the large number of separate IIAs, their main contents are somewhat uniform.<sup>76</sup> Nevertheless, some differences in details can be found. These small alterations, especially pertaining to the lenient definition of investor and certain dispute resolution mechanisms, can affect the level of investment protection to a surprising extent. Treaties with broad wording are generally perceived as more beneficial, as they provide more room for manoeuvre. The subtle divergences enable and encourage foreign investors to shop for better alternatives. After all, investing in a foreign country is generally a long-term commitment in which the investor sinks substantial resources.<sup>77</sup> Making sure that the investment is protected in the best possible manner is merely sensible business. Consequently, multiplicity of agreements granting various rights and protections is a key ingredient to the practice of treaty shopping.

The emergence of the treaty shopping phenomenon was also furthered by the introduction of ISDS clauses in investment treaties. As discussed above, this development brought a

<sup>75</sup> UNCTAD, based on World Bank. See United Nations Conference on Trade and Development, *Investment Provisions in Economic Integration Agreements* (United Nations Publication 2005) 10.

<sup>76</sup> Shaw Malcolm, *International Law* (7th edn, Cambridge University Press 2014) 609.

<sup>77</sup> Dolzer and Scheuer (n 35) 3.

substantial paradigm change; investment protection was no longer in the realm of diplomatic protection, but private investors were granted a self-standing right to bring claims against the host State in case of a violation of their rights.<sup>78</sup> Without this fundamental shift, treaty shopping would most likely be inconsequential, if not theoretically impossible altogether, as it is the independent standing of foreign investors that gives them the possibility (and incentive) to enforce claims in a particular forum and treaty framework, which they perceive to be the most favourable.<sup>79</sup> Consequently, investors' direct standing is yet another key factor to the practice of treaty shopping.

From European perspective the situation is currently looking interesting. The Court of Justice of the European Union (CJEU) gave its decision on *Achmea v. Slovakia* case (C-284/16) in March 2018 declaring ISDS provisions of intra-EU BITs incompatible with the EU law.<sup>80</sup> For now, the future of intra-EU BITs is hanging in the balance. Therefore, for EU based investors investing in another EU Member State, the ruling gives an additional incentive treaty shop to ensure that their corporate structure includes at least one entity outside the EU in a country that has a BIT with the relevant host State. It remains to be seen whether this development increases treaty shopping practice within the EU.

The final factor facilitating the occurrence of treaty shopping in international investment law is the relative ease of establishing particular legal entities, thereby creating diversity of nationality.<sup>81</sup> As mentioned above, in many domestic jurisdictions mere incorporation is sufficient for a juridical entity to acquire legal personality and corporate nationality.<sup>82</sup> These companies (often with no more than a post-box address) are typically simple to set up and, if necessary, insert into an existing corporate chain to maximise investment protection in the face of, for example, increasing political risks in the host State. In addition, shareholdings are nowadays highly transferable, which makes it easy to assign shares of an investment to an entity with the required nationality.<sup>83</sup> Therefore, foreign investors are able to make

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<sup>78</sup> Douglas Zachary, *The International Law of Investment Claims* (4th edn, Cambridge University Press 2012) Rules 1 and 2.

<sup>79</sup> Baumgartner, 'Treaty Shopping' (n 63) 27.

<sup>80</sup> *Achmea B.V. v. The Slovak Republic*, UNCITRAL, PCA Case No. 2008-13 (formerly *Eureko B.V. v. The Slovak Republic*), Judgement of the Grand Chamber of the European Court of Justice (6 March 2018). Request for a preliminary ruling under Article 267 TFEU from the Bundesgerichtshof (Federal Court of Justice, Germany). For closer examination of the *Achmea* case see Fouchard Clément and Krestin Marc, 'The Judgment of the CJEU in *Slovak Republic v Achmea* – A Loud Clap of Thunder on the Intra-EU BIT Sky!' (Kluwer Arbitration Blog, 7 March 2018). Available at: <http://arbitrationblog.kluwerarbitration.com/2018/03/07/the-judgment-of-the-cjeu-in-slovak-republic-v-achmea/> (accessed 12 April 2018).

<sup>81</sup> *ibid* 32.

<sup>82</sup> See Section 3.3.

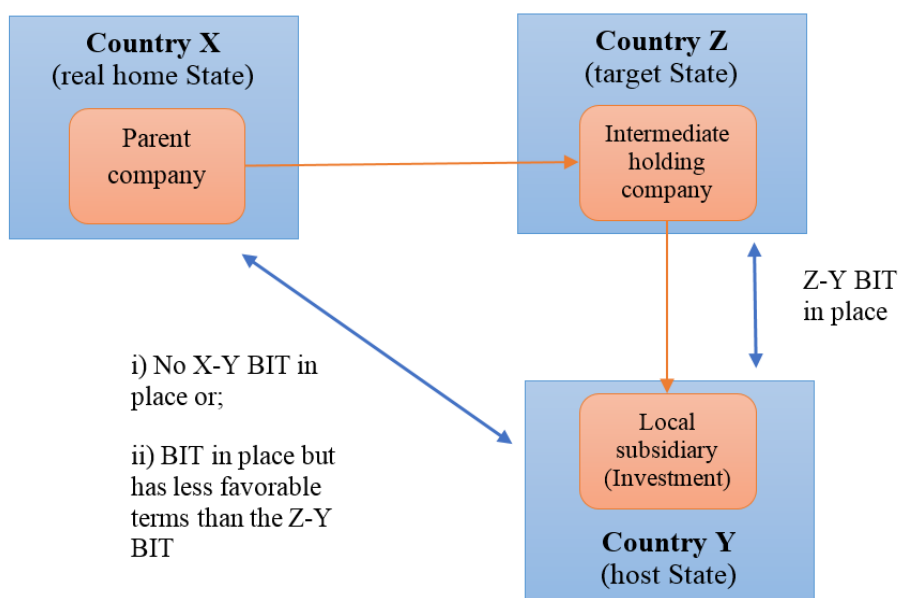
<sup>83</sup> Baumgartner, 'Treaty Shopping' (n 63) 32.

changes in their corporate structures, and thus shop for an advantageous treaty, relatively quickly as a response to developments in the host State's investment climate.

In conclusion, the combination of investment regime specific features is the seed of treaty shopping practice. The more legal instruments regulating protection of foreign investment exists, and the less harmonised the coordinated they are, the more incentivised investors are to gain the protection of the IIA (one or several) that serves its purposes the best. At least there is no harm trying as the shopping "operation" is often not too burdensome.

### 3.3. Treaty Shopping Methods

There are two basic scenarios in which treaty shopping can enhance the investor's position: i) the investor's home State (*Country X*) does not have a BIT with the host State (*Country Y*) but a third State (*Country Z*) has; or ii) *Country X* has a valid BIT with *Country Y* but the provisions under the BIT between *Country Z* and *Country Y* are more advantageous.<sup>84</sup> In effect, the investor seeks to become a national of *Country Z* and thus eligible for treaty protection under the BIT in question. The following figure illustrates these two situations.



**Figure 3.** Typical situation of treaty shopping through an intermediate company<sup>85</sup>

<sup>84</sup> The example in the text is drawn from Skinner *et al.* (n 59) 267. For more elaborate analysis in the context of umbrella clauses see 267–270 thereof.

<sup>85</sup> Author's modification from the figure in van Os and Knottnerus (n 33) 10.

The patterns in making nationality changes also vary and can create extremely complicated corporate structures. In essence, treaty shopping occurs in two principal ways: direct and indirect arrangements to channel investments through a preferred country. The investor can incorporate in the target State by establishing a new subsidiary under the laws of the State in question. Then the investor inserts the subsidiary in its existing corporate chain and transfers the control over the original investments to that new entity (the pattern demonstrated in Figure 3).<sup>86</sup> The newly founded holding company can be nothing more than a shell without any economic activity, merely owning the investment.<sup>87</sup> Thus, the ultimate controlling party is still the same. Another method of gaining nationality is by acquiring an already existing corporation that is a national under the desired IIA and channelling the investment through that company.<sup>88</sup> Both manoeuvres have raised questions whether arbitral tribunals should primarily examine the substance of the relationship between the investor and the host State, rather than merely focus on its form.<sup>89</sup> The details of this discussion and the most relevant case law are tackled in the following Chapter.

Moreover, the types of treaty shopping can be divided by a temporal element. Some commentators, such as Skinner, Miles and Luttrell, have used the terms "back end" and "front end" treaty shopping to describe the classification. "Back end" refers to situations where the investor performs nationality changing arrangements after the investment is already under some imminent threat (for instance, revocation of a licence or termination of a contract) or even after the dispute between the host State and the legal entity has already materialised.<sup>90</sup> As for "front end" type, the phrasing means that the foreign investor plans its

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<sup>86</sup> Lee Chieh, 'Resolving Nationality Planning Issue through the Application of the Doctrine of Piercing the Corporate Veil in International Investment Arbitration' [2016] 9(1) Contemporary Asia Arbitration Journal 99; Baumgartner, 'Treaty Shopping' (n 63) 13–14.

<sup>87</sup> *ibid* 99–100. This happened in e.g. *Tidewater Inc., Tidewater Investment SRL, Tidewater Caribe, C.A., et al. v. The Bolivarian Republic of Venezuela*, ICSID Case No. ARB/10/5, Decision on Jurisdiction (8 February 2008)

<sup>88</sup> Such arrangements were made in e.g. *Banro American Resources, Inc. and Société Aurifère du Kivu et du Maniema S.A.R.L. v. Democratic Republic of the Congo*, ICSID Case No ARB/98/7, Award (1 September 2000); *Société Générale In respect of DR Energy Holdings Limited and Empresa Distribuidora de Electricidad del Este, S.A. v. The Dominican Republic* LCIA Case No UN 7927, Award on Preliminary Objections to Jurisdiction (19 September 2008) and *Philip Morris Asia Limited v. The Commonwealth of Australia*, UNCITRAL, PCA Case No. 2012–12, Award on Jurisdiction and Admissibility (17 December 2015).

<sup>89</sup> In addition to the two ways introduced here, investors can also engage treaty shopping by transfer of claims whereby the actual claim arising out of alleged violation is assigned to another investor covered by a relevant IIA. This form of treaty shopping is relatively rare as it is highly problematic with regard to jurisdiction *ratione temporis*. Baumgartner, 'Treaty Shopping' (n 63) 13–14. For case law see e.g. *Mihaly International Corporation v. Democratic Socialist Republic of Sri Lanka*, ICSID Case No. ARB/00/2, Award (15 March 2002) and *Loewen Group, Inc. and Raymond L. Loewen v. United States of America*, ICSID Case No. ARB(AF)/98/3, Award 26 June 2003).

<sup>90</sup> Chaisse (n 63) 228; Skinner *et al.* (n 59) 260–261.

nationality in advance pursuant to the BIT of convenience.<sup>91</sup> That is, before the dispute arises or even before initiating the investment itself. The former method has evoked a strong reaction from arbitral tribunals, and it has been frowned upon in many cases whereas the latter has mostly been characterised as appropriate nationality planning or company strategy.<sup>92</sup>

Finally, it should be noted that none of these scenarios is confined to foreign investors as also nationals of the host State are also known to internationalise a wholly domestic matter to avail themselves of IIAs their country has concluded with foreign countries.<sup>93</sup> This internationalisation of domestic investment disputes has been a major cause of friction in international investment law. In general, attitudes towards both the legality and desirability of treaty shopping differ, often depending on one's interest and position within the system. Next, I will consider some arguments for and against treaty shopping.

### **3.4. Possible Benefits of Allowing Treaty Shopping**

Despite the fact that treaty shopping as a concept has a rather negative connotation it can also have some positive nuances, and it might essentially enhance the underlying objectives of the whole investment law system. As discussed in Chapter 2, nearly all IIAs are grounded on two elementary premises: foreign investment tends to spur economic development, and fundamental legal protections tend to encourage and promote foreign investment.<sup>94</sup> To reach the goals, the investment regime is designed to provide a reasonable level of security from the host State's arbitrary or discriminatory measures, guarantee fair and equal treatment and, in most cases, allow direct access to effective dispute settlement mechanisms, so as to avoid possibly biased courts of the host State and the need to resort to diplomatic protection.<sup>95</sup> When foreign investors engage in treaty shopping, they do so in pursuance of greater protection for their investments – which basically comprises of exactly the same aspects as goals of investment law. One could say that, theoretically, a Treaty Shopper gains no more than what the investment law was tailored to provide. Further, encouraging non-

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<sup>91</sup> *ibid.*

<sup>92</sup> Such as *Phoenix Action Ltd v. Czech Republic*. Here, the tribunal found that the practice of this belated corporate restructuring in order to gain better treaty benefits was a "breach of the fundamental caveat of good faith". See *Phoenix Action, Ltd. v. The Czech Republic*, ICSID Case No. ARB/06/5, Award (15 April 2009) and Section 5.3 below.

<sup>93</sup> Muchlinski (n 68) 3.

<sup>94</sup> Legum Barton, 'Defining Investment and Investor: Who Is Entitled to Claim?' [2006] 22(4) *Arbitration International* 2; OECD, *Foreign Direct Investment for Development: Maximising Benefits, Minimising Costs* (OECD Publishing 2002).

<sup>95</sup> See Chapter 2 of this Study.

discrimination is vital to promote foreign investment, as investors take higher risks when conducting business in an unfamiliar jurisdiction. That entails not only treating foreign investors like domestic investors under similar circumstances, but also providing equal treatment among foreign investors of different nationalities.<sup>96</sup> Thus, treaty shopping has the potential of levelling the playing field for foreign investors as they are able to customise their treaty coverage regardless where they originate.<sup>97</sup>

Also, in case law, some tribunals have embraced the idea of purposeful nationality planning. For example, in *Aguas del Tunari v. Bolivia*, the tribunal held that “It is not uncommon in practice and – absent a particular limitation – not illegal to locate one’s operations in a jurisdiction perceived to provide a beneficial regulatory and legal environment...including the availability of a BIT.” Further it noted: “The language of the definition of national in many BITs evidences that such national routing of investment is entirely in keeping with the purpose of the instruments and the motivations of the state parties.”<sup>98</sup>

As a conclusion, when viewed through the lens of the rationale and purpose of the investment regime, it could be said that treaty shopping coincides with the spirit of the underlying system.<sup>99</sup> Treaty shopping has the potential to further liberate investment law and therefore enhance FDI flow.<sup>100</sup> Capital mobility, in turn, promotes economic development and

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<sup>96</sup> Von Moltke Konrad, *Discrimination and Non-Discrimination in Foreign Direct Investment* (OECD Publishing 2002) 3. Concretely this is done in the form of adherence to the principles of national treatment and most-favoured nation treatment. Despite the efforts, inequalities do exist. Treaty shopping practice can be seen as investor's response to fix these inequalities by themselves.

<sup>97</sup> Similar in Wälde Thomas, 'International Investment Law: An Overview of Key Concepts and Methodology' [2007] 4(4) *Transnational Dispute Management* 53. "The Tokios Tokelés v Ukraine case has opened the door to domestic investors organised through a foreign, member-state holding company. There are indeed arguments for pursuing this course, *in particular as this would eliminate the difference in treatment between foreign investors (treaty-protected) and domestic investors (not protected)*..." (emphasis added).

<sup>98</sup> See *Aguas del Tunari, S.A. v. Republic of Bolivia* (n 173) paras 330(d) and 332.

<sup>99</sup> From individual State's point of view it is clear that treaty shopping creates broader investor eligibility for investment treaty protections. However, whether this is an issue depends on the State's motives for signing the IIA. Countries that consider that IIA commitments enhance investor confidence and promote more orderly and effective investment policies might feel quite comfortable with the expansion of investor eligibility for these protections to investors from third parties, or even to their own nationals. Countries that do not share this view, or for other reasons, wish to limit eligibility to foreigners tend to have a different perspective on treaty shopping. Ultimately, the decision as to what States should seek to do (if anything) about investment treaty shopping is closely linked to their underlying objectives in signing investment treaties, and to how they perceive treaty shopping as either hindering or facilitating the realisation of these objectives. OECD, *Investor-State Dispute Settlement Public Consultation: 16 May - 9 July 2012* (OECD Publishing 2012) para 160.

<sup>100</sup> In this regard one should bear in mind that the question whether IIAs succeed in their purpose of attracting foreign investments is (at the very least) contested as numerous empirical surveys have reached surprisingly different conclusions. The usefulness of IIAs is a rich area of debate by itself, and thus beyond the scope of this Study. For more about the topic see e.g. Sauvant Karl and Sachs Lisa, *The Effect of Treaties on Foreign Direct Investment: Bilateral Investment Treaties, Double Taxation Treaties, and Investment Flows* (Oxford University Press 2009) and Hallward-Driemeier Mary, *Do Bilateral Investment Treaties Attract Foreign Direct Investment? Only a Bit and They Could Bite* (World Bank Policy Research Working Paper 2003).

international trade as a whole. Moreover, such practice is inevitable part of modern business activity. There is, without a doubt, room for abuses. However, in the context of treaty shopping, these abuses are limited to situations where corporate restructuring is done with the sole purpose of gaining access to investment arbitration in anticipation of an upcoming dispute. Investment tribunals are increasingly condemning such behaviour and setting limits on legitimate forms of treaty shopping. Treaty shopping through corporate restructuring remains legal as there are no rules outright prohibiting it – nor there should be.

### **3.5. Why Is Treaty Shopping So Contentious?**

After defining treaty shopping and the reasons for its occurrence and popularity, one important question arises: if treaty shopping is not forbidden, why does it cause so much controversy? States have put across several potential policy concerns relates to the practice of treaty shopping. In this Section, I will explain the most common objections: reciprocity, sovereign consent, sustainable development and governance gap. I analyse critically each arguments' justification and credibility. Considerations against treaty shopping, especially the last two on the list, often seem to concern the investment system as a whole, and therefore it is likely that the solutions lie somewhere else as well. The thematics of this part of the Study revolve around both political and legal considerations. This is because when signing IIAs, States effectively take upon binding obligations thus giving up a part of their sovereign power.<sup>101</sup> Therefore, policy arguments are always tightly linked to questions related to FDI.

#### **3.5.1. Reciprocity**

Probably the most common criticism of treaty shopping is that it breaches the principle of reciprocity.<sup>102</sup> Investment treaties, especially bilateral ones, purport to establish mutual rights and obligations among contracting States.<sup>103</sup> In most treaties the ideal of reciprocity in promotion and protection of investments is expressly stipulated in their titles and/or preambles. Treaty shopping runs counter to this principle by giving corporations with no substantial ties to a contracting State the possibility to gain favourable treaty protections

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<sup>101</sup> Thaliath Joseph, 'Bilateral Investment Treaties and Sovereignty: An Analysis with Respect to International Investment Law' [2016] 5(2) Christ University Law Journal 3 and Reinicke Wolfgang, 'Global Public Policy' [1997] 76(6) Foreign Affairs. It has been said that IIAs "rob the states of their sovereign immunity" making them vulnerable to legal claims by foreign investors, alleging breach in the promised commitments. See also Paulsson Jan, 'The Power of States to Make Meaningful Promises to Foreigners' [2010] 1(2) Journal of International Dispute Settlement 341–352.

<sup>102</sup> Lee John (n 6) 358; van Oss and Knottnerus (n 33) 11.

<sup>103</sup> Sornarajah M., *The International Law on Foreign Investment* (4<sup>th</sup> edn, Cambridge University Press 2014) 8; Melachlan Campbell, Shore Laurence and Weiniger Matthew, *International Investment Arbitration* (2<sup>nd</sup> edn, Oxford University Press 2007).

even though its real home State may not be willing to reciprocate the gesture.<sup>104</sup> Treaty Shoppers thus gain protection "for free" because their home State does not guarantee the same standards of protection to the investors of the host State. Such corporations are sometimes critically denounced as "corporations of convenience" or "free riders", and the host States at the receiving end of this behaviour often wish to deny their access to investment arbitration due to lacking ties and reciprocity.<sup>105</sup>

The reciprocity can also be infringed in a situation where corporate restructuring is used to internationalise a domestic dispute.<sup>106</sup> Local investors may benefit from investment protection offered only to foreign investors by channelling investments through other States. Consequently, nationals of the host state can create a scenario where "a company is *legally* that of a contracting state (home state), while *financially* it is that of the host State"<sup>107</sup> and open the door to investment treaty claims against their country of origin.<sup>108</sup> This scheme can be seen contrary to the character and spirit of the BITs and the very purpose of ISDS. First of all, the investment protection regime is inherently designed for the State to attract foreign capital,<sup>109</sup> so the use of international investment arbitration to settle *de facto* domestic disputes does not further that purpose for the host State.<sup>110</sup> Secondly, reciprocity supposes that the host State ought to receive some converse benefit in return for submitting themselves to arbitration, which is highly improbable in cases where the dispute is essentially a wholly domestic matter.<sup>111</sup>

Although the reciprocity argument is quite persuasive, it has its shortcomings. The considerations behind the reasoning are founded on the premise that BITs and the treaty benefits derived from them are always built on a pattern of true reciprocity, which should be reflected in the provisions of the treaty itself.<sup>112</sup> The assumption of strict *quid pro quo*

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<sup>104</sup> Azaino Efe Uzezi, 'Nationality/Treaty Shopping: Can Host Countries Sift the Wheat from the Chaff?' [2013] CAR 16 CEPMLP Annual Review, 10.

<sup>105</sup> Sornarajah (n 103) 8; Schreuer 'Nationality of Investors' (n 158) 524.

<sup>106</sup> Lee John (n 6) 359.

<sup>107</sup> Azaino (n 104) 11.

<sup>108</sup> Interesting question regarding this issue is whether granting direct access to arbitration under an IIA could in fact amount to a discrimination between foreign and national investors? If a "level playing field" is the core purpose of investment law system, placing foreign investors in a better position than domestic ones jeopardizes that goal. See more in Baumgartner, 'Treaty Shopping' (n 63) 2.3.5 Lack of a 'level-playing' field, 63–64.

<sup>109</sup> See Roberts Anthea, 'Power and Persuasion in Investment Treaty Interpretation: The Dual Role of States' [2010] 104(2) American Journal of International Law 179.

<sup>110</sup> Lee John (n 6) 359.

<sup>111</sup> *ibid.*

<sup>112</sup> Avi-Yonah, Reuven S., 'Rethinking Treaty Shopping: Lessons for the European Union' C. H. Panay (co-author) in *Tax Treaties: Building Bridges between Law and Economics* (IBDF 2010) 27.



underlying all investment treaties may not always be true.<sup>113</sup> First, there is no guarantee that the underlying balance of the treaty benefits is a fair one. An IIA may be biased in favour of the country that has better bargaining power, usually being the economically more powerful country.<sup>114</sup> Therefore, infringing the principle reciprocity does not necessarily mean that a "fair" contractual balance has become "unfair". It is the negotiated balance that is being distorted, no matter what the actual fairness credentials of this balance are.<sup>115</sup>

Secondly, defenders of corporate nationality planning have argued that although the notions of mutuality and reciprocity do exist in investment agreements, they do not work in the same manner as in classical reciprocal State agreements.<sup>116</sup> The difference can be found at the structural level; instead of providing a mutual exchange of privileges, IIAs set accepted standards for the unilateral conduct of the host State and assume that the interests of States and investors are mutually compatible, even reinforcing.<sup>117</sup> IIAs aim to facilitate the prosperity "flowing from the long-term commitment of resources by the foreign investor under the territorial sovereignty of the host state" which could be seen as a joint ambition of States and investors.<sup>118</sup> Hence, if we accept the presumption that the primary purpose of IIAs is to create a favourable climate to attract foreign capital, it should not even matter from which foreign country the capital comes from.<sup>119</sup> From this point of view, the lack of strict reciprocity is not detrimental to the integrity of the investment law system.

### 3.5.2. State Consent

Another often pleaded argument against treaty shopping is related to State consent. All investment treaties constrain sovereignty of State. When a State enters into an IIA it actually limits its own rights over "the intrusive process of foreign investment" within its sovereign

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<sup>113</sup> Dolzer and Schreuer (n 51) 20.

<sup>114</sup> Avi-Yonah (n 112); see also Baumgartner, 'Treaty Shopping' (n 63) 42–49.

<sup>115</sup> *ibid.* Baumgartner also emphasises that even in a situation where the treaty provisions are formally equivalent for both contracting States, the advantages arising from them might not be. But do we define equivalence on the basis of formal or factual equivalence? For example the US–Bangladesh BIT imposes similar provisions for both Parties but still it is more beneficial to the US investors investing in Bangladesh than vice versa due to the unequally higher probability of US investors having the capital in invest. See more in Baumgartner, 'Treaty Shopping' (n 63) 42–43.

<sup>116</sup> *ibid.*; Lee John (n 6) 358; van Roos and Knottnerus (n 33) 12.

<sup>117</sup> *ibid.*

<sup>118</sup> Dolzer and Schreuer (n 51) 20.

<sup>119</sup> UNCTAD 'Scope and Definition' (n 54) 92. This debate divided the tribunal and led to resignation of one of the arbitrators in *Tokios Tokelés* –case (see Chapter 5.2). In his dissenting opinion, professor Weil who, was also the chairman of the tribunal, argued that ignoring the origins of the capital is "flying in the face of the object and purpose of the ICSID Convention" given the its expressly international nature. See *Tokios Tokelés v Ukraine*, Dissenting Opinion (n 225) para 6.

territory.<sup>120</sup> Thus, in order to be bound by treaty obligations, State must have validly consented to it. The legitimacy of the investment protection system is founded upon consent the State parties have expressed in the IIAs and therefore it is important to evaluate the concept of treaty shopping from this perspective.<sup>121</sup>

The historical background of the investment protection regime and the sudden growth of BITs are relevant factors in this argumentation. At that time of concluding numerous BITs, the phenomenon of treaty shopping was nearly unknown, or at least it occurred on a much smaller scale. The incentive to gain better investment protection via corporate restructuring emerged along with the selection of BITs to choose from. Thus, it can be argued that when States bound themselves to IIAs – and consequently consented to protect foreign investors and to resolve investment disputes in arbitration – they were not fully, if at all, aware of the future consequences of the growing treaty shopping trend.<sup>122</sup> Furthermore, before the mid-1990s there were only few investment arbitration decisions from which States could seek guidance regarding how IIAs should be interpreted.<sup>123</sup> At the time of signing, States may have been blissfully unaware of the consequences of broad treaty language that enables treaty shopping. Can we derive State consent to the present-day situation from their initial consent, when circumstances have changed so fundamentally? The existence of State consent to treaty shopping is thus exposed to a challenge.

Interestingly, State consent can be used also as a justification to allow treaty shopping. If we follow a strictly formal approach, the wide scope and loose terminology of many BITs indicates that States have given their blessing to this course of action.<sup>124</sup> This reasoning has its merits; States as sovereign entities have the power to negotiate and consent to such investment treaties as they find useful or necessary. Not only are the States free to decide whether to conclude a treaty in the first place, but they are also free to negotiate its terms, broad or narrow.<sup>125</sup> Consistent State practice in wording and overall design of BITs, including the definitions that allow treaty shopping, supports the notion that States do not

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<sup>120</sup> Sornarajah M. (n 103) 231.

<sup>121</sup> Lee John (n 6) 360.

<sup>122</sup> Van Os and Knottnerus (n 33) 11; Lee John (n 6) 360.

<sup>123</sup> Pauwelyn Joost, 'At the Edge of Chaos? Foreign Investment Law as a Complex Adaptive System, How It Emerged and How It Can Be Reformed' [2014] 29(2) ICSID Review 396.

<sup>124</sup> Lee John (n 6) 360. This pattern of thought was adopted by the arbitral tribunal in *Aguas del Tunari v. Bolivia* –case, where the tribunal found that "the language of the definition of national in many BITs evidences that such national routing of investments is entirely in keeping with the purpose of the instruments and the motivations of the state parties". See *Aguas del Tunari, S.A. v. Republic of Bolivia*, ICSID Case No. ARB/02/3, Decision on Jurisdiction (21 October 2005) [332].

<sup>125</sup> Baumgartner, 'Treaty Shopping' (n 63) 34.

stand against the current praxis.<sup>126</sup> Moreover, extending State consent to a slightly wider range of investors is technically not in contradiction with the IIAs ultimate goal to attract foreign investments and thus with the underlying motivation of the given consent.

However, the issue of ignorant consent may be real for some developing countries.<sup>127</sup> This notion is illustrated for example by the recent critical reactions to treaty shopping from countries in Latin America and Southern Africa, who have begun to adopt a more cautious attitude towards IIAs.<sup>128</sup> Many other nations have also voiced similar criticism and claimed that they were not giving well-informed consent to treaty shopping, nor did they agree to arbitrate the avalanche of claims brought by it.<sup>129</sup> For example, in June 2009 the South African Government highlighted this point in its position paper reviewing South Africa's BIT policy by stating:

*"Prior to 1994, the RSA [Republic of South Africa] had no history of negotiating BITs and the risks posed by such treaties were not fully appreciated at that time. The Executive had not been fully apprised of all the possible consequences of BITs. While it was understood that the democratically elected government of the time had to demonstrate that the RSA was an investment friendly destination, the impact of BITs on future policies were not critically evaluated. As a result the Executive entered into agreements that were heavily stacked in favour of investors without the necessary safeguards to preserve flexibility in a number of critical policy areas."<sup>130</sup>*

The same argument has been also used in the context of the substantive provisions of BITs. Some scholars have suggested that IIAs ought to be reformed to correspond the modern world because they were drafted in different social, economic and political circumstances.<sup>131</sup> Nonetheless, the root of this criticism should rather be addressed by renegotiating the

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<sup>126</sup> Broad definitions of investor, especially the incorporation test. Van Os and Knottnerus (n 33) 11.

<sup>127</sup> Not all capital-importing countries fully grasped all implications of IIAs at the time of signing, which supported by the case of the *Hull Rule* (prompt, adequate and effective requirement for compensation). Most of the developing countries fought fiercely against this old rule of customary international law but at the same time they signed over a thousand BITs that incorporate obligations similar to the Hull Rule. See more in Guzman Andrew, 'Why LDCs Sign Treaties That Hurt Them: Explaining the Popularity of Bilateral Investment Treaties' [1998] 38 *Virginia Journal of International Law* 639–688.

<sup>128</sup> See Section 5.1.2. See also Wells Louis, 'The Emerging Global Regime for Investment: A Response' [2010] 52 *Harvard International Law Journal* 46–48; van Os and Knottnerus (n 33) 11.

<sup>129</sup> Lee John (n 6) 360.

<sup>130</sup> Department of Trade and Industry, Republic of South Africa, *Bilateral Investment Treaty Policy Framework Review (Government Position Paper)* [2009] 5.

<sup>131</sup> Elkins Zachary, Guzman Andrew and Simmons Beth, 'Competing for Capital: The Diffusion of Bilateral Investment Treaties, 1960 – 2000' [2006] 60 *International Organization* 811.

balance of the rights and obligations in the substantive parts of IIAs instead of restricting corporate nationality planning.<sup>132</sup>

### 3.5.3. Other Objections

Two additional arguments have come up with respect to the opposition to treaty shopping. The arguments are linked to notions of sustainable development and governance gap.<sup>133</sup> Both of the objections are regularly brought up by States in respect to treaty shopping. However, it should be noted that they actually concern international investment law system as a whole, and thus are not *per se* criticism towards the treaty shopping phenomenon. Nevertheless, treaty shopping can operate as an exacerbating factor and it is important to understand its role in these challenges.

#### *Sustainable Development*

It has been submitted that treaty shopping practice can adversely effect on the implied goal of many BITs to encourage the host State's sustainable development.<sup>134</sup> Recent developments indicate that sustainable development features are starting to play a more prominent role in international investment policies. While still not common, these elements are meant to ensure that the IIA does not interfere with, but instead contributes to, States' sustainable development agenda to promote economic growth and the positive environmental and social impacts of investment.<sup>135</sup>

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<sup>132</sup> Lee John (n 6) 360. Although, treaty shopping might hinder the efforts of such reform as multinational entities can manoeuvre to avoid the more modern and narrow BITs by incorporating somewhere else.

<sup>133</sup> Baumgartner, 'Treaty Shopping' (n 63) 59; van Os and Knottnerus (n 33) 12.

<sup>134</sup> For example the Canada model BIT states in its preamble: "Recognizing that the promotion and the protection of investments of investors of one Party in the territory of the other Party will be conducive to the stimulation of mutually beneficial business activity, to the development of economic cooperation between them and to the promotion of sustainable development, Have agreed as follows" See Canada Model BIT (2014). One could say that the roots of the concept of sustainable development go back to the so called "Brundtland Report" which characterised it as "development that meets the needs of the present without compromising the ability of future generations to meet their own needs". See Brundtland Gro Harlem, *Our Common Future: The Report of the World Commission on Environment and Development* (Oxford University Press 1987) Chapter 2: Towards Sustainable Development, 54.

<sup>135</sup> United Nations Conference on Trade and Development, *World Investment Report 2012* (United Nations Publication 2012) 89. Even though the concept of sustainable development can cover several aspects, one can identify three intersecting core areas: environmental protection (such as natural resources and climate change), social development (particularly human rights and health care) and economic growth. According to UNCTAD the objective of sustainable development in IIA context entails that: "a treaty should (i) promote and protect those investments that are conducive to host-country development; (ii) provide treatment and protection guarantees to investors without hindering the government's power to regulate in the public interest; (iii) not overexpose a country to costly litigation and the risk of exorbitant financial liabilities; and (iv) stimulate responsible business practices by investors."

The first way treaty shopping could obstruct the goals of sustainable development is by exposing States to additional investment claims.<sup>136</sup> This is an obvious consequence of the fact that treaty shopping expands the group of privileged investors entitled to protection under the IIA in question. Even if the arbitral tribunal eventually denies jurisdiction, litigious Treaty Shoppers can force States to invest their resources in high arbitration costs.<sup>137</sup> Money from the State Treasury spent to defend investment claims (or possible damage awards) might then be missing from the implementation of policies consistent with sustainable development.<sup>138</sup>

The second threat that treaty shopping practice might pose to sustainable development is related to balancing investor's rights and obligations in IIAs, namely corporate social responsibility.<sup>139</sup> International law, for the time being, does not impose any *direct*<sup>140</sup> legal obligations upon corporations.<sup>141</sup> Nothing prevents States from concluding IIAs containing such obligations, but the risk is that government regulation of companies based on sustainable development considerations (*e.g.* human rights or environmental criteria) may be undermined by treaty shopping when investors opt for "treaty havens" that abstain from including provisions of this kind.<sup>142</sup> Following this logic, the phenomenon of treaty shopping could discourage governmental efforts to include sustainable development stipulations in their investment treaties.<sup>143</sup>

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<sup>136</sup> This observation has been made for example by Jorun Baumgartner. See Baumgartner, 'Treaty Shopping' (n 63) 59–61.

<sup>137</sup> Wouters Jan and Hachez Nicolas, 'Chapter 25: The Institutionalization of Investment Arbitration and Sustainable Development' in Cordonier Segger, Gehring *et al.* (ed), *Sustainable Development in World Investment Law, Global Trade Law Series, Volume 30* (Kluwer Law International 2011) 620; Gaukrodger David and Gordon Kathryn, 'Investor–State Dispute Settlement: A Scoping Paper for the Investment Policy Community' in OECD Working Papers on International Investment, 2012/03 (OECD Publishing 2012) 20.

<sup>138</sup> Baumgartner, 'Treaty Shopping' (n 63) 60–61.

<sup>139</sup> See Muchlinski (n 68).

<sup>140</sup> As for the indirect obligations Professor Peter Muchlinski has argued that the FET protection offered by host governments to foreign investors can be interpreted so as to impose certain duties on those same investors, including the duty to refrain from unreasonable conduct. See Muchlinski Peter, 'Caveat Investor? The Relevance of the Conduct of the Investor Under the Fair and Equitable Treatment Standard' [2006] 55(3) *International and Comparative Law Quarterly* 576–577. From human rights perspective see Dumberry Patrick and Dumas-Aubin Gabrielle, 'How to Impose Human Rights Obligations on Corporations Under Investment Treaties?' in Sauvant Karl (ed), *4 Yearbook on International Investment Law & Policy 2011-2012* (Oxford University Press 2013) 569-600.

<sup>141</sup> Report of the Special Representative of the Secretary–General on the issue of human rights and transnational corporations and other business enterprises, *Business and Human Rights: Mapping International Standards of Responsibility and Accountability for Corporate Acts*, U.N. Doc. A/HRC/4/035 (9 February 2007) para 44.

<sup>142</sup> Muchlinski (n 68) 22; Lee John (n 6) 361.

<sup>143</sup> Peterson Luke, 'Human Rights and Bilateral Investment Treaties: Mapping the role of human rights law within investor–state arbitration' [2009] *Rights & Democracy* (International Centre for Human Rights and Democratic Development) 15; van Os and Knottnerus (n 33) 12.

Although both arguments are essentially consistent, they seem rather one-sided and the connection to treaty shopping is distant. The global community is increasingly aware of the environment, human rights and other aspects of sustainable development; a responsible image has become a corporate asset. Therefore, corporations do not necessarily desire to opt for the most lenient provisions. Besides, arguably all investments have a positive effect on State's development. In particular to developing countries, foreign investment is critical to achieve needed economic growth to improve the welfare of their populations and to meet their basic needs in a sustainable manner.<sup>144</sup> Of course this requires that the Treaty Shopper actually brings capital into the country rather than planting nothing more than a "mailbox".

### ***Governance Gap***

Unsatisfied States have also suggested that treaty shopping exacerbates the phenomenon of governance gap, or more familiarly known as "regulatory chill", which implies that governments may refrain from adopting legitimate domestic regulatory changes, for *e.g.* the environment, natural resources or health, due to the threat of being dragged into investor-state arbitration.<sup>145</sup> The phenomenon concerns the entire system of international investment because IIAs, unlike many other international instruments, grant investors directly enforceable procedural rights and access to dispute resolution mechanisms (arbitration without privity).<sup>146</sup> Consequently, States fear that if they introduce new domestic legislation it may adversely affect the financial value of a foreign investment and thus expose them to investor claims.<sup>147</sup>

The argument, when used to campaign against treaty shopping, lies open to criticism. First, the effect of regulatory chill is difficult to prove or disprove. There are opposing views over the causal link between regulatory chill and the threat of investment arbitration.<sup>148</sup> Moreover,

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<sup>144</sup> United Nations Conference on Environment & Development (UNCED), *Agenda 21: Programme of Action for Sustainable Development* (United Nations Sustainable Development 1992) para 2.23.

<sup>145</sup> Tietje, Christian and Baetens Freya, 'The Impact of Investor–State–Dispute Settlement (ISDS) in the Transatlantic Trade and Investment Partnership', Study prepared for: Minister for Foreign Trade and Development Cooperation, Ministry of Foreign Affairs, The Netherlands (2014) 9; Van Os and Knottnerus (n 33) 12–13.

<sup>146</sup> In investment arbitration the parties' arbitration agreement is based on a unilateral offer by contracting States expressed in IIAs. This peculiar characteristic of ISDS has provoked discussion especially in relation to States' counterclaims against claimant investor. For more about the topic see *e.g.* Paulsson Jan, 'Arbitration Without Privity' [1995] 10(2) ICSID Review 232–257.

<sup>147</sup> Baumgartner, 'Treaty Shopping' (n 63) 62.

<sup>148</sup> For opinion against see *e.g.* Schill Stephan, 'Do Investment Treaties Chill Unilateral State Regulation to Mitigate Climate Change?' [2007] 24(5) *Journal of International Arbitration* 469–477. For opinion acknowledging the possible correlation see *e.g.* Brown Julia, 'International Investment Agreements: Regulatory Chill in the Face of Litigious Heat?' [2013] 3(1) *Western Journal of Legal Studies*.

there is no reliable method to measure this relation, as regulators may have multiple motives to withdraw from a planned domestic regulatory measure. Even if the looming threat of investment claims caused a State to surrender legislative action, it is not likely to publicly admit this.<sup>149</sup> Second, as mentioned above, the governance gap (if it exists) does not derive directly from treaty shopping but rather is connected to the ISDS mechanism.<sup>150</sup> In spite of that, treaty shopping can potentially aggravate the chilling effect as it increases the number of potential investment claims that may be brought as a counterattack to State measures.

In conclusion, States have raised various concerns when arguing against treaty shopping. Some points are more substantiated than others, but none of them seems persuasive enough to justify prohibition of treaty shopping altogether.

### 3.6. Importance of Nationality in Treaty Shopping Framework

Treaty shopping, as we see later in the case analyses, revolves heavily around the notion of "nationality". Simply put, treaty shopping is all about having the right nationality at the right time. The meaning of the term for the purposes of international investment law deviates from that of public international law.<sup>151</sup> Particularly pertaining to multinational corporate investors, the concept of nationality offers, at least *prima facie*, flexibility that may be utilised and also exploited when structuring foreign investments.<sup>152</sup> An investor's nationality is a substantial precondition for treaty shopping, and also a source of controversy.

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<sup>149</sup> For example, it has been speculated that Canada retreated from its planned tobacco restrictions in both 1994 and 2001 because of threats from the tobacco industry to bring actions under Chapter 11 of NAFTA. However, Australia did not withdraw from its plan to implement even stricter restrictions on tobacco packaging, despite extensive pressure from tobacco lobbyists and the simultaneous investment arbitration against Uruguay that was based on similar grounds. See Kyla Tienhaara, 'Regulatory Chill and the Threat of Arbitration: A View from Political Science' in Brown Chester and Miles Kate (eds), *Evolution in Investment Treaty Law and Arbitration* (Cambridge University Press 2011) 617 and Baumgartner, 'Treaty Shopping' (n 63) 63. See also *Philip Morris Asia Limited v. The Commonwealth of Australia*, UNCITRAL, PCA Case No. 2012–12, Award (8 July 2016).

<sup>150</sup> Côté, Christine, 'A chilling effect? The impact of international investment agreements on national regulatory autonomy in the areas of health, safety and the environment', PhD thesis, The London School of Economics and Political Science [2014] Chapter 2: The Globalization of Investment – IIAs and their purported impact on government regulatory autonomy; Tietje and Baetens (n 145) 39–49. Moreover, investment claims normally do not challenge the State's competence to regulate *per se*, but are more administrative in character; challenging the treatment of an individual investor in the context of a particular license or permit granted by government officials.

<sup>151</sup> In public international law, the practice related to determining nationality has mostly developed in the context of diplomatic protection. In the *Nottebohm* case, the ICJ held that there must be a real connection between the State and the national. In the international investment law sphere, there is not any general requirement for a real connection when defining a national. In fact, investment treaties typically impose only a place of incorporation requirement to gain nationality. Investors can rather easily satisfy this requirement without having an economic connection to the State, which leaves host States vulnerable to treaty shopping practices.

<sup>152</sup> ILA German Branch / Working Group (n 48).

Understanding the concept of nationality and its importance in investment law is crucial in order to fully examine the issues of this research. In fact, nationality has multiple functions when it comes to protecting foreign investments. The vast majority of investment law's substantive and procedural guarantees are contained in IIAs.<sup>153</sup> These standards apply to a limited group of investors, generally nationals of each State party to the particular IIA.<sup>154</sup> The State is only obliged to observe special treatment in favour of certain privileged persons and legal entities. Another reason why an investor's nationality matters is because the jurisdiction of an arbitral tribunal is determined, among other things, by the claimant's nationality.<sup>155</sup> Particularly, if the host state has given its consent to arbitration through an investment treaty, that consent cannot be extended to nationals of a state that is not a contracting party.<sup>156</sup> Finally, nationality can be a prerequisite for a State to exercise diplomatic protection.<sup>157</sup> Hence, the investor seeking protection under a treaty must demonstrate that it is a national of the contracting State.<sup>158</sup> Nationality is the most important tool for an investor who is planning to treaty shop. But what kind of connection to the home state must the investor show in order to gain the benefits of the IIA? This is where the individual treaty comes into play.

Almost every IIA contains a specific provision defining the term *investor*<sup>159</sup> and, although the specific criteria may vary, the definition is generally derived from the concept of nationality.<sup>160</sup> There is no internationally settled definition of investor but instead the states are free to assert their own interpretations of the term in their individual IIAs. By doing so the states can limit the scope of the investment protections offered in other parts of the IIA as only those investors who fall within the definition will be eligible for the benefits and protections of the treaty.<sup>161</sup> In other words, the definition of the term investor is critical to

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<sup>153</sup> IIA German Branch / Working Group (n 48) 52. See also 1.2 of this Study.

<sup>154</sup> McIlwrath and Savage (n 60) 372; Spiermann Ole, 'Individual Rights, State Interests and the Power to Waive ICSID Jurisdiction under Bilateral Investment Treaties' [2004] 20(2) *Arbitration International* 179.

<sup>155</sup> Jurisdiction *Ratione Personae*, see more e.g. Dolzer and Schreuer (n 51) 233–238.

<sup>156</sup> Dolzer and Schreuer (n 51) 47 and Collins (n 8) 79–80.

<sup>157</sup> Acconci Pia, 'Determining the Internationally Relevant Link between a State and a Corporate Investor: Recent Trends concerning the Application of the Genuine Link Test' [2004] 5(J) *World Investment & Trade* 139.

<sup>158</sup> Schreuer Christoph, 'Nationality of Investors: Legitimate Restrictions vs Business Interests' [2009] 24(2) *ICSID Review – Foreign Investment Law Journal* 521. In a case of multilateral or regional investment treaty, e.g. NAFTA or ECT, the investor must show that it has a nationality of one of the State parties to the treaty.

<sup>159</sup> Another provision found in nearly all IIAs is the definition of *Investment* that lays out the characteristics of the economic activity that must be undertaken in the host state in order to the IIA to be applicable.

<sup>160</sup> IIA German Branch / Working Group (n 48) 11 and Martin Antoine 'Disputes, Nationality and Corporate Veil: Some Insights from Tokios Tokelés and TSA Spectrum De Argentina' [2011] 8(1) *Transnational Dispute Management* 1–17.

<sup>161</sup> Collins David, *An Introduction to International Investment Law* (Cambridge University Press 2017) 74.



determining the scope of an investment treaty.<sup>162</sup> Therefore, whether the investor holds a specific nationality is a fundamental question that must be answered before proceeding with the substantive investment issues.

At first glance, it might not seem complicated to determine if there is such legal bond between an investor and a state that would constitute nationality. However, in today's globalised economy, multinational corporations are not uncommon and even smaller legal entities may have complex organisational structures that make tracing the legal bond challenging. Investments can be channelled through multiple entities in different jurisdictions and owned by nationals of different countries.<sup>163</sup> Especially in the field of international investment and trade, nationality is often deemed a fact of coincidence or convenience rather than a true bond to a state.<sup>164</sup>

### **3.6.1. How to Determine Corporate Investor's Nationality**

IAs tend to use three nationality tests: a) the incorporation test, b) *siège social* (also known as the seat test) or c) the control test.<sup>165</sup> In some cases all three of these are used together or they might be combined with other factors to create a higher threshold for corporate nationality.<sup>166</sup> Yet another approach refrains from including a precise definition in the treaty provisions and instead refers to the conditions prescribed by the domestic law of the home State where the juridical person was incorporated.<sup>167</sup> As nationality is the key facilitator of treaty shopping, it is useful to understand different methods to define eligible investors. In this Subsection, I will introduce the most commonly used criteria and analyse the strengths and weaknesses of each approach from a treaty shopping perspective.

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<sup>162</sup> Professor Schreuer has pointed out an interesting paradox regarding investor's nationality. With respect to access to protection under IAs, nationality is of the utmost importance but when an investment case reaches the substantive phase distinctions of nationality are a taboo. See Schreuer Christoph, 'Nationality Planning' in Rovine Arthur (ed), *Contemporary Issues in International Arbitration and Mediation: The Fordham Papers* (Martinus Nijhoff Publishers 2012) 26. See also Schill Stephan, 'The Fair and Equitable Treatment Standard in the International Law of Foreign Investment' [2009] 20(1) *European Journal of International Law* 236–239 and Grierson–Weiler Todd and Laird Ian, 'Standards of Treatment' in Muchlinski, Ortino and Schreuer (eds), *The Oxford Handbook of International Investment Law* (Oxford University Press 2008) 261–304.

<sup>163</sup> Wisner Robert and Gallus Nick, 'Nationality Requirements in Investor–State Arbitration' [2004] 5 *J. The Journal of World Investment & Trade* 927; OECD, *International Investment Law: Understanding Concepts and Tracking Innovations: A Companion Volume to International Investment Perspectives* (OECD 2008) 18.

<sup>164</sup> ILA German Branch / Working Group (n 48) 11.

<sup>165</sup> Van Os and Knottnerus (n 33) 23.

<sup>166</sup> Feldman Mark, 'Setting Limits on Corporate Nationality Planning in Investment Treaty Arbitration' [2012] 27(2) *ICSID Review* 281; Tekin Zeynep, 'International Investment Law and Treaty Shopping through Corporate Nationality Structuring' (University of Pennsylvania Journal of International Law, 2017).

<sup>167</sup> ILA German Branch / Working Group (n 48) 13.

### ***a) Place of Incorporation***

The so-called incorporation theory is the most frequently used method to determine an investor's nationality. It is also the most relevant in the treaty shopping framework as it sets the lowest possible threshold to qualify as an investor. According to this approach, juridical persons that are incorporated or constituted in accordance with the laws of a particular State are considered to be nationals of that State.<sup>168</sup> Consequently, the incorporation test covers investors that are established and organised according to the relevant national legislation. No additional requirements apply, so the corporation can be owned by nationals of a third State or even nationals of the host State itself. Furthermore, the test does not oblige the corporation to exercise any real economic activity in the contracting State, which means that "mailbox" or "shell" companies are deemed to be investors as well, provided that the formal prerequisites are met.<sup>169</sup>

As an example, the Energy Charter Treaty (hereafter ECT) Article 1 (7) (a) (ii) defines *investor* with respect to a Contracting Party to include: “*a company or other organization organized in accordance with the law applicable in that Contracting Party*”.<sup>170</sup>

The mere incorporation requirement is the most liberal approach, and one of the chief advantages associated with determining investor status in this manner is its simplicity, flexibility and predictability.<sup>171</sup> Identifying the State under whose laws a legal entity is

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<sup>168</sup> Thorn Rachel and Doucleff Jennifer, Part I Chapter 1: Disregarding the Corporate Veil and Denial of Benefits Clauses: Testing Treaty Language and the Concept of “Investor” in Waibel and Kaushal, Chung, et al. (eds), *The Backlash against Investment Arbitration* (Kluwer Law International 2010) 6–7; Tekin (n 166) para 7.

<sup>169</sup> Savage John, 'Investment Treaty Arbitration and Asia: Review of Developments in 2005 and 2006' [2007] 3(1) *Asian International Arbitration Journal*, (*Singapore International Arbitration Centre in co-operation with Kluwer Law International*) 17–18. The simplistic definition of the incorporation theory also reflects the criteria used to determine nationality of a legal entity under customary international law. Perhaps it is part of the reason why a vast majority of investment treaties rely solely on this criterion and why it has also been applied frequently by arbitral tribunals. See e.g. Barcelona Traction case and Tokios Tokelès, which is also dealt with greater depth in section 4.2. Illustratively, the country of incorporation test is used in number of multilateral and regional treaties such as the North American Free Trade Agreement (NAFTA), the Dominican Republic–Central America Free Trade Agreement (CAFTA-DR) and the Energy Charter Treaty (ECT). It also tends to be more popular amongst 1<sup>st</sup> and 2<sup>nd</sup> generation BITs and common law countries, with States like the United Kingdom, Singapore, Canada and the United States routinely construing an investor's nationality based on this requirement. However, incorporation theory's popularity is also increasing in Continental Europe and its relevance has grown even further as a consequence of the ECJ jurisprudence on freedom of establishment. See United Nations Conference on Trade and Development, 'Scope and Definition' in *UNCTAD Series on Issues in International Investment Agreements II* (United Nations Publication, 2011) 81; Thorn and Doucleff (n 168) 7 and Baumgartner, 'Treaty Shopping' (n 63) 74.

<sup>170</sup> Energy Charter Treaty, opened for signature 17 December 1994 in Lisbon, 2080 UNTS 95 (entered into force April 16, 1998). See also Energy Charter Secretariat, 'The Energy Charter Treaty: A Reader's Guide' [2002].

<sup>171</sup> Zhang Xiao-Jing, 'Proper Interpretation of Corporate Nationality under International Investment Law to Prevent Treaty Shopping' [2013] 6(1) *Contemporary Asia Arbitration Journal* 50; Thorn and Doucleff (n 168) 7; UNCTAD 'Scope and Definition' (n 54) 82–82.

organised is, in most cases, fairly straightforward operation.<sup>172</sup> Moreover, linking nationality with the State of incorporation is more likely to result in consistent nationality over the life of the investment as the place of incorporation is generally permanent or at least not easily changed.<sup>173</sup> There should be no major pitfalls with regard to the confirmation of investor's nationality. From the investor's perspective, the test of incorporation is fairly easy to satisfy and thus it offers the widest access to treaty benefits. Accordingly, treaties that rely only on the incorporation criteria are the easiest to gain access to for treaty shopping purposes. Yet another benefit of this method is that it can help to create a more stable investment environment, which is valuable for both States and investors.<sup>174</sup> A clear-cut requirement that is not depended on other factors than lawful establishment of a judicial person reduces the risk that the treaty protections under an IIA will be either gained or lost as a result of changes in ownership structure for instance.<sup>175</sup>

Nationality constructed based solely on incorporation has its deficiencies. There is no guarantee that the investor actually engages in economic activity or has any other genuine link to the incorporation-state. Thus it exposes states to potentially negative treaty shopping practises.<sup>176</sup> The legal entity may be wholly owned or controlled by nationals of a third State, or it might be a mailbox company that does not generate any economic benefits in the host State.<sup>177</sup> For this reason some States have objected defining nationality strictly on incorporation, even if the formal requirements set by the IIA and the national legislation were satisfied. Many arbitral tribunals have concluded that the incorporation test laid down in the IIA does not authorise them to examine the true nature of the investor's nationality nor require them to do so.<sup>178</sup>

However, the incorporation test is sufficient if a State is willing to grant treaty benefits and protection to investor-corporations irrespective of the nationality of individuals who ultimately own or manage them.<sup>179</sup>

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<sup>172</sup> *ibid.*

<sup>173</sup> *ibid.*; Tekin (n 166) para 7. As an exception see *Agua del Tunari, S.A. v. Republic of Bolivia*, ICSID Case No. ARB/02/3, Decision on Jurisdiction (21 October 2005) where the tribunal recognised that a nationality of a corporate shareholder could "migrate" from the Cayman Islands to Luxembourg.

<sup>174</sup> Thorn and Doucleff (n 168) 7.

<sup>175</sup> *ibid.*

<sup>176</sup> Addison-Agyei Sange, *Nationality Planning Und Treaty Shopping Im Internationalen Investitionsrecht: Der Rechtsschutz Von Briefkastengesellschaften Nach Der ICSID Conventio* (Lang, Peter Gmbh 2012) 26–27.

<sup>177</sup> UNCTAD 'Scope and Definition' (n 54) Executive Summary xii–xiii; Thorn and Doucleff (n 168) 7; Baumgartner, 'Treaty Shopping' (n 63) 75.

<sup>178</sup> See e.g. Tokios Tokèles, Saluka Investment and Rompetrol. More details in section X.

<sup>179</sup> UNCTAD 'Scope and Definition' (n 54) Executive Summary xiii, 83.

## ***b) Siège Social***

Some States, more frequently civil law countries, have adopted the Siège social theory, also commonly known as the seat theory.<sup>180</sup> The seat theory has the potential to deter treaty shopping because it requires greater commitment from the investor.<sup>181</sup> The theory rests upon the place where the effective management is located.<sup>182</sup> The "effective management"<sup>183</sup> most commonly refers to the centre of administration, the place where "the fundamental decisions of the company's management are actually executed into valid and externally focused management acts".<sup>184</sup> A statutory seat would not suffice to meet this criterion, nor would a mere head office even though the latter may be referred to as a "seat" too.<sup>185</sup> Accordingly the siège social theory demands more genuine link between the legal entity and the country of nationality than the incorporation theory introduced above.<sup>186</sup>

For instance, according to Art 1 (2) of the BIT between the People's Republic of China and the Federal Republic of Germany the term "investor" means:

*"(a) in respect of the Federal Republic of Germany:*

*- any juridical person as well as any commercial or other company or association with or without legal personality having its seat in the territory of the Federal Republic of Germany, irrespective of whether or not its activities are directed at profit;*

*(b) in respect of the People's Republic of China:*

*- economic entities, including companies, corporations, associations, partnerships and other organizations, incorporated and constituted under the laws and regulations of and with their seats in the People's Republic of China,*

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<sup>180</sup> It is worth mentioning that some IIAs also use other terms such as *main office* or *residence* to refer to the same theory. See Perkams Markus, 'The Determination of Nationality of Investors in International Investment Agreements (IIAs)—Taking Stock of the Criteria Used in Modern Investment Law' in ILA German Branch, *Determination of the Nationality of Investors under Investment Protection Treaties* [2011] 15. Perkams also highlights a possible difficulty with ambiguous terms since they could be interpreted as referring to either the statutory seat or the administrative seat of the legal entity. Thus the terminology can lead to problematic situations if the decisive seat is not clearly determined in the treaty text.

<sup>181</sup> Lee John (n 6) 365.

<sup>182</sup> Baumgartner, 'Treaty Shopping' (n 63) 75; Schreuer 'Nationality of Investors' (n 158) 521.

<sup>183</sup> Expression "effective management" as the requirement for nationality has caused its share of problems as well. The ASEAN Agreement for the Promotion and Protection of Investments (dated 15 December 1987) uses this terminology and in the *Yaung Chi Oo* –case proved that the terminology is vulnerable for interpretation. In the case, the tribunal considered mere incorporation to be proof of effective management. Thus, the provision was no more restrictive than the sole incorporation test. See more: *Yaung Chi Oo Trading Pte. Ltd. v. Government of the Union of Myanmar*, ASEAN I.D. Case No. ARB/01/1, Award 31 March 2003.

<sup>184</sup> Kussmaul Heinz, Richter Lutz, and Ruiner Christoph, 'Corporations on the Move, the ECJ off Track: Relocation of a Corporation's Effective Place of Management in the EU'[2009] 6(6) European Company Law 246.

<sup>185</sup> Addison-Agyei (n 176) 29; Baumgartner, 'Treaty Shopping' (n 63) 75.

<sup>186</sup> UNCTAD 'Scope and Definition' (n 54) 83.

*irrespective of whether or not for profit and whether their liabilities are limited or not"*<sup>187</sup>

The seat test is more "treaty shopping proof" than mere incorporation as the investor must show a more significant economic relation to the home State.<sup>188</sup> However, compared to the theory presented above, the seat theory is not as straightforward since specifying the seat of a multinational corporation may be a troublesome exercise.<sup>189</sup> Generally speaking, it is still a more functional and far simpler analysis than investigating the origins of the person(s) controlling the company.

### ***c) Control Theory***

The final criterion of nationality examined in this section is the control test, also known as the ownership test. It means that a juridical person is deemed to be an investor of that State whose nationals own or control it.<sup>190</sup> Instead of looking into the nature of the legal entity itself, the nationality of person(s) behind it is definitive. In this regard, the corporation is assumed to be more an investment vehicle than an actual independent investor. The control theory is not as widely used as the two other tests and actually it is, in most cases, combined with other nationality indicators.<sup>191</sup>

Exercise of control, along with limiting criteria, is adopted in the BIT between the Kingdom of the Netherlands and the Argentine Republic. Under Art (1) (b) (iii) of the treaty the term "investor" shall comprise with regard to either Contracting Party:

*"[L]egal persons, wherever located, controlled, directly or indirectly, by nationals of that Contracting Party"*<sup>192</sup>

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<sup>187</sup> Agreement between the People's Republic of China and the Federal Republic of Germany on the Encouragement and Reciprocal Protection of Investments (China–Germany BIT), 1 December 2003 (entered into force 11 November 2005). See also Art. 1(1)(b) of the Spain–Albania BIT (2003) and Art. 1(3)(b) of the Finland–Argentina BIT (1993).

<sup>188</sup> Sornarajah Muthucumaraswamy, 'Good Faith, Corporate Nationality, and Denial of Benefits' in Mitchell Andrew, Sornarajah M. and Voon Tania (eds), *Good Faith and International Economic Law* (Oxford University Press 2015) 117; UNCTAD 'Scope and Definition' (n 54) 83.

<sup>189</sup> For further problems that the seat theory has generated for EU Member States see e.g. Baelz Kilian and Baldwin Teresa, 'The End of the Real Seat Theory (Sitztheorie): the European Court of Justice Decision in Ueberseering of 5 November 2002 and its Impact on German and European Company Law' [2002] 3(12) German Law Journal; Baumgartner, 'Treaty Shopping' (n 63) 76.

<sup>190</sup> Baumgartner, 'Treaty Shopping' (n 63) 77.

<sup>191</sup> Perkams (n 180) 15.

<sup>192</sup> Agreement on encouragement and reciprocal protection of investments between the Kingdom of the Netherlands and the Argentine Republic (Netherlands–Argentina BIT), 20 October 1992 (entered into force 1 October 1994). See also Art. 1(b) of the Hong Kong–Australia BIT (1993) and Art. 25(2)(b) of the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (ICSID Convention 1965).

On the positive side, the control test, whether alone or consolidated with other factors, has the benefit of looking into "substance over form" by examining genuine economic links.<sup>193</sup> Thus, it can hinder potential attempts to abuse corporate restructuring and essentially functions in a similar manner to the doctrine of piercing the corporate veil.<sup>194</sup>

The control-focused approach also has its drawbacks. First, legal entities making international investments oftentimes involve complex holding structures and may have several layers of ownership, which makes it difficult to identify the nationality of the true controllers.<sup>195</sup> In addition, it raises the question of the nature of the "control" required. That is whether the investor must show actual exercise of control (factual control) or legal ability to control (legal control) and whether we should examine the nationality of the ultimate controller (the final link in the chain) or the initial layers of control.<sup>196</sup> For example, if the term is defined broadly to include both direct and indirect control, the host State may be exposed to concurrent or multiple proceedings concerning the same investment.<sup>197</sup> Finally, there is a high risk that the nationality could change over the lifetime of the investment, especially in the case of limited companies as shares are typically freely transferable.<sup>198</sup> The exposure to frequent changes in nationality status is one of the main reasons why the control theory is often bundled with other nationality standards.

#### ***d) Combined Factors***

The final commonly used approach to set limits on investor's nationality is to cumulatively use some or all three theories analysed above. Combination might also include additional elements, such as "actually doing business" or "actual business activities" in the territory of

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<sup>193</sup> Baumgartner, 'Treaty Shopping' (n 63) 77. For further analysis see Ester Guillermina. "Returning to the Issue of Nationality Case Comments" *Journal of World Investment and Trade* 17, Issue 5 (2016): 833-842. The article examines the relation between state of incorporation approach and effective control rule through case study *Venoklim Holding B.V. v. Bolivarian Republic of Venezuela*, ICSID Case No. ARB/12/22, Award (3 April 2015).

<sup>194</sup> Usually a corporate entity is treated as a separate legal person. Piercing (or lifting) the corporate veil is a legal decision to treat the rights or duties of a legal entity as the rights or liabilities of its shareholders.

<sup>195</sup> Thorn and Doucleff (n 168) 8.

<sup>196</sup> Voon Tania, Mitchell Andrew and James Munro, 'Legal Responses to Corporate Manoeuvring in International Investment Arbitration' [2014] 5(1) *Journal of International Dispute Settlement* 55–56; Burgstaller Markus, 'Nationality of Corporate Investors and International Claims against the Investor's Own State' [2006] 7(6) *The Journal of World Investment & Trade* 857–858 and 866–871.

<sup>197</sup> Dimsey Mariel, *The Resolution of International Investment Disputes: Challenges and Practical Solutions*, in Schwenzer Ingeborg (ed), *International Commerce and Arbitration, Volume 1* (Eleven International Publishing 2008) 65–70. Some BITs have taken the problem of multiple claims into account by stipulating that when a corporate investor is incorporated in a third-party State but owned and/or controlled by nationals of a contracting State, the investor will not be entitled to invoke provisions of the BIT in question if it has already brought claims in respect of the same matter under a treaty involving the third State. See e.g. Australia–Uruguay BIT (2001) Art 2(4).

<sup>198</sup> Baumgartner, 'Treaty Shopping' (n 63) 77.

the home State.<sup>199</sup> For example Art. 1 of the BIT between Canada and the Republic of Peru goes as follows:

*"[E]nterprise of a Party means an enterprise constituted or organized under the law of a Party, and a branch located in the territory of a Party and carrying out business activities there".<sup>200</sup>*

Cumulative usage of several criteria can help to narrow the scope of the treaty protection to only those corporations that have real and continuous economic ties to the home State, so it is arguably the most effective method for States that wish to curb treaty shopping.<sup>201</sup> However, the obvious consequence is that it is also the most complicated approach in practice.

To conclude, the investor's origins matters greatly for the purposes international investment law in general. It is the dominant factor with regards to the applicability of an IIA *ratione personae*. Yet there are multiple approaches to define who is a national of a certain State and thus privileged to enjoy the benefits it entails. A concept that seems so simple at first has provoked a lot of discussion and confusion among commentators and arbitral tribunals. In regard to the research questions of this Study, the definition of nationality, or more precisely investor status, seems to be a primary enabler of treaty shopping practices but perhaps also a part of the solution to control the adverse effects of such activity.

Now that we have a general idea what treaty shopping is, how it works and what kind of consequences it might bear, we can move ahead to the case studies where arbitral tribunals have undertaken to draw the line between permissible and prohibited treaty shopping practice.

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<sup>199</sup> UNCTAD 'Scope and Definition' (n 54) 15; Thorn and Doucleff (n 168) 8–9; Tekin (n 166) para 10.

<sup>200</sup> Agreement between Canada and the Republic of Peru for the Promotion and Protection of Investments (Canada–Peru BIT), 14 November 2006 (entered into force 20 June 2007). See also Art. 1(3)(c) of the Chile–Finland BIT (1993).

<sup>201</sup> Tekin (n 166) para 10.

## **4. DRAWING THE LINE BETWEEN LEGITIMATE AND ABUSIVE TREATY SHOPPING – ANALYSIS THROUGH CASE STUDIES**

In this Chapter, I will highlight some of the most influential arbitral cases regarding treaty shopping in order to draw general conclusions as to when treaty shopping is allowed and when it becomes prohibited. The different approaches and reasoning in the case law illustrate how controversial the issue is, for not even international tribunals have found common ground on the permissibility of treaty shopping behaviour. Divergent jurisprudence has created great uncertainty about the scope of legitimate corporate nationality planning in investor-State arbitration. The storm of controversy surrounding treaty shopping phenomenon seems to be gathering force, and thus far arbitral tribunals have been unable to satisfy the need for legal certainty.

As stability and predictability are key premises for a viable investment system, the unsettled case law emphasises existing insecurity and is potentially harmful for the entire flow of FDI. Both States and investors should be able to predict the limits of their rights in order to properly contribute to investment activities. It must be noted that when determining appropriate limits for treaty shopping, there are many forms of it, some of which are more objectionable than others. That is understandably part of the explanation for inconsistent arbitral decisions. However, significant discrepancies occur among similar cases too, which has caused major confusion.

In spite of split opinions, some identifiable trends have emerged. In the following Sections, I will divide these approaches into two main categories: the permissive response and the prohibitive response. Under each Section, I will provide a summary of the leading cases and analyse the reasoning behind arbitrators' decision. To conclude, I will draw some common guidelines as to where to place the line between acceptable and unacceptable treaty shopping.

### **4.1. Treaty Interpretation – General Principles**

In order to be fully able to assess arbitral awards concerning treaty shopping, it is necessary to briefly review the general approaches to investment treaty interpretation. As international investment law is part of public international law, the starting point of interpreting IIAs is



that of interpretation of international treaties in general.<sup>202</sup> Such rules are contained in the Vienna Convention on the Law of Treaties (hereafter VCLT).<sup>203</sup> In fact, investment tribunals invariably begin their interpretation by invoking Article 31 of VCLT, according to which: "*A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.*"<sup>204</sup> Two main approaches have emerged from this phrasing: the textual and the teleological interpretation.<sup>205</sup> Interpreting IIA provisions in treaty shopping cases, as we can see in the upcoming Sections, divides similarly. Namely, some tribunals have confined themselves strictly to the wording of the applicable IIA, while others have gone beyond the treaty text in search of an interpretation consistent with the objective and purpose of the treaty.

According to the textual approach, treaty interpretation should be primarily based on the actual terms expressed in the IIA. The wording of the IIA is the main source in determining the Contracting States' intention, and the tribunal cannot deviate from what the parties have agreed.<sup>206</sup> Thus, when interpreting treaty text, the tribunal tries to give the words, as they are used in the treaty context, their "ordinary meaning".<sup>207</sup> Consequently, the textual approach leaves no room for considerations beyond the wording of the IIA, even if the outcome is incompatible with the spirit of the treaty.

By contrast, the tribunals employing teleological interpretation tend to emphasise the underlying objective and purpose of the treaty.<sup>208</sup> The teleological approach may better

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<sup>202</sup> Weeramantry Romesh, *Treaty Interpretation in Investment Arbitration* (Oxford University Press 2012) Chapter 1.

<sup>203</sup> Vienna Convention on the Law of Treaties, 23 May 1969.

<sup>204</sup> Schreuer Christoph, 'Diversity and Harmonization of Treaty Interpretation in Investment Arbitration' in Malgosia Fitzmaurice, Olufemi Elias and Panos Merkouris (eds), *Treaty Interpretation and the Vienna Convention on the Law of Treaties: 30 Years on* (Brill Nijhoff 2010) 129.

<sup>205</sup> Koskeniemi Martti, *From Apology to Utopia: The Structure of International Legal Argument* (Cambridge University Press 2005) 333. However, the treaty interpretation by investment tribunals has evoked strong critique as well. Some scholars are concerned about the various nuances in the interpretation methods of investment tribunals, which may lead to (even more) fragmented case law and damage the predictability and stability of international investment. See e.g. Pauwelyn Joost and Elsig Manfred, 'The Politics of Treaty Interpretation: Variations and Explanations Across International Tribunals' in Dunoff Jeffrey and Pollack Mark (eds), *Interdisciplinary Perspectives on International Law and International Relations: The State of the Art* (Cambridge University Press 2013).

<sup>206</sup> De Figueiredo Roberto, 'Interpreting Investment Treaties' (Kluwer Arbitration Blog, 21 October 2014). Available at: <http://arbitrationblog.kluwerarbitration.com/2014/10/21/interpreting-investment-treaties/> (accessed 18 March 2018).

<sup>207</sup> Pauwelyn and Elsig (n 205) 452. For arbitral decision employing the textual interpretation see e.g. *Salini Costruttori S.p.A. and Italstrade S.p.A. v. The Hashemite Kingdom of Jordan*, ICSID Case No. ARB/02/13, Decision on Jurisdiction (9 November 2004).

<sup>208</sup> The objective and purpose of the treaty are often found in the preamble. In the context of BITs, this interpretation generally leads to an interpretation that is more favourable to investor. This investor friendly tendency was recognised by, for example, the *Noble Ventures* tribunal. See *Noble Ventures, Inc. v. Romania*,

reflect the Contracting States' original intentions, but it also risks the most fragmentation and conflict among tribunals, as such interpretation is inevitably value-based and gives the arbitrators great leeway.<sup>209</sup> In treaty shopping cases, the teleological interpretation is repeatedly paired with the good faith (or, more accurately, its derivative, abuse of process) argument.<sup>210</sup> This combination has played a significant role in decisions condemning treaty shopping.

Next I will elaborate on treaty shopping case law. Here, the tribunal's choice of interpretation has proven to be decisive with regards to the permissibility of the phenomenon. Consequently, the cases are systematised in accordance with the textual versus teleological approach separation. As of yet, it is not possible to determine which approach will prevail. While newer cases have increasingly relied on good faith considerations, support for the formal reading of the treaty text remains strong.

#### **4.2. Permissive Approaches: Staying Within the Limits of the Treaty**

The permissive approach covers cases in which arbitral tribunals accepted treaty shopping via restructuring as a lawful action within the limits of the IIA text. Several investment tribunals have rejected requests by State-respondents to look beyond the wording of the applicable IIA for limits on corporate nationality planning. In each instance, the tribunal took a consent-oriented stand and noted that the explicit terms of the applicable treaty provided the necessary and adequate criteria for determining corporate nationality, namely the place of incorporation.<sup>211</sup> In other words, the approach is strictly based on a formal reading of the treaty text emphasizing the freedom of States to set limits, if they wish to do so, on treaty shopping when they negotiate the IIA in question.

##### **4.2.1. Round-Tripping – Case of Tokios Tokelès and Rompetrol**

The analysis starts with cases involving so-called "round-tripping", which refers to an arrangement whereby an investor, who is a national of the host State, owns or controls a

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ICSID Case No. ARB/01/11, Award (12 October 2005) para 52. However, with regards to treaty shopping cases, it seems that the effect is the opposite; reference to the objective and purpose of the applicable IIA often leads to State-friendly interpretation since Treaty Shoppers with no (or very little) business activity in the host State rarely promote the economy of that State.

<sup>209</sup> Pauwelyn and Elsig (n 205) 453. For further critique on the teleological approach see ILA German Branch / Working Group (n 48) 52.

<sup>210</sup> For more discussion about the status of good faith principle in international investment law see Đajić Sanja, 'Mapping the Good Faith Principle in International Investment Arbitration: Assessment of Its Substantive and Procedural Value' [2012] 46(3) Proceedings of Novi Sad Faculty of Law 207–233; Ponce and Cevallos (n 18).

<sup>211</sup> Feldman (n 166) 285.

legal entity incorporated in another State that has signed an IIA with the host State.<sup>212</sup> In these instances States have argued that an investor brings domestic investment claims against its own State of nationality via a formally international entity.

### ***Tokios Tokelès v. Ukraine***

To begin with an ICSID case, *Tokios Tokelès v. Ukraine*, was one the very first substantive considerations of treaty shopping in investment jurisprudence.<sup>213</sup> The case is the most compelling example of the formalistic interpretation of an investor's nationality. The Claimant, Tokios Tokelès, was a publishing company incorporated in Lithuania that accused the Ukrainian government of engaging in series of actions that amounted to mistreatment of its investment in Ukraine, a wholly owned subsidiary called Taki Spravy.<sup>214</sup> The Claimant brought action against the host State under the Ukraine-Lithuania BIT.<sup>215</sup> A dispute arose over jurisdiction when Ukraine, the Respondent, argued that the Claimant was not a "genuine entity" of Lithuania because it was owned and controlled predominantly by Ukrainian nationals: 99 per cent of the capital of Tokios Tokelès and two thirds of its management were of Ukrainian origin.<sup>216</sup> Consequently, allowing the Claimant to pursue the claim would be tantamount to allowing Ukrainian nationals to pursue international arbitration against their own government, which the Respondent argued would contravene the international character of BITs and the ICSID Convention.<sup>217</sup> In fact, the Respondent did not contest that Tokios Tokelès was *de jure* Lithuanian under the BIT as the treaty only required incorporation. Nonetheless, the Respondent requested the tribunal to "pierce the corporate veil" and find that it had no jurisdiction *ratione personae* in this case.<sup>218</sup> As for the Claimant,

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<sup>212</sup> The term is used for example in Baumgartner, 'Treaty Shopping' (n 63) 102–108.

<sup>213</sup> *Tokios Tokelès v. Ukraine*, ICSID Case No ARB/02/18, Decision on Jurisdiction (29 April 2004); Ascensio Hervé, 'Abuse of Process in International Investment Arbitration' [2014] 13(4) Chinese Journal of International Law 771; Skinner *et al.* (n 59) 277.

<sup>214</sup> Gupta Vidushi, 'Exclusion From Within the Ambit of a Protected Investor, a Fair Price to Pay for the Act of Abusive Treaty Shopping?' [2014] 11(1) Transnational Dispute Management 12; Martin Antoine, 'International Investment Disputes, Nationality and Corporate Veil: Some Insights From Tokios Tokelès and TSA Spectrum de Argentina' [2011] 8(1) Transnational Dispute Management 2; Wisner and Gallus (n 163) 942.

<sup>215</sup> Art 1 (2) of the Agreement between the Government of the Republic of Lithuania and the Government of Ukraine for the promotion and reciprocal protection of investment (Ukraine-Lithuania BIT), 8 February 1994 (entered into force 6 March 1995).

<sup>216</sup> *Tokios Tokelès v. Ukraine*, Decision (n 213) para 21.

<sup>217</sup> *ibid* para 22. "The Convention is designed to facilitate the settlement of investment disputes between States and nationals of other States. It is not meant for disputes between States and their own nationals." Schreuer Christoph, *The ICSID Convention - A Commentary* (Cambridge University Press 2001) 690. See also Section 2.3 of this Study.

<sup>218</sup> *ibid* para 23.

it argued that the incorporation test was quite straightforward and it had met the applicable criteria.

The tribunal's decision was split two-to-one in favour of the Claimant. Uncommonly, it was the presiding arbitrator, Professor Prosper Weil, who strongly dissented and eventually even resigned his position in protest of the decision to accept jurisdiction.<sup>219</sup> The majority adopted a narrow consent-oriented reading of the BIT.<sup>220</sup> The arbitrators emphasised that "Contracting Parties are *free to define their consent to jurisdiction in terms that are broad or narrow*; they may employ a control-test or reserve the right to deny treaty protection to claimants who otherwise would have recourse under the BIT. Once that consent is defined, however, *tribunals should give effect to it*, unless doing so would allow the Convention to be used for purposes for which it clearly was not intended."<sup>221</sup> Therefore, as the Claimant *prima facie* fulfilled the nationality requirement, and the majority of the tribunal refused to limit the scope of the BIT in the absence of a treaty provision requiring them to do so.

As to the Respondent's request to "pierce the corporate veil", the majority reviewed the International Court of Justice's (ICJ) reasoning in the case *Barcelona Traction*<sup>222</sup> and held that "none of the Claimant's conduct with respect to its status as an entity of Lithuania constitutes an abuse of legal personality".<sup>223</sup> Even though the tribunal only relied on the IIA's wording and declined to deeper evaluate the true nature of the Claimant's corporate structure, one may draw a conclusion, *a contrario*, that it would be possible to disregard the formal corporate structure should any fraud allegation be confirmed, and in this case it was the absence of such abuse that justified complete reliance on the incorporation test.<sup>224</sup>

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<sup>219</sup> Professor Weil was then replaced by Lord Michael Mustill and the tribunal finally rendered its award on 26 July 2007. See Skinner *et al.* (n 59) 278.

<sup>220</sup> *Tokios Tokeles*, Decision (n 213) para 24; Baumgartner, 'Treaty Shopping' (n 63) 103–104. The majority noted that Article 25 of the ICSID Convention leaves the task of defining the nationality of juridical entities to "the reasonable discretion of the Contracting Parties" and therefore looked strictly at the ordinary meaning of the BIT, which required mere incorporation in order for a company to qualify as an investor.

<sup>221</sup> *ibid.*, para 40 (emphasis added).

<sup>222</sup> *Barcelona Traction, Light and Power Company, Limited* (Belgium v. Spain), International Court of Justice, Judgement (5 February 1970).

<sup>223</sup> The tribunal found that the Claimant "made no attempt whatever to conceal its national identity from the Respondent" and that the Claimant "manifestly did not create [Tokios Tokelès] for the purpose of gaining access to ICSID arbitration against Ukraine, as the enterprise was founded six years before the BIT between Ukraine and Lithuania entered into force". *Tokios Tokeles*, Decision (n 213) para 56.

<sup>224</sup> Ascensio (n 213) 771–772 and Martin (n 160) 6.

As mentioned, "the philosophy of the Decision" triggered profound disagreement by Professor Weil, the President of the tribunal.<sup>225</sup> He was of the opinion that capital and corporation should not be mechanically separated when determining the investor's true nationality. Professor Weil argued that the ICSID Convention was designed to stimulate a larger flow of private international capital into those States that wish to attract it, and its scope is therefore limited to "*only* the genuinely international investments".<sup>226</sup> Consequently, he would have construed the nationality requirement in conformity with Article 31 of the VCLT, according to which a treaty provision shall be interpreted "in the light of its object and purpose."<sup>227</sup> As the *raison d'être* of the Convention was to encourage a trans-border flux of capital, he held that "Contrary to what the Decision maintains, when it comes to ascertaining the *international* character of an investment, the origin of the capital *is* relevant, and even decisive."<sup>228</sup>

The main outcome of the *Tokios Tokelés* case is that the States have the discretion in defining investors' nationality. Hence, as long as the host State has stipulated the incorporation test as the decisive factor, this will be respected absent an abuse of legal personality by the investor.<sup>229</sup> Following this logic it seems that the origin of the capital is irrelevant; even if it stems from the host State itself.

### ***Rompetrol Group N.V. v. Romania***

Another case involving an investor bringing action against its own State of nationality through a formally foreign entity is *Rompetrol Group N.V. v. Romania*.<sup>230</sup> In the case, Rompetrol Group N.V. which was a Netherlands-incorporated company, brought an ICSID

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<sup>225</sup> *Tokios Tokelés v Ukraine*, ICSID Case No ARB/02/18, Dissenting\_Opinion of Professor Weil (29 April 2004) para 1.

<sup>226</sup> *ibid* paras 3 and 24 (emphasis in original). Para 3 is referring to the Report of the Executive Directors of the International Bank for Reconstruction and Development on the Convention on the Settlement of Investment Disputes between States and Nationals of Other States, ICSID/15/Rev. 1 (January 2003).

<sup>227</sup> See Art. 31 of the Vienna Convention on the Law of Treaties, Vienna 1969

<sup>228</sup> *Tokios Tokelés*, Dissenting opinion (n 225) para 20. Professor Weil wrote: "To sum up: The ICSID mechanism and remedy are not meant for, and are not to be construed as, allowing – and even less encouraging – nationals of a State party to the ICSID Convention to use a foreign corporation, whether pre-existent or created for that purpose, as a means of evading the jurisdiction of their domestic courts and the application of their national law. It is meant to protect – and thus encourage – international investment. It is regrettable, so it seems to me, to put the extraordinary success met by ICSID at risk by extending its scope and application beyond the limits so carefully assigned to it by the Convention. This might dissuade Governments either from adhering to the Convention or, if they have already adhered, from providing for ICSID arbitration in their future BITs or investment contracts."

<sup>229</sup> Kjos Hege Elisabeth, 'Case Comments & Awards: Tokios Tokelés v Ukraine, Decision on Jurisdiction of April 29, 2004' [2004] 1(3) Transnational Dispute Management 6.

<sup>230</sup> *The Rompetrol Group N.V. v. Romania*, Decision on Respondent's Preliminary Objections on Jurisdiction and Admissibility, ICSID Case No. ARB/06/3, Decision on Respondent's Preliminary Objections on Jurisdiction and Admissibility (18 April 2008).

claim against Romania under the Netherlands-Romania BIT.<sup>231</sup> Rompetrol was a wholly owned subsidiary of a Swiss company, which in turn was owned and controlled by a Romanian national (80 per cent of shares).<sup>232</sup> Rompetrol then set up an affiliate in Romania in which it held a controlling interest (51 per cent), and that affiliate owned one of the largest oil refineries in Romania. In 2004 the National Anti-Corruption Office of Romania commenced investigations relating the refinery which the Claimant considered oppressive, giving rise to the dispute.<sup>233</sup>

Romania contested the tribunal's jurisdiction, pleading that regardless of the fact that the formal nationality requirements were indisputably met, the Claimant could not bring a claim under the treaty because its "real and effective" nationality was, in fact, that of the respondent State.<sup>234</sup> The Claimant company should not be allowed to initiate international proceedings in what was really a domestic dispute; Rompetrol was owned and controlled by a Romanian citizen, had its real seat in Romania, and the origin of its funds was Romanian.<sup>235</sup>

However, the tribunal rejected the Respondent's arguments, thereby confirming the line taken by the majority in *Tokios Tokelès*. The tribunal declined to read any additional requirements into the definition of "investor", and declared that:

*"Hence the question becomes simply, what did these two States themselves agree to of their own free will in concluding the BIT? The Tribunal therefore holds that the definition of national status given in The Netherlands-Romania BIT is decisive for the purpose of establishing its jurisdiction."*<sup>236</sup>

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<sup>231</sup> Agreement on encouragement and reciprocal protection of investments between the Government of the Kingdom of the Netherlands and the Government of Romania (Netherlands-Romania BIT) 19 April 1994 (entered into force 1 February 1995).

<sup>232</sup> *The Rompetrol Group N.V. v. Romania* (n 230) para 41; Gupta (n 214) 13.

<sup>233</sup> The Romanian owner, Mr. Patriciu, was for example arrested and put in detention, his phone telephone was wire-tapped and a travel ban was imposed on him. TRG alleged that the state authorities' investigations of Mr. Patriciu and his associates were conducted in an unjust and non-transparent manner and in breach of international standards of due process. It argued that the investigations amounted to "state-sponsored harassment" and were motivated by a desire to injure Mr. Patriciu for political and commercial reasons. See International Institute for Sustainable Development (IISD), 'Awards and Decisions' (*Investment Treaty News*, 26 June 2013) Available at <https://www.iisd.org/itm/2013/06/26/awards-and-decisions-12/> (accessed 3 February 2018) and Kribaum Ursula, 'The Rompetrol Group N.V. v. Romania' [2014] 15(5–6) *The Journal of World Investment & Trade* 1022–1024.

<sup>234</sup> *The Rompetrol Group N.V. v. Romania* (n 230) paras 54 and 84. It is noteworthy that Romania relied strongly on the well-known *Nottebohm*-case (ICJ). It argued that there is an exception to the application of the formal incorporation test when it can be proven that the *real and effective* nationality of the corporation is that of the respondent State. See more in *Nottebohm Case (Liechtenstein v. Guatemala)*, International Court of Justice (ICJ), 6 April 1955.

<sup>235</sup> *ibid*, para 55.

<sup>236</sup> *Ibid*, para 83.

Accordingly, the Claimant qualified as an investor, and the *Rompetrol Group N.V. v. Romania* decision further affirmed the literal reading of the treaty and permissive approach to treaty shopping.

#### 4.2.2. The Use of Mailbox Companies – Saluka and ADC

The second group of cases covers situations where the investor is a so-called "mailbox"<sup>237</sup> company and the investor actually owning or controlling the investment is a national of a third State.<sup>238</sup> These disputes are thus international by nature, but States have nevertheless objected the jurisdiction *ratione personae*, pleading that without real economic connection the investor should not benefit from the treaty protection either.

##### *Saluka Investments B.V. v. The Czech Republic*

In *Saluka Investments B.V. v. The Czech Republic*<sup>239</sup> the dispute arose out of the reorganisation and privatisation of the Czech banking system. Nomura Europe (an English subsidiary of a Japanese investment bank conglomerate Nomura Group) acquired 46 per cent of the shares in a Czech commercial bank Investiční a Poštovní Banka (IPB) after it was privatised. Subsequently, Nomura Europe transferred the relevant shares to its wholly owned subsidiary *Saluka Investments B.V.*, a company established under the laws of the Netherlands for the sole purpose of holding Nomura's investment in the Czech Republic.<sup>240</sup> The controversies started when the Czech government extended state aid to all major banks excluding IPB. Saluka commenced arbitration under the UNCITRAL rules, claiming a violation of Article 3 (fair and equitable treatment) and Article 5 (deprivation of investment) of the Netherlands-Czech BIT.<sup>241</sup>

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<sup>237</sup> The term "mailbox company" does not have a universal definition but, for example, International Law Commission (ILC) characterises it as a corporation that "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." See Art. 9 of the Draft articles on Diplomatic Protection, International Law Commission (2006).

<sup>238</sup> This classification overlaps with the "round-tripping" cases presented in the Subchapter above since the vehicle companies used by host State nationals in order to access international protection are often mere "mailbox companies". However, for the sake of clarity, the cases analysed in this part only concern investors from third States shopping into BITs more favourable than the ones their real home State has.

<sup>239</sup> *Saluka Investments B.V. v. The Czech Republic*, UNCITRAL/PCA, Partial Award (17 March 2006).

<sup>240</sup> Blyschak Paul Michael, 'Access and advantage expanded: Mobil Corporation v Venezuela and other recent arbitration awards on treaty shopping' [2011] 4(1) *Journal of World Energy Law and Business* 32–39; Feldman (n 166) 286. See a figure simplifying *Saluka's* ownership structure in Dugan Christopher *et al.*, *Investor-State Arbitration* (Oxford University Press 2012) 336.

<sup>241</sup> Agreement on encouragement and reciprocal protection of investments between the Kingdom of the Netherlands and the Czech and Slovak Federal Republic (Netherlands-Czech BIT), 24 April 1991 (entered into force 1 October 1992).

The Czech Republic, the Respondent, challenged the tribunal's jurisdiction, asserting that the true investor was not Saluka but Nomura, which was not an eligible claimant under the BIT.<sup>242</sup> The Respondent did not contest the fact that Saluka satisfied the incorporation test set out in the BIT, but instead it argued that the Claimant was nothing more than a shell for Nomura and thus not a *bona fide* investor because it had no "real and continuous links" to the Netherlands.<sup>243</sup>

The tribunal followed the formal, consent-oriented approach similarly to *Tokios Tokelès* and *Rompétrol*, ultimately rejecting the Czech Republic's submissions. It underlined that the contracting States had complete freedom to define "investor" and that it is beyond the tribunal's powers to import additional requirements which contracting States could themselves have added but which they omitted to add.<sup>244</sup>

Nevertheless, the tribunal expressed some sympathy for the Respondent's arguments that a company without real economic ties to a State party to a BIT should not be entitled to invoke the provisions of that treaty. Further, the tribunal noted that accepting this possibility enables abuses of arbitral procedure and practices of treaty shopping, which can entail many disadvantages.<sup>245</sup> It acknowledged the apparent closeness between Saluka and Nomura, and that the true beneficiary of the investment might be the latter, but stated that "the companies concerned have simply acted in a manner which is commonplace in the world of commerce."<sup>246</sup> However, ultimately, the predominant factor that must guide the tribunal's exercise of its functions is the terms in which the contracting parties have agreed to establish the tribunal's jurisdiction.<sup>247</sup>

### ***ADC Affiliate Limited v. Hungary***

A similar situation arose in *ADC Affiliate Limited and ADC & ADMC Management Limited v. The Republic of Hungary*.<sup>248</sup> In this case the Claimant companies, which were incorporated in Cyprus but ultimately controlled by Canadian entities,<sup>249</sup> brought a claim

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<sup>242</sup> *Saluka Investments B.V. v. The Czech Republic* (n 239) para 199 (c).

<sup>243</sup> *ibid*, paras 138 (b) and 239.

<sup>244</sup> *ibid*, para 229 and 241.

<sup>245</sup> *ibid*, para 240.

<sup>246</sup> *ibid*, para 228 and 242; Gupta (n 214) 14. The tribunal also attached importance to the awareness of Czech authorities; they knew all along that Saluka was a special-purpose vehicle set up for the specific and sole purpose of holding those shares.

<sup>247</sup> *ibid*, para 241.

<sup>248</sup> *ADC Affiliate Limited and ADC & ADMC Management Limited v. The Republic of Hungary*, ICSID Case No. ARB/03/16, Award on 2 October 2006.

<sup>249</sup> *ibid*, paras 1 and 84.



against Hungary under the Cyprus-Hungary BIT.<sup>250</sup> The Respondent maintained that the Claimants were nothing but two shell companies established by Canadian investors with the ulterior motive to gain access to ICSID jurisdiction for nationals whose home State is not a contracting Party of the ICSID Convention.<sup>251</sup> Even so, the Respondent conceded that those companies, in fact, had been incorporated in compliance with the laws of Cyprus and thus the definition of investor under the BIT was met.<sup>252</sup> Alternatively, Hungary sought dismissal of jurisdiction based on a missing "genuine link" between the corporation and the State of its claimed nationality, which, it argued, was a "fundamental requirement of the rules of international law".<sup>253</sup> Finally, it added that, quoting the words of Professor Weil, the object and purpose of the ICSID Convention require consideration of the origin of the investment capital when deciding on the investor's nationality.<sup>254</sup> Thus, the tribunal should pierce the Claimants' corporate veil.

Again, the tribunal rejected both arguments, noting that the question of Claimants' nationality was "settled unambiguously" by the wording of the BIT, and therefore there was no room for the consideration of customary law principles of nationality.<sup>255</sup> The government of Hungary could have included the requirement of a genuine link in the respective BIT, but it chose not to do so.<sup>256</sup>

#### **4.2.3. Preliminary Conclusions**

In each of the four cases analysed above, the Respondent State argued that the claim ought to be dismissed on account of abusive corporate restructuring by the Claimant. The tribunals responded to those allegations in two different ways. Firstly, the Rompetrol tribunal flatly rejected the policy-focused argument that the Claimant's "real and effective" nationality could supersede the language of the treaty. Secondly, the Tokios Tokelès, Saluka and ADC awards included some consideration with respect to the legitimacy of the claimant's

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<sup>250</sup> Agreement between the Republic of Cyprus and the Government of the Hungarian People's Republic on mutual promotion and protection of investments (Cyprus-Hungary BIT) 24 May 1989 (entered into force 25 May 1990).

<sup>251</sup> At the time of the dispute, Canada was not a Member State. Canada ratified the ICSID Convention seven years later on 1 November 2013 (entered into force 1 December 2013).

<sup>252</sup> *ibid*, paras 333 and 335.

<sup>253</sup> *ibid*, paras 336–341. With this submission Hungary relied heavily on the *Barcelona Traction* case.

<sup>254</sup> *ibid*, paras 342–343.

<sup>255</sup> *ibid*, para 357; Schill Stephan, *The Multilateralization of International Investment Law* (Cambridge University Press 2010) 226.

<sup>256</sup> *ibid*, para 358.

corporate activity without addressing the question under what circumstances abusive conduct might lead to the dismissal of claims in investor–State arbitration.<sup>257</sup>

According to Professor Mark Feldman, the abovementioned jurisprudence reflects two key developments in corporate nationality planning in investment law. First, any attempt to read additional requirements into a BIT's definition of investor (such as "genuine connection", "origin of capital" and/or "real and continuous links") is likely to be unsuccessful.<sup>258</sup> Furthermore, the state of the law is unsettled concerning the impact, if any, that abusive corporate activity has on questions of jurisdiction.<sup>259</sup>

In the following Section, I will present a different kind of approach: decisions taking a prohibitive stand on treaty shopping. These cases repeatedly rely on teleological interpretation and considerations beyond the treaty text, thus adopting a completely different starting point for their reasoning. One can find apparent support for the proposition that abusive corporate restructuring can lead to the dismissal of claims in investor-State arbitration. However, the decisions seem to disagree on the relevant factors that should be considered when drawing the line between legitimate nationality planning and abusive practices.

#### **4.3. Prohibitive Approaches: Solutions beyond the Treaty Text**

In the cases prohibiting treaty shopping, tribunals have taken upon themselves to investigate the true nature of investor's nationality and the intentions behind the change of nationality. In this quest they have routinely relied on general principles of law, particularly abuse of process, which can be seen as a corollary of good faith. The decisions have often boiled down to the timing of the corporate restructuring, but the reasoning pertaining to it has been inconsistent, leaving some relevant questions open to doubt. Through case law, some guidelines have progressively emerged. Below, I will examine three cases prohibiting treaty shopping. First, in the *Phoenix* case, the tribunal dismissed the claims on the grounds of

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<sup>257</sup> Feldman (n 166) 287–288. Likewise, two additional decisions that considered Respondent's allegations of abusive restructuring did not clarify the circumstances under which a tribunal might be deprived of jurisdiction. See *Autopista Concesionada de Venezuela C.A. v. Bolivarian Republic of Venezuela*, ICSID Case No ARB/00/5, Decision on Jurisdiction (27 September 2001), para 67 finding that no "state, court, or tribunal" has the right to 'set aside' a company's corporate identity absent party consent or 'abuse or fraud' by the corporation, and finding that the Claimant had not engaged in any abuse or fraud in the dispute". See also *Aguas del Tunari SA v Republic of Bolivia* (n 173) para 331 assuring that the Tribunal will "bear in mind its duty to protect the integrity of ICSID jurisprudence during the merits phase" of the proceedings.

<sup>258</sup> *ibid* 288.

<sup>259</sup> *ibid*.

breach of good faith. Subsequently, the *Mobil* tribunal took the analysis a bit further distinguishing the jurisdiction *ratione temporis*<sup>260</sup> objection from the abuse of process<sup>261</sup> objection. Temporal scope of jurisdiction is relevant in cases where dispute (or the events giving rise to it) already existed at the time of corporate nationality change. If the restructuring is done in a timely manner, it is a matter of admissibility of the claim which can be deprived on the basis of violation of the good faith principle.<sup>262</sup> Finally, in *Philip Morris*, the tribunal specified how to assess the abuse of process in relation to foreseeable disputes.

#### 4.3.1. Good Faith Defence – Phoenix Action

*Phoenix Action Ltd v. The Czech Republic*<sup>263</sup> is a landmark case reflecting reliance on factors beyond the formulation of the IIA. It offers the best starting point to examine prohibitive arbitrator attitudes towards treaty shopping via corporate restructuring. The case concerned two Czech metal companies (Benet Praha and Benet Group) that were owned and controlled by the same individual, a Czech national called Vladimír Beňo. Both companies became involved in proceedings before Czech courts: Benet Group in connection with the ownership of three other Czech entities (one of which was insolvent) and Benet Praha in a public prosecution for alleged tax and custom duty evasions in which the company's assets were frozen and seized.<sup>264</sup> Subsequently, Mr. Beňo sold the two companies to Phoenix Action Ltd, a company constituted under the laws of Israel but ultimately controlled by family members of Mr. Beňo. Two months after the acquisition, Phoenix Action Ltd informed the Czech Republic of an investment dispute, and later commenced arbitration proceedings under the Israel-Czech BIT.<sup>265</sup> In its submission, the Claimant alleged that the national courts

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<sup>260</sup> "By reason of time" Because of the relevant timing or period of time pertaining to the subject under consideration. Fellmeth Aaron and Horwitz Maurice, *Guide to Latin in International Law* (Oxford University Press 2011).

<sup>261</sup> For further characterisation see Ribco Borman Yael, 'Treaty Shopping Through Corporate Restructuring of Investments: Legitimate Corporate Planning or Abuse of Rights?' in Lavranos Nikolaos, Kok Ruth *et al.* (ed), *Hague Yearbook of International Law / Annuaire de La Haye de Droit International*, Vol 24 (Martinus Nijhoff Publishers 2011) 368–371.

<sup>262</sup> Jurisdiction refers to the power of a court or tribunal to entertain an action. Conversely, admissibility concerns the power of a tribunal to decide a claim at a particular point in time in view of possible temporary or permanent defects of the claim. Whereas jurisdiction typically looks at the dispute as a whole, admissibility is concerned with particular claims. See Waibel Michael, 'Investment Arbitration: Jurisdiction and Admissibility' University of Cambridge Faculty of Law Research Paper No. 9/2014.

<sup>263</sup> *Phoenix Action, Ltd. v. The Czech Republic* (n 92).

<sup>264</sup> *ibid*, paras 3–7; Skinner *et al.* (n 59) 280.

<sup>265</sup> Agreement between the Government of the Czech Republic and the Government of the State of Israel for the Reciprocal Promotion and Protection of Investments (Israel-Czech BIT) 23 September 1997 (entered into force 16 March 1999).

of the Czech Republic had failed to promptly resolve the actions involving Benet Praha and Benet Group, which was equivalent to an expropriation of the Claimant's assets as well as violation of the fair and equitable treatment (FET) provision as well as the full protection and security (FPS) standards of the BIT.<sup>266</sup>

According to the Respondent, Phoenix's allegations fell outside the tribunal's jurisdiction both *ratione temporis* and *ratione materiae*. Regarding the former the Respondent argued that the alleged breaches of the BIT occurred before the Claimant acquired the Czech companies, i.e. before the investment was made, so the tribunal had no jurisdiction prior to that point of time.<sup>267</sup> As to the latter, the Respondent claimed that Phoenix's alleged purchase of the Benet Companies was not an "investment" within the meaning of Article 25 of the ICSID Convention and Articles 1 and 7 of the BIT.<sup>268</sup> Lastly, the Respondent asked the tribunal to lift the corporate veil due to abuse of process because "Phoenix [was] nothing more than an ex post facto creation of a sham Israeli entity created by a Czech fugitive from justice, Vladimír Beňo, to create diversity of nationality."<sup>269</sup>

During deliberations the tribunal engaged in a deep discussion of the applicability and role of "good faith" in investment law and, in the end, dismissed the Claimants requests in their entirety for the lack of jurisdiction on the basis of Claimant's abusive treaty shopping, thereby accepting the universality of good faith in international investment.<sup>270</sup> Even though the case involved a round-tripping scenario (the investor company's ultimate owner was of the same nationality than the host State) the tribunal's reasoning focused solely on the timing and the motives of the nationality change. The tribunal set four criteria to be taken into

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<sup>266</sup> *Phoenix Action, Ltd. v. The Czech Republic* (n 92) paras 44–45.

<sup>267</sup> *ibid*, para 34.

<sup>268</sup> *ibid*, paras 35(c) and 38. Respondent argued in its memorial that there was no "allegation or evidence that Phoenix has been involved in the business activities relating to its investment. It has been, at most, a passive investor in two inactive companies. Surely that cannot suffice to satisfy the definition of "investment" under Article 25(1) of the ICSID Convention. As Dr Ben Hamida has astutely observed: ICSID jurisprudence is well established on the fact that capital or passive money is not enough to be protected". Additionally, with regards to the determination of "investment", the Respondent heavily relied on so-called *Salini* test, which states that for an arrangement to qualify as an "investment" it should have, "a certain duration, a regularity of profit and return, an element of risk, a substantial commitment and that it should constitute a significant contribution to the host State's development". See *Salini Costruttori SpA and Italstrade Spa v. Kingdom of Morocco*, ICSID Case No. ARB/00/4, Decision on Jurisdiction (23 July 2001).

<sup>269</sup> *Phoenix Action, Ltd. v. The Czech Republic* (n 92) para 34. The Respondent stated that "this case represents one of the most egregious cases of 'treaty-shopping' that the investment arbitration community has seen in recent history." The harsh language used in the State's submission illustrates the strong reactions treaty shopping has caused among States. For more discussion about State reactions to treaty shopping see Chapter 5.

<sup>270</sup> De Brabandere Eric, "Good Faith", 'Abuse of Process' and the Initiation of Investment Treaty Claims' [2012] 3(3) Journal of International Dispute Settlement 624.

consideration in evaluating whether the investor had a *bona fide* intention to engage in economic activities in the host State:<sup>271</sup>

*I. Timing of the investment:*

Was the investment or other asset already distressed, and was the incoming investor aware of these difficulties when it committed to the investment? The Tribunal stated that "Phoenix bought an 'investment' that was already burdened with the civil litigation as well as the problems with the [Czech] tax and customs authorities"<sup>272</sup>

*II. Timing of the claim*

How long after making the investment did the Claimant bring its ICSID claim? And also, is the claim solely based on violations and damages that occurred pre-investment? In this case, the tribunal found that Phoenix had notified the Czech Republic of an investment dispute even before its ownership of the Benet Companies was registered with local authorities. Furthermore, the actions amounting to the alleged violations of the BIT provisions occurred prior to the investment.<sup>273</sup>

*III. Substance of the transaction*

What was the main substance of the transaction, and how was it carried out? The tribunal investigated all of the transfers of interest and concluded that the dealings were not made on arm's-length basis (which the Claimant admitted). Thus it held the alleged investment appeared to be a mere redistribution of assets within the Beňo family.<sup>274</sup>

*IV. True nature of the operation*

Was any real economic activity performed or even genuinely intended by the investor? Here, Phoenix had no business plan, programme of re-financing the Czech entities, or economic objectives.<sup>275</sup>

Eventually, the Claimant ended up with an order to pay the Respondent's legal fees, as the tribunal declined jurisdiction finding that the Claimant's treaty shopping behaviour amounted to an "abusive manipulation of the system of international investment protection

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<sup>271</sup> See Skinner *et al.* (n 59) 281–282.

<sup>272</sup> Phoenix Action, Ltd. v. The Czech Republic (n 92) para 136.

<sup>273</sup> *ibid.*, para 138.

<sup>274</sup> *ibid.*, para 139.

<sup>275</sup> *ibid.*, para 140. With this regard it is important to notice the tribunal's concession that "the fact of buying a bankrupt or inactive company must not necessarily be disqualified as an investment, as the intent of the investor can precisely be to make the company profitable again."

under the ICSID Convention and the BITs." In the award, the tribunal emphasised that the transaction was not *bona fide*, but simply the Claimant's creation of a legal fiction in order to gain access to an international arbitration procedure to which it was not entitled.<sup>276</sup> The combination the timing and the underlying motivations of the restructuring was the crucial factor.

#### 4.3.2. *Ex Ante* and *Ex Post* Nationality Changes – Mobil v. Venezuela

The subsequent case *Mobil Corporation v. Venezuela*<sup>277</sup> likewise adopted the good faith principle as a tool to identify the nationality of the investor. However, the standard of evaluation for whether the actions in question were abusive was slightly different.

In this case, Mobil Corporation and its affiliates were incorporated in the U.S. and in the Bahamas, and they entered into series of contracts for the exploitation, production and upgrading of heavy crude oil in the Orinoco oil belt with Venezuela's state-owned petroleum company. This period represented a time of liberalisation Venezuela's energy market.<sup>278</sup> However, the political climate in the country changed following the millennium (after the election of President Hugo Chávez) and a series of measures were taken by the government of Venezuela to reform the petroleum industry. In 2001, Venezuela passed a new Hydrocarbons Law, and in 2004 it led to an increase in the taxes and royalty rates paid by private companies. For Mobil Corporations' agreements this meant a royalty increase from 1 per cent to 16.67 per cent. In 2006 Venezuela introduced a new extraction tax of 33.33 per cent against the foreign operating service agreements while simultaneously increasing the associated income tax rate from 34 to 50 per cent.<sup>279</sup> Finally, in early 2007, the President announced that all the projects that had been operating outside the framework of the 2001 Hydrocarbons Law, including Mobil projects Cerro Negro and La Ceiba, would be nationalised.<sup>280</sup>

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<sup>276</sup> *ibid*, paras 143–144.

<sup>277</sup> *Mobil Corporation, Venezuela Holdings, B.V., Mobil Cerro Negro Holding, Ltd., Mobil Venezolana de Petróleos Holdings, Inc., Mobil Cerro Negro, Ltd., and Mobil Venezolana de Petróleos, Inc. v. Bolivarian Republic of Venezuela*, ICSID Case No. ARB/07/27, Decision on Jurisdiction (10 June 2010).

<sup>278</sup> In the 1990s Venezuela introduced a new "flexible" oil policy called *Apertura Petrolera*, which opened its upstream oil sector to private investors. This facilitated, for example, the creation of 32 operating service agreements with 22 different foreign oil companies – This brought an investment of more than 2 billion dollars. See more about the development of Venezuela's energy policies in Mommer Bernard, *Changing Venezuelan Oil Policy* (The Oxford Institute for Energy Studies 1999).

<sup>279</sup> Blyschak (n 240) 33; *Mobil Corporation v. Venezuela* (n 277) para 19.

<sup>280</sup> *ibid*; Jagusch Stephen, Sinclair Anthony, Wickramasooriya Manthi, 'Chapter 13: Restructuring Investments to Achieve Investment Treaty Protection' in Kinnear Meg *et al.* (ed), *Building International Investment Law: The First 50 Years of ICSID* (Kluwer Law International 2015) 181.

In 2005, amid these changes in Venezuela's oil industry, the Claimant created a new entity (Venezuela Holdings B.V.) under the laws of the Netherlands and inserted it into its corporate chain as an indirect owner of the local companies.<sup>281</sup> Following the nationalisation of the Cerro Negro and La Ceiba projects, the Dutch company initiated ICSID proceedings under the Netherlands-Venezuela BIT<sup>282</sup> seeking compensation for the State's measures. Venezuela objected to the tribunal's jurisdiction claiming that Mobil had engaged in unlawful treaty shopping by planting a Dutch holding company into an otherwise non-Dutch chain of corporate ownership with the sole purpose of accessing more beneficial treaty protection. The Claimant, as it was established long after the investment was made, was nothing more than a *mala fide* "corporation of convenience" and its actions were an "abuse of the corporate form and blatant treaty-shopping [that] should not be condoned".<sup>283</sup> As a matter of fact, the Claimant openly confirmed that it made the changes as a precautionary measure because the investment climate in Venezuela was deteriorating rapidly, which in turn increased the risks of the investment.<sup>284</sup>

In light of these statements, the tribunal decided that "the main, if not the sole purpose of the restructuring was to protect Mobil investments from adverse Venezuelan measures in getting access to ICSID arbitration through the Dutch-Venezuela BIT."<sup>285</sup> Nevertheless, the arbitrators did not outright condemn this conduct. Instead, they emphasised that the distinction between legitimate corporate planning and abuse of rights depended on the circumstances in which the restructuring happened.<sup>286</sup>

The tribunal recognised the notions of abuse of process and good faith in investment law but at the same time held that nationality planning to achieve better protection was a justifiable measure – not only in pursuit of substantive advantages but also better dispute settlement provisions. With this in mind, the tribunal focused on the timing of the nationality change

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<sup>281</sup> *Mobil Corporation v. Venezuela* (n 277) para 20. For further information about the chain structures, see paras 21–22.

<sup>282</sup> The Claimant submitted the claims also under national law (the 1999 Venezuelan Law on the promotion and protection of interest), but the tribunal found that it has no jurisdiction on those grounds. See Agreement on encouragement and reciprocal protection of investments between the Kingdom of the Netherlands and the Republic of Venezuela (Netherlands-Venezuela BIT) 22 October 1991 (entered into force 1993).

<sup>283</sup> *Mobil Corporation v. Venezuela* (n 277) para 27.

<sup>284</sup> *ibid.*, para 189; Jagusch *et al.* (n 280) 181. The Claimant stated in its counter memorial that after the unilateral imposition of a higher royalty rate, Mobil promptly "undertook a review of the extent of the legal protection for its investments in Venezuela".

<sup>285</sup> *Mobil Corporation v. Venezuela* (n 277) para 190. In addition, the tribunal considered the fact that the restructuring was never hidden from the Respondent. In fact, the Claimant had notified the government of the transfer which the Respondent did not object at the time (para 192).

<sup>286</sup> *ibid.*, para 191.

*vis-à-vis* the timing of the dispute. It concluded that regarding to pre-existing disputes the situation is different, and "to restructure investments *only* in order to gain jurisdiction under a BIT for such disputes would constitute abuse of the ICSID Convention and the BITs."<sup>287</sup> Consequently, it accepted jurisdiction over the claims related to the 2007 nationalization of Mobil's investments but dismissed jurisdiction over the claims concerning the increased royalties and taxes, which occurred before the establishment of the Dutch entity.<sup>288</sup> What is interesting here is that the Mobil tribunal declined jurisdiction with regards to the pre-existing disputes on the grounds of abuse of process, when it could have also tackled the issue from more a formal point of view – namely by applying the rules of jurisdiction *ratione temporis*.<sup>289</sup>

In sum, the *Mobil Corporation* decision endorses a rather black and white approach to treaty shopping. On one hand, it is an acceptable element of strategic corporate planning when used to safeguarding overseas investment from disputes that have yet to occur (*ex ante*). On the other hand, such manoeuvres are unacceptable when seeking to compensate for insufficient corporate planning earlier in the life of an investment (*ex post*).<sup>290</sup> Such a criterion is easy to apply, but it is definitely not immune to question. For instance, how does one determine the point of time when the dispute arose? This issue is analysed in greater detail in Section 4.4. below.

### 4.3.3. Abuse of Rights – Philip Morris

A more recent, and much debated, case declining jurisdiction for abuse of process is *Philip Morris v. Australia*.<sup>291</sup> Unlike the *Mobil* tribunal, the arbitrators in this case made a clear distinction between *ratione temporis* objections and abuse of process objections, consequently digging deeper into the application of the latter. Here, the dispute arose from

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<sup>287</sup> *ibid*, para 205 (emphasis added).

<sup>288</sup> *ibid*, para 206. Mobil had actually given Venezuela written notifications in February, May and June 2005 (so before the reorganization) of the existence of a dispute resulting from the adverse royalty and tax increases.

<sup>289</sup> On the contrary, the tribunal in *Levy and Gremcitel v. Peru* considered that an abuse of process objection must be distinguished from a *ratione temporis* objection: "If a claimant acquires an investment after the date on which the challenged act occurred, the tribunal will normally lack jurisdiction *ratione temporis* and there will be no room for an abuse of process." See *Renée Rose Levy and Gremcitel S.A. v. Republic of Peru*, ICSID Case No. ARB/11/17, Award (9 January 2015), para 182.

<sup>290</sup> Blyschak (n 240) 35.

<sup>291</sup> *Philip Morris Asia Limited v. The Commonwealth of Australia*, UNCITRAL, PCA Case No. 2012-12, Award on Jurisdiction and Admissibility (17 December 2015). This case is significant in the context of broader policy and political perspectives as well – namely regarding State's sovereign right to decide on their laws and regulations to protect the health of their population and the danger of chilling effect. See more in a similar case that proceeded to the merits phase: *Philip Morris Brands Sàrl, Philip Morris Products S.A. and Abal Hermanos S.A. v. Oriental Republic of Uruguay*, ICSID Case No. ARB/10/7, Award (8 July 2016).



the enactment and enforcement of the Australian Tobacco Plain Packaging Act of 21 November 2011 and its implementing regulations, which imposed strict restrictions on the appearance of retail tobacco products.<sup>292</sup> The regulatory and related measures were part of the Australian government's comprehensive efforts to reduce smoking in the country.

The Claimant, Philip Morris Asia (PM Asia), was a Hong-Kong incorporated company that served as the regional headquarters for the tobacco giant Philip Morris International (PMI). On 23 February 2011, PMI transferred its two Australian subsidiaries (Philip Morris Australia and Philip Morris Limited) to PM Asia, thus putting the company into the chain of ownership and control of the Australian investments.<sup>293</sup> This reorganisation enabled the Claimant to initiate arbitration under the Hong Kong-Australia BIT. It claimed damages for indirect expropriation and unfair treatment, alleging that Australia's plain packaging measures infringed the intellectual property rights of its new subsidiaries.<sup>294</sup> The Respondent contested all claims on the merits and raised jurisdictional objections. The Respondent argued that the claim was not in the scope of the BIT because it related to a dispute that predated the restructuring by which the Claimant acquired ownership of the Australian companies (the *ratione temporis* objection), or, failing that, because the Claimant's actions amounted to abuse of process.

Besides the important public health considerations, this case was characterised by the timing factor, namely the foreseeability of the dispute. First, the arbitral tribunal confirmed that the distinction between the *ratione temporis* objection and abuse of rights objection was now clear from the jurisprudence.<sup>295</sup> Concerning the former, the tribunal held that the critical date is when the State adopted the disputed measure, which in this case was the date of enacting the plain packaging legislation, because before that moment the investor's right could not be affected.<sup>296</sup> Since the restructuring was both decided (3 September 2010) and completed (23

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<sup>292</sup> The regulation basically prevents any use of colours, logos, other embellishments and trademarks. Tobacco product packaging must have plain olive colouring (according to research that is the least attractive to consumers), must display a large health warning (both in writing and disturbing images) and may list only the names of the brand and type of tobacco in a standard font. See Linderfalk Ulf, 'Philip Morris Asia Ltd v Australia – Abuse of Rights in Investor-State Arbitration' [2017] 86(3) Nordic Journal of International Law 403–404.

<sup>293</sup> *Philip Morris v. Australia* (n 291) paras 6 and 96–97. PM Asia owns 100 per cent of the shares of Philip Morris Australia, which in turn owns 100% of the shares of Philip Morris Limited.

<sup>294</sup> *ibid*, paras 7–8; Baumgartner Jorun, 'The Significance of the Notion of Dispute and Its Foreseeability in an Investment Claim Involving a Corporate Restructuring' [2017] 18(2) Journal of World Investment and Trade 206–207.

<sup>295</sup> *Philip Morris v. Australia* (n 291) para 527.

<sup>296</sup> *ibid*, para 533.

February 2011) before the date of enactment (21 November 2011), the tribunal concluded that the requirements for jurisdiction *ratione temporis* were met.<sup>297</sup>

The tribunal then turned to the question of abuse of rights and reviewed the relevant case law on this point. As a preliminary observation the tribunal clarified that "[I]t is clear, and recognised by *all* earlier decisions that the threshold for finding an abusive initiation of an investment claim is *high*."<sup>298</sup> Further, referring to several prior arbitral awards, the tribunal concluded that the "mere fact of restructuring an investment to obtain BIT benefits is not *per se* illegitimate."<sup>299</sup> On the other hand, if restructuring is made to obtain BIT benefits for a *foreseeable* dispute, it may amount to abuse of process, depending on the circumstances of the particular case.<sup>300</sup>

In this case, the tribunal examined the restructuring in the context of political developments in Australia. Several facts implicated that the risk of a specific dispute was foreseeable to the Claimant. The Claimant had notified the Australian Minister for Health already in 2009 that the plain packaging would interfere with its property rights. On 29 April 2010, the then-Australian government unequivocally announced its intentions to introduce major tobacco control measures. A few months later the government published a timetable that displayed the implementation schedule of the tobacco legislation. In the tribunal's view, there was no uncertainty about the Respondent's intention to introduce plain packaging regulation as of April 2010. Accordingly, there was at least a reasonable probability that such measures would eventually be adopted, which would trigger a dispute.<sup>301</sup>

Interestingly, the tribunal did not stop there, but went on to investigate the Claimant's alleged commercial reasons for the restructuring. By this, it acknowledged that, in principle, a legitimate and credible motive for the restructuring might invalidate an otherwise abuse of process finding.<sup>302</sup> The reality is that corporate groups, particularly multinational ones, are

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<sup>297</sup> *ibid*, para 533–534.

<sup>298</sup> *ibid*, para 539 (emphasis added). Unlike in the *Mobil* case, the tribunal made a clear distinction between jurisdictional and good faith objections by stating that "under the case law, the abuse is subject to an objective test and is seen in the fact that an investor who is not protected by an investment treaty restructures its investment in such a fashion as to fall within the scope of protection of a treaty in view of a specific *foreseeable* dispute. Although it is sometimes said that an abuse of right might also exist in the case of restructuring in respect of an existing dispute, if the dispute already exists, then a tribunal would normally lack jurisdiction *ratione temporis*"

<sup>299</sup> *ibid*, para 540.

<sup>300</sup> *ibid*, para 545 (emphasis added) quoting *Levy v. Peru* case (n 289). See more about the assessment of foreseeability in Section 4.4.2.

<sup>301</sup> *ibid*, para 566. However, the tribunal added that "the length of time it takes to legislate is not decisive factor in determining whether the legislation is foreseeable".

<sup>302</sup> Baumgartner, 'The Significance of the Notion of Dispute and Its Foreseeability' (n 294) 210.

routinely restructured for many reasons. However, the Claimant was not able to prove that tax or other business reasons were determinative for the reorganisation. Instead, all of the evidence pointed to the conclusion that "the main and determinative, if not sole, reason for the restructuring was the intention to bring a claim under the Treaty, using an entity from Hong Kong."<sup>303</sup> Consequently, the tribunal found the Claimant's claims inadmissible and, thereby, it declined to exercise jurisdiction over the dispute.<sup>304</sup>

To conclude the discussion on the *Philip Morris* case, the determination of jurisdiction in treaty shopping cases is a two-tier-test. In the first stage one must identify the point in time when the dispute materialised and compare it to the date of the change of nationality. If the restructuring was made before the State measure (i.e. when the adverse effect on the investment came true), jurisdiction exists. When this test is passed, the tribunal can evaluate the admissibility of the claim using abuse of process principle. In this phase the foreseeability of a future dispute becomes crucial. The decision, albeit clarifying in many respects, raises further issues – namely, when does a dispute arise and when is it foreseeable to the investor.

#### 4.3.4. Preliminary Conclusions

Case law prohibiting treaty shopping is diverse and rather inconsistent. In addition to the most ground-breaking decisions analysed above, the jurisdiction was also denied in cases like *Banro American Resources v. Congo*<sup>305</sup>, *Société Générale v. The Dominican Republic*<sup>306</sup> and *Cementownia v. Turkey*<sup>307</sup>. Although reaching similar conclusions, the tribunals' justifications appear inconsistent. For example, in *Banro* a Canadian entity transferred its investment to an U.S. subsidiary to gain access to ICSID arbitration.<sup>308</sup> The U.S. investor commenced arbitration proceedings merely two days after the transfer, which raised the suspicions. Here, the tribunal relied on the *nemo plus iuris transfere potest quam ipse habet* principle (no one can transfer more rights than he himself has) and concluded that a non-

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<sup>303</sup> *Philip Morris v. Australia* (n 291) para 584.

<sup>304</sup> *ibid*, para 588.

<sup>305</sup> *Banro American Resources, Inc. and Société Aurifère du Kivu et du Maniema S.A.R.L. v. Democratic Republic of the Congo*, ICSID Case No. ARB/98/7, Award (1 September 2000).

<sup>306</sup> *Société Générale In respect of DR Energy Holdings Limited and Empresa Distribuidora de Electricidad del Este, S.A. v. The Dominican Republic*, UNCITRAL, LCIA Case No. UN 7927, Award on Preliminary Objections to Jurisdiction (19 September 2008). The tribunal in this case required that the "the transaction in question must be a *bona fide* transaction and not devised to allow a national of a State not qualifying for protection under a treaty to obtain an inappropriate jurisdictional advantage otherwise unavailable by transferring its rights after-the-fact to a qualifying national."

<sup>307</sup> *Cementownia "Nowa Huta" S.A. v. Republic of Turkey*, ICSID Case No. ARB (AF)/06/2, Award (17 September 2009).

<sup>308</sup> At that time Canada was not a Member State to the ICSID Convention.

ICSID State cannot transfer any valid consent to ICSID arbitration to its subsidiary located in a ICSID Member State since such right never existed in the first place.<sup>309</sup> Then again, in *Cementownia* the tribunal found the Claimant's conduct downright illegal, a prime example of a fraudulent *mala fide* claim. The crucial issue was whether Cementownia had acquired the investment prior to the dispute. Surprisingly, the Claimant in this case was unable to prove the timing of the acquisition, but the tribunal assessed the issue of abuse of rights nevertheless. It found the Claimant "guilty of procedural misconduct" and declared that "the Claimant has intentionally and in bad faith abused the arbitration; it purported to be an investor when it knew that this was not the case."<sup>310</sup> This is a rather strong attitude compared to other similar cases, although the circumstances were distinctive as well. Despite their unique characteristics, these decisions also stressed the timing factor as a conclusive factor in determining the permissibility of treaty shopping.

The overview of jurisprudence discussed in previous Subsections allows for some preliminary conclusions. First, even when the tribunals have adopted a prohibitive attitude towards treaty shopping, no universal rule against the lawfulness of treaty shopping in general has emerged. Second, it appears that the abuse of process doctrine has a growing significance in future cases. Tribunals acknowledge that investors are free to arrange their affairs so as to gain the most favourable IIA protection, but simultaneously require some level of good faith. However, what level can still be regarded as appropriate remains ambiguous. The assessment is not only based on timing but also the underlying circumstances and intentions, which makes the line between legitimate nationality changes and abusive behaviour very fine. The bottom line is that the foresighted investors are rewarded, while those who fail to act well in advance are excluded from the protection of the IIA.

Moving on from the battle between treaty-based and external standard approaches and to further clarify the crucial distinction between foreseeable and unexpected disputes, I will next advance to the question of timing. Above all, I will analyse the different "foreseeability

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<sup>309</sup> In this case the Claimant was a Canadian company, which had transferred its investment to an American affiliate in order to gain access to ICSID mechanism. The action was brought merely two days after the transaction.

<sup>310</sup> *Cementownia v. Turkey* (n 307), para 159. Here, the Claimant Company was operated by the infamous Uzan family that was also involved in various fraud cases in Turkey. Still, the tribunal's statements reflect an attitude against treaty shopping in general.

tests" used by investment tribunals and attempt to find a common rule as to when an investor can be expected to predict a future dispute.

#### **4.4. Tipping the Scales: The Question of Timing**

It seems that, at least for the time being, foreign investors may enjoy the advantages of treaty shopping as long as they abide by the principle of good faith. The investor's good faith has been assessed heavily based on the timing of the actions that led to the nationality change in relation to the dispute. In this regard, we can distinguish disputes that have already risen before the corporate restructuring from the disputes that have yet to materialise. Both categories are troubled by uncertainty and are, to a certain extent, intertwined. For the sake of clarity, I will analyse pre-existing disputes and foreseeability separately. After all, their difference is fundamental; the former effects jurisdiction *ratione temporis*,<sup>311</sup> while the latter is a tool to evaluate whether the reorganization or acquisition of an investment constitutes an abuse of rights.

##### **4.4.1. Pre-Existing Disputes**

The discussion of pre-existing disputes boils down to one question: when does a dispute arise? Although this may appear clear-cut at first sight, discovering the precise starting point of a dispute is another story. Furthermore, arbitral tribunals have produced rather inconsistent conclusions in this respect.<sup>312</sup>

In some cases, the tribunals have found the date of the notification of the claim or the request for arbitration to be decisive for the commencement of a dispute.<sup>313</sup> This method has the advantage of providing a high degree of certainty, as the commencement of the dispute requires the satisfaction of certain formalities.<sup>314</sup> However, the act or omission causing the actual harm to the investment frequently pre-dates the legal initiation of the claim or arbitral proceedings. The inevitable time-lag between the event and the formal commencement of the dispute leaves arbitrators practically blind to any changes in the investor's nationality or

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<sup>311</sup> For discussion on the question why pre-existing disputes should be excluded in the first place see Baumgartner, 'The Significance of the Notion of Dispute and Its Foreseeability' (n 294) 214–219.

<sup>312</sup> *ibid* 219.

<sup>313</sup> See e.g. *Azurix Corp. v. The Argentine Republic*, ICSID Case No. ARB/01/12, Decision on Jurisdiction (8 December 2003) para 55; *Ronald S. Lauder v. The Czech Republic*, UNCITRAL, Ad Hoc Tribunal, Final Award (3 September 2001) para 185; *The Rompetrol Group N.V. v. Romania* (n 230) para 79.

<sup>314</sup> Voon, Mitchell and Munro (n 196) 47.

ownership structure of the investment between the date when the claim could have been initiated and the date when it was actually initiated.<sup>315</sup>

On the other hand, some tribunals have focused on the date of the (alleged) breach of the treaty obligations or on the date of the harm or injury, such as taking of an asset or revocation of a permit.<sup>316</sup> Under normal circumstances the exact starting time of the dispute has very little significance, given that once the Claimant has sent the request for arbitration, it is clear for everyone involved that a dispute exists between the parties. However, it matters greatly in cases of treaty shopping, considering that the case may be dismissed entirely if the investor's restructuring is ill-timed in relation to the date of breach or harm.<sup>317</sup>

Identifying a specific date of breach or harm/injury is often problematic. Several points in time may be relevant in this context. Indeed, a breach or the harm resulting from it can be a one-time act, a continuing act or a composite series of acts,<sup>318</sup> which distinction is also reflected in International Law Commission's (ILC) *Articles on State Responsibility for Internationally Wrongful Acts*.<sup>319</sup> In a typical one-time act, for example, enactment of an expropriation decree or a law that interferes with the investment, the dispute commences at the precise moment when the act is performed, even if its consequences extend in time.<sup>320</sup> A continuing act extends over the period during which the act is not in conformity with the treaty obligation, e.g. refusing to issue a license or a permit over a certain period of time.<sup>321</sup> Conversely, a composite act includes a series of different actions or omissions making up the wrongful act and takes place at the time when the last relevant event occurs.<sup>322</sup> The

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<sup>315</sup> *ibid.* For example, in *Phoenix Action* and *Cementownia and Europe Cement* cases the dispute commenced before the claimant investor took possession of the relevant investment. See *Phoenix Action, Ltd. v. The Czech Republic* (n 92) paras 65–71; *Cementownia v. Turkey* (n 307) paras 116–117; *Europe Cement Investment & Trade S.A. v. Republic of Turkey*, ICSID Case No. ARB(AF)/07/2, Award (13 August 2009) paras 139 and 143–145.

<sup>316</sup> Voon, Mitchell and Munro (n 196) 48. See *Levy v. Peru* (n 289) para 149; *Libananco Holdings Co. Limited v. Republic of Turkey*, ICSID Case No. ARB/06/8, Award (2 September 2011) paras 95, 400 and 492.

<sup>317</sup> Baumgartner, 'The Significance of the Notion of Dispute and Its Foreseeability' (n 294) 219.

<sup>318</sup> In some cases the dispute might even commence before any breach or harm to the investment has occurred. Some scholars have pointed out that major bodies of arbitration rules expressly allow provisional and interim measures that can be initiated to prevent the harm/injury from taking place. The availability of such measures enables the investor to engage with the host State on a conflict level ahead of time and suggests that the dispute can date prior to the harmful measure. For example, Art 14(7) of the ASEAN-China Investment Agreement (2009). See Voon, Mitchell and Munro (n 196) 48.

<sup>319</sup> International Law Commission, *Draft Articles on Responsibility of States for Internationally Wrongful Acts* (2001) articles 14 and 15. See also *Pac Rim Cayman LLC v. Republic of El Salvador*, ICSID Case No. ARB/09/12, Decision on the Respondent's Jurisdictional Objections (1 June 2012) para 2.67.

<sup>320</sup> *Pac Rim v. El Salvador* (n 319) para 2.68; International Law Commission, *Yearbook of the International Law Commission II (2): Documents of the fifty-third session* (United Nations Publication 2001) 59–60.

<sup>321</sup> *Pac Rim v. El Salvador* (n 319) paras 2.69 and 2.73; International Law Commission (n 320) 60.

<sup>322</sup> *Pac Rim v. El Salvador* (n 319) paras 2.70 and 2.74; International Law Commission (n 320) 62–63. Since in composite acts the dispute arises from the *last* event, the tribunal's decision to perceive a given act as

classification may sometimes come close to arbitrary as the facts and events surrounding investment disputes are often complex and entangled.

Moreover, tribunals have taken both broad and narrow views on the boundaries of a dispute. The previously examined *Mobil v. Venezuela* case is an example of a narrow framing of a dispute; the tribunal regarded the dispute over royalties and income tax to be separate from the dispute over nationalization.<sup>323</sup> Then again, the tribunal in *AMTO v. Ukraine* decided that the dispute had already started at the time of filing the claim letters relating to a commercial dispute because the subsequent treaty claims stemmed from the same factual background.<sup>324</sup> The preference of narrow or broad understanding of the dispute depends largely on whether the arbitrators focus on the underlying facts or the nature of the disagreement itself.<sup>325</sup>

In conclusion, the various approaches to determine the starting point and the scope of a dispute leave wide discretion to the arbitrators and thus generate considerable confusion and unpredictability regarding the timing issue in treaty shopping cases.

#### 4.4.2. Foreseeable Disputes

In the previously analysed *Philip Morris v. Australia* case the Claimant had undisputedly completed its restructuring and acquired an interest in the Australian investments before the dispute had arisen. Yet, the Claimant's behaviour was not perceived as legitimate nationality planning and the claims were dismissed. The tribunal held that under the specific circumstances of the case, the Claimant could certainly foresee the impending disagreement with the Australian government, and thus its actions amounted to abuse of process. From the investor's (who technically carried out the nationality change in a timely manner) point of view, the outcome is alarming. When is the anticipation of a dispute so detectable that the investor is expected to see it coming?

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composite instead of continuing has a significant impact in cases where nationality or ownership is changed between the first and last acts.

<sup>323</sup> *Mobil v. Venezuela* (n 277) para 203. Similarly, in *Tidewater v. Venezuela* the tribunal regarded the debt dispute as a commercial dispute that was legally distinct from the consequent expropriation dispute. See *Tidewater v. Venezuela* (n 87) para 198.

<sup>324</sup> This reasoning follows the so-called Lucchetti test according to which if a single set of facts gives rise to two allegedly separate grievances, these would likely be considered part of the same dispute. See *Limited Liability Company AMTO v. Ukraine*, SCC Case No. 080/2005, Final Award (26 March 2008) para 51–53; *Empresas Lucchetti, S.A. and Lucchetti Peru, S.A. v. The Republic of Peru*, ICSID Case No. ARB/03/4, Award (7 February 2005).

<sup>325</sup> Voon, Mitchell and Munro (n 196) 49–51.

To answer this question, several investment tribunals have developed foreseeability tests that are broadly similar, yet in detail slightly diverging.<sup>326</sup> The most prevalent test was created by the tribunal in *Pac Rim v. El Salvador*: "[T]he dividing-line occurs when the relevant party can see an actual dispute or can foresee a specific future dispute as *a very high probability* and *not merely as a possible controversy*".<sup>327</sup> If the line is crossed, abuse of process will ordinarily be found. However, the tribunal emphasised that the outcome is dependent on the particular facts and circumstances of each individual case.

The tribunal in *Tidewater v. Venezuela* endorsed this test, but added that a nationality change in order to facilitate access to treaty coverage is generally abusive if the subsequently commenced dispute was within the "reasonable contemplation" of the investor or "reasonably foreseeable" at the time of the reorganization.<sup>328</sup> Further, in the case of *Lao Holdings v. Laos*, the arbitrators asked whether the dispute was "highly probable".<sup>329</sup>

All these tests set a rather high threshold for the foreseeability of a dispute, which implies that an abuse of process should not be easily found either. This was also confirmed in *Levy v. Venezuela*, where the tribunal stated that "[it] will obviously not presume an abuse, and will affirm the evidence of an abuse only in *very exceptional* circumstances."<sup>330</sup> Further, it clarified that "the closer the acquisition of the investment is to the act giving rise to the dispute, the higher the degree of foreseeability will normally be."<sup>331</sup>

Foreseeability is a profoundly fact-specific notion. All relevant facts and circumstances must be evaluated, and still an element of juridical discretion remains.<sup>332</sup> Dr Jorun Baumgartner notes that requiring only that the investor could foresee an upcoming dispute with a high probability arguably emphasises the investor's horizon too much, and correspondingly lacks a vital objective element that would prevent strategic allegations.<sup>333</sup> Adding the requirement of reasonableness introduces the assessment of whether *a reasonable investor* would have been able to anticipate the future dispute.<sup>334</sup> Even with this corrective, a tribunal always

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<sup>326</sup> Baumgartner, 'The Significance of the Notion of Dispute and Its Foreseeability' (n 294) 227.

<sup>327</sup> *Pac Rim v. El Salvador* (n 319) para 2.99 (emphasis added).

<sup>328</sup> *Tidewater v. Venezuela* (n 87) paras 148, 193. Also the Tribunal in *Philip Morris* adopted test of "reasonable foreseeability" created by the *tidewater* tribunal.

<sup>329</sup> *Lao Holdings N.V. v. Lao People's Democratic Republic*, ICSID Case No. ARB (AF)/12/6, Decision on Jurisdiction (21 February 2014) para 76.

<sup>330</sup> *Levy v. Peru* (n 289) para 186 (emphasis added).

<sup>331</sup> *ibid*, para 187.

<sup>332</sup> Jagusch *et al.* (n 280) 189.

<sup>333</sup> Baumgartner, 'The Significance of the Notion of Dispute and Its Foreseeability' (n 294) 228.

<sup>334</sup> *ibid*.



evaluates foreseeability of a certain dispute with the benefit of hindsight, and thus it may be impossible for the investor to know if the dividing-line has been passed at time of reorganising its corporate structure. The problem is particularly acute in cases of continuous and composite acts when the entire course of State's conduct has significant commonalities. However, it seems clear that the foreseeability requirement refers to a specific future dispute and, consequently, a generally deteriorating investment climate would not suffice.<sup>335</sup> The opposite conclusion would be rather unreasonable for foreign investors.

As a final remark on this matter, it is worth noticing that the above-mentioned tests may unintentionally encourage calculated sovereign measures or the threat of such. A strategically prudent State, trying to anticipate and avoid future investment claims, may deliberately escalate potential controversies with a foreign investor. Alternatively, a State could "flag" in advance all the potential sovereign measures it might take, in order to prematurely tackle any doubts regarding foreseeability of a dispute.<sup>336</sup> Therefore, foreign investors would be well-advised to execute any corporate structure changes before any deterioration of relations with the host State occurs. In situations where the atmosphere is already tense, it would be wise to notify the host State of the acquisition or transfer, and to ensure a track of record concerning the post-restructuring investment activities.<sup>337</sup>

In conclusion, the timing of a corporate restructure or transfer is of utmost importance in both determining arbitral jurisdiction and identifying an abuse of process. There are, however, multiple ways to pinpoint the outset or probability of a specific dispute. Whichever approach introduced above prevails in the future case law, arbitrators should make their decisions with a view to legal certainty. What is more, defining the boundaries of abusive claims will promote a climate of mutual trust between investors and host States which is vital for the investment flows.

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<sup>335</sup> Jagusch *et al.* (n 280) 189. See *Pac Rim v. El Salvador* (n 319) para 2.99. This raises a follow-up-question regarding whether the investor must have been able to foresee the precise measures taken by the State.

<sup>336</sup> *ibid.*

<sup>337</sup> *ibid* 190.

## 5. RESPONSES AND SOLUTIONS

Having clarified the line between acceptable and unacceptable treaty shopping, it is time to move on to practical implications of the practice. In this Chapter, I will elaborate on some State reactions to the treaty shopping phenomenon. This is done through two examples, after which I will assess the possible means to curb treaty shopping – if States wish to do so. Finally, I will discuss the most relevant aspects that an investor should consider before making the decision to engage in treaty shopping.

### 5.1. How Have States Reacted?

As discussed above in Chapter 3, it is, in principle, neither illegal nor inappropriate for a foreign investor to organise its investment to avail itself of maximum protection under existing IIAs. Rather, changing nationality via changing corporate structure to gain a beneficial regulatory and legal environment is a standard feature of diligent management in international economic relations.<sup>338</sup> However, such conduct has frequently been frowned upon by the community of States. This negative reaction is understandable considering that host States are at the receiving end of treaty shopping, particularly vulnerable to additional investment claims brought by investors who were not initially intended to be covered by the treaty in question.

Below I provide two real life examples of how States have responded to treaty shopping. First, in Subsection 5.1.1, I will examine the Netherlands' pro-business approach to drafting investment treaties and how this has aroused opposition among contracting parties who have been exposed to arbitration proceedings brought under Dutch BITs. Then in Subsection 5.1.2, I will canvass States' resistance to ISDS mechanisms with a special emphasis on Latin American States' growing interest in withdrawing from the ICSID Convention. It should be noted that treaty shopping has not *per se* been the core issue in these examples. Rather, it is part of the problem emphasising the concerns about the entire investment system. In this regard, treaty shopping can be characterised as a triggering factor.

#### 5.1.1. Just pretend to be Dutch – Case of the Netherlands

The letter combination B.V. comes up frequently in arbitration cases concerning treaty shopping. The acronym stands for Dutch limited liability company (*besloten vennootschap*) which is an often used vehicle to shop into Dutch BITs. Indeed, Dutch companies are widely

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<sup>338</sup> Schreuer 'Nationality Planning' (n 162) 19.

used in international trade and dispute resolution, which for one part stems from Dutch foreign trade policy.<sup>339</sup> The government of the Netherlands pursues one of the most liberal foreign investment policies in the developed world. With some 160 IIAs in force, the country maintains one of the largest BIT networks and is therefore an attractive target State for nationality planning.<sup>340</sup> Duly, the Netherlands has taken a central position in the ongoing debate around IIAs.<sup>341</sup> More than 12 per cent of all known investment treaty claims exploit Dutch BITs, which makes the Netherlands the most frequent home State for investment arbitration cases after the United States.<sup>342</sup> According to an analysis by the Centre for Research on Multinational Corporations (SOMO) a remarkable majority (over 75%) of investment cases involving a Dutch IIA are brought by mailbox companies with no real economic ties to the Netherlands and their ultimate or controlling parent company based somewhere else than the Netherlands.<sup>343</sup> Overall, it is estimated that foreign investors have used Dutch BITs to claim more than USD 100 billion from host States.<sup>344</sup>

Foreign investors are tempted to set up corporate structures that route investments through the Netherlands precisely because of the broadly phrased and open-ended protections included in its BITs (named as the "gold standard" of investment protection). Firstly, Dutch BITs generally qualify indirectly controlled foreign investors as nationals, entitled to full protection.<sup>345</sup> Therefore, they facilitate the easy establishment of shell companies, which

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<sup>339</sup> Skinner *et al.* (n 59) 275. An equally relevant factor for the popularity is the liberal taxation regime. With a competitive (on both European and International level) corporate income tax rate – 20% on the first EUR 200,000 and 25% for taxable profits exceeding EUR 200,000 – as well as a number of attractive incentive programs, the Netherlands offers a supportive fiscal climate for international companies. See KPMG, *Investment in the Netherlands* (2016).

Available at: <https://assets.kpmg.com/content/dam/kpmg/pdf/2016/07/Investment-in-the-Netherlands-2016.pdf> (accessed 7 March 2018).

<sup>340</sup> By March 2018 the Netherlands has 64 BITs and 68 TIPs. Twelve of these are so-called intra-EU BITs (with Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Romania, Slovenia and Slovakia). See UNCTAD, *International Investment Agreements Navigator* (n 1).

<sup>341</sup> For discussion on the concerns relating to the IIA system and the pressure to reform it see van Harten Gus, 'Five Justifications for Investment Treaties: A Critical Discussion' [2010] 2(1) *Trade, Law and Development* 19–58.

<sup>342</sup> As of July 2017 the Netherlands had been involved in 96 investment cases, all of which it was the home State of Claimant. Only the United States rose above that number with a total of 168 cases, out of which it was the Respondent State in 16 cases and the home State of the investor in 152 cases. See also van Os Roos, 'Dutch Investment Treaties: Socialising Losses, Privatising Gains' in Singh Kavaljit and Ilge Burghard (eds), *Rethinking Bilateral Investment Treaties: Critical Issues and Policy Choices* (Both ENDS, Madhyam and SOMO 2016) 176.

<sup>343</sup> Van Os and Knottnerus (n 33) 28–30. Altogether the investor-friendly BIT framework has attracted an estimated 12,000 shell companies into the Netherlands.

<sup>344</sup> *ibid* 30.

<sup>345</sup> See Subsection 3.6.1. The Dutch Model BIT provides in Article 1(b): "the term 'nationals' shall comprise with regard to either Contracting Party...legal persons constituted under the law of that Contracting Party; Legal persons not constituted under the law of that Contracting Party but controlled, directly or indirectly, by

enables legal entities with no substantial link to the Netherlands to gain treaty protections that their own State of origin may not be willing to extend to investors from the State actually hosting their investments, including the host State's own nationals.<sup>346</sup> Secondly, Dutch BITs mostly include the widest possible definition of investment, which covers "every kind of asset" and does not require any actual contribution to the country's economic development.<sup>347</sup> Thirdly, these treaties include expansive ISDS clauses, which guarantee more comprehensive private property rights to foreign investors than what is usually granted in national constitutions or EU law.<sup>348</sup>

These characteristics have rendered the Netherlands a popular "base camp", particularly for investment in the developing world, consequently leaving some investment-importing States dissatisfied. In 2008, the Venezuelan government unilaterally denounced its BIT with the Netherlands.<sup>349</sup> Thereafter four more States have followed suit: Bolivia terminated its BIT in 2009, South Africa in 2014, Indonesia in 2015, and most recently India in 2016.<sup>350</sup>

Terminating an entire IIA is a radical response to the threat of investment arbitration, that treaty shopping increases, and profoundly effects the whole investment framework of that country.<sup>351</sup> Therefore, the States feeling the pressure to change the course of things should rather endeavour to renegotiate more suitable wording for treaty provisions which they deem the most critical.<sup>352</sup> As for the Netherlands, there is currently an active discussion with regards to revising Dutch investment policy.<sup>353</sup> While eager to preserve their investor-friendly approach as a trump card to attract entities to incorporate within Dutch borders, it may endanger diplomatic relations with host States that are being sued under Dutch BITs.<sup>354</sup>

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natural persons as defined in (i) or by legal persons as defined in (ii)". See The Netherlands Model Bilateral Investment Treaty (2004).

<sup>346</sup> Van Os (n 342) 174–175.

<sup>347</sup> *ibid.* This covers also some unusual asset categories such as good will and knowhow.

<sup>348</sup> *ibid.* 175. In addition, exhaustion of local remedies is regularly omitted.

<sup>349</sup> Peterson Luke Eric, 'Venezuela surprises the Netherlands with termination notice for BIT' [2008] 1(1) Investment Arbitration Reporter. The Venezuelan government indicated that the BIT was incompatible with the government's 'national policy', but it is believed that the decision was made in response to a number of foreign companies (e.g. Exxon Mobil, Conoco Phillips and Eni SpA) attempting to use the Netherlands-Venezuela BIT to drag Venezuela into an ICC-administered investment arbitration.

<sup>350</sup> UNCTAD, 'International Investment Agreements Navigator' (n 1).

<sup>351</sup> Moreover, termination may not produce the desired results, at least in the short term. That is because most BITs include self-defence mechanisms, namely tacit renewal and "survival clauses", that either delay or turn impossible the realisation of exit strategies. For more discussion see Lavopa Federico, Barreiros Lucas and Bruno Victoria, 'How to Kill a BIT and not Die Trying: Legal and Political Challenges of Denouncing or Renegotiating Bilateral Investment Treaties' [2013] 16(4) Journal of International Economic Law 869–891.

<sup>352</sup> Renegotiation of BITs as a way of addressing treaty shopping is examined in Subsection 5.2.2.

<sup>353</sup> Not only concerning treaty shopping but also issues relating to the global governance of multinational corporations and sustainable development, including human rights and environmental concerns.

<sup>354</sup> Van Os and Knottnerus (n 33) 17.

A State is not an attractive destination in the first place if it does not have IIAs with States that attract investment.

### **5.1.2. The Backlash against Investment Arbitration – Withdrawal from the ICSID Convention**

Another noteworthy example of State reactions to treaty shopping is the trend to remove ISDS clauses from IIAs. This is particularly evidenced by some Latin American countries' withdrawal from the ICSID Convention. As indicated in Section 2.1, one of the main characteristics of the BIT proliferation was the introduction of ISDS mechanisms, namely giving foreign investors a direct right to sue the host State. While the ISDS regime has arguably made a significant contribution to the fluent settlement of investment disputes,<sup>355</sup> the dramatic increase in the number of investment arbitration has generated increasing signs of backlash against ISDS and pressure to reform the current system.<sup>356</sup> Such a backlash from States is not solely a symptom of treaty shopping, but is indisputably aggravated by it as host States become more exposed to a growing number of investment claims by nationals of a third State, or even their own nationals. In any event, granting foreign investors direct remedies against host governments has surely encouraged foreign investors to shop for IIAs that provide them the best possible dispute resolution clauses.<sup>357</sup>

As discussed in Section 3.2, ISDS mechanisms are an important incentive to treaty shop. Hence, omitting ISDS clauses from the IIAs has the potential to greatly reduce the practice of treaty shopping and exposure to additional investment claims, albeit only under the

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<sup>355</sup> ISDS system has many advantages (especially from investor's perspective) compared to the more lengthy, cumbersome and politically loaded process provided by the rules of diplomatic protection. Firstly, the right of diplomatic protection is held by the home State of the investor and, as a matter of policy, it may choose not to exercise this right in defence of an investment claim. The home State may decide not to pursue the investor's claim for reasons that are more related to the broader international relations between the home and host countries than to the actual validity of the investor's claim. Secondly, even if the home State successfully pursues an investor's claim, it is not legally obliged to transfer the proceeds of the claim to its national investor. Thirdly, in the case of a complex multinational corporation with subsidiaries in several States (each possessing, in all probability, a different legal nationality) and a very international shareholder profile, it may be difficult, if not impossible, to determine accurately what the entity's nationality is for the purposes of establishing the right of diplomatic protection on the part of a protecting State. Brownlie Ian, *Principles of Public International Law* (7th edn, Oxford University Press 2008) 701–710 and Timmers Leonie, Venezuela: A Right to Property in Theory? in Baetens Freya (ed), *Investment Law within International Law: Integrationist Perspectives* (Cambridge University Press 2013) 141–142.

<sup>356</sup> In the EU the "crisis" of the ISDS is more acute than ever after the CJEU gave its ruling in *Achmea v. Slovakia* (80). In the decision, the CJEU found ISDS clause of an intra-EU BIT incompatible with the EU Law and thus inadmissible. See section 3.2. See also Waibel Michael, 'The Backlash against Investment Arbitration: Perceptions and Reality' in Waibel and Kaushal, Chung, *et al.* (eds), *The Backlash against Investment Arbitration* (Kluwer Law International 2010) xxxvii.

<sup>357</sup> See the "shopping list" in section 5.3. Dispute resolution mechanism is one of the essential features to take into account when foreign investor is considering to engage treaty shopping.

condition that the great majority of States would adopt this approach.<sup>358</sup> However, for the time being, few States have deliberately decided to opt out of ISDS. For example, the Australian government announced in its 2011 Trade Policy Statement<sup>359</sup> that it would no longer agree to investor-State arbitration provisions in its future investment treaties or FTA chapters.<sup>360</sup> Australia's stricter policy was, at least in part, motivated by the *Philip Morris* case that threatened to limit its legislative powers with regard to public health issues. Indeed, the country concluded the 2012 Australia-Malaysia FTA<sup>361</sup> and the 2014 Australia-Japan EPA<sup>362</sup> without ISDS clause.<sup>363</sup>

Perhaps the most drastic and visible manifestation of the backlash against ISDS is the denunciation of the ICSID Convention by some Latin American States.<sup>364</sup> Similar to any other international treaty, the ICSID Convention is subject to denouncement by a Contracting Party if it considers that the treaty no longer corresponds to its interests. Bolivia was the first country to withdraw the Convention in 2007,<sup>365</sup> followed by Ecuador in 2009,<sup>366</sup>

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<sup>358</sup> Baumgartner, 'Treaty Shopping' (n 63) 241.

<sup>359</sup> Australian Government, Department of Foreign Affairs and Trade, 'Gillard Government Trade Policy Statement: Trading our way to more jobs and prosperity' April 2011. Available at: [http://blogs.usyd.edu.au/japaneselaw/2011\\_Gillard%20Govt%20Trade%20Policy%20Statement.pdf](http://blogs.usyd.edu.au/japaneselaw/2011_Gillard%20Govt%20Trade%20Policy%20Statement.pdf) (accessed 11 March 2018). In Australia the investor-State arbitration system was described to act like a 'Trojan Horse', opening the floodgates for multinational enterprises to impinge on state sovereignty. See Whish-Wilson Peter, 'Greens introduce Bill to protect the Public Interest against Trojan horse provisions in Trade Agreements' (*GreensMPs*, 5 March 2014) Available at: <https://peter-whish-wilson.greensmps.org.au/articles/greens-introduce-bill-protect-public-interest-against-trojan-horse-provisions-trade> (accessed 23 March 2018).

<sup>360</sup> Tan Liang-Ying and Bouchenaki Amal, 'Limiting Investor Access to Investment Arbitration - A Solution without a Problem?' [2014] 11(1) *Transnational Dispute Management* 8–9; see also Tienhaara Kyla and Randal Patricia, 'Australia's rejection of Investor-State Dispute Settlement: Four potential contributing factors' (*International Institute for Sustainable Development (IISD)*, July 2011) Available at: <https://www.iisd.org/itn/2011/07/12/australias-rejection-of-investor-state-dispute-settlement-four-potential-contributing-factors/> (accessed 11 March 2018).

<sup>361</sup> Free Trade Agreement between Australia and Malaysia (Australia-Malaysia FTA) 22 May 2012 (entered into force 1 January 2013).

<sup>362</sup> Agreement between Australia and Japan for an Economic Partnership (Australia-Japan EPA) 8 July 2014 (entered into force 15 January 2015).

<sup>363</sup> Interestingly, the investment chapter of the Australia-South Korea FTA, concluded in 2014, did include such a dispute settlement clause. The change of heart is connected to a change of government in 2013, two years after the Policy Statement was announced. The new liberal government retracted considerably from the previous strict position, which is evidenced by the Australia-Korea FTA. However, the new government has not completely rejected the policy, but has indicated instead that it will consider inclusion of ISDS clauses in its treaties on a case-by-case basis. See Trakman Leon, 'Investor-State Arbitration: Evaluating Australia's Evolving Position' [2014] 15(1–2) *Journal of World Investment and Trade* 152–192.

<sup>364</sup> Tan and Bouchenaki (n 360) 6. See also Macías María J.L. 'Current Approaches to the International Investment Regime in South America' in Herrmann, Krajewski and Terhechte (eds), *European Yearbook of International Economic Law*, volume 5 (Springer International Publishing AG 2014) 285–308.

<sup>365</sup> Denunciation notified in May 2007 and effective in November 2007. See ICSID News Release, 'Bolivia Submits a Notice under Article 71 of the ICSID Convention' 16 May 2007. Available at: <http://icsidfiles.worldbank.org/icsid/icsid/staticfiles/Announcement3.html> (accessed 11 March 2018).

<sup>366</sup> Denunciation notified in July 2009 and effective in January 2010. See ICSID News Release 'Ecuador Submits a Notice Under Article 71 of the ICSID Convention' 9 July 2009.

and Venezuela in 2012.<sup>367</sup> The trend is not surprising considering the relevant role Latin American countries have played in ICSID arbitration (and the unfavourable decisions obtained) over the years. Approximately 30 per cent<sup>368</sup> of all known ICSID cases are brought against Latin American States. Consequently, as frequent respondents, they are also most influenced by treaty shopping. Therefore, these three States have determined that investment protection backed by ICSID arbitration – and intensified by treaty shopping – poses an unacceptable risk to their policy space and public budgets.<sup>369</sup> Whether this reaction results in the desired effect as a protective shield against treaty shopping is still debatable. The current system undeniably has its weaknesses and abuses do exist. However, it was created for good reason and thus far the great majority of States do not seem to fundamentally call it into question. There are also far less radical options for States that wish to protect themselves from Treaty Shoppers.

## 5.2. Ways to Curb Treaty Shopping

Having demonstrated that States have maintained rather negative perceptions towards treaty shopping, I will next discuss and assess three possible lines of strategy that are available to States in decreasing their exposure to treaty shopping practices. However, listing these means does not imply that treaty shopping ought to be forbidden. On the contrary, in this Study, I argue that it is an inevitable part of global business activity, and despite some of the downsides, treaty shopping as a whole does not endanger the investment regime.<sup>370</sup> Nevertheless, when done solely for the purpose of commencing arbitration against the host State, it might amount to abuse of the system and that type of treaty shopping ought to be prevented. States are, figuratively speaking, the "Masters" of the investment treaties and therefore any solution to the unwanted consequences created by treaty shopping lies, to a great extent, in their own hands.<sup>371</sup> These solutions can be political by nature, such as multilateral/global initiatives, termination of risky IIAs or a State's decision to leave out ISDS provisions. States can also act through treaty drafting methods like adopting more restrictive definitions of investor or using of denial of benefits clauses. In this Chapter, I will

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<sup>367</sup> Denunciation notified in January 2012 and effective in July 2012. See ICSID News Release 'Venezuela Submits a Notice Under Article 71 of the ICSID Convention' 26 January 2012.

<sup>368</sup> By March 2018 there are a total of 668 cases. In 199 of them a Latin American State was the Respondent. See ICSID Database <https://icsid.worldbank.org/en/Pages/cases/AdvancedSearch.aspx>.

<sup>369</sup> Giraud Martinelli Vanessa, 'Modern Authoritarian Regimes and the Denunciation of the ICSID Convention' in Baltag Crina (ed), *ICSID Convention after 50 Years: Unsettled Issues* (Kluwer Law International 2016) 504–507.

<sup>370</sup> See the possible benefits of treaty shopping in Section 3.4.

<sup>371</sup> Baumgartner, 'Treaty Shopping' (n 63) 239.

introduce some of these means, and assess their feasibility for curbing treaty shopping in international arbitration.

### 5.2.1. Denial of Benefits Clause

An often favoured method to limit treaty shopping by corporate nationality planning is the so-called "denial of benefits clause" (hereafter DOB). With such provisions the host State reserves the right, in certain circumstances, to deny the benefits of the applicable IIA to a claimant that in theory meets the definition of "investor" but in reality lacks a relevant connection to its purported home State.<sup>372</sup> DOB clauses are grounded in treaty text, and therefore by including such a provision in the IIA, contracting States are able to articulate in precise terms the kind of closeness is required to receive treaty protection.<sup>373</sup> The preconditions of invoking such a clause are stated in the wording of the provision, for example, the claimant company is owned or controlled by non-protected investors, or has no substantial business activities in the country of incorporation.<sup>374</sup> Nonetheless, tribunals have reached remarkably inconsistent decisions as to when, how and with what effect DOB clauses can and should be invoked.<sup>375</sup>

Professor Mark Feldman particularly advocates using DOB provisions as the main method to curb treaty shopping. According to him, they provide greater stability and predictability in investor-State arbitration (in comparison to solving the issue with the abuse of rights doctrine, which has been applied inconsistently by different tribunals). DOB clauses are treaty-based and therefore they reflect the express and shared views of the parties to the treaty instead of ambiguous principles.<sup>376</sup> However, the formulation of DOB clauses is often

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<sup>372</sup> Ziadé Roland and Melchionda Lorenzo, 'Structuring and Restructuring of Investment in Investment Treaty Arbitration' in Rovine Arthur W. (ed), *Contemporary Issues in International Arbitration and Mediation: The Fordham Papers* (Brill – Nijhoff 2015) 395; Douglas Zachary, *The International Law of Investment Claims* (4th edn, Cambridge University Press 2012) 468–472 and Collins (n 8) 87–88.

<sup>373</sup> For example Article 17 of the ECT provides that: "Each Contracting Party reserves the right to deny the advantages of this Part to...a legal entity if citizens or nationals of a third state own or control such entity and if that entity has no substantial business activities in the Area of the Contracting Party in which it is organized..." See Energy Charter Treaty (n 170).

<sup>374</sup> Early versions of DOB clauses can be traced back to the time after World War II as they appeared in FCN treaties signed by the United States in 1950s. From then on such clauses have been increasingly incorporated in both multilateral and bilateral investment treaties. Especially the United States continues to include DOB provisions in BITs and investment chapters of FTAs. In addition, frequent users of such clauses are Canada, Mexico, Japan, Korea, China, Australia, New Zealand, Peru, Lebanon and Austria. Most significant multilateral treaties including DOB provision are ECT, ASEAN Comprehensive Agreement on Investment and CAFTA-DR. Zhang (n 171) 57; Feldman (n 166) 293–294.

<sup>375</sup> Gastrell Lindsay and Le Cannu Paul-Jean, 'Procedural Requirements of 'Denial-of-Benefits' Clauses in Investment Treaties: A Review of Arbitral Decisions' [2015] 30(1) ICSID Review 78–97.

<sup>376</sup> Feldman (n 166) 283, 301, 302.



vague, and thus their interpretation has raised various issues. DOB clauses usually provide that each contracting party "reserves the right"<sup>377</sup> to deny or "may"<sup>378</sup> deny benefits to an investor whenever certain substantive conditions are met. On that account, tribunals have often held that the right to deny benefits does not operate *ipso jure*. Instead the State must positively exercise it.

DOB clauses have also raised certain practical questions. In response to States' attempts to deny treaty benefits, several investment tribunals have imposed an evidentiary burden on the respondent State to demonstrate that the factual prerequisites in the applicable DOB provision have been fulfilled.<sup>379</sup> However, given that the Claimant, in most cases, will have better access to the evidence connected with its own business activities and ownership structure, a rigid application of the burden of proof could undermine the utility of DOB provisions in the future. Instead, if the tribunals adopted a more flexible approach,<sup>380</sup> DOB clauses would function more effectively in discouraging foreign investors from treaty shopping through corporate restructuring.

Another issue regarding DOB clauses is whether the host State is required to make a formal declaration of its intent to avail itself of the right to deny benefits to investors. Further, if such a requirement to notify exists, will it be considered as having prospective effect, bearing only on future investors, or retroactive effect, covering investments already made?<sup>381</sup> The distinction is crucial as accepting retroactive invocation remarkably limits the possibility of treaty shopping.

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<sup>377</sup> See *e.g.* Art 17 ECT (n 170).

<sup>378</sup> See *e.g.* Art. 10.12.2 CAFTA-DR and Art. 1113(2) NAFTA (n 169)

<sup>379</sup> Feldman (n 166) 296. For example, in the case of *Petrobart v. Kyrgyz Republic* the tribunal ruled that the Respondent had the burden to establish relevant facts regarding the Claimant Company's ownership structure and nature of its business activities. Similarly, the tribunal in *AMTO v. Ukraine* (n 324) placed the burden of proof to the State. However, the tribunal expressly acknowledged that it might be difficult for the Respondent to "determine who owns or controls an Investor when ownership or control might involve a number of entities in different jurisdictions." Then again, the tribunal in *Generation Ukraine Inc. v. Ukraine* was not so understanding. It refused to make any accommodation in light of the Claimant's superior access to the relevant proof concerning denial of benefits issue. See *Petrobart Limited v. The Kyrgyz Republic*, SCC Case No. 126/2003, Award (29 March 2005); *Generation Ukraine, Inc. v. Ukraine*, ICSID Case No. ARB/00/9, Award (16 September 2003) and *AMTO v. Ukraine* (n 324) para 65.

<sup>380</sup> Similar to *AMTO v. Ukraine* (n 324).

<sup>381</sup> Thorn and Doucleff (n 168) 24–25; Ziade and Melchionda (n 372) 395. For more discussion see Pinto Débora, *Is the retrospective exercise of the 'denial of benefits' clause contrary to the investor's legitimate expectations under the Energy Charter Treaty?* (Working Paper, Maastricht University 2016).

One of the first cases in which this question was profoundly analysed was *Plama Consortium Limited v. Republic of Bulgaria*.<sup>382</sup> Here, the Respondent sought to deny benefits to the Claimant after the arbitration had already commenced. The tribunal took an investor-friendly approach and ruled that a presumed investor has the right to "reasonable notice" as to whether the host State will exercise its right under the DOB clause. The tribunal emphasised that the right to deny benefits should not be retroactive but only prospective from the date of exercising that right.<sup>383</sup>

To impose such a proactive notification duty on States is not without problems. Some scholars have criticised the *Plama* line of reasoning as potentially rendering DOB provisions *de facto* meaningless.<sup>384</sup> Namely, "[t]he host State may not even be aware at the time of the existence of a new investment made in its territory, let alone the nationality of that investor, the extent of its business activities in its home State, and the nationality of its underlying owners or controllers."<sup>385</sup> This difficulty was also noted in the *Pac Rim* case, and hence the tribunal reached the opposite conclusion. According to this tribunal there was no express time limit in the applicable treaty (here CAFTA-DR) for the host State to exercise its right to deny benefits as imposing such a limitation "would create considerable practical difficulties" for parties of the treaty.<sup>386</sup> A State cannot be expected to keep track of the day-

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<sup>382</sup> *Plama Consortium Limited v. Republic of Bulgaria*, ICSID Case No. ARB/03/24, Decision on Jurisdiction (8 February 2005). For discussion on balancing between the investor's interests and conflicting concerns of state sovereignty in this case see Essig Holger, 'Balancing Investors' Interests and State Sovereignty: The ICSID-Decision on Jurisdiction *Plama Consortium Ltd v Republic of Bulgaria*' [2007] 4(5) *Transnational Dispute Management*.

<sup>383</sup> Similarly the tribunals in *Yukos, Pan America* and *Liman Caspian Oil* imposed a notice requirement on States, reaffirming that the exercise of DOB right only has retrospective effect. See *Yukos Universal Limited (Isle of Man) v. The Russian Federation*, UNCITRAL, PCA Case No. AA 227, Interim Award on Jurisdiction and Admissibility (30 November 2009); *Pan American Energy LLC and BP Argentina Exploration Company v. The Argentine Republic*, ICSID Case No. ARB/03/13, Decision on Preliminary Objections (27 July 2006); *Liman Caspian Oil BV and NCL Dutch Investment BV v. Republic of Kazakhstan*, ICSID Case No. ARB/07/14, Award (22 June 2010).

<sup>384</sup> See Thorn and Doucleff (n 168) 25. Similarly in Feldman (n 166) 300; Voon, Mitchell and Munro (n 196) 55.

<sup>385</sup> Sinclair Anthony, 'Investment Protection for "Mailbox Companies" under the 1994 Energy Charter Treaty: A note on one aspect of the Decision on Jurisdiction in *Plama Consortium Ltd v Republic of Bulgaria*' [2005] 2(5) *Transnational Dispute Management* 5.

<sup>386</sup> *Pac Rim v. Republic of El Salvador* (n 319) para 4.85. Costa Rica and the United States submitted non-disputing party submission regarding this issue. Costa Rica argued that "[a] State Party to DR-CAFTA is not necessarily informed at all times of the share make-up and corporate structure of all investors from other Parties to the Treaty in its territory. What is more likely is that the State only becomes aware of who owns or controls a company at the time when there is a dispute, which escalates into an investment arbitration." The U.S. further observed that requiring a respondent to provide notice before a claim is submitted to arbitration would, in effect, require the respondent "to monitor the ever-changing business activities of all enterprises in the territories of each of the other six CAFTA-DR Parties that attempt to make, are making, or have made investments in the territory of the respondent." See paras 4.53 and 4.56 (quoting the respective submissions).

to-day business activities and ownership structure of all legal entities investing in its territory.<sup>387</sup> It remains to be seen which approach will prevail.

To conclude, DOB clauses offer one of the most effective tools for States to set boundaries to treaty shopping by corporate investors. In addition, such provisions can also provide clearer guidance to investors with regard to the level of connection they must have to their respective home State in order to be assured of IIA protections.<sup>388</sup> The efficiency of DOB clauses, however, requires that they are phrased explicitly enough and that the tribunals interpret them in a flexible manner, refraining from imposing unrealistic requirements on States invoking DOB provisions.

### 5.2.2. Renegotiating the Substantive Provisions of IIAs

Another possible way to deal with treaty shopping is through renegotiating *substantive* provisions of IIAs. As previously discussed in this Study, arbitral tribunals have over the past years adopted inconsistent attitudes towards the treaty shopping practice, leaving some essential questions open or raising more questions than they actually answer.<sup>389</sup> By reformulating some of the key provisions,<sup>390</sup> States can adapt their treaty framework to counter the possibility of treaty shopping, and at the same time increase overall certainty in their investment regimes. In fact, rapid developments in investment practice and jurisprudence have already led some States to renegotiate old IIAs and to develop new model

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<sup>387</sup> The tribunals in *EMELEC* and *Ulysseas* were thinking along the same lines and explicitly accepted invocation of DOB clause simultaneously with the statement of defence. See *Empresa Eléctrica del Ecuador, Inc. v. Republic of Ecuador*, ICSID Case No. ARB/05/9, Award (2 June 2009) para 71 and *Ulysseas, Inc. v. The Republic of Ecuador*, UNCITRAL, PCA Case No. 2009-19, Interim Award (28 September 2010) para 173. However, allowing the retrospective effect may indeed put foreign investors in a somewhat fragile position, since the investor will never know if there might be a denial of benefits exactly when the investor needs to rely on them. However, one cannot say that such a denial would come as a total surprise for the investor as the existence of DOB provision is known to the investor who has opted to invest into the contracting State through a corporate vehicle controlled by a national of a third State and which had no substantial business activities in its incorporation State. Same observations were made by the tribunal in *Guaracachi America v. Bolivia*. See *Guaracachi America, Inc. and Rurelec PLC v. The Plurinational State of Bolivia*, UNCITRAL, PCA Case No. 2011-17, Award (31 January 2014) para 383.

<sup>388</sup> Feldman (n 166) 302.

<sup>389</sup> See Chapter 4; Baumgartner, 'Treaty Shopping' (n 63) 242.

<sup>390</sup> In addition to the substantive parts of a treaty, States should further clarify the respective preambles. Though preamble has no binding force in international law, its interpretative value should not be overlooked. Preamble generally contains the policy rationale for the conclusion of the treaty, and therefore including explicit referral to the reciprocal nature of the treaty can, at least to some extent, contribute to prevent treaty shopping attempts by putative investor-claimants. While it is not the sharpest-cutting knife for States wishing to curb treaty shopping, the preamble communicates the underlying intents of the parties to the tribunal when it is engaging in treaty interpretation. See Article 31 VCLT (n 203) and Gardiner Richard, *Treaty Interpretation* (2nd edn, Oxford University Press 2015) 186–187. For arbitral decisions see *Aguas del Tunari v. Bolivia* (n 173) para 241; *Standard Chartered Bank v. The United Republic of Tanzania*, ICSID Case No. ARB/10/12, Award (2 November 2012) para 270.

IAs to address issues that worry them.<sup>391</sup> With regard to treaty shopping, the most important provision for States to renegotiate is the definition of investor.

There are new specific "anti-treaty shopping" criteria that States can use in their IAs. Namely, the requirements of seat,<sup>392</sup> substantial business activities and foreign control<sup>393</sup>. The first two criteria ensure that the foreign investor has a meaningful link to its purported home State and consequently thwart treaty shopping by pure mailbox companies. The seat requirement may be further enhanced by adding that in case of doubt, the burden to prove true centre of administration lies on the investor. As for substantial business activities, the term can prove to be quite ambiguous. Therefore, a State wishing to make its IAs as "treaty shopping-proof" as possible would be advised to include clarification of the indicators for finding business activity to be substantial.<sup>394</sup> With respect to the notion of foreign control, it mainly protects States from claims brought by their own nationals. It is recommended to specify that control means actual/effective control and whether nationalities of the initial layers of control will suffice or if the ultimate controller (usually a natural person) must be identified.<sup>395</sup> The restrictive elements included in the provision essentially have similar effects to DOB clauses.

Renegotiating IAs raises its own difficulties, mostly due to the fact that it requires the consent of the opposing contracting State(s).<sup>396</sup> Given that the vast majority of the IAs are concluded between developed and less developed countries, which have conflicting interests when it comes to investments, the opposing State might have little incentive to agree to

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<sup>391</sup> By the end of 2007, a total of 121 BITs had been renegotiated. Germany led this development with sixteen renegotiated BITs, and was soon followed by China (15), Morocco (12) and Egypt (11). The experience of the U.S. and Canada as respondents in NAFTA investment arbitrations has led these States to develop new Model BITs that clarify the scope and meaning of investment obligations. Compared to the total number of existing BITs, the share of renegotiated agreements is still very small – less than 5 percent. However, more countries are revising their BITs to reflect new concerns related to environmental and social issues, including the host State's right to regulate. As a result, by the end of 2013 over 1,300 BITs were open for termination or renegotiation. See UNCTAD 'Recent Developments' 2005 (n 39) 5; Newcombe and Paradell (n 34) 61.

<sup>392</sup> Also formulated as principal place of business, registered office or central administration. See more in Section 3.6.

<sup>393</sup> Similar to ICSID Article 25(2)(b) which states: "National of another Contracting State" means...any juridical person which had the nationality of a Contracting State other than the State party to the dispute...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).

<sup>394</sup> Such clarification can be found in COMESA (Common Market for Eastern and Southern Africa) Investment Agreement Article 4 (ii): "*The concept of 'substantial business activity' requires an overall examination, on a case-by-case basis, of all the circumstances, including, inter alia: (a) the amount of investment brought into the country; (b) the number of jobs created; (c) its effect on the local community; and (d) the length of time the business has been in operation.*" See Investment Agreement for the COMESA Common Investment Area, 25 May 2007. Baumgartner, 'Treaty Shopping' (n 63) 250–251.

<sup>395</sup> Baumgartner, 'Treaty Shopping' (n 63) 277.

<sup>396</sup> Lee John (n 6) 373.

changes in the terms.<sup>397</sup> Even if the State were amenable to reformulation of IIA provisions, the sheer number of liberally drafted treaties in force means that acquiring consent for negotiation on a broad scale amounts to a burdensome and time-consuming task. Therefore it seems improbable that States could take control over treaty shopping on a large scale with this method in the near future. With regards to individual States, the Netherlands and alike, renegotiations could provide a quick-fix.

### 5.2.3. Global Investment Treaty

As discussed earlier in Chapter 2, the entire investment regime is built on a world-wide network of BITs, which are the root and incentive of the treaty shopping phenomenon. Apart from few multilateral efforts, which are either limited geographically (e.g. NAFTA) or by sector (ECT), no truly global architecture for foreign investment has been established.<sup>398</sup> The negotiation of one joint multilateral investment framework is a possible, and rather powerful, solution to treaty shopping. Such a global instrument, replacing at least the majority of currently existing (and often overlapping) IIAs, would have a significant impact on treaty shopping. A global treaty would, in principle, eliminate the need for individual BITs between two States, and therefore remarkably curtail the possibility to treaty shop.<sup>399</sup> Furthermore, a multilateral solution might be the ideal answer, as it could also remove the necessity of treaty shopping altogether. After all, investors would not feel the urge to find better solutions if the playing field was level to begin with.<sup>400</sup>

As an additional argument, a global framework could also address multiple other substantive concerns of States, for example with respect to human rights and protection of the environment.<sup>401</sup> Such a mutual endeavour would bring general consistency and certainty to

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<sup>397</sup> The developed countries commonly wish to include the broadest possible protection for foreign investors, as they are mainly investment exporting, while developing countries are regularly occupying the respondent position in investment arbitration being mostly the investment receiving party.

<sup>398</sup> In comparison, the global trade regime is covered by the World Trade Organization (WTO). See the Marrakesh Agreement Establishing the World Trade Organization (15 April 1994) 1867 UNTS. 154, 33 I.L.M. 1144.

<sup>399</sup> Drabek Zdenek, 'A Multilateral Agreement on Investment: Convincing the Sceptics', Staff Working Paper ERAD-98-05 (World Trade Organization, Economic Research and Statistics Division 1998) 5; Subedi (n 44) 242; Lee John (n 6) 374.

<sup>400</sup> In this context some scholars have also introduced the idea of a permanent investment court to be established within such global treaty. This could potentially improve the consistency of the jurisprudence and satisfy at least some of the legitimacy concerns with regard to the current investment regime. See. UNCTAD, 'Investor-State Dispute Settlement, A sequel' in UNCTAD Series on Issues in International Investment Agreements II (United Nations Publication 2014) 194–195 and van Harten Gus, *Investment Treaty Arbitration and Public Law* (Oxford University Press 2007) 180–184.

<sup>401</sup> See Schreuer 'Nationality Planning' (n 162) 17. For more arguments in favour of the conclusion of a global investment treaty see e.g. Simic Sandra, 'Our Future is in the Eye of the Beholder – An Initiative for a Global Investment Treaty' [2016] 7 Croatian Academy of Legal Sciences Yearbook, 374–388.

protection of foreign investors compared to addressing problematic issues through arbitral tribunals. However, the road to such a global effort is likely to be long and burdensome. For the time being, the negotiation of a global treaty on foreign investment law is not on the agenda of any international organisation and some commentators predict that there will not be any such efforts in the foreseeable future either.<sup>402</sup> Attempts to draft a wide-ranging multilateral investment treaty have been made few times but they have failed for a variety of reasons. These include the proposed Multilateral Agreement on Investment (MAI) initiative under the auspices of the OECD (1995–1998), and later the efforts within the WTO in include investment issues on the Organization's mandate (Doha Round 2004), both of which failed.<sup>403</sup> The latest example of an international initiative to reach large-scale consensus on investment matters is the Transatlantic Trade and Investment Partnership (TTIP) agreement between the European Union and the United States, the negotiations for which were called to a halt in 2016.<sup>404</sup>

At the moment, prospects for the success of such a multilateral project are slim. Even if States achieved an agreement on the textual content, universal (or near universal) acceptance is extremely unlikely.<sup>405</sup> Despite having mutual wishes to reform IIAs, State proposals to improve the system represent a vast variety of approaches, which makes it difficult to imagine a consensus on single set of global investment protection rules.<sup>406</sup> That is simply because States have different interests.<sup>407</sup> To be precise, the level of investment protection that States are willing to offer for foreign investors varies significantly depending on whether the State is developed or developing and also whether is its capital-exporting or capital-

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<sup>402</sup> Schreuer 'Nationality Planning' (n 162) 27; Subedi (n 44) 242 and Baumgartner, 'Treaty Shopping' (n 63) 240.

<sup>403</sup> See OECD Draft for a Multilateral Agreement on Investment (MAI), 22 April 1998 and WTO, Decision of the General Council of 1 August 2004 on the Doha Agenda Work Program, section 1(g). For deeper analysis of the reasons behind the failures see Salacuse Jeswald, 'Towards a Global Treaty on Foreign Investment: The Search for a Grand Bargain' in Horn Norbert and Kröll Stefan (eds), *Arbitrating Foreign Investment Disputes: Procedural and Substantive Legal Aspects* (Kluwer Law International 2004) 50–88.

<sup>404</sup> See e.g. Louet Sophie, Blenkinsop Philip, 'EU-US trade deal in doubt as France urges end to talks' (Reuters, 30 August 2016) Available at: <https://www.reuters.com/article/us-eu-usa-ttip-france/eu-u-s-trade-deal-in-doubt-as-france-urges-end-to-talks-idUSKCN1150H2> (accessed 2 March 2018)

<sup>405</sup> Schreuer 'Nationality Planning' (n 162) 27

<sup>406</sup> See 'Taking Stock of IIA Reform', in *IIA Issues Note No 1* (United Nations Publication 2016); Baumgartner, 'Treaty Shopping' (n 63) 240.

<sup>407</sup> In addition, Professor Subedi observes that one reason for States' reluctance to bind themselves to a global MIT could be that BITs are an easier option. Bilateral agreements commonly have a limited or fixed lifespan (normally 10 or 20 years), and States can also quite easily denounce or renegotiate such treaties since the number of contracting parties is small. Subedi (n 44) 241.

importing.<sup>408</sup> In contrast, BITs are relatively easy to establish since there are only two parties to please.<sup>409</sup> Consequently, finding sufficient common ground to conclude a far-reaching multilateral investment treaty seems unlikely. Furthermore, as the (nearly) all-embracing network of BITs has taken over the investment scheme by now, it would require a complete overhaul of the current regime through coordinated action by a large number of States to make such a comprehensive construction happen.<sup>410</sup> Therefore, as Professor Pauwelyn observes, it is likely that the negotiation costs of a global comprehensive treaty would outweigh the benefits derived from such uniform investment system.<sup>411</sup> Overall, it may be said that despite the ability to remove the need for treaty shopping (along with other investment related issues) altogether, a global multilateral solution is a back-breaking option to execute and thus unrealistic.

To sum up, States have some methods at their disposal to curb the treaty shopping phenomenon. The most promising option is either to use DOB clauses or negotiate stricter definitions to the IIAs posing the highest risk of attracting Treaty Shoppers. However, when planning to take action, States should always bear the bigger picture in mind as some of the means affect the State's investment framework on a larger scale as well.

### **5.3. Investor's Shopping List – Points to Consider before Treaty Shopping**

Having introduced protective measures from State's perspective, I will now turn to investor's interests. Even though reorganising the legal, ownership, operational or other structures of a corporate entity is not (in most cases) overly challenging, shopping for more beneficial treaty protections is not without hurdles. Investors who plan to utilise treaty shopping possibilities must first ensure that the planned corporate structure fulfils all of the treaty requirements.<sup>412</sup> In practice, the process of nationality planning is dominated by due diligence, and some variables should be considered before the change of nationality is carried out.<sup>413</sup> Below, I

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<sup>408</sup> Comparison between the interests of capital-exporting States and capital-importing States in Salacuse Jeswald, 'The Emerging Global Regime for Investment,' [2010] 51(2) Harvard International Law Journal 436–441.

<sup>409</sup> Skinner *et al.* (n 59) 263.

<sup>410</sup> UNCTAD, 'Investor-State Dispute Settlement' (n 400) 195.

<sup>411</sup> Pauwelyn (n 123) 417. "*Even if, in the abstract, multilateralism...could be more efficient, it is now very difficult for this mutation to occur: today's benefits of a multilateral treaty must outweigh today's cost of negotiating a multilateral treaty and replacing thousands of BITs....*"

<sup>412</sup> Saldarriaga Andrea and Vohrzek–Griest Ana, Zuleta Jaramillo Eduardo, 'Treaty Planning: Current Trends in International Investment Disputes that Impact Foreign Investment Decisions and Treaty Drafting' In Ángel Fernández–Ballesteros Miguel and Arias David (eds), *Liber Amicorum Bernardo Cremades* (Wolters Kluwer España, La Ley, Madrid 2010) 1211.

<sup>413</sup> Skinner *et al.* (n 59) 270.

will lay out some crucial points that a prudent investors need to take into account before engaging in treaty shopping. It should be noted, however, that even if all of these aspects were in order, a foreign investors still has to weigh the potential benefits of being protected under the target IIA against the trouble and costs of restructuring process.

**a) How is 'Investor' defined?**

As described in Section 3.6., investment treaties contain different requirements for determining a corporate investor's nationality. If the foreign investor does not qualify under the IIA, all of the protections and benefits provided in it are out of the investor's reach. Assuming that a typical Treaty Shopper does not wish to *de facto* transfer its business activities or its seat to another State, it should opt for an IIA which has the most leniently defined investor requirements. Definition by reference to incorporation alone is the most liberal option and therefore a "golden ticket" to an investor shopping for better protections.<sup>414</sup> Whereas, if the IIA contains further restrictions, requiring a prospective corporate investor to, for example, have its principal place business within or maintain a genuine economic connection with the purported home State, the investor must deliberate if it is willing to satisfy the relevant criteria.

**b) Is there a Denial of Benefits clause?**

In Subsection 5.2.1. I explained that a DOB clause enables States to deny treaty benefits to a corporate investor that lacks a meaningful economic connection with the State on whose nationality it relies. Therefore, the goals of DOB clause are broadly similar to a restrictive definition of "investor" within the IIA.<sup>415</sup> If the targeted BIT contains such a clause,<sup>416</sup> a purported Treaty Shopper should be wary of it, since the risk of not qualifying for investment protection increases remarkably. If a Treaty Shopper is not willing to institute relevant business activity in the territory of the State in question, it should choose another IIA, or reconsider treaty shopping altogether. A potential investor should note that, the activities prescribed by the DOB clause should be more than the minimum business activities required by applicable law for a business to exist.<sup>417</sup> On the other hand, the business activities usually

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<sup>414</sup> The 'incorporation alone' requirement is generally more common in 1st and 2nd generation BITs. The 3<sup>rd</sup> generation BITs tend to restrict the definition of "investor" so as to preclude purported outsiders to the treaty from benefitting from its provisions. See Van Os and Knottnerus (n 33) 8–9; UNCTAD 'Recent Developments' 2005 (n 39) 4–5.

<sup>415</sup> Skinner *et al.* (n 59) 271.

<sup>416</sup> DOB clause is normally inserted into the definition section of the treaty or included as an independent provision.

<sup>417</sup> IIA German Branch / Working Group (n 48) 64.



do not have to be large-scale, and the decisive factor is "the materiality not the magnitude of the business activity"<sup>418</sup> What is certain is that a treaty containing a DOB clause will limit the use of shell companies considering that these will by definition only have the lowest level of economic activities.

### ***c) The dispute settlement mechanism***

Investor-State arbitration is the most important procedural feature in IIAs.<sup>419</sup> The mere qualification as a protected investor under the IIA is cold comfort if the foreign investor has no mechanisms to enforce the substantive rights guaranteed in the treaty. While the overwhelming majority of IIAs contain at least some kind of a dispute settlement clause, not all are as desirable to a prospective investor, let alone Treaty Shopper.

There are two principal mechanisms to resolve investment disputes: one for disputes between two contracting Parties concerning the application and interpretation of an applicable BIT (State-State), and another for disputes between the host country and an injured foreign investor (investor-State).<sup>420</sup> The latter is predominant, at least for the time being, and also undoubtedly more beneficial to a Treaty Shopper as it provides an independent and more straightforward access route to dispute resolution, without political restraints. However, a Treaty Shopper should be mindful of any additional conditions attached to the right to commence investment arbitration proceedings. For example, a prerequisite of "exhaustion of local remedies"<sup>421</sup> could lengthen the dispute resolution process considerably, and consequently increase investor's expenses in case of a dispute.<sup>422</sup>

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<sup>418</sup> *AMTO v. Ukraine* (n 324) para 69.

<sup>419</sup> Collins (n 8) 222.

<sup>420</sup> OECD, *International Investment Perspectives 2006* (OECD Publishing 2006) 170.

<sup>421</sup> The exhaustion of local remedies provision requires that a foreign investor (allegedly) harmed by a State must first resort to the administrative and judicial system of that State, until a final decision has been rendered, before initiating international proceedings against the State. The purpose of such a rule is to give the State where the violation occurred "an opportunity to redress it by its own means, within the framework of its own domestic system...before its international responsibility can be called into question". Cançado Trindade Antônio Augusto, *The Application of the Rule of Exhaustion of Local Remedies in International Law* (Cambridge University Press 1983) 1. However, the requiring exhaustion of local remedies might also carry disadvantages to the host State: public proceedings in multiple level of domestic courts are likely to aggravate the dispute and might affect the host State's investment climate. Schreuer Christoph, 'Calvo's Grandchildren: The Return of Local Remedies in Investment Arbitration' [2004] 4(1) *The Law & Practice of International Courts and Tribunals* 1.

<sup>422</sup> Exhaustion of local remedies provision is included in, for example, the Albania-Lithuania BIT: "If such a dispute cannot be settled amicably within six months from the date of the written notification provided in paragraph 1, and an domestic judicial and administrative remedies have been exhausted, the Contracting Party or the investor shall be entitled to submit the dispute either to [ad hoc UNCITRAL or ICSID arbitration]." See Agreement between the Council of Ministers of the Republic of Albania and the Government of the Republic of Lithuania on the Promotion and Protection of Investments (Albania-Lithuania BIT) 28 March 2007 (entered into force 7 December 2007). In recent years, some States such as Argentina, India, Romania, Turkey, the

Furthermore, a Treaty Shopper should observe whether the IIA provides for *ad hoc* or institutional arbitration. As mentioned in Section 2.3 on this Study, ICSID arbitration offers some distinct benefits compared to other methods of arbitration.<sup>423</sup> ICSID's self-contained system covers all phases of the proceedings and, most importantly, extends to the enforcement and recognition of awards, providing only limited grounds to challenge an ICSID award.<sup>424</sup> Consequently, it is highly probable that a final ICSID award can be effectively enforced, and thus an IIA with a reference to ICSID should be preferred by a Treaty Shopper.<sup>425</sup>

#### ***d) Other considerations***

There are few other considerations that may affect the Treaty Shopper's decision on which particular investment treaty (and therefore State) to choose. One of these is the *nature of the investment*. Some IIAs include so-called "carve-outs" that exclude certain business sectors, such as defence, construction, pharmaceuticals, petroleum and other energy related sectors.<sup>426</sup> These sectors may be subject to heavy regulation by the host State. Hence, if the Treaty Shopper conducts business in these specific areas, it should avoid treaties and jurisdictions with such pitfalls.

Also, as established in Chapter 4, *the timing of the investment* should be taken into account before engaging extensive corporate restructuring or other treaty shopping activities. This will be the most relevant when an asset is distressed and a dispute has already arisen or is

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United Arab Emirates and Uruguay, as well as few States in the Southern African Development Community (SADC) and East African Community (EAC) regions, have reintroduced the mandatory requirement to exhaust local remedies for the settlement of investment disputes in their IIAs. This practice is aimed to empower domestic legal systems and other States might follow a similar path. Dietrich Brauch Martin, *IISD Best Practices Series: Exhaustion of Local Remedies in International Investment Law* (International Institute for Sustainable Development 2017) 1.

<sup>423</sup> Above all, the advantage of ICSID is the investment dispute is placed under the framework of an international agreement, which accordingly is the only source of regulation governing all aspects of the dispute. ICSID forms, essentially, a self-contained system of arbitration, entirely independent of national legal systems. See Section 2.3 of this Study.

<sup>424</sup> Bernardini Piero, 'ICSID versus non-ICSID Investment Treaty Arbitration' in Arias David and Fernández-Ballesteros M.A. (eds), *Liber Amicorum: Bernardo Cremades* (Kluwer Law International 2010) paras 7, 9. In addition, the text of the ICSID Convention is complemented by the arbitration rules, the administrative and financial regulation as well as the conciliation rules adopted by the Administrative Council of the Centre under Article 6(1). In comparison, all other methods of arbitration provide for the conduct of arbitration under the rules chosen by the parties, which are further complemented by the rules of procedure of the legal system of the seat of arbitration. As a consequence, depending on the seat of arbitration (and therefore on the applicable legal system) non-ICSID arbitrations are subject to different rules and the award is subject to different means of recourse.

<sup>425</sup> In addition, the investor should verify that both Contracting States of the IIA are party to the ICSID Convention.

<sup>426</sup> Skinner *et al.* (n 59) 272.

imminent.<sup>427</sup> However, timing may also become of relevance if the investor is planning to acquire an interest in an existing asset as some IIAs contain time bars to actions concerning investments made before the treaty entered into force.<sup>428</sup>

Last but not least, a prudent investor should also evaluate the *commercial viability* of the treaty shopping process, that is, balance the costs and time devoted to restructuring activities against the additional benefits (or disadvantages) stemming from *e.g.* tax regulation and the general investment climate in the relevant territory.

To conclude, the appropriate corporate restructuring in order to attract treaty protection can be very useful to a mindful investor should a dispute with the host State arise. However, the significant strategic advantage provided by treaty shopping requires that the restructuring is carried out in good time, and that the Treaty Shopper is conscious of the specific conditions set in the target IIA. To conclude with the words of Professor Schreuer: "A wise investor will structure its investment from its inception or at any rate as early as possible so as to benefit from treaty relations that offer maximum protection."<sup>429</sup>

## 6. CONCLUSIONS – ENEMY OR ALLY?

The phenomenon of treaty shopping has been gaining momentum during the recent years. Although it is generally accepted that treaty shopping is not illegitimate *per se*, but rather sensible business practice, States seem concerned about having to extend protections of their IIAs to investors of third countries and/or their own nationals. Then again, in circumstances where an investor lacks access to a favourable IIA, it usually is recommended for it restructure its operations to gain maximum protection for its investment.

The need for a clear dividing line between permissible nationality planning and abusive treaty shopping became apparent already a while ago, yet there is still no common consensus as to where to draw such line. Nevertheless, as the case analyses showed, the arbitral decisions have begun to set out the broad contours of the boundaries of treaty planning by corporate investors. Three general guidelines can be extracted. First, the case law confirms

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<sup>427</sup> *ibid.* See also Chapter 4 of this Study.

<sup>428</sup> See, for example, Article 10 of the Cambodia Model BIT (1998) which excludes "any dispute, claim or difference, which arose before [the treaty's] entry into force", in comparison to the Article 10 of the Netherlands Model BIT stating that "the provisions of this Agreement shall, from the date of entry into force thereof, also apply to investments which have been made before that date". Douglas (n 372) 340; Legum Barton, Bradfield Michelle, Castagno Niccolò and Gilfedder Catherine, 'Ratione Temporis or Temporal Scope' in Legum Barton (ed), *The Investment Treaty Arbitration Review* (2<sup>nd</sup> edn Law Business Research Ltd 2016) 29, 34–37.

<sup>429</sup> Schreuer, 'Nationality Planning' (n 162) 26.

the assumption that foreign investors are generally free to arrange their business affairs so as to gain the most favourable conditions to their investments. Second, despite this freedom, it is not permissible to change nationality merely to gain access to ISDS mechanisms in circumstances where the dispute is already extant or reasonably foreseeable. Third, when evaluating the permissibility, the timing and motives of the restructuring become decisive, but it remains unsettled how far investment tribunals can interpret the *bona fide* nature of investors' actions. Drawing the line as to whether a dispute has arisen, or whether it was already foreseeable, is a highly fact-specific assessment which can only be made after all of the circumstances of the case have been considered. Thus, the Study cannot provide absolute rules as to where the decisive line precisely lies. Instead, foreign investors planning to engage treaty shopping would be well-advised to carry out corporate restructuring in good time, before any signs of deteriorating relationship with the host State occur.

Even though the guiding factors are now clearer, a grey area still exists. Multinational corporations are constantly engaged in anticipating legal risk and collecting tools to protect themselves from various business threats. Yet in the current state of legal development, it is not easy to conclude whether treaty shopping in order to gain treaty coverage is an effective and legitimate use of the law, or ineffective and abusive. Further clarification from the future tribunals is needed.

This Study advocates that treaty shopping as a concept should remain permissible but only to the extent that it is executed in advance. If an investor engages in treaty shopping as a part of strategic business planning, the practice does not run counter to the underlying purpose of the investment regime. Whereas if the treaty shopping is done with a sole intent to sue the host State, the system may be misused. At the end of the day, States hold all the power in their hands when it comes to prospects of treaty shopping. Therefore, it is up to the States to protect themselves from Treaty Shoppers – if they wish to do so. States can do this best by using a clear and narrow definition of "investor" in their IIAs and/or including a DOB clause that explicitly does not require prior notice to be given to the investor.

Time will tell how the boundaries of treaty shopping practice continue to crystallise. The future tribunals should strive for precision and transparency in their decisions and reasoning. Until then, treaty shopping is not an enemy of the investment system but an – albeit sometimes slightly troublesome – ally.