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# CORPORATE RESTRUCTURING TRYING TO GAIN INVESTMENT PROTECTION: ABUSE OF RIGHT OR NORMAL BUSINESS MANAGEMENT PRACTICE

Master thesis

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## LIST OF ABBREVIATIONS

BIT(s) – Bilateral investment treaty(ies)

CAFTA – Dominican Republic-Central America-United States Free Trade Agreement

CJEU – Court of Justice of the European Union

EU – European Union

FDI – Foreign direct investment

FTA(s) – Free trade agreement(s)

*Ibid.* – Ibidem

ICSID – International Centre for Settlement of Investment Disputes

IIA(s) – International investment agreement(s)

ISDS – Investor-state dispute settlement

NAFTA – North American Free Trade Agreement

OECD – Organization for Economic Cooperation and Development

PCA – Permanent Court of Arbitration

SCC – Stockholm Chamber of Commerce

TIP(s) – Treaty(ies) with investment provisions

UNCITRAL – United Nations Commission on International Trade Law

UNCTAD – United Nations Conference on Trade and Development

WIR – World Investment Report

## INTRODUCTION

**Relevance and scientific problem of the research.** As of the beginning of 2019, the question of legal regulation of international investment regime is increasingly emerging in a global context. The main reason for this is that the modern world is more integrated than ever before in terms of international trade and investment with cross-border capital flows. The present situation shows that international investment regime is still not governed by a single system of multilateral rules. Instead, the accumulation of international investment agreements (hereafter referred to as IIAs) continues to grow, notwithstanding the difficulties faced by investment participants in the course of exercising their rights and obligations under mentioned IIAs.

The recent statistics[1] demonstrate that the total number of ongoing IIAs has already reached the point of 3322. Overall, 55 new IIAs were concluded during 2016 – 2017 and at least 22 IIAs were effectively terminated. The numbers signalize that selected governments try to take certain steps[2] towards reforming their international investment policy environment, nevertheless, the rate of treaty-based disputes between foreign investors and host States remains high. This is evidenced by the facts that in 2017 at least 65 new investment proceedings were initiated, bringing the aggregate number of known treaty-based cases to 855. Such an increase has triggered concerns among different nations regarding the transparency and effectiveness of currently available dispute settlement mechanisms in the field of investment activities, the inconsistency of arbitral interpretation of treaty provisions and, as a consequence, the expansion of such phenomenon as **'treaty shopping'**, which constitutes a subject matter of this research.

It is widely recognised that treaty shopping is one of the most challenging questions in the framework of international investment arbitration. Since the first potential treaty shopping case appeared in 2000 year[3], there is still no official definition of that phenomenon. Essentially, treaty shopping implicates the practice of structuring/restructuring investments in order to obtain access to foreign jurisdiction with more attractive IIA.[4] Nonetheless, its admissibility and legality are not completely understandable yet.

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[1] All statistics in this paragraph are presented on the basis of data taken from UNCTAD, *World Investment Report 2018. Investment and the Digital Economy* (New York and Geneva: United Nations Publication, 2018), xiii, accessed on 22 April 2019, https://unctad.org/en/PublicationsLibrary/wir2018_en.pdf

[2] Since 2012, over 150 countries have taken steps to formulate a new generation of sustainable development-oriented IIAs. See UNCTAD, *World Investment Report 2018*, xiii.

[3] Eunjung Lee, "Treaty Shopping in International Investment Arbitration: How often has it occurred and how has it been perceived by tribunals?" *LSE Working Paper Series* 2015, no. 15-167 (February 2015): 16, accessed on 22 April 2019, http://www.lse.ac.uk/internationalDevelopment/pdf/WP/WP167.pdf

[4] Julien Chaisse, "The Treaty Shopping Practice: Corporate Structuring and Restructuring to Gain Access to Investment Treaties and Arbitration," *Hastings Business Law Journal* 11, no. 2 (Summer 2015): 228, accessed on 22 April 2019, http://repository.uchastings.edu/hastings_business_law_journal/vol11/iss2/1

The existing arbitration practice is fairly contradictory in this behalf. This is confirmed by the absence of relevant *jurisprudence constant*[5]. In view of the above, the following questions logically arise: **whether it is acceptable to use corporate restructuring in order to obtain investment protection under IIA? To what extent such corporate restructuring can be considered as a normal business management practice or an abuse of rights?**

**Scientific novelty and overview of the research.** The comprehensive analysis of currently available literature shows that the issue of treaty shopping is the subject matter of many studies among various researches in the field of international investment law. The topic in question, by some means or other, was highlighted by authors like Jorun Baumgartner[6], Julien Chaisse[7], Eunjung Lee[8], Stephan Schill[9], Mark Feldman[10], Christoph Schreuer[11] etc. Apart from that, examination of the extensive arbitration practice[12] indicates that the matter under investigation has an applicable nature and is widely known in law enforcement practice. The aforesaid suggests that the problem of considering the practice of treaty shopping is not new. However, some of its aspects are not fully explored, that is why the need for this study is so purposeful.

Here the novelty is mainly determined by the demand for a contextual analysis of the treaty shopping phenomenon amid certain events recently shocked the whole investment world. To be more precise, starting from 2011, the arbitration case law once again enhanced its treatment of treaty shopping issues on international level. After a decision in ***Philip Morris v Australia case***[13], the Australian government made a policy announcement that it would no

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[5] Charles N. Brower and Stephan W. Schill, "Is Arbitration a Threat or a Boon to the Legitimacy of International Investment Law?" *Chicago Journal of International Law* 9, no. 2 (2009): 474, accessed on 22 April 2019, https://chicagounbound.uchicago.edu/cgi/viewcontent.cgi?article=1489&context=cjil

[6] Jorun Baumgartner, *Treaty Shopping in International Investment Law* (Oxford, England: Oxford University Press, 2016), 351.

[7] Julien Chaisse, *The Treaty Shopping Practice*, 225-306.

[8] Eunjung Lee, *Treaty Shopping in International Investment Arbitration*, 1-59.

[9] Stephan W. Schill, *The Multilateralization of International Investment Law* (Cambridge, England: Cambridge University Press, 2009), 221-236.

[10] Mark Feldman, "Setting Limits on Corporate Nationality Planning in Investment Treaty Arbitration," *ICSID Review* 27, no. 2 (2012): 281–302, accessed on 22 April 2019, https://doi:10.1093/icsidreview/sis026

[11] Christoph Schreuer, "Nationality Planning," *Contemporary Issues in International Arbitration and Mediation: The Fordham Papers* 2012, no. 6 (2013): 17-27, accessed on 22 April 2019, https://www.univie.ac.at/intlaw/wordpress/wp-content/uploads/2013/11/nationality_planning_end.pdf

[12] Hereinafter, the following cases will be considered in more: *Phoenix Action Ltd v. Czech Republic, Mobil and Others v. Venezuela, Philip Morris v Australia, Tokios Tokelés v. Ukraine, Pac Rim v. El Salvador* etc.

[13] *Philip Morris Asia Limited v. The Commonwealth of Australia*, PCA Case No. 2012-12, Award on Jurisdiction and Admissibility (17 December 2015), accessed on 22 April 2019, https://www.italaw.com/sites/default/files/case-documents/italaw7303_0.pdf

longer include investor-state dispute settlement (hereafter referred to as ISDS) clauses in future IIAs. Besides of that, the United Nations Conference on Trade and Development (hereafter referred to as UNCTAD) has supported the reform towards the development of a new generation of investment policies by improving the investment dispute settlement mechanism.[14]

**Aim of the research.** The primary goal of the present research is to clarify the line between the practice of corporate restructuring as a normal business management activity and the abusive behaviour focused on obtaining treaty protection under particular investment agreement.

**Research objectives.** For the purpose of achieving the desired goal, it is necessary to solve a number of the following tasks:

1. To outline the causes and consequences of the existence of 'treaty shopping' concept in international investment law.
2. To identify the core elements of 'treaty shopping' manipulations.
3. To compare existing approaches in the practice of investment arbitration towards treaty shopping treatment.
4. To specify the appropriate ways of reducing the treaty shopping expansion in international investment environment.

**Significance of the research.** The findings of this Master thesis are equally useful for practitioners and theorists in the field of investment law. Since this paper contains the analysis of the reasons for the emergence of 'treaty shopping' concept, its key elements, as well as an overview of relevant arbitration practice, it turns out that it will be helpful for further academic pursuits on the proposed topic.

Apart from that, several recommendations of the research at hand can be used by investors (corporate entities) in the course of doing their business and especially for the purposes of structuring the investments.

Finally, certain recommendations of the present study have a practical importance for national legislators who are responsible for drafting provisions of the new international investment treaties and for reviewing of ongoing IIAs.

**Research methodology.** In order to archive the aim of the Master thesis, the next methods were used:

1) ***linguistic method.*** The linguistic method was used to understand the meaning of the legal concepts and their definitions while analysing the core elements of treaty shopping manipulations.
2) ***historical method.*** The historical method was used to outline the main reasons for the occurrence of treaty shopping phenomenon in investment law.

[14] Catharine Titi and Joerg Weber, "UNCTAD's Roadmap for IIA Reform for an improved investment dispute settlement," *New Zealand Business Law Quarterly* 21, no. 4 (December 2015): 319.

3) ***system-analysis method.*** The system-analysis method was used to determine the common features of 'treaty shopping' concept in international investment law and to specify appropriate ways of reducing the treaty shopping expansion.
4) ***synthesis method.*** The method of synthesis was used in order to integrate the UNCTAD's recommendations for the sole purpose of creating a new system of knowledge.
5) ***comparative analysis method.*** The method of comparative analysis was used to define inconsistencies and to correlate common points in views of legislators and arbitrators towards treatment of treaty shopping issues.
6) ***method of assumptions.*** This method was used to propose recommendations and to assess their effectiveness.
7) ***analytical techniques*** were exercised at all stages of the study in order to establish connections between the causes and consequences of certain events, actions or taken decisions.

**Structure of the research.** According to the designated aim and objectives, the Master thesis consists of introduction, two parts – general and special – which are divided into chapters and subchapters, conclusions and recommendations, and list of bibliography.

The first part mainly outlines the general statement on the 'treaty shopping' concept in international investment law. In relation to that, the first chapter defines the very meaning of discussed phenomenon. Within its subchapters, the reasons for the occurrence and reaction of different countries towards the treaty shopping expansion are considered. Hereinafter, in the second chapter, the most controversial elements of IIAs, that investors use to manipulate under the treaty shopping activity, are described. Correspondingly, each of the subchapters is devoted to a separate element.

The second part indicates practical significance of the treaty shopping application. Its chapters, together with respective subchapters, introduce a variety of arbitration approaches to the interpretation of corporate restructuring activities for the purposes of obtaining treaty protection, as well as classify appropriate proposals for eliminating the misuse of treaty shopping practice in international investment environment.

**Statements to be defended.**

1. The practice of treaty shopping is neither unethical nor illegal activity in the framework of international investment.
2. Corporate restructuring for the purpose of obtaining investment protection constitutes a normal business management practice until it involves the signs of abusive conduct.

## 1. GENERAL STATEMENT ON THE 'TREATY SHOPPING' CONCEPT

Foreign direct investment (hereafter referred to as FDI) is one of the key drivers in prosperity of global economy. By tradition, FDI was perceived as capital flows from North to South, namely flowing from industrial countries to developing ones, but nowadays the reality of international investment world has changed in a significant way.[15] In XXI century FDI has become as a part of international production progression that relates not only to trade processes *per se*, but involves a distribution of innovative technologies and know-hows around the world. This in turn leads to new forms of cross-border investment which requires an adequate level of legal guarantees and protection.

Generally, investing (especially on an international scale) is a longstanding and complex process that demands a careful preparation in finding favourable conditions for cooperation and doing business. In the paradigm of performing foreign investment, international investment agreements, including both bilateral investment treaties (hereafter referred to as BITs) and treaties with investment provisions (hereafter referred to as TIPs), are the main instruments for regulating relationships between states towards protection, promotion and liberalization of such investments. IIAs provide entities and individuals with higher security and certainty under international law, when they invest or set up a business in other Countries Party to the agreement. Permitting foreign investors to settle disputes with the host Country through international arbitration is an important aspect in this context.[16]

In relation to the above mentioned, it is quite obvious that investors, in the process of carrying out their investing activities, are willing to cooperate with jurisdictions that offer the most stable conditions, both in legal and economic perspective.[17] However, in many cases such willingness turns into a hunt for just a better IIA. All of this gives a rise to such phenomenon as treaty shopping that can be materialized in various forms.

Over the course of many years, treaty shopping or so-called 'nationality planning' is an extremely debatable issue which is rather interpreted in the practice of international arbitral tribunals, than officially determined in any manner by certain national legislation. To that extent, Professor Schreuer recognized that:

> In principle, there is no reason why a prudent investor should not organize its investment in a way that affords maximum protection under existing treaties. It is neither illegal nor improper for an investor of one nationality to establish a new

[15] Christine Qiang, "Foreign direct investment and development: Insights from literature and ideas for research," The World Bank, 2015, accessed on 22 May 2019, https://blogs.worldbank.org/psd/foreign-direct-investment-and-development-insights-literature-and-ideas-research

[16] Julien Chaisse, *The Treaty Shopping Practice*, 260.

[17] *Aguas del Tunari, S.A. v. Republic of Bolivia*, ICSID Case No. ARB/02/3, Decision on Jurisdiction (21 October 2005), paras 330 and 332, accessed on 22 May 2019, https://www.italaw.com/cases/57

> entity in a jurisdiction perceived to provide a beneficial regulatory and legal environment, including the availability of an investment treaty. The establishment of companies so as to obtain benefits from domestic law and treaties is neither unethical nor illegal and is standard practice in international economic relations. Nationality planning has become as much a standard feature of diligent management as tax planning.[18]

These lead one to think about the real admissibility and legality of treaty shopping practice in the modern investment world.

In order to better understand what nationality planning is, as well as to analyse the concept and its main elements, the following part of the present research is established.

The first chapter mainly defines the very meaning of treaty shopping. Within its subchapters, the reasons for the occurrence and reaction of different countries towards treaty shopping expansion are considered. Hereinafter, in the second chapter, the most controversial elements of IIAs, that investors use to manipulate under the treaty shopping activity, are described. Correspondingly, each of the subchapters is devoted to a separate element.

[18] Christoph Schreuer, *Nationality Planning*, 4.

## 1.1 MEANING OF THE 'TREATY SHOPPING' CONCEPT IN INTERNATIONAL INVESTMENT LAW

Before giving any terminological configuration, it should be noted that at the present time there is no consensus about verbal expression for the activity that is considered to be a treaty shopping. As a point of law, treaty shopping is not in general prohibited under international investment law.[19] Different authors give different wordings, thereby naming similar situations like 'nationality planning', 'corporate structuring/restructuring' or 'treaty planning'. In certain circumstances, treaty shopping is also referred to as 'treaty abuse' or, more simply, abuse of granted investment rights. Basically, the choice of a suitable term depends on the attitude of a particular author to this phenomenon, however, everything goes to the fact that treaty shopping is perceived more as negative than a positive thing.[20]

Returning to the definition, it might be said that a generic term of treaty shopping is described by UNCTAD as a conduct of foreign investors who are intentionally looking for a 'home State of convenience' that has favourable investment treaty with the host State where their investments are or will be made.[21] In the context of the latter, two forms of the phenomenon under consideration must be specified.

The first one is the **'front-end'** of the investment. This is materialized by means of structuring, whereby a foreign investor plans its nationality properly in advance in order to acquire the benefits that come with a 'national status' of a Contracting State with a favorable IIA.[22] In such a case, it will be reasonably to talk about **nationality planning**.

The second form is more frequent one and describes the situation when an investor tries to restructure its business within other countries in order to gain more satisfactory investment protection under available IIAs. In most cases such restructuring is caused by intention to get an access to international dispute settlement mechanisms, especially when a dispute, concerning the investment in a host State, has arisen. The above-mentioned form is called **'back-end'** of the investment. In this particular case, **treaty shopping** is presented in the pure state. For the purposes of this study, both verbal expressions will be used simultaneously or interchangeably without specific reference to *ex ante* or *ex post* business structuring.

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[19] Chaisse, *The Treaty Shopping Practice*, 228.

[20] See more in Jorun Baumgartner, *Treaty Shopping in International Investment Law*, 7-8.

[21] UNCTAD, *Investor–State Disputes Arising from Investment Treaties: A Review. Series on International Investment Policies for Development* (New York and Geneva: United Nations Publication, 2005), 21–22, accessed on 22 April 2019, https://unctad.org/en/Docs/iteiit20054_en.pdf

[22] Matthew Skinner, Cameron A. Miles, Sam Luttrell, "Access and Advantage in Investor-State Arbitration: The Law and Practice of Treaty Shopping," Investment Claims, 2010, accessed on 22 April 2019, http://oxia.ouplaw.com/view/10.1093/law:iic/journal062.document.1/law-iic-journal062

Generally speaking, structuring and restructuring can be performed in a variety of ways, but the principal alternatives are direct or indirect engagements. For instance, any foreign investor can incorporate a subsidiary under the laws of target State. Hereupon, investor inserts this newly established subsidiary into already existing corporative network and transfers the control over the initial investments to that entity.[23] For the record, that founded undertaking can be nothing more than a dummy company without any precise economic activity, simply owning the investment.[24] Accordingly, the actual controlling party remains the same.

Another way to gain a preferable nationality is an acquisition of already in place enterprise, which is a national under the targeted IIA, and allocation of the investment through that company. Investors have resorted to the illustrated scenarios in ***Banro American Resources, Inc. and Société Aurifère du Kivu et du Maniema S.A.R.L. v. Democratic Republic of the Congo***[25] and in ***Philip Morris v Australia case*** [26] cases.

To sum up, the treaty shopping, as neither prohibited nor illegal phenomenon, is a common practice that investors all over the world use to get more attractive investment protection under IIAs in force. Regardless of the form, the activity of investors, one way or another, aims to alter the organizational structure of the business in the process of investing.

Before proceeding to more extensive analysis of the key elements that allow tomanoeuvre within the treaty shopping, it is necessary to clarify in following subchapters: (a) the reasons that contributed to the emergence of practice at issue, and (b) the reactions of different countries towards discussed phenomenon.

### 1.1.1 Reasons for the Occurrence of 'Treaty Shopping' Phenomenon

Despite the widespread recognition of treaty shopping in more recent times, at the very beginning of the 21st century, this concept was something new and incomprehensible. The emergence and expansion of the treaty shopping practice is directly proportional to the

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[23] Chieh Lee, "Resolving Nationality Planning Issue through the Application of the Doctrine of Piercing the Corporate Veil in International Investment Arbitration," *Contemporary Asia Arbitration Journal* 9, no. 1 (2016): 99, accessed on 22 April 2019, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2790669

[24] *Ibid*., 99–100. This happened in *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 2013), accessed on 22 May 2019, https://www.italaw.com/sites/default/files/case-documents/italaw1277.pdf

[25] *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), accessed on 22 May 2019, https://www.italaw.com/cases/documents/3457

[26] *Philip Morris v Australia*, PCA Case No. 2012-12.

internationalization of investment, which includes a number of vital factors. They can be identified as follows:

(i) the quantitative increase of the IIA network,

(ii) the popularization of investor-state dispute resolution mechanisms, and

(iii) the simplicity of business incorporation among the majority of countries.

In the process of analysing the first factor, it should be noted that, at the first set-out, FDI were fully governed by national rules and principles. In this way countries wanted to ensure the prospective benefits of FDI and to avoid the possible related costs.[27] Quite apart from the fact that the first investment treaty was signed in 1959 between the Federal Republic of Germany and Pakistan[28], only in 1980-90s the situation with regard to the foreign investing activities changed a little bit. Since that period of time, states have begun to express their consent to investor-state dispute settlement mechanisms in IIAs.[29] In turn, this gave a rise to a proliferation of IIAs around the world. Consequently, at the end of 2017, according to UNCTAD, there were 3322 IIAs (2946 BITs and 376 TIPs), 2638 of which were in force.[30] Very often such a complex network of investment treaties is called a 'Spaghetti Bowl'[31]. This issue was firstly debated by Jagdish Bhagwati in 1995, and now it is defined as a practical tool for treaty shopping manipulations (Scheme 1. Illustration of Spaghetti Bowl)[32].

[27] Chaisse, *The Treaty Shopping Practice*, 230-232.

[28] "Germany-Pakistan BIT (1959)," Investment Policy Hub: International Investment Agreements Navigator, accessed on 22 April 2019, https://investmentpolicyhubold.unctad.org/Download/TreatyFile/1387

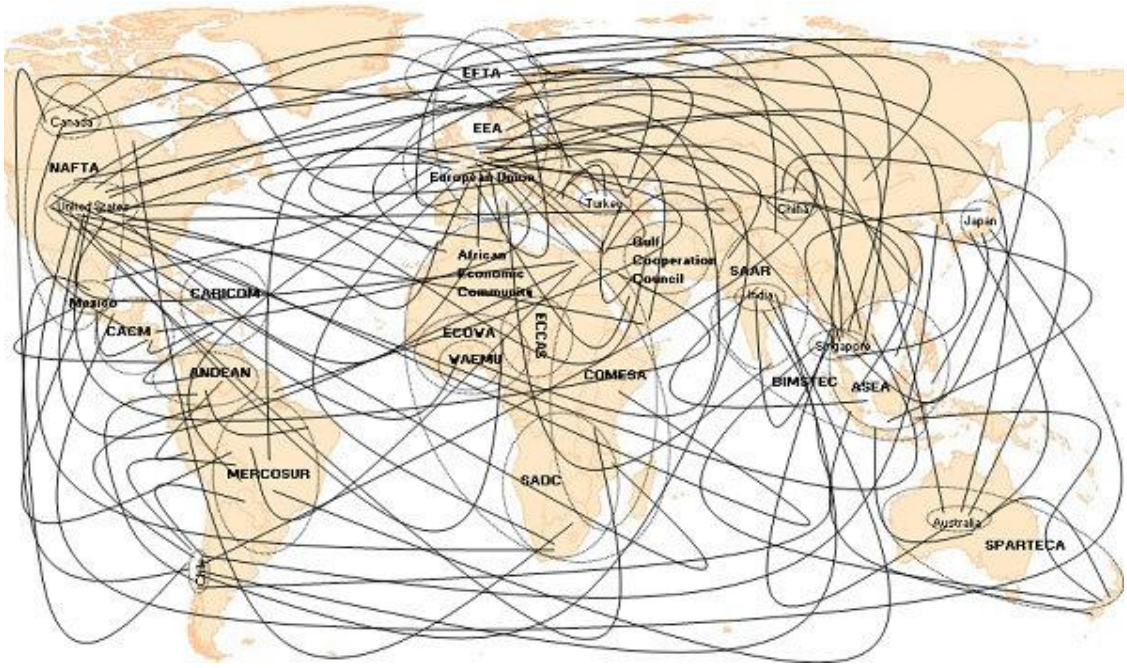
[29] Andrew Newcombe and Luis Paradell, "Historical Development of Investment Treaty Law" in *Law And Practice Of Investment Treaties: Standards Of Treatment* (The Netherlands: Kluwer Law International, 2009), 42-44, accessed on 22 April 2019, https://www.italaw.com/documents/NewcombeandParadellLawandPracticeofInvestmentTreaties-Chapter1.pdf

[30] UNCTAD, "Recent developments in the international investment regime," *IIA Issue Note*, no. 1, (May 2018): 2.

[31] Jagdish Bhagwati, "US Trade Policy: The Infatuation with FTAs," *Discussion Paper* Series, no. 726 (April 1995): 1-23, accessed on 22 April 2019, https://academiccommons.columbia.edu/doi/10.7916/D8CN7BFM

[32] Scheme 1. Illustration of Spaghetti Bowl – extract from UNCTAD, *Investment Provisions in Economic Integration Agreements* (New York and Geneva: United Nations Publication, 2006), 10, accessed on 22 April 2019, https://unctad.org/en/Docs/iteiit200510_en.pdf

Scheme 1. Illustration of Spaghetti Bowl




Source: Investment Provisions in Economic Integration Agreements (UNCTAD)

For the sake of argument, as many IIAs are in force at the present time, as many opportunities for treaty shopping exist. Despite this particular statement, it is also important to say that the content of most IIAs is roughly the same.[33] The main differences can be found in the formulation of the definitions 'investor' and 'investment', as well as variations in the choice of qualified dispute resolution mechanisms. Among other things, all of this makes it possible to form different levels of investment protection with a different set of granted rights. Since the investing is a long-term and resource-consuming business, it is very reasonable that investors want to protect their inputs in the best possible way.[34] In this respect, a wide network of IIAs with numerous sets of conditions can help them.

With regard to the second factor, it is worth starting with the thought that the occurrence of the treaty shopping practice was also expanded by the inclusion of ISDS clauses in IIAs. Historically, international investment disputes were resolved by supranational arbitral tribunals in different forms: state-state arbitration with mutual consent after the accrual of dispute, investor-state arbitration under investor-state agreement, and investor-state arbitration under BITs.[35]

[33] Malcolm Shaw, *International Law, Seventh Edition* (Cambridge, England: Cambridge University Press, 2014), 609.

[34] Rudolf Dolzer and Christoph Schreuer, *Principles of International Investment Law, Second Edition* (Oxford, England: Oxford University Press, 2012), 3.

[35]Ahmad Ghouri, "The Evolution of Bilateral Investment Treaties, Investment Treaty Arbitration and International Investment Law," *International Arbitration Law Review* 14, no. 6 (December 2011): 196-198, accessed on 22 April 2019, https://ssrn.com/abstract=1970561

The first BIT (bilateral investment treaty) that explicitly contains provisions for investor-state arbitration (with qualifications) was concluded in 1968 between the Kingdom of the Netherlands (hereafter referred to as the Netherlands) and the Republic of Indonesia[36]. A year later, the International Centre for Settlement of Investment Disputes (hereafter deferred to as ICSID issued Model Clauses Relating to the Convention on Settlement of Investment Disputes Designed for Use of Bilateral Investment Treaties[37]. That same 1969 year, the Italian Republic and the Republic of Chad signed the BIT[38] providing the investor-state arbitration with unqualified state consent. These particular investment treaties laid the foundation of modern BIT-practice and combined essential investment promotion with binding investor-state arbitration to eliminate the apparent breaches of prescribed obligations.[39]

The popularization of investor-state arbitration substantially changed the reality of investment protection. In light of this, investors got an opportunity to take legal steps against the host States in cases where their rights are violated.[40] Such a self-sufficient right to initiate arbitral proceedings puts foreign investors in an independent position, wherein they can bring claims in a specific forum and under precise treaty framework which are more beneficial.[41] As can be seen from the above, the inclusion of ISDS clauses in investment treaties gives another reason for investors to practice treaty shopping.

Also, the situation does not look really unambiguously due to initiatives from the European Union (hereafter referred to as the EU). In March 2018 the Court of Justice of the European Union (hereafter referred to as the CJEU) in ***Achmea v. Slovakia case*** ruled that incorporation of arbitration clauses into intra-EU BITs is not compatible with the EU law.[42] The judiciary board of CJEU believes that such provisions remove disputes concerning the interpretation and/or application of EU law from the mechanism of judicial supervision provided

[36] "Indonesia-Netherlands BIT (1968)," Investment Policy Hub: International Investment Agreements Navigator, accessed on 22 April 2019, https://investmentpolicyhub.unctad.org/IIA/mappedContent/treaty/1987

[37] "Model Clauses Relating to the Convention on the Settlement of Investment Disputes Designed for Use in Bilateral Investment Agreements," ICSID, accessed on 22 April 2019, http://icsidfiles.worldbank.org/icsid/icsid/staticfiles/model-clauses-en/main-eng.htm

[38] "Chad-Italy BIT (1969)," Investment Policy Hub: International Investment Agreements Navigator, accessed on 22 April 2019, https://investmentpolicyhub.unctad.org/IIA/mappedContent/treaty/826

[39] Andrew Newcombe, *Historical Development of Investment Treaty Law*, 45.

[40] Zachary Douglas, *The International Law of Investment Claims* (Cambridge, England: Cambridge University Press, 2009), rules 1 and 2.

[41] Baumgartner, *Treaty Shopping in International Investment Law*, 27.

[42] *Achmea B.V. v. The Slovak Republic*, UNCITRAL, PCA Case No. 2008-13 (formerly Eureko B.V. v. The Slovak Republic), Judgment of the Grand Chamber of the European Court of Justice (6 March 2018), accessed on 22 April 2019, https://www.italaw.com/sites/default/files/case-documents/italaw9548_0.pdf

for by the EU legal order.[43] Based on this decision, it can be assumed that in the near future any European investor will be forced to structure its corporate organization chart in such a way that it includes an enterprise in country that is not EU Member-State. Such a scenario is appropriate to the situation whereas mentioned investor wants to invest within the territory of the EU. This turn of events adds one more reason for the expansion of rational nationality planning and/or treaty shopping.

The third factor of the treaty shopping occurrence in international investment paradigm is the relative simplicity of business incorporation among the majority of states. All too often, due to the broad wording of 'investor' definition in many jurisdictions, it is sufficient to merely incorporate legal entity with intent to obtain legal personality and corporate nationality, as a consequence. Such business chain is usually simple to establish and, where necessary, insets into functioning corporate body in order to optimize the investment protection on the odd chance that the existing investment climate in host Sate will be changed.

At the present day, investments in the form of shareholdings are extremely transferable, which makes it possible to allocate without effort a desired amount of shares to a company with a 'required nationality'.[44] As a result, overseas investors are capable to quickly response to plurality of changes in the host State's investment environment, needless to say, by means of treaty shopping manoeuvres.

Come to a conclusion, the existence of factors mentioned in this subchapter, separately or in combination, in the investment regime of a particular jurisdiction gives rise to the emergence and expansion of nationality planning or treaty shopping practice that satisfy investor's goals in the best possible way. But to determine only the causes is not sufficient, it is also necessary to clarify the attitudes of various states towards availability of treaty shopping activities.

[43] «The CJEU judgment is likely to send a shockwave through the ranks of proponents of investment treaty arbitration and large parts of the wider arbitration community. At the same time, one can see the judgment as the next step in the evolution of a trend marked by years of opposition by the European Commission against investor-state arbitration under existing intra-EU BITs, its relentless efforts to push several EU Member States to terminate their intra-EU BITs and the recent public backlash against ISDS more generally. As such, the CJEU's decision may need to be read within the political context in which it is rendered». See Clément Fouchard and Marc Krestin (Linklaters), "The Judgment of the CJEU in Slovak Republic v Achmea – A Loud Clap of Thunder on the Intra-EU BIT Sky!" Kluwer Arbitration Blog, 2018, accessed on 22 April 2019, http://arbitrationblog.kluwerarbitration.com/2018/03/07/the-judgment-of-the-cjeu-in-slovak-republic-v-achmea/

[44] Baumgartner, *Treaty Shopping in International Investment Law*, 32.

### 1.1.2 Reaction of the Investment World Towards Treaty Shopping Expansion

As has been already noted, it is not enough just to define the reasons for the occurrence of treaty shopping. It is also important to analyse the consequences of that kind of practice. Now the point at issue is not to consider the consequences for selected participants, namely investors or Contracting States, but there is a question of general attitudes that prevail in the investment world in relation to the above-mentioned phenomenon.

It is worth starting with the fact that usually treaty shopping is criticized by countries that are vulnerable recipients of investment claims that appear after several restructurings carried out by investors in order to obtain better treaty protection. And that is quite reasonable and obvious. For this very reason, a number of real-life examples of states' reactions will be demonstrated below.

The first example describes the situation when countries terminate BITs in response to the threat of undesirable investment arbitration proceedings. Coming back in 2008, the Venezuelan government gave a notice to the Netherlands of its intentions to terminate BIT[45] between these two states. It was done due to the fact that indicated treaty was incompatible with the national policy. But in truth, the motives were completely different, namely because of the point that numerous energy companies, like Exxon Mobil, Conoco Phillips or Eni SpA, have attempted to use the Dutch – Venezuela BIT for the purpose of commencing the ICC-arbitrations vis-a-vis the Bolivarian Republic of Venezuela.[46] Following this, few other countries expressed their desire to denounce BITs with the Netherlands: the Plurinational State of Bolivia in 2009[47], the Republic of South Africa in 2014[48], the Republic of Indonesia in 2015[49], and not that long ago the Republic of India in 2016[50].

It has happened because the largest BIT network with one of the most attractive foreign investment policies is concentrated in the Netherlands. That very network includes around 150

[45] "Dutch-Venezuela BIT (1991)," Investment Policy Hub: International Investment Agreements Navigator, accessed on 22 April 2019, https://investmentpolicyhub.unctad.org/IIA/mostRecent/treaty/2668

[46] PLC Dispute Resolution, "Venezuela gives notice to terminate Netherlands' BIT," Thomson Reuters, Practical Law, 2008, accessed on 22 April 2019, https://uk.practicallaw.thomsonreuters.com/9-381-7749?transitionType=Default&contextData=(sc.Default)&firstPage=true&comp=pluk&bhcp=1

[47] "Dutch-Bolivia BIT (1992)," Investment Policy Hub: International Investment Agreements Navigator, accessed on 22 April 2019, https://investmentpolicyhub.unctad.org/IIA/mappedContent/treaty/587

[48] "Dutch-South Africa (1995)," Investment Policy Hub: International Investment Agreements Navigator, accessed on 22 April 2019, https://investmentpolicyhub.unctad.org/IIA/country/148/treaty/2652

[49] "Dutch-Indonesia (1994)," Investment Policy Hub: International Investment Agreements Navigator, accessed on 22 April 2019, https://investmentpolicyhub.unctad.org/IIA/country/148/treaty/1988

[50] "Dutch-India (1995)," Investment Policy Hub: International Investment Agreements Navigator, accessed on 22 April 2019, https://investmentpolicyhub.unctad.org/IIA/country/148/treaty/1940

IIAs and 31 investment related instruments in force, as of April 2019.[51] In addition, Dutch 'investment heaven' is also advantageous by virtue of the investor-friendly BIT standard that encompasses an extensive wording of 'investor' and 'investment' definitions, and ISDS clauses. Based on research done by Roos van Os[52] it can be said that:

(i) the Dutch model of investment treaties identifies indirectly controlled foreign investors as 'national' one;

(ii) the term 'investment' overcomes the non-exhaustive list of every kind of asset, ranging from 'property' to 'good will';

(iii) the ISDS clause does not contain obligations to exhaust all national remedies before addressing to international arbitral tribunals.

Summarizing all of the above, it is not surprising that the Netherlands is especially eligible country for foreign investors in terms of nationality planning and treaty shopping practice.

The second example outlines the situation when states remove arbitration clauses from their IIAs. This trend is relatively new and was originated in 2011, in a greater degree, by the Australian government. Its Trade Policy Statement of that time implied that the Commonwealth of Australia will no longer agree to ISDS provisions in its future IIAs.[53] This solution was caused by already specified ***Philip Morris v Australia case***, which will be considered in more details in the second part of this paper.

Subsequently, in 2012 and 2014 Australia signed trade and economic agreements without ISDS clauses with Malaysia[54] and Japan[55] accordingly. And most recently, in May 2016, the Australian government agreed on changes in dispute settlement mechanisms (including an

[51] UNCTAD, "International Investment Agreements Navigator," Investment Policy Hub, accessed on 22 April 2019, https://investmentpolicyhub.unctad.org

[52] Roos Van Os, "Dutch Investment Treaties: Socialising Losses, Privatising Gains" in *Rethinking Bilateral Investment Treaties: Critical Issues and Policy Choices*, Singh Kavaljit and Ilge Burghard (Both ENDS, Madhyam and SOMO, 2016), 174-176.

[53] Kyla Tienhaara and Patricia Ranald, "Australia's rejection of Investor-State Dispute Settlement: Four potential contributing factors," Investment Treaty News, 2011, accessed on 22 April 2019, https://www.iisd.org/itn/2011/07/12/australias-rejection-of-investor-state-dispute-settlement-four-potential-contributing-factors/

[54] "Australia-Malaysia FTA (2012)," Australian Government, Department of Foreign affairs and Trade, accessed on 22 April 2019, https://dfat.gov.au/trade/agreements/in-force/mafta/Pages/malaysia-australia-fta.aspx

[55] "Australia-Japan EPA (2014)," Australian Government, Department of Foreign affairs and Trade, accessed on 22 April 2019, https://dfat.gov.au/trade/agreements/in-force/jaepa/pages/japan-australia-economic-partnership-agreement.aspx

expulsion from ISDS for tobacco control measures) with the Republic of Singapore in the Singapore – Australia Free Trade Agreement (2003).[56]

Broadly speaking, Australian-like behaviour is largely provoked by the extremely growing amount of investment complaints based on the remedies granted to overseas investors against the host States. Despite its noble purpose to easily settle investment disputes, ISDS mechanisms brought on a negative response from a significant number of countries. It is of importance to note that such behaviour is not merely an evidence of treaty shopping *per se*, but is an indication of a global investment regime that needs to be reformed.

Rejection of ISDS provisions is not the only thing resorted to by different countries. In that way, more radical measures were taken by Latin American nations. Some of them have expressed a monumental desire to withdraw from the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (hereafter referred to as ICSID Convention)[57]. This legal act was adopted for the purpose of encouraging the cross-border investing activities in developing countries by providing efficient tools for contractual rights enforcement. Article 71 of the ICSID Convention stipulates the possibility that «any Contracting State may denounce this Convention by written notice to the depositary of this Convention»[58], which the Plurinational State of Bolivia took an advantage of in 2007 for the first time. Later on, the Republic of Ecuador (in 2009) and the Bolivarian Republic of Venezuela (in 2012) took the same decisions.[59]

It seems reasonable to conjecture that the main motive for such tendencies is that for many years Latin American states have ranked the highest 27% rate of all cases handled by the ICSID.[60] According to the statistics given by Evo Morales (the President of Bolivia), 230 ICSID-cases out of 232 have been rendered by ICSID in favour of foreign investors, whereas according to Venezuela's Foreign Ministry «ICSID has ruled 232 times in favour of transnational interests out of the 234 cases filed throughout its history» (January, 2012).[61]

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[56] UNCTAD, *UNCTAD's Reform Package for the International Investment Regime, 2018 Edition* (New York and Geneva: United Nations Publication, 2018), 80.

[57] "ICSID Convention," ICSID, World Bank Group, accessed on 22 April 2019, https://icsid.worldbank.org/en/Documents/resources/2006%20CRR_English-final.pdf

[58] *Ibid*., 32.

[59] Christoph Schreuer, "Denunciation of the ICSID Convention and Consent to Arbitration," in *The Backlash against Investment Arbitration: Perceptions and Reality*, Michael Waibel, Asha Kaushal, Kyo-Hwa Liz Chung, and Claire Balchin (Kluwer Law International, 2010), 354.

[60] Vanessa Giraud, "Is Investment Arbitration in Latin America in Crisis?" Kluwer Arbitration Blog, 2014, accessed on 22 April 2019, http://arbitrationblog.kluwerarbitration.com/2014/05/19/is-investment-arbitration-in-latin-america-in-crisis/?_ga=2.110020677.194067409.1551795682-1522809653.1547465977

[61] *Ibid*.

Consequently, actions highlighted in the previous paragraphs confirm once again the debatable nature of the current investment regime that needs a lot of changes.

Finally, the third example underlines the situation that is simultaneously the cause and effect of what has already been described. This is UNCTAD's Reform Package for the International Investment Regime (hereafter referred to as the Reform Package), which includes a multiplicity of policy options, namely the Investment Policy Framework for Sustainable Development (WIR 2012), the Road Map for IIA Reform (WIR 2015), the 10 Options for Phase 2 of IIA Reform (WIR 2017) and the guidance for Phase 3 of IIA Reform (WIR 2018).[62] The Reform Package presents a comprehensive tool for the consistent and sustainable development-oriented reformation of the current investment regime.

The initiatives under above-stated framework enclose lessons from the 60-year-old existence of the worldwide IIAs network and generate directions for further development. The Reform Package efficiently systematizes actions and methods that are already diligently used by many states (i.e. replacing old IIAs with new ones, amending the controversial provisions of investment treaties), and also defines the basis for future challenges that need to be overcome (i.e. updating investment regulation at the multinational level, changing the system of arbitration institutions etc).

Taking all the aforesaid into consideration, as of spring 2019, the retention of nationality planning and treaty shopping practice provokes many oppositions from a number of countries. This reflects into the adoption of quite a bit radical measures by several national authorities and policymakers. However, the beginning of a global investment reform suggests that alternative action patterns in this area do exist.

[62] UNCTAD, *Reform Package*, foreford page 4.

## 1.2 ELEMENTS OF MANIPULATION IN TREATY SHOPPING

The most crucial and controversial points in any investment regulatory instrument are definitions of investor and investment. These categories, to a greater extent, define the scope of applicable rights and obligations in investment treaties and facilitate the establishment of the jurisdiction of arbitral tribunals, especially in case of investor-state dispute (i.e. all those issues that are essential for a potential treaty shopper).

Among other things, aforementioned terms determine the sphere of interests of each Party to the investment process. For example, from the standpoint of a capital exporting state, discussed definitions recognize the group of investors whose foreign investments are seeking to be protected under particular investment treaty. From the capital importing country's point of view, it ascertains the desirable investor group and type of investment. And from the investor's perspective, it identifies the way in which the investment can be structured in order to obtain better investment protection.[63]

The present chapter will further outline the available legal wordings and interpretations of 'investor' and 'investment' terms. In the first place it will refer to criteria which IIAs encompass for the purposes of qualifying the corporate nationality of investor. Hereinafter, it will address the definition of investment and conditions for its legality under specific national legal orders. In relation to the both aspects the case law will be also analysed.

### 1.2.1 Definition of 'Investor' in IIAs

It so happened that nowadays businesses operate within complex corporate structures that do not allow easily determination of corporate nationality in each individual case. This is facilitated by numerous methods such as: layering of shareholders (natural and legal persons), registering and operating from and in different states, establishing long chain of subsidiaries, joining to multinational holdings and consolidated groups etc. Aadditionally, there is no single definition of investor agreed by all nations, instead, it is common to place a certain set of criteria, to which the subject must conform in order to be considered as an investor. For this very reason, in the event of investor-state disputes, arbitration tribunals apply various so-called 'nationality tests' which can be extracted from the texts of IIAs *per se*.

Keeping in mind the huge amount of currently effective IIAs around the world (Spaghetti Bowl)[64], it would be reasonable to say that the number of nationality tests corresponds

[63] OECD, *International Investment Law: Understanding Concepts and Tracking: A Companion Volume to International Investment Perspectives* (OECD Publishing, 2008), 9.
[64] See footnote 31.

to the number of IIAs in force. However, in accordance with the comprehensive research performed by the Organisation for Economic Cooperation and Development (hereafter referred to as the OECD), among all potential scenarios of determining the nationality of juridical person the next indicators have a prime importance:

- the place of constitution in accordance with the law in force in the country,
- the place of incorporation (registered office),
- the place of administration (company seat), and
- the place of control.[65]

The presented classification does not preclude the possibility of combining any of the indicators.

In the first scenario the nationality test includes the only requirement that corporate entity should be **constituted in accordance with the law**. Such formula in IIAs provides a reference to national regulatory instruments of each Contracting Party. It is important to emphasize that on the same lines particular provisions of each national order may prescribe any of the before proposed criteria (i.e. registered office, seat or control).[66] Making an example, United States of America – Uruguay BIT (2005) stipulates in Article 1 that «enterprise 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».[67]

Another example, the Energy Charter Treaty in Article 1(7)(a)(ii) defines investor «with respect to a Contracting Party […] as a company or other organization organized in accordance with the law applicable in that Contracting Party». This is slightly qualified by Article 17 where the company's substantive connection with the State of incorporation is indicated.[68]

In the second scenario the main element in the process of determining the corporate nationality is **the location of registered office**. The last one is commonly coupled with previously examined indicator. In the text of investment treaty it looks like Article 1(d)(i) of Croatia – United Kingdom BIT (1997), specifying that «companies means: (i) in respect of the United Kingdom: corporations, firms and associations incorporated or constituted under the law in force in any part of the United Kingdom or in any territory to which this Agreement is extended […]».[69]

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[65] OECD, *International Investment Law*, 19.

[66] *Ibid*.

[67] "United States of America-Uruguay BIT (2005)," Investment Policy Hub: International Investment Agreements Navigator, accessed on 22 April 2019, https://investmentpolicyhub.unctad.org/Download/TreatyFile/2380

[68] "The Energy Charter Treaty and Related Documents," International Energy Charter, accessed on 22 April 2019, http://www.ena.lt/pdfai/Treaty.pdf

[69] "Croatia-United Kingdom BIT (1997)," Investment Policy Hub: International Investment Agreements Navigator, accessed on 22 April 2019, https://investmentpolicyhub.unctad.org/Download/TreatyFile/896

With respect to case law, it will be observed ***Tokios Tokelés v. Ukraine case***[70], when the arbitral tribunal very formally interpreted nationality test agreed upon Contracting Parties under Lithuania – Ukraine BIT (1994)[71] and the ICSID Convention. The Tribunal recognized the Claimant (Tokios Tokelés – company incorporated in Lithuania and controlled by 99% of the Ukrainian nationals) as a genuine investor under the Article 2 of Lithuania – Ukraine BIT, according to which «investor means […] any entity established in the territory of the Republic of Lithuania in conformity with its laws and regulations».[72] However, the Respondent requested to 'pierce the corporate veil', but in relation to decision of International Court of Justice rendered in ***Barcelona Traction case***, the Tribunal confirmed that Claimant's actions were not evidenced by signs of 'fraud' or 'abuse', for this reason the named doctrine cannot be applied.[73] Specifically in these circumstances the issue of the application of 'abuse of rights' doctrine was raised.[74]

The key element in the third scenario is **the place of effective management** or as it is called 'company seat'. In practice, IIA with this kind of provision provide for the opportunity to merely relocate the head office, from which the economic activity of the company is managed, in the territory of another country. To illustrate, Article 1(3)(a) of Germany – Oman BIT (2007) prescribe that «the term 'investor' means 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 […]».[75]As another example, in Article 1(2) of Dominican Republic – Italy BIT (2006) investor defines as «any natural or legal person of a Contracting Party investing in the territory of the other Contracting Party […]».[76] In that case the term 'legal person' means «any entity having its head office in the territory of one of the Contracting Parties and recognized by it […]».[77]

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[70] *Tokios Tokelés v. Ukraine*, ICSID Case No. ARB/02/18, Decision on Jurisdiction (29 April 2004), accessed on 22 April 2019 https://www.italaw.com/sites/default/files/case-documents/ita0863.pdf

[71] "Lithuania-Ukraine BIT (1994)," Investment Policy Hub: International Investment Agreements Navigator, accessed on 22 April 2019, https://investmentpolicyhub.unctad.org/IIA/country/219/treaty/2432

[72] The Tribunal also emphasized that «The Treaty contains no additional requirements for an entity to qualify as an "investor" of Lithuania […] and […] it is not for tribunals to impose limits on the scope of BITs not found in the text». See *Tokios Tokelés* v. *Ukraine*, paras 28 and 36.

[73] The Tribunal noted that «the veil is lifted, for instance, to prevent the misuse of the privileges of legal personality, as in certain cases of fraud or malfeasance, to protect third persons such as a creditor or purchaser, or to prevent the evasion of legal requirements or of obligations». See *Barcelona Traction, Light and Power Co., Ltd. (Belg. v. Spain)*, 1970 I.C.J. 3 (Feb. 5), para 58, (cited from *Tokios Tokelés* v. *Ukraine*, para 54).

[74] The 'abuse of rights' doctrine will be further analysed in the present research.

[75] "Germany-Oman BIT (2007)," Investment Policy Hub: International Investment Agreements Navigator, accessed on 22 April 2019, https://investmentpolicyhub.unctad.org/Download/TreatyFile/1383

[76] "Dominican Republic-Italy BIT (2006)," Investment Policy Hub: International Investment Agreements Navigator, accessed on 22 April 2019, https://investmentpolicyhub.unctad.org/Download/TreatyFile/3194

[77] *Ibid*., Article 1(4).

As an alternative, in Article 1(4) of Philippines – United Kingdom BIT (1980)[78] a special qualification is given to the company definition. This implies that the company should not only be incorporated or constituted under the laws in force of the Contracting Party, but actually doing business in a place of effective management location.

Taking into account the case law, the following decision of the ICSID tribunal in ***Yaung Chi Oo Trading Pte Ltd v. Government of the Union of Myanmar case***[79] shall be mentioned. *In casu*, Article 1(2) of ASEAN Agreement for the Promotion and Protection of Investments (i.e. the IIA at issue)[80] contained a condition of effective management place with regard to the term 'company'. According to the Tribunal, this was largely included with intent «to avoid what has been referred to as 'protection shopping'; i.e. the adoption of a local corporate form without any real economic connection in order to bring a foreign entity or investment within the scope of treaty protection».[81] In such a manner, the arbitral tribunal explicitly pointed out the causal link between the element in the nationality test, which is directly contained in the text of the agreement, and the potential practice of treaty shopping.

Lastly, the central indicator in the fourth scenario is **the place of control**, although, this approach is rarely used in IIAs. Nevertheless, a logical question arises: what is commonly understood by the word 'control'? The answer can be found in clauses of certain regulatory instruments. For instance, Article 1(b)(ii) and (iii) of Armenia – Netherlands BIT (2005) treat as investors «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 natural persons as defined in (i) or by legal persons as defined in (ii)».[82]

It is possible to find a completely different wording, by way of illustration, in Article 1 of Ethiopia – Switzerland BIT (1998). In that treaty Contracting States agreed to recognize legal entity as an investor while:

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[78] "Philippines-United Kingdom BIT (1980)," Investment Policy Hub: International Investment Agreements Navigator, accessed on 22 April 2019, https://investmentpolicyhub.unctad.org/Download/TreatyFile/2178, (cited from OECD, *International Investment Law*, 24).

[79] *Yaung Chi Oo Trading Pte. Ltd. v. Government of the Union of Myanmar*, ASEAN I.D. ICSID Case No. ARB/01/1, Award (31 March 2003), accessed on 22 April 2019, https://www.italaw.com/sites/default/files/case-documents/ita0909.pdf

[80] "ASEAN Investment Agreement (1987)," Investment Policy Hub: International Investment Agreements Navigator, accessed on 22 April 2019, https://investmentpolicyhubold.unctad.org/Download/TreatyFile/5554. Replaced by ASEAN Comprehensive Investment Agreement (2009).

[81] *Yaung Chi Oo Trading Pte. Ltd. v. Government of the Union of Myanmar*, para 52.

[82] "Armenia-Netherlands BIT (2005)," Investment Policy Hub: International Investment Agreements Navigator, accessed on 22 April 2019, https://investmentpolicyhub.unctad.org/Download/TreatyFile/140

a) it is constituted under the law of a particular Contracting State and is engaged in substantive economic activity within its territory;

b) it is not established under the law of a particular Contracting State, but more than 50 percent of its equity interest is beneficially owned by persons of a particular Contracting State, or those persons have the power to name a majority of its directors or otherwise legally direct its actions.[83]

Case law on control matters stands on the position of a broad interpretation. The Tribunal in ***Thunderbird v. Mexico case***[84] emphasized that «control can also be achieved by the power to effectively decide and implement the key decisions of the business activity of an enterprise and, under certain circumstances, control can be achieved by the existence of one or more factors such as technology, access to supplies, access to markets, access to capital, know how, and authoritative reputation».[85]

In another situation, ***Sedelmayer v. Russia case***[86], the arbitral tribunal has interpreted the notion of investor in a broad manner and recognized Mr. Sedelmayer[87] as a *de facto* investor. Concerning the meaning of 'control theory' the Tribunal found that «[…] the mere fact that the Treaty is silent on the point now discussed should not be interpreted so that Mr. Sedelmayer cannot be regarded as a de facto investor».[88] However, in its Dissenting Opinion, Professor S. Zykin (arbitrator in mentioned case) ascertained that «the claimant could have made investments personally or through a German company, but instead he preferred to act, as explained, for tax reasons through a company of a third state».[89] In such a way, the arbitrator doubted that German – Russia BIT (1989) was signed with the object to protect such kind of investment.

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[83] "Ethiopia-Switzerland BIT (1998)," Investment Policy Hub: International Investment Agreements Navigator, accessed on 22 April 2019, https://investmentpolicyhub.unctad.org/Download/TreatyFile/4813

[84] *International Thunderbird Gaming Corporation v. The United Mexican States*, Ad Hoc Tribunal (UNCITRAL), Award (26 January 2006), accessed on 22 April 2019, https://www.iisd.org/pdf/2006/itn_award.pdf

[85] «Ownership and legal control may assure that the owner or legally controlling party has the ultimate right to determine key decisions», *ibid.*, para 108.

[86] *Franz Sedelmayer v. The Russian Federation*, Ad Hoc Tribunal (SCC), Award (7 July 1998), accessed on 22 April 2019, https://www.italaw.com/sites/default/files/case-documents/ita0757.pdf

[87] Mr.Sedelmayer, a German national, was the sole owner and CEO of SGC International incorporated in Missouri, USA. He made an investment in Russia Federation in the area of enforcement equipment. For the purpose of initiating an arbitration procedure in a dispute arose from investment activity, he used the German-Russia BIT (1989), since the US-Russia BIT was not in force. See OECD, *International Investment Law*, 27.

[88] *Ibid.*, 28.

[89] *Ibid.*, footnote 68.

Finally, in ***Lanco v. Argentina case***[90] a broad interpretation method was also applied, and the presence of 18,3% shareholding was a *quantum satis* for the Tribunal to definitely recognize a minority shareholder's right to asset claims under Argentina – United States of America BIT (1991)[91]. According to the findings of the Tribunal, BIT at issue was silent on any 'capital stock' or other control requirements in order to qualify a company as investor for the purposes of the treaty.[92] Therefore, nothing prevented the arbitrators from reaching a different decision.[93]

Concluding this subchapter, the following should be said. Currently, there is no single definition of investor, and this allows countries to formulate several criteria for determining corporate nationality. As the above analysis shows, all these criteria can be classified into 4 groups depending on the place of establishment of the company or its substantial business activity. In most cases, Contracting Parties prefer to combine two or more nationality indicators in their investment agreements. The most common approach is a combination of the place of incorporation and company seat, or the combination of incorporation and control location.

By consolidating the number of indicators into a single 'investor model', countries are trying to prevent the unfair use of protection provided for by the provisions of IIAs ***(Yaung Chi Oo Trading Pte Ltd v. Government of the Union of Myanmar case)***. However, the practice of interpretation of corporate nationality tests by international tribunals is quite ambiguous and varies depending on the case circumstances. Consequently, in certain situations arbitrators interpret the text of the investment treaty too broadly by virtue of principle *ubi jus incertum, ibi nullum*[94] ***(Lanco v. Argentina and Sedelmayer v. Russia cases)***. In another context, they render a decision strictly in accordance with the text agreed by the Parties ***(Tokios Tokelés v. Ukraine case)***. All of that introduces some kind of uncertainty in the predictability of arbitral awards.

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[90] *Lanco International Inc. v. Argentine Republic*, ICSID Case No. ARB/97/6, Jurisdiction of the Arbitral Tribunal (8 December 1998), accessed on 22 April 2019, https://www.italaw.com/sites/default/files/case-documents/ita0450_0.pdf

[91] "Argentina-United States of America BIT (1991)," Investment Policy Hub: International Investment Agreements Navigator, accessed on 22 April 2019, https://investmentpolicyhub.unctad.org/Download/TreatyFile/127

[92] *Lanco v. Argentina case*, para10.

[93] The tribunal further noted *inter alia* that Lanco was liable for all contractual obligations «to the extent of its equity share» and concluded that Lanco was a party to the Agreement «in its own name and right». See *ibid*., paras 12 and 14, (cited from Katia Yannaca-Small, *Arbitration Under International Investment Agreements: A Guide to the Key Issues* (Oxford, England: Oxford University Press, 2010), 237).

[94] Definition: Where the law is uncertain, there is no law. See "Black's Law Dictionary: 2nd Edition (1910)," Open Jurist, accessed on 22 April 2019, https://openjurist.org/law-dictionary/ubi-jus-incertum-ibi-jus-nullum.

### 1.2.2 Definition of 'Investment' in IIAs

For the purpose of making an investment, it is not enough just to meet the 'investor' criteria imposed by a particular host State. It is also important to understand what features a specific country puts forward to the concept of investment, as an integral part of the investing activities. The analysis in this subchapter should be started with the notion that among the existing regulatory instruments in international investment law there is no single approach to the wording of investment. This is largely due to the fact that different nations pursue different investment objectives and goals, concluding one or another IIA. As was already mentioned, each capital importing country prefers a certain type of investment, taking into account the level of the country's economy, its political system, as well as concentration of natural resources, level of development, availability of new technologies etc.

It should be emphasized that at different times investments were categorised as 'foreign property'[95], portfolio (passive) or direct investments (FDI). At the beginning of the 20th century, the main form of foreign inputs was a portfolio investment (stocks, government bonds, corporate bonds, treasury bills etc). However, after the Second World War[96] the concept of portfolio investment in developing countries had collapsed and the rising extension of multinational corporations with direct forms of investment came to the fore.[97] These days, the concept of investment in international investment law includes a wide range of assets, thereby explaining the appearance of quite a bit broad definitions in IIAs, which are highly adorable for treaty shoppers.

According to the UNCTAD's research on trends in investment rulemaking (2007)[98], several kinds of 'investment' definitions can be demonstrated. All of them are divided into four groups with:

(i) 'asset-based' approach,

(ii) 'circular' or 'tautological' approach,

(iii) 'closed-list' approach, and

(iv) 'exclusion' approach.

The first one is commonly used approach and refers to those investment agreements, wherein the scope of 'investment' definition goes beyond covering only FDI. As an illustration,

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[95] Dealing in a similar manner with imported capital and property of long-resident foreign nationals. See OECD, *International Investment Law*, 47.

[96] A global war that lasted from 1939 to 1945.

[97] OECD, 47.

[98] UNCTAD, *Bilateral Investment Treaties 1995–2006: Trends in Investment Rulemaking* (New York and Geneva: United Nations Publication, 2007), 7, accessed on 22 April 2019, https://unctad.org/en/Docs/iteiia20065_en.pdf

Article 1(6) of the Energy Charter Treaty defines investment as «every kind of asset, owned or controlled directly or indirectly by an Investor […]»[99] and refers to any investment associated with an economic activity in the energy sector. Very often such phrasing is accompanied by a non-exhaustive list of assets examples, which includes further categories:

- movable and immovable, tangible and intangible property and related property rights (i.e. mortgages or pledges);
- forms of equity participation in a company (i.e. shares, stock or bonds);
- claims to money claims under a contract with an economic value and associated with an investment;
- intellectual property rights;
- any rights conferred by law or contract.[100]

Also, some examples can be found in Azerbaijan – Finland BIT (2003)[101] or in Japan – Russian Federation BIT (1998) with 'capital investments' concept[102].

It seems fair that the prime objective of discussed approach is to guarantee a protection of as many types of investment as possible. Nevertheless, in the numerous texts of IIAs definite limitations on the protected investment are enclosed. For instance, in Article 1(5) of Hong Kong, China SAR – New Zealand BIT (1995), investment means «every kind of asset which has been invested in accordance with the laws of the Contracting Party […]».[103] This condition implies investors to observe the laws and development policy of the host States.[104] Other BITs contain a requirement that the assets should be invested by an investor of one country in the territory of another country. Hereafter, Article 1 of Algeria – Serbia BIT (2012) stipulates that investment shall mean «every kind of assets established or acquired by an investor of one Contracting Party in the territory of the other Contracting Party […]».[105]

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[99] *Energy Charter Treaty and Related Documents*, 41.

[100] UNCTAD, *Bilateral Investment Treaties 1995*–2006, 8.

[101] Article 1 of "Azerbaijan-Finland BIT (2003)," Investment Policy Hub: International Investment Agreements Navigator, accessed on 22 April 2019, https://investmentpolicyhub.unctad.org/Download/TreatyFile/231

[102] The use of this particular term responds more to considerations of drafting than to parties' intentions to apply the BIT only to those entailing a commitment of capital. See UNCTAD, *Bilateral Investment Treaties*, 9. See also Article 1 of "Japan - Russian Federation BIT (1998)," Investment Policy Hub: International Investment Agreements Navigator, accessed on 22 April 2019, https://investmentpolicyhub.unctad.org/Download/TreatyFile/1734

[103] "Hong Kong, China SAR-New Zealand BIT (1995)," Investment Policy Hub: International Investment Agreements Navigator, accessed on 22 April 2019, https://investmentpolicyhub.unctad.org/Download/TreatyFile/1518

[104] UNCTAD, *ibid*.

[105] "Algeria-Serbia BIT (2012)," Investment Policy Hub: International Investment Agreements Navigator, accessed on 22 April 2019, https://investmentpolicyhub.unctad.org/Download/TreatyFile/3168

The limitation 'in accordance with the laws' should be given special attention, because the possibility of providing for investment protection in many BITs requires a compliance with such clause. The legality condition does not mean that the notion of investment in domestic law prevails or somehow supersedes the treaty definition. It is only necessary that the legality be observed at the time of the investment entry, in other words, the ongoing legitimacy is not so decisive, since the admission policy in respect of foreign inputs may be changed later. By way of example, in ***Salini* v. *Morocco case***[106] the ICSID Tribunal emphasized that «[…] in focusing on the 'categories of invested assets […] in accordance with the laws and regulations of the aforementioned party', **this provision refers to the validity of the investment and not to its definition**. More specifically, it seeks to prevent the Bilateral Treaty from protecting investments that should not be protected, particularly because they would be illegal».[107]

And to the contrary, if the admission process is totally disrupted by means of bribery or falsification, the completed admission is not protectable. In confirmation of the above, arbitrators in ***Inceysa v. El Salvador case***[108] decided that «the Claimant had **fraudulently misrepresented itself in a bidding process** for government contracts […] Inceysa's investment did not meet the BIT's Requirement of legality».[109]

Circular approach provides that a notion of investment should apply to already covered, as well as to emerging forms of investment in future. Bahrain – United States of America BIT (1999)[110] could be specified as a good example of investment treaty that follows such a way. Article 1(d) outlines that «investment of a national or company means every kind of investment owned or controlled directly or indirectly by the national or company, and includes, but it is not limited to, […]».[111] Nonetheless, this tautological approach is not so widespread during last decade, because as early as in 2005 and 2008 years, the same United States concluded BITs with

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[106] *Salini Costruttori S.p.A. and Italstrade S.p.A. v. Kingdom of Morocco*, ICSID Case No. ARB/00/4, Decision on Jurisdiction (23 July 2001), accessed on 22 April 2019, https://www.italaw.com/sites/default/files/case-documents/ita0738.pdf

[107] *Salini* v. *Morocco*, para 46.

[108] *Inceysa Vallisoletana S.L. v. Republic of El Salvador*, ICSID Case No. ARB/03/26), Award (2 August 2006), accessed on 22 April 2019, https://www.italaw.com/sites/default/files/case-documents/ita0424_0.pdf

[109] Rahim Moloo and Alex Khachaturian, "The Compliance with the Law Requirement in International investment Law," Fordham International Law Journal 34, no. 6 (2011): 1-31, (cited from Chaisse, *The Treaty Shopping Practice*, 296).

[110] "Bahrain-United States of America BIT (1999)," Investment Policy Hub: International Investment Agreements Navigator, accessed on 22 April 2019, https://investmentpolicyhub.unctad.org/Download/TreatyFile/261

[111] It is important to note that BIT defines investment too broadly and refers NOT only to 'every kind of asset'.

the Oriental Republic of Uruguay[112] and with the Republic of Rwanda[113], using a still broad, but more precise asset-based definition of investment.[114]

The next approach is called a 'closed-list' and it defines an extensive, but fixed list of assets that could be treated as investment under IIA. This concept has been particularly developed from the Article 1139 of NAFTA[115] and it was not until the early 2000s that countries began using this method in BITs. For instance, Article 1(a) of the newest one Israel – Japan BIT (2017) determines investment as every kind of asset, including «an enterprise and a branch […] shares, stocks or forms of equity participation […] bonds, debentures, loans and other forms of debt; futures, options […] rights under contracts; […] claims to money and to any performance under contract having a financial value; intellectual property rights […] concessions, licenses, authorizations […] any other movable and immovable property [...]».[116] It also includes «the amounts yielded by an investment, in particular, profit, interest, capital gains, dividends, royalties and fees […]».[117]

The peculiarity of illustrated article is that it contains additional clarifications to avoid applying investment treaty to certain types of assets and transactions. Such wording of clauses in recently concluded IIAs stimulates the occurrence of 'exclusion' approach, the last one being analysed herein.

The sets of exclusions vary among different investment arrangements, but they can be divided into two major categories. The first one mostly covers asset-based investment used for non-business purposes.[118] The second category comprises financial transactions that do not involve a real acquisition of interests by a foreign investor in the host State.[119] As an comprehensive example, Article 1(f) of Republic of Korea – Mexico BIT (2000) shall be

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[112] "United States of America-Uruguay BIT (2005)," Investment Policy Hub: International Investment Agreements Navigator, accessed on 22 April 2019, https://investmentpolicyhub.unctad.org/Download/TreatyFile/2380

[113] "Rwanda-United States of America BIT (2008)," Investment Policy Hub: International Investment Agreements Navigator, accessed on 22 April 2019, https://investmentpolicyhub.unctad.org/Download/TreatyFile/2241

[114] UNCTAD, *Bilateral Investment Treaties*, 10.

[115] NAFTA includes «FDI, portfolio investment (equity securities), partnership and other interests and tangible and intangible property acquired "in the expectation […] of economic benefit". Loan financing is only protected when funds flow within a business group or when debt is issued on a relatively long-term basis (more than three years)». See OECD, *International Investment Law*, 49-50.

[116] "Israel-Japan BIT (2017)," Investment Policy Hub: International Investment Agreements Navigator, accessed on 22 April 2019, https://investmentpolicyhub.unctad.org/Download/TreatyFile/5575

[117] *Ibid.*

[118] It can be, for instance, «investments in real estate for recreational purposes, which are not expected to generate profit and contribute towards the host country economy […] Similarly, a host country may also have a policy of not allowing a specific area of residential real estate to be sold to foreign buyers». See Chaisse, *The Treaty Shopping Practice*, 293.

[119] UNCTAD, *Bilateral Investment Treaties*, 11-12.

highlighted, because it excludes «claims to money that arise solely from: (i) commercial contracts for the sale of goods or services by an investor in the territory of a Contracting Party to a company or a business enterprise in the territory of the other Contracting Party, or (ii) the extension of credit in connection with a commercial transaction, such as trade financing other than a loan covered by subparagraph (c), or (iii) any other claims to money […]».[120]

Not only limiting by the analysis of treaty provisions, examples of the following cases should be given in order to clarify the logic of arbitral tribunal interpretation of the notion of investment.

Firstly, in ***Petrobart v. Kyrgyz case***[121] arbitrators had to decide whether a contract for the sale of goods (gas condensate), which did not involve any transfer of money or property as capital in a business, constituted an investment under the Energy Charter Treaty. The Tribunal confirmed:

> The term investment must therefore be interpreted in the context of each particular treaty in which the term is used. Article 31(1) of the Treaty on the Law of Treaties provides, as the main rule for treaty interpretation, that 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**. It is obvious that, when there is a definition of a term in the treaty itself, that definition shall apply and the words used in the definition shall be interpreted in the light of the principle set out in Article 31(1) of the Treaty on the Law of Treaties.[122]

The Tribunal found that a right granted by contract to undertake business activity concerning the sale of condensate, including the right to be paid for such a transaction, is an investment according to the treaty at issue.

Secondly, in ***William Nagel v. Czech Republic case***[123], brought under Czech Republic – United Kingdom BIT (1990)[124], the Tribunal had to decide whether the Claimant had been deprived of his rights, claims to money or to any contractual performance under a joint operation agreement with a state owned company established for the purpose of obtaining the necessary licenses for doing a telecommunication business. Despite the fact that Article 1(a) of the treaty contained an extensive asset-based definition of investment, after a detailed examination of the

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[120] "Republic of Korea-Mexico BIT (2000)," Investment Policy Hub: International Investment Agreements Navigator, accessed on 22 April 2019, https://investmentpolicyhub.unctad.org/Download/TreatyFile/1809

[121] *Petrobart Ltd. v. The Kyrgyz Republic*, SCC Case No. 126/2003, Award (29 March 2005), accessed on 22 April 2019, https://www.italaw.com/sites/default/files/case-documents/ita0628.pdf

[122] *Ibid*., '6. Investor and Investment'.

[123] *William Nagel v. The Czech Republic*, SCC Case No. 049/2002, Award (9 September 2003), accessed on 22 April 2019, https://www.italaw.com/sites/default/files/case-documents/ita0551.pdf

[124] "Czech Republic-United Kingdom BIT (1990)," Investment Policy Hub: International Investment Agreements Navigator, accessed on 22 April 2019, https://investmentpolicyhub.unctad.org/Download/TreatyFile/993

contractual terms, arbitrators concluded that Mr. Nagel's rights under cooperation agreement did not constitute an investment, i.e. claims to money or to any performance under contract having a financial value. The financial value only could be «if a claim appears to be well-founded or at the very least creates a legitimate expectation of performance in the future».[125] As a consequence, nothing else than Claimant's plans to close the deal could not be raised to the level of legitimate expectations with a financial value, at least for the reason that there were no 100% guarantees for obtaining the necessary licenses.

In summary it can be said that in the view of traditional investment protection most IIAs define 'investment' in a very open-ended manner, covering not only the capital inputs flowing between the treaty Participants, but almost 'every kind of asset' that is or could be transmitted in the territory of another country. It is not unusual when a standard wording of investment encompasses generally illustrative list of assets for wholly clarification purposes. Among all examined approaches in this subchapter, there are several methods for narrowing the scope of 'investment definition' application. In some cases, the Parties prefer to specifically dictate which types of assets constitute foreign inputs, thereby forming a kind of 'closed list'. In other circumstances, the Parties voluntarily exclude certain categories of assets that by no means can be considered as investments, hence presenting such a 'negative list' approach.

Choosing a particular method, nation pursues a multiple set of goals, one of which is to prevent the protection of inappropriate or illegal investments – that is to say – tools for possible manipulations in the context of treaty shopping. More striking examples of sophisticated use of 'investor' and 'investment' definitions in the frame of nationality planning and treaty shopping practice will be presented in the next chapters.

[125] *William Nagel v. The Czech Republic*, para 301.

## 2. PRACTICAL SIGNIFICANCE OF THE TREATY SHOPPING APPLICATION

Leaving behind the theoretical aspects of the concept of treaty shopping, it is time to consider the significance of its practical application. Therefore, the following part, on a large scale, is designated to the analysis of real cases, when foreign investors resort to the methods of corporate reorganization in order to obtain a protection under IIA with more favorable conditions. Very often, the sole purpose of such behaviour is the necessity to get an access to ISDS mechanisms. Nevertheless, the following examination of arbitration decisions will show how controversial the phenomenon is, and even international tribunals cannot come to the common treatment in this regard. Eventually, there will be proposed an algorithm with the help of which it is possible to differentiate the 'right' and 'wrong' nationality planning.

Despite the fact that in the preceding part the question of the attitude of various countries to the phenomenon of nationality planning has been partially considered, the introduced part will contemplate in more details the possible ways of eliminating the expansion of treaty shopping practice. The classification of those ways will be based on the findings of the UNCTAD's Reform Package, which forms the most extensive guideline in the area of investment policymaking, and which is developed by the international community.

For the record, the structure of this part is totally similar to the previous one and consists of two ample chapters. Its subchapters consequently describe the variety of arbitration approaches towards treaty shopping treatment, as well as the range of appropriate ways of eliminating the misuse of treaty shopping practice in international investment environment.

## 2.1 ARBITRATION APPROACHES TOWARDS TREATY SHOPPING TREATMENT

Before considering the existing approaches in investment arbitration with regard to treaty shopping phenomenon, it is time make a clear reference to the title of this paper, namely to word collocation 'abuse of right'[126] which constitutes a comprehensive doctrine in the field of investment law. Notwithstanding the fact that some theorists split up the notion of abuse of rights and misuse of a process, hereinafter a single cumulative expression 'abuse of rights' will be used for the purposes of this study.

Basically, the 'abuse of rights' doctrine originated in civil law jurisdictions and now it can be found in many national legal traditions.[127] Regardless of the fact that its content vary significantly among certain legal systems, many scholars acknowledge the 'abuse of rights' doctrine as a principle of general international law.[128] Some other academics recognise the doctrine as collateral of 'good faith' principle.[129]

Under all circumstances, the meaning of abuse of rights in international law could be rather illustrated than defined. In witness whereof the following list of examples should be specified. According to Kiss, the abuse of rights may arise in situations where «[…] the State exercises its rights in such a way that another State is hindered in the exercise of its own rights and, as a consequence, suffers an injury. […] the right is exercised intentionally for an end that is different from that for which the right has been created; with the result that injury is caused. […] the arbitrary exercise of its rights by the State, causing injury to other States but without clearly violating their rights […]».[130]

Precisely in ***Saipem S.p.A. v. People's Republic of Bangladesh case*** the Tribunal emphasized that «it is generally acknowledged in international law that a State exercising a right for a purpose that is different from that for which that right was created commits an abuse of

[126] Full title – Corporate Restructuring Trying to Gain Investment Protection: Abuse of Right or Normal Business Management Practice.

[127] Alexandre Kiss, "Abuse of Rights," Max Planck Encyclopedia of Public International Law, 2006, accessed on 22 April 2019, http://opil.ouplaw.com/abstract/10.1093/law:epil/9780199231690/law-9780199231690-e1371?rskey=ILdOU1&result=6&prd=EPIL

[128] David J. Bederman, *The Spirit of International Law* (Athens: University of Georgia Press, 2002), 31.

[129] Andrew D Mitchell, "Good Faith in WTO Dispute Settlement", Melbourne Journal of International Law, 2006, accessed on 22 April 2019, http://www5.austlii.edu.au/au/journals/MelbJIL/2006/14.html

[130] Alexandre Kiss, *Abuse of Rights*.

rights».[131] Therefore, the 'abuse of rights' doctrine is a commonly used to avoid the misuse of law.[132]

With regard to international investment law, the 'abuse of rights' concept normally applies to limit the practice of treaty shopping or nationality planning. However, it was more likely developed as a remedy in the process of adjudication, given the fact that it has no basis under provisions of IIAs. Therefore, at this stage of consideration, it is necessary to proceed for more detailed evaluation of the existing approaches in arbitration practice. In the next two subchapters the 'permissive' and the 'prohibitive' approaches will be examined by virtue of the most significant examples of arbitral awards.

### 2.1.1 Permissive Approach

Here the analysis should start with the statement that Permissive Approach relates to investment cases where international tribunals are quite tolerant to the practice of treaty shopping. This happens because arbitrators limit the decision-making process only to the interpretation within the text of IIA in question. In each instance, the tribunal refuses to go beyond the wording of particular investment treaty, thereby applying a consent-oriented reading. In order to better understand the essence of the Permissive Approach, the following cases will be outlined.

One of the very first substantive evaluations of the treaty shopping in investment jurisprudence was made in ***Tokios Tokelés v. Ukraine case***[133]. The factual background shows that the Claimant, Tokios Tokelés, was registered as a closed joint-stock company under the laws of the Republic of Lithuania in 1991 and operated in the business of advertising, publishing and printing. In 1994 Tokios Tokelės created Taki Spravy – a wholly owned subsidiary established under the laws of Ukraine. Tokios Tokelés filed for arbitration, alleging that in February 2002 governmental authorities in Ukraine commenced a series of unreasonable tax investigations against Taki Spravy that adversely affected the Claimant's investment, thereby breaching the obligations under Lithuania – Ukraine BIT (1994)[134]. The Respondent, in its turn, argued that the

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[131] *Saipem S.p.A. v. People's Republic of Bangladesh*, ICSID Case No. ARB/05/7, Award (30 June 2009), accessed on 22 April 2019, http://www.italaw.com/sites/default/files/case-documents/ita0734.pdf, para 160.

[132] Yael Ribco Borman, "Treaty Shopping Through Corporate Restructuring of Investments: Legitimate Corporate Planning or Abuse of Rights?" in *Hague Yearbook of International Law (Vol. 24, 2011)*, ed. Nikolaos Lavranos and Ruth A. Kok (Brill, 2017), 360-368.

[133] *Tokios Tokelés v. Ukraine*, paras 1-4.

[134] "Lithuania-Ukraine BIT (1994)," Investment Policy Hub: International Investment Agreements Navigator, accessed on 22 April 2019, https://investmentpolicyhub.unctad.org/IIA/country/219/treaty/2432

Claimant was not a 'genuine entity' of Lithuania, because it was owned and controlled predominantly by Ukrainian nationals (99% of the outstanding shares of Tokios Tokelès and two thirds of its management were of Ukrainian origin).[135] In fact, the Respondent did not contest Tokios Tokelés incorporation under the laws of Lithuania, but he asked the Tribunal to 'pierce the corporate veil' in order to define the corporate nationality within the application of 'place of control' test, instead of prescribed test in the disputed investment treaty.[136]

The position of the arbitrators was based on the fact that since the Parties «are free to define their consent to jurisdiction in terms that are broad», they could employ a 'control test' or reserve the right to deny treaty protection.[137] Declining the interpretation beyond the treaty provisions, the Tribunal refused to limit the scope of BIT on its own motion.

With respect to the doctrine of veil piercing, citation from the previous ***Barcelona Traction case*** has been applied, according to which the lifting of the veil is possible only in exceptional circumstances with the purpose «to prevent the misuse of the privileges of legal personality, as in certain cases of fraud or malfeasance, to protect third persons such as a creditor or purchaser, or to prevent the evasion of legal requirements or of obligations».[138] By doing so, the Tribunal found no reason to believe that Claimant's conduct, in regard to its status of Lithuanian company, constitutes an abuse of legal personality.

In addition, arbitrators made a reference to the assessment of *ratione temporis*[139] and concluded that the Claimant did not create Tokios Tokelès for the sole purpose of gaining access to the ICSID arbitration, because the enterprise had been founded six years before Lithuania – Ukraine BIT entered into force.[140] As a result, the Claimant was not convicted of corporate nationality misuse.

In contrast to the taken decision, Professor Prosper Weil (the President of the Tribunal) expressed his Dissenting Opinion[141], in which he argued that so narrow method of interpretation

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[135] «The Respondent also argues, but the Claimant strongly contests, that Tokios Tokelès has no substantial business activities in Lithuania and maintains its siège social, or administrative headquarters, in Ukraine». See *Tokios Tokelés v. Ukraine*, para 21.

[136] In accordance with Article 2 of Lithuania - Ukraine BIT, the term of investor means «any entity established in the territory of the Republic of Lithuania in conformity with its laws and regulations».

[137] *Tokios Tokelés v. Ukraine*, paras 39-41.

[138] *Ibid*., paras 54-55.

[139] By reason of time. Because of the relevant timing or period of time pertaining to the subject under consideration. See Aaron Fellmeth and Maurice Horwitz, *Guide to Latin in International Law* (Oxford, England: Oxford University Press, 2011), accessed on 22 April 2019, http://www.oxfordreference.com/view/10.1093/acref/9780195369380.001.0001/acref-9780195369380-e-1795

[140] *Tokios Tokelés v. Ukraine*, para 56.

[141] Chairman Prosper Weil, "Dissenting Opinion," 2004, accessed on 22 April 2019, https://www.italaw.com/sites/default/files/case-documents/ita0864.pdf

runs counter to the object and purpose of the whole ICSID system.[142] According to him, the ICSID Convention governs only international investment, to that extent the origin of a transborder capital flow is decisive[143], thereby focusing on the need for a comprehensive analysis of the circumstances of the case, including both the form and the substance of precise activity.

***Tokios Tokelés v. Ukraine case*** became the fundamental one in the practice of considering nationality planning issues, since arbitrators in the meantime took completely opposite points in factual estimating. Here the only difference is that some limited themselves to a very literal reading of the provisions of the ICSID Convention and relevant BIT, while others tried to look at the situation from the perspective of 'abuse of rights' concept.

The next example with a similar factual matrix is ***Saluka Investments v. Czech Republic case***[144], which came from the reorganization of the Czech banking system. Saluka Investments BV was a holding company of Nomura Europe and was incorporated under the laws of the Netherlands as may be required by Article 1(b)(ii) of Czech Republic – Netherlands BIT (1991)[145].

The Respondent, the Czech Republic, did not oppose that Saluka had an investor status under the BIT.[146] On the same lines, the Respondent contested:

(i) the closeness of the relationship inside the Nomura Group,

(ii) the lack of good faith involved in the acquisition of Investiční a Poštovní Banka shares, and

(iii) the lack of genuine links between Saluka and the Netherlands[147], thereby challenging the investor's good business practice.

In relation to the above, the Tribunal confirmed the logic of interpretation rendered in ***Tokios Tokelés v. Ukraine case*** and rejected all arguments, because:

> The parties had complete freedom of choice […], and they chose to entitled 'investors' to those satisfying the definition set out in Article 1 of the Treaty. […] it is not open to the Tribunal to add other requirements which the parties could themselves have added but which they omitted to add.
> The parties to the Treaty could have included in their agreed definition of 'investor' some words which would have served, for example, to exclude wholly-

[142] Professor Weil notably emphasized the importance of Article 31 of the Vienna Convention on the Law of Treaties 1969.

[143] Prosper Weil, *Dissenting Opinion*, paras 19-21.

[144] *Saluka Investments BV v The Czech Republic*, UNCITRAL, Partial Award (17 March 2006), accessed on 22 April 2019, https://www.italaw.com/sites/default/files/case-documents/ita0740.pdf

[145] "Czech Republic-Netherlands BIT (1991)," Investment Policy Hub: International Investment Agreements Navigator, accessed on 22 April 2019, https://investmentpolicyhub.unctad.org/Download/TreatyFile/968

[146] *Saluka Investments v Czech Republic*, para 223.

[147] *Ibid*., para 225.

owned subsidiaries of companies constituted under the laws of third States, but they did not do so.[148]

But among other things, the Tribunal paid due attention to the question of nationality planning. It acknowledged that company without direct connection to a Contracting State, but controlled by another entity constituted under the laws of the third State, cannot enjoy the investment protection under that IIA. Such activity may lead itself to a misuse of the arbitral procedure and extension of treaty shopping practice.[149] Nevertheless, arbitrators did not further develop the relevance of 'treaty shopping' concept in these particular circumstances. They rather pointed out to the Respondent that from the very beginning Czech authorities were aware of the Nomura's intention to transfer disputed shares to another company, specifically incorporated for the sole purpose of holding those shares.[150]

One more illustration of the consent-oriented reading of treaty provisions is a ***Rompetrol Group N.V. v. Romania case***[151]. The Claimant, the Rompetrol Group N.V., was a public limited liability company established under the Dutch law. Precise dispute arose from the Claimant's share purchase in Rompetrol Rafinare S.A. – a privatised Romanian company that owned and operated an oil refinery and petrochemical complex.[152] The Rompetrol Group N.V. alleged that the Romanian authorities started unreasonable investigations against Rompetrol Rafinare S.A., thus violating Netherlands – Romania BIT (1994).[153]

In its turn, the Republic of Romania did not challenge the question of the formal sense of corporate nationality under BIT, but like in ***Tokios Tokelés v. Ukraine case***, the Respondent argued that the Claimant was effectively controlled by Romanian citizen and Rompetrol's funds actually were Romanian.[154] In this way the Respondent tried to demonstrate that a complaint filed «by a Romanian national against Romanian authorities and in relation to activities in Romania»[155] must be considered exclusively by national courts.[156]

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[148] *Ibid*., paras 241 and 229.

[149] *Ibid*., para 240.

[150] The Tribunal identified that «the Share Purchase Agreement contained express provision to that effect». See *ibid*., para 242.

[151] *The Rompetrol Group N.V. v. Romania*, ICSID Case No. ARB/06/3, Decision on Respondent's Preliminary Objections on Jurisdiction and Admissibility (18 April 2008), accessed on 22 April 2019, https://www.italaw.com/sites/default/files/case-documents/ita0717.pdf

[152] *Rompetrol Group N.V. v. Romania*, para 3.

[153] "Netherlands-Romania BIT (1994)," Investment Policy Hub: International Investment Agreements Navigator, accessed on 22 April 2019, https://investmentpolicyhub.unctad.org/Download/TreatyFile/2075

[154] *Rompetrol Group N.V. v. Romania*, para 55.

[155] *Ibid*., para 50.

[156] The Respondent relied in this connection on the Dissenting Opinion of Professor Prosper Weil in order to prevent the occurrence of international investment claims initiated by nationals against their own countries. See *ibid*., para 52.

The Tribunal carefully examined Article 1 of the BIT in relation to the term 'investor' and came to the following conclusions. Indicating introductory phrase 'For the purposes of this Agreement' to the Article 1, the Parties attached a quite sufficient and clear meaning to all definitions in discussed investment treaty.[157] Therefore, this is a matter of free choice between the Contracting States to agree on 'nationality test' without further analysis by the Tribunal of additional criteria not stipulated in the particular BIT (i.e. examination of ownership and control issues, sources of investment or corporate body's effective seat).[158] Concerning the ***Dissenting Opinion of Professor Weil***[159], to which the Respondent referred to as a basis for objections, the Tribunal refused to share the Professor Weil's methodological critique, because it was not widely approved in the academic and professional literature, as well as it was not generally adopted by subsequent tribunals.[160]

Under all circumstances, this case is remarkable because arbitrators did not want to interpret Article 1 of Netherlands – Romania BIT in such a way as to set aside the clear language agreed upon by the Parties in favour of a large-scale policy discussion. From the perspective of the Tribunal, that approach «could not be reconciled with Article 31 of the Vienna Convention on the Law of Treaties (which lays down the basic rules universally applied for the interpretation of treaties), according to which the primary element of interpretation is 'the ordinary meaning to be given to the terms of the treaty'».[161]

Finally, as part of the permissive approach analysis in this subchapter, ***Aguas del Tunari S.A. v. Republic of Bolivia case***[162] shall be described. This is a clear example of the Claimant's complex corporate structure which was formed on the back of numerous reorganizations.[163] In its decision the Tribunal explicitly recognized the legality of treaty shopping practice, stating 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

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[157] *Ibid*., para 97.

[158] The Tribunal confirmed that 'incorporation' is a widely used criterion internationally for determining the nationality of corporate bodies, accordingly, countries have a possibility to determine corporate nationality by a wide variety of criteria in a wide variety of contexts. See *ibid*., para 83.

[159] See footnote 141.

[160] *Rompetrol Group N.V. v. Romania*, paras 82 and 85.

[161] *Ibid*., para 85.

[162] *Aguas del Tunari S.A. v. Republic of Bolivia*, ICSID Case No. ARB/02/3, Decision on Jurisdiction (21 October 2005), accessed on 22 April 2019, https://www.iisd.org/pdf/2005/AdT_Decision-en.pdf

[163] «In anticipation of the corporate reorganization anticipated as a part of the joint venture with Edison, Baywater Holdings, B.V., ("Baywater") was incorporated under Dutch law on November 25, 1999. On December 8, 1999, International Water Holdings B.V. ("IWH B.V.") and International Water (Tunari) B.V. ("IWT B.V.") were incorporated under Dutch law by Baywater and IWH B.V., respectively. On December 21, 1999, IW Ltd of the Cayman Islands "migrated" to Luxembourg where it became known as International Water (Tunari) S.a.rl (IW Sa.r.l.") Finally, on December 22, 1999, IWT B.V. became the 100 percent shareholder of IW S.a.rl.». See *Aguas del Tunari S.A. v. Republic of Bolivia*, para 70.

beneficial regulatory and legal environment in terms, for example, of taxation or the substantive law of the jurisdiction, including the availability of a BIT».[164] Rejecting the Respondent's argument, in whose opinion the changes in the organizational structure of Aguas del Tunari S.A. rose to the level of fraud or abuse of corporate form, the arbitrators emphasized that due to such extensive definition of investor, Contracting States create portals through which investments can be structured or organized in a neutral forum.[165] It also concluded that there was no a sufficient basis to support the allegation of abuse of corporate form or fraud.

Summarizing all the above, it should be stated that illustrated cases in this subchapter represent the extremely loyal attitude to the practice of nationality planning in international investment paradigm. In many respects, this is caused by the unwillingness of the tribunals to interpret the 'abuse of rights' doctrine beyond the precise texts of investment treaties. In most scenarios the line of tribunal's reasoning reflects either to the fact that:

1) setting aside agreed language and meaning of the BIT's terms will be contrary to the treaty interpretation principles under Article 31 of the Vienna Convention on the Law of Treaties; or
2) there are no evidences about Claimant's abusive corporate activity (without in-depth analysis of the abusive corporate activity that may lead to the rejection of claims in investor-state disputes).[166]

It may seems that mentioned arbitration practice suggests that the 'abuse of rights' concept in investment law is completely lacking, since the tribunals in every way tried to avoid the substantial evaluation of business activities in cases with signals of possible treaty shopping. This is confirmed by a number of refusals to include any additional requirements into provisional definition of investor. However, the further research will show how the arbitrators managed to develop the 'abuse of rights' doctrine as a remedy in the process of adjudication.

### 2.1.2 Prohibitive Approach

This specifically analyzed approach is characterized by the fact that arbitration tribunals, in view of nationality planning consideration, have elaborated the meaning of the 'abuse of rights' concept to the level of principle of international investment law. In its turn, that particular statement demonstrates the desire of arbitrators to more solidly assess the actual investor's nationality through the lens of intentions behind each of the corporate reorganizations.

[164] *Ibid*., para 330.
[165] *Ibid*., para 332.
[166] Mark Feldman, *Setting Limits on Corporate Nationality*, 288.

It is also important to remark that during decision-making they had consistently relied on generally recognized principles of international law, such as 'good faith', 'abuse of process' and 'no harm 'principles. Despite the diversity of legal argumentation in that regard, the overall picture of the evolution of the tribunal interpretation within the framework of the Prohibitive Approach can be illustrated by the following case law.

The first example that should be given in the present subchapter is ***Phoenix Action Ltd v. Czech Republic case***[167]. This is one of the first arbitral awards where the factual assessment was expanded beyond the debatable investment treaty, namely Czech Republic – Israel BIT (1997).[168] The procedural history shows that the initial request to the ICSID arbitration, dated 15 February 2004, was based on a claim from two Czech companies (Benet Praha, spol. s.r.o. and Benet Group, a.s., hereafter referred to as Benet Companies), which were involved in several court proceedings in the Czech Republic. However, the Claimant in this case was Phoenix Action Ltd – a company constituted under the laws of the State of Israel and effectively controlled by a Czech national, Mr. Vladimír Beňo.[169] In December 2002, Israeli company acquired all interests in Benet Companies, and later on, in March 2003, it informed the Respondent about the existence of investment dispute.[170] Upon the consideration of all stated claims and objections[171], the Tribunal had the task, among other things, to find out whether the Claimant's actions constitute an abuse of rights.

Looking ahead, it should be said that the arbitrators rejected the entire claim on a basis of the interpretation of the principle of good faith. The Tribunal confirmed that «the principle of good faith has long been recognized in public international law, […]. This principle requires parties 'to deal honestly and fairly with each other, […]'. Nobody shall abuse the rights granted by treaties, and more generally, every rule of law includes an implied clause that it should not be abused […]».[172] Arbitrators also indicated that as widely recognised principle, it applies to the

[167] *Phoenix Action Ltd v. The Czech* Republic, ICSID Case No. ARB/06/5, Award (15 April 2009), accessed 22 April 2019, https://www.italaw.com/sites/default/files/case-documents/ita0668.pdf

[168] "Czech Republic-Israel BIT (1997)," Investment Policy Hub: International Investment Agreements Navigator, accessed on 22 April 2019, https://investmentpolicyhub.unctad.org/Download/TreatyFile/943

[169] Phoenix Action Ltd was registered under the laws of the State of Israel on October 14, 2001, with Israeli corporation number 51-3153502 and permanent seat at 50 Dizeongoff Street, Tel Aviv, Israel. It was entirely owned by Mr. Vladimír Beňo. See *Phoenix Action Ltd v. Czech Republic*, para 22.

[170] *Ibid*., para 22.

[171] The Claimant argued that the Czech Republic had failed to guarantee necessary investment protection under the BIT, including violation of the fair and equitable treatment (FET) provision and the full protection and security (FPS) standards. See ibid para 44-45. The Respondent alleged that «this case represents one of the most egregious cases of 'treaty-shopping' that the investment arbitration community has seen in recent history […]». See *ibid*., para 34.

[172] *Ibid*., para 107.

international arbitration mechanism of ICSID. Therefore, the Tribunal has a duty to protect only genuine investments and prevent any attempt to misuse the ICSID system.[173]

Nonetheless, the Phoenix Tribunal upheld an idea that foreign investors can structure the upstream investments, but only those that meet the requirement of participating in the economy of the host State. Of course, such structuring must be done by means of choosing an appropriate corporate organisation and in a manner that best fits the need for international protection. At the same time, overseas investor should not modify downstream the investment protection, granted by the host State, after the proceedings regarding the damage to his investments have already been commenced.[174]

Examining the Claimant's actions, arbitrators relied on a certain amount of features, such as:

(a) the timing of the investment, which was made after all claimed damages had been incurred by the Benet Companies;
(b) the initial request to ICSID, which was based on a claim by the Benet Companies;
(c) the timing of the claim, which was presented to the Respondent right before the registration of ownership of the Benet Companies in the Czech Republic and a mere two months after their acquisition;
(d) the substance of the transaction, which was done for a mere redistribution of assets within the Beňo family; and
(e) the true nature of the operation, which had no indicia of strong economic activity in the market place.[175]

By this means, the ICSID Tribunal ruled that «the whole 'investment' was an artificial transaction to gain access to ICSID»[176] and formed an explicit abuse of the system of international investment arbitration. For this very reason, the pre-existing national dispute could not be filed to ICSID arbitration just by a sheer fact of transferring the national economic interest to any foreign enterprise in attempt to seek a protection under the BIT, i.e. treaty shopping practice.[177]

In respect of this case, it should be noted that the Tribunal approached the assessment of actual circumstances and actions of Mr. Beňo in the contextual interpretation of 'good faith'

[173] *Ibid*., para 113.
[174] *Ibid*., paras 94-95.
[175] *Ibid*., paras 136-140. With regard to the true nature of the operation, the Tribunal stated that «no business plan, no program of refinancing, no economic objectives were ever presented, no real valuation of the economic transactions were ever attempted».
[176] *Ibid*., para 143.
[177] The Tribunal emphasized that «the ICSID mechanism does not protect investments that it was not designed for to protect, because they are in essence domestic investments disguised as international investments for the sole purpose of access to this mechanism». See *Ibid*., para 144.

principle in international investment law. Such way of consideration can be named as substantive, because the issue of timing, as well as the essence of specific conduct, was investigated.

The findings in ***Phoenix Action Ltd v. Czech Republic case*** were served as a ground for rendering the abuse of rights in ***Mobil and Others v. Venezuela case***[178]. That case is significant in the sense that the Tribunal has made some progress in its interpretation, namely by analysing the aim and the timing of the corporate restructuring. In September 2007 the Claimant (hereafter referred to as Mobil Corporation)[179] filed a request for ICSID arbitration against the Bolivarian Republic of Venezuela, the Respondent, seeking compensation for the measures taken by Venezuelan authorities. In its return, the Respondent argued that Mobil Corporation created a 'corporation of convenience'[180] for the sole purpose of gaining access to the ICSID, thereby stating on the abuse of treaty shopping practice.[181]

During the decision-making arbitrators proceeded from the fact that the 'abuse of rights' principle is a collateral of 'good faith' principle, and it has to be determined in each case taking into account all the facts of the matter.[182] Evaluating the circumstances of this particular case, the Tribunal concluded 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».[183] Such findings were preceded by a series of events that forced the Mobil Corporation to resort to the reorganization of its corporate structure.

Notwithstanding that the initial Mobil's investment was made in a 'hospitable investment climate'[184], the subsequent changes in the national policy caused damage to the company. To be more precise, in 2001 a new Hydrocarbon Law was adopted, and in October 2004 the royalty rates were increased from 1% to 16,67%. A few years later, in May-August

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[178] *Mobil Cerro Negro Holding, Ltd., Mobil Cerro Negro, Ltd., Mobil Corporation and others v. Bolivarian Republic of Venezuela*, ICSID Case No. ARB/07/27, Decision on Jurisdiction (10 June 2010), accessed on 22 April 2019, https://www.italaw.com/sites/default/files/case-documents/ita0538.pdf

[179] (i) three U.S. (Delaware) companies, Mobil Corporation ("Mobil"), Mobil Cerro Negro Holding, Ltd. ("Mobil CN Holding"), and Mobil Venezolana de Petróleos Holdings, Inc. ("Mobil Venezolana Holdings"); (ii) two Bahamian companies, namely Mobil Cerro Negro, Ltd. ("Mobil CN"), and, Mobil Venezolana de Petróleos, Inc. ("Mobil Venezolana"); and (iii) one Dutch company, Venezuela Holdings, B.V. ("Venezuela Holdings"). See *Mobil and Others v. Venezuela*, para 1.

[180] In October 2005 the Claimant created a new entity under the laws of the Netherlands, Venezuela Holdings B.V., and inserted it into the corporate chains for the Cerro Negro and La Ceiba Projects in February 2006 and November 2006 respectively. See *ibid*., para 20.

[181] *Ibid*., para 27.

[182] *Ibid*., paras 169-177.

[183] *Ibid*., para 190.

[184] In 1990s the Bolivarian Republic of Venezuela changed national investment policy, known as Apertura Petrolera, which brought back foreign investors the Venezuelan oil industry through 'progressively more strained interpretations of the 1975 Nationalization Law. See *Ibid*., para 17.

2006, an extraction tax of 33,3% was enacted and the income tax rate was increased to 50%. As the final result, on 8 January 2007 the President of the Republic announced about nationalisation of all projects that had been operating outside the 2001 Hydrocarbons Law regulation, including the Cerro Negro and La Ceiba, which were the original projects of Mobil Corporation in Venezuelan oil sector.[185] Therefore, according to the Claimant, establishment of holding company in the Netherlands[186] was treated as a justified move, taking into account the existing activities of Exxon Mobil in that country.

Assessing the purposes for reorganization, the Tribunal indicated that nationality planning in principle can be legitimate.[187] In that regard, arbitrators distinguished claims that arose prior and after the restructuring. With respect to the announced nationalization, the Tribunal confirmed that by way of restructuring foreign investor tried to protect its investment against breaches from the side of Venezuelan authorities, consequently «this was a perfectly legitimate goal as far as it concerned future disputes».[188] But relating to the royalty and income tax increases, the ICSID Tribunal found that they were essentially pre-existing disputes and constituted an abusive manipulation of the protection under the international investment system.[189]

In view of this, several important points can be drawn from the decision in ***Mobil and Others v. Venezuela case***. First of all, it is not unusual or prohibited to structure any business in the most convenient way, even for the sole purpose of gaining access to the ICSID mechanisms. Here is more important to understand the true reasons of companies that resort to such seemingly obvious treaty shopping practice. Because in concreto, by doing so overseas investors may simply seek an appropriate protection against the aggressive actions of the host States (in certain circumstances, when the initial IIA cannot provide a sufficient level of legal guarantees). Secondly, it is equally important to consider every business intention in the context of the time, which is to say to analyse all previous and subsequent events, and external factors that accompanies a particular corporate reorganization.[190]

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[185] *Ibid*., para 19.

[186] The Kingdom of the Netherlands and the Bolivarian Republic of Venezuela concluded the Netherlands-Venezuela BIT in 1991.

[187] *Ibid*., para 191.

[188] *Ibid*., para 204.

[189] For that matter the Tribunal cited the words of the Phoenix Tribunal, according to which the restructuring may constitute «an abusive manipulation of the system of international investment protection under the ICSID Convention and the BITs». See *Ibid*., para 205.

[190] With regard to *Mobil and others v. Venezuela case*, the Tribunal rejected its jurisdiction under the ICSID Convention and the BIT with respect to any dispute born before dates of restructuring (21 February 2006 for the Cerro Negro project and after 23 November 2006 for the La Ceiba project). See *Ibid*., para 206.

From the perspective of the findings in previous cases, the interpretation of the doctrine of abuse of rights in investment law has gained a new round in ***Pac Rim v. El Salvador case***[191]. More specifically, arbitrators paid a deliberate attention to the question of timing and sought to determine the moment of foreseeability of a future dispute. It appears that generally they confirmed the practicability of division of disputes into 'already existing' and 'future' ones.[192]

Briefly collecting the factual circumstances it should be said that the Claimant, Pac Rim Cayman LLC (hereafter referred to as Pac Rim), was an American legal person organised under the laws of Nevada[193] and wholly owned by Pacific Rim Mining Corporation, a legal person incorporated under Canadian laws. One important remark here is that before December 2007 Pac Rim had been registered as a Cayman Islands entity. According to the Respondent, the Republic of El Salvador, the Claimant abused the international arbitration process by changing its corporate nationality in order to initiate ICSID arbitration for a pre-existing dispute and to assert claims under CAFTA.[194] Regarding the abuse of rights, or rather to say the 'abuse of process'[195], Salvadoran authorities did not challenge an advanced nationality planning made in good faith before any investing activity, they contested «a retrospective gaming of the system to gain jurisdiction for an existing dispute based on existing facts over which there would not otherwise be jurisdiction».[196] In its tern, the Claimant argued that restructuring was carried out as a part of complex reorganization of the whole Pac Rim Group in order to save the money.

The Tribunal found that the factual situation was materially similar to that one in ***Mobil and Others v. Venezuela case***. For instance, before the reorganisation in December 2007 the Claimant had had several difficulties in obtaining the permit and concession. Throughout the discussions with Salvadoran authorities on those difficulties until mid-2008[197], in March of the same year the President Elias Antonio Saca announced a 'new policy' of opposing the issuance

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[191] *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), accessed on 22 April 2019, https://www.italaw.com/sites/default/files/case-documents/ita0935.pdf

[192] The Pac Rim Tribunal followed the Mobil approach of considering only the issue of timing. See Feldman, *Setting Limits on Corporate Nationality*, 292.

[193] Principal office at 3545 Airway Drive, Suite 105, Reno, Nevada 89511, USA. See *Pac Rim v. El Salvador*, para 1.1

[194] Since 13 December 2007, the Claimant has been a national of a Contracting State to the ICSID Convention and CAFTA, in force for the USA as from August 2005. The Respondent was a Contracting State to the ICSID Convention and CAFTA, in force for the Republic of El Salvador as from 1 March 2006. See *ibid*., paras 1.3 and 1.6.

[195] The Respondent operated on this very term, although it is no different from the 'abuse of rights' concept that covers the material and procedural misuses of rights.

[196] *Pac Rim v. El Salvador*, para 2.19

[197] No formal decision was taken by the Respondent. Therefore this suggests that proceedings were still live at the beginning of 2008. See *ibid*., para 2.85.

of mining permits. Thus, it turned out that the actual dispute between litigants, in the form of alleged continuous act, coincided with a change of the Pac Rim nationality.

Considering a statement about the abuse of process, arbitrators decided to determine the starting point in time when mentioned changes could lead to an excessive usage. Hereupon, the dividing-line may appear «(i) where facts at the root of a later dispute have already taken place and that future dispute is ***foreseen or reasonably foreseeable***; or (ii) where facts have taken place giving rise to an actual dispute […]».[198]

In the Tribunal's opinion, that dividing-line may occur «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. […] as a matter of practical reality, this dividing-line will rarely be a thin red line, but will include a significant grey area».[199] Despite such ambiguous word expression, arbitrators accepted Respondent's submission that «it is clearly an abuse for an investor to manipulate the nationality of a shell company subsidiary to gain jurisdiction under an international treaty at a time when the investor is aware that events have occurred that negatively affect its investment and may lead to arbitration».[200] However, in the circumstances of the present case, the ICSID Tribunal concluded that Claimant's reorganisation, on 13 December 2007, does not indicate the abuse of process.

It is important to clarify that the logic of interpretation, with respect to the abuse of process, was based on the application of CAFTA's *ratione temporis*. Therefore, the Tribunal ruled that in relation to continuous act (discussions on obtaining the mining permits) it has a jurisdiction solely over that portion of the continuous act that lasted after the application of CAFTA to the Claimant (i.e. after the completion of the Pac Rim reorganization on 13 December 2007).[201] Among other things, such conclusion was influenced by the fact that the Claimant demanded compensation only for the period from March 2008, when Pac Rim definitely became aware of the *de facto* mining ban from the President Saca's speech on 11 March 2008. Consequently, before December 2007, the above discussions were not known to or foreseen to the Claimant as an actual or specific future dispute under CAFTA.[202]

Summarizing, it should be mentioned that not all the conclusions of arbitrators in this case are indisputable and unambiguous. However, it is significant that the Tribunal followed the example of its predecessors and developed the issue of abusive treaty shopping in the context of timing criterion. In spite of the fact that it would be reasonable to describe the aforesaid

[198] *Ibid*., para 2.96
[199] *Ibid*., para 2.99
[200] *Ibid*., para 2.100
[201] Nevertheless, the Tribunal acknowledged that this solution was contrary to the analysis of the abuse of the process issue. See *ibid*., paras 2.104 and 2.106.
[202] *Ibid*., para 2.109.

illustration within the meaning of the Permissive Approach, its inclusion at this stage of the research looks more rational.

The last example in the framework of the Prohibitive Approach is a fore-mentioned ***Philip Morris v. Australia case***[203]. In some ways, conclusions of the Tribunal in this matter are highly controversial as they, on the one hand, have developed already-existing practice of examining the issues of abuse of corporate nationality relocations in investment paradigm. But on the other hand, the line of arbitration argumentation in assessing the factual circumstances contradicts the one chosen by the predecessors.

The procedural history highlights that a dispute arose between the Claimant, a limited liability company Philip Morris Asia Limited (hereafter referred to as PM Asia) incorporated under the laws of Hong Kong, and the Respondent, a sovereign state the Commonwealth of Australia (hereafter referred to as Australia). The statement of arbitration concerned the Respondent's enactment of the Tobacco Plain Packaging Measures of November 2011 (i.e. the Tobacco Plain Packaging Act and the Tobacco Plain Packaging Regulations)[204], which had violated the intellectual property rights of the Claimant, in particular the recognition of its brands.[205] The agreement under investigation was Australia – Hong Kong, China SAR BIT (1993)[206].

The Claimant identified itself as the regional headquarters for the Asia region of the Philip Morris International Group[207]. PM Asia actually owned 100% of the shares of Australian subsidiaries Philip Morris Australia and Philip Morris Limited.[208] Notwithstanding the foregoing, until February 2011, these two companies were owned by Philip Morris Brands Sarl, a Swiss part of Philip Morris International Group.[209]

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[203] *Philip Morris v Australia*, PCA Case No. 2012-12. See footnote 13.

[204] The purpose of the new Tobacco Policy was to discourage smoking initiation and to implement the Framework Convention on Tobacco Control, as imposed by the WHO. See Chaisse, *The Treaty Shopping Practice*, 245. For more information see *Philip Morris v. Australia*, paras 99-106.

[205] *Ibid*., paras 1-7.

[206] "Australia-Hong Kong, China SAR BIT (1993)," Investment Policy Hub: International Investment Agreements Navigator, accessed on 22 April 2019, https://investmentpolicyhub.unctad.org/Download/TreatyFile/152

[207] Philip Morris International Inc. is a company incorporated and headquartered in New York, United States, which produces seven of the top fifteen cigarette brands in the world, including the number one selling brand of cigarettes, Marlboro. It owns dozens of subsidiaries and affiliates around the world and manages its business in different regions, including in Asia, where the Claimant has its regional headquarters. See *Philip Morris v. Australia*, para 96.

[208] PM Asia owned 100% of the shares of Philip Morris Australia, a holding company incorporated in Australia, which in turn owned 100% of the shares of Philip Morris Limited, a trading company incorporated in Australia, which was engaged in the manufacture, import, marketing and distribution of tobacco products for sale within Australia and for export to New Zealand and the Pacific Islands. See *ibid*., para 6.

[209] *Ibid*., para 97.

Australia sought the Tribunal to dismiss each of the PM Asia's claims, arguing that «the Claimant's investment was not properly admitted in the host State […] the dispute had arisen before the Claimant had obtained the protection of the Treaty as a result of restructuring […] or because the Claimant's restructuring constitutes an abuse of right».[210] Thus, there was a situation, when once again the Respondent challenged the abuse of rights during the restructuring of the company for the purpose of obtaining unjustified protection under investment agreement with a third State (Australia – Hong Kong BIT 1993).

As in previously analysed case, the Phillip Morris Tribunal confirmed the distinction between the *ratione temporis* objection (that is the moment when the alleged breach occurred) and abuse of rights objection (that is the foreseeability of a dispute). With respect to the first objection, arbitrators determined that the date of adoption of the Tobacco Plain Packaging Measures, precisely 21 November 2011, has the initial value. Therefore, taking into account the dates of restructuring, from 3 September 2010 to 23 February 2011, it can be concluded that the requirements for the *ratione temporis* jurisdiction were met.[211] With respect to the second objection, arbitrators recognized that the abuse is subject to an objective test, according to which the intention for restructuring determines by the existence or foreseeability of an investment dispute.[212]

Generally, by virtue of a detailed examination of ***Tidewater v. Venezuela, Mobil Corporation v. Venezuela, Gremcitel v. Peru, Aguas del Tunari SA v. Bolivia, Pac Rim v. El Salvador cases***, the Phillip Morris Tribunal acknowledged that «the mere fact of restructuring an investment to obtain BIT benefits is not *per se* illegitimate».[213] However, corporate reorganisation towards obtaining particular BIT benefits may amount to an abuse in the light of a foreseeable dispute.[214] What is remarkable in this case is that the Tribunal considered the issue of treaty shopping, performed by the Claimant, in the context of political developments in Australia. In such a way, it indirectly analysed the substance of the intentions for the restructuring under investigation.

Unlike in ***Pac Rim v. El Salvador*** case, arbitrators in the present case found the pre-existing discussions on Tobacco Policy between the Parties as a sufficient ground for a foreseeable dispute. This is evidenced by the fact that already in 2009 Philip Morris International Group had opposed the plain packaging in the ministerial consultations. Then in April 2010, Australian government decided to introduce tobacco regulatory measures. And in July 2010, the

[210] *Ibid*., para 9.
[211] *Ibid*., paras 533-534.
[212] *Ibid*., para 539.
[213] *Ibid*., 540.
[214] The Tribunal emphasized that in each particular case all factual circumstances should be investigated. See *ibid*., 545.

timetable for the implementation of new legislation was published.[215] So, in the Tribunal's view «there was no uncertainty about the Government's intention to introduce plain packaging as of that point. Accordingly, there was at least a reasonable prospect that legislation equivalent to the Plain Packaging Measures would eventually be enacted, which would trigger dispute».[216]

In its final remarks, arbitrators stated that the Claimant did not provide any admissible evidences about any tax or other business reasons for company's reorganisation. Moreover, they strongly questioned the PM Asia's President, Mr. Matteo Pellegrini, testimony as it became obvious during the hearing that Mr. Pellegrini was not familiar with the details of legal or corporate strategy. Consequently, the Philip Morris Tribunal concluded 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».[217]

Summing up the findings in ***Philip Morris v. Australia case***, it should be said that despite some inconsistency, the Tribunal has managed to confirm the scheme for determining the jurisdiction in cases which involve changes of corporate nationality, i.e. the treaty shopping practice. This scheme includes the analysis of:

(i) correlation in time between the actual appearance of alleged breach and the relocation of nationality; **and only then**

(ii) foreseeability of a dispute within the 'abuse of rights' concept.

Taking the whole subchapter into consideration, it is necessary to observe that outlining the place of 'abuse of rights' doctrine in international investment law, all mentioned tribunals applied various ways in assessing the factual circumstances in cases with clear signs of resorting to the practice of altering the corporate nationality after the investment had already been made. These encompass the analysis of a true nature of the operation in ***Phoenix Action Ltd v. Czech Republic case***, the aim and the timing of restructuring in ***Mobil and Others v. Venezuela case***, as well as the issue of foreseeability of a dispute in ***Pac Rim v. El Salvador*** and ***Philip Morris v. Australia cases***. In due course it came to the point that arbitrators have started to pay more attention to the timing criterion, which may indicate a kind of formal interpretation of particular situation (in contrast with earlier ***Mobil and Others v. Venezuela case***). Nevertheless, arbitration conclusions in ***Philip Morris v. Australia case*** have showed that tribunals, as a general principle, do not ignore the issue of the true reasons for any type of corporate reorganization.

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[215] *Ibid*., paras 389-393.

[216] The Tribunal was not convinced that the political developments after 29 April 2010 had been as such that the Claimant could reasonably conclude that the enactment of Plain Packaging Measures and the ensuing dispute were no longer foreseeable. See *ibid*., para 566.
However, according to findings in para 567, the length of time it takes to legislate is not decisive factor in determining whether the legislation is foreseeable.

[217] *Ibid*., paras 582-584.

## 2.2 WAYS OF REDUCING THE TREATY SHOPPING EXPANSION IN THE INTERNATIONAL INVESTMENT ENVIRONMENT

After analysis in the previous chapter, it should be said that the treaty shopping *per se* is not hazardous as its abuse. This statement is confirmed both by the arbitration practice of settled investment disputes and by the doctrinal positions of individual theorists. Notwithstanding the foregoing, the misuse of nationality planning led to the need to find appropriate ways of reducing the expansion of that phenomenon. Earlier, in subchapter 1.1.2, the reaction of different nations to the question of treaty shopping has already been described. Among other things, the debate on the enhancement of the existing global investment regime within the framework of the UNCTAD's Reform Package[218] was also mentioned. At this stage of the research it seems justified to consider possible options for decreasing the abusive nationality (re)structuring in the context of the Reform Package.

The compositional logic of this chapter is defined in such a way that each of the following subchapters will highlight the possible options depending on the reasons that determine the existence of treaty shopping.[219] Therefore, it is assumed that problems of the ongoing IIA network and investor-state dispute settlement mechanisms will be also shown in this way. For the record, it is important to note that the Reform Package, as a comprehensive tool for consistent improvement of the current investment regime, consists of many methods and alternatives, unfortunately, not all of them can be applicable to the subject matter of this paper. Accordingly, the most useful variants will be further considered.

### 2.2.1 Reformation of IIA Network

At the very beginning of this subchapter it should be recalled that one of the reasons for the emergence of the treaty shopping practice is **a wide network of investment agreements**[220]. This aspect is the central one in the UNCTAD's proposals, because most of the options in the Reform Package are precisely directed to the reduction of IIA network. It is envisaged that with a decrease in number of international investment instruments, the total amount of possible ways for structuring corporate nationality will also decrease. To that extent, the next 4 alternatives under the Reform Package should be examined.

[218] See footnote 56, subchapter 1.1.2.
[219] The reasons for the occurrence of treaty shopping phenomenon are described in subchapter 1.1.1.
[220] See footnotes 30 and 31.

1. **Replacement of 'outdated treaties'**[221]. This action provides for the substitution of outdated IIAs with their newer versions. Those versions can be concluded by the same treaty Partners (e.g. when one BIT is replaced by a new BIT), or by a larger group of states (e.g. when a multilateral treaty appears). A full update of investment treaty enables the Parties to reach a higher degree of change and to be more accurate in the preparation of IIA that responds to their commonly shared views.

   According to the UNCTAD's statistics[222], about 130 BITs have been replaced mostly by other BITs or bilateral TIPs. The most active countries in this regard are the Federal Republic of Germany, the People's Republic of China, the Arab Republic of Egypt, Romania and the Kingdom of Morocco. To be more precise, for example, the Republic of Peru replaced three of its old BITs with subsequent free trade agreements (hereafter referred to as FTAs) that it concluded with the same Partners, among which are the Republic of Chile (2006)[223], the Republic of Singapore (2008)[224], and the Republic of Korea (2010)[225]. But some other BITs are replaced only conditionally, which leaves the possibility to revive the old BIT if the new agreement is terminated, for instance, FTA between Canada and the Republic of Panama (2010)[226].
2. **Consolidation of IIA network**[227]. Consolidation is a form of replacement, which means the annulment of a number of pre-existing treaties and the enactment of a single investment instrument. That type of replacement has a dual positive effect, because in such a way there is a possibility to achieve the modernization of the treaty content and the establishment of uniform rules for many nations. For example, in a European context, whenever the EU (as a supranational organisation) concludes IIA with a third State, this new agreement correspondingly substitutes all BITs previously signed with that particular country by each of the EU Member-State.

   It is expected that Canada – EU CETA (2016)[228] will replace eight prior investment treaties between Canada and the EU Member-States. The same is true for recently

[221] UNCTAD, *The Reform Package*, 80.
[222] All statistics in the following paragraph are taken from *The Reform Package*, 80.
[223] "Chile-Peru FTA (2006)," Investment Policy Hub: International Investment Agreements Navigator, accessed on 22 April 2019, https://investmentpolicyhub.unctad.org/IIA/treaty/3384
[224] "Peru-Singapore FTA (2008)," Investment Policy Hub: International Investment Agreements Navigator, accessed on 22 April 2019, https://investmentpolicyhub.unctad.org/IIA/treaty/3240
[225] "Korea-Peru FTA (2010)," Investment Policy Hub: International Investment Agreements Navigator, accessed on 22 April 2019, https://investmentpolicyhub.unctad.org/IIA/treaty/3277
[226] "Canada-Panama FTA (2010)," Investment Policy Hub: International Investment Agreements Navigator, accessed on 22 April 2019, https://investmentpolicyhub.unctad.org/IIA/treaty/3286
[227] *The Reform Package*, 82.
[228] "CETA (2016)," Investment Policy Hub: International Investment Agreements Navigator, accessed on 22 April 2019, https://investmentpolicyhub.unctad.org/Download/TreatyFile/5380

negotiated FTA between the EU and the Republic of Singapore, which will replace 12 pre-existing BITs. In 2013 the Mexico – Central America FTA[229] came into force and simultaneously interchanged the former trade agreements concluded between the United Mexican States and the Republic of Costa Rica, the Republic of Nicaragua, the Republic of El Salvador, the Republic of Guatemala, and the Republic of Honduras during 1994-2000s. Additionally, there is a proposal to replace more than 100 currently in place BITs in African states with a single COMESA–EAC–SADC Tripartite FTA[230].

3. **Abandonment of unratified old treaties**[231]. This action presupposes that country can formally indicate its intention not to be bound by provisions of old IIA that for some reason has not entered into force. The existence of such type of agreement is quite common.[232] The final outcome of this option is mainly directed to the reduction of present IIA network.

   It is crucial to note that in accordance with Article 18 of the Vienna Convention on the Law of Treaties, countries are «obliged to refrain from acts which would defeat the object and purpose of a treaty».[233] This means that the Contracting Parties to a certain extent are bound by the provisions of signed agreement, even if it has not entered into force yet. Subsequently, by way of abandoning the particular state can release itself from the fulfillment of the specified obligation.

   As an example, the Federative Republic of Brazil has abandoned 14 BITs concluded in the 1990s. It was done after the National Congress declared unconstitutional some of their provisions.[234] Not too many years ago, in January 2017, the United States of America publicly announced its intention to withdraw from the Trans-Pacific Partnership Negotiations and Agreement.[235]

4. **Termination of existing old treaties**[236]. Termination of the investment treaty is a straightforward way that allows the Parties from the obligation to further perform under

[229] "Mexico-Central America FTA (2011)," Investment Policy Hub: International Investment Agreements Navigator, accessed on 22 April 2019, https://investmentpolicyhub.unctad.org/IIA/countryGrouping/17/treaty/3291

[230] As of April 2016, the total number of participating member states has risen to 27. See also *The Reform Package*, 83.

[231] *Ibid*., page 90.

[232] This statement is confirmed by the statistics on Bolivia, where 5 of 29 international investment instruments are not in force, as of April 2019. See Investment Policy Hub search system https://investmentpolicyhub.unctad.org/IIA/AdvancedSearchBITResults

[233] "The Vienna Convention on the Law of Treaties," *United Nations, Treaty Series* 1155, 18232 (1969), 336.

[234] *The Reform Package*, 90.

[235] *Ibid*.

[236] *Ibid*.

its terms (not to be confused with the replacement of the agreement). As a general rule, each IIA can be terminated unilateral or by mutual consent. Provisions for unilateral treaty termination are usually stipulated in the BIT itself. Such kind of breakdown gives an effect to the survival clause, which normally prolongs the operation of the treaty for a certain period of time.[237] Hereupon, the UNCTAD's analytics[238] shows that various states resort to the practice of termination. But more often it is related to the process of drafting a new IIA. Only over the past decade a number of countries have terminated their BITs. For instance, the Plurinational State of Bolivia cancelled about 10 investment agreements, while the Republic of Indonesia cancelled almost 2 times more. In 2016, the Republic of India sent notices of termination to its 50 Partners with the clear intention to renegotiate their investment relationships on a basis of the revised Model BIT 2015. In May 2017, the national authorities of the Republic Ecuador approved the termination of 16 BITs.[239]

Continuing the analysis in this subchapter, it is time to recall the next reason – **the simplicity of business incorporation among the majority of jurisdictions**. Since that reason is mainly caused by extensive 'investor' and 'investment' definitions in old IIA-models, it is quite obvious to pay attention to such an option under the Reform Package as **amendment of treaty provisions**. That action does not only reduce the ways of structuring the business, but generally has a positive effect on updating the content of the existing IIA network.

According to UNCTAD, about 1/3 of all investor-state claims in 2010 – 2015 were filed by entities that are eventually owned by holding companies in the third States, which are not the Contracting Parties to the disputed treaties. More than 1/4 of those Claimants do not have substantial operations in host States. This figure may increase up to 75%, taking into account claims based on IIAs concluded by major ownership hub locations.[240] Therefore, amendment (as policy option) should be considered in relation to the following types of investors:

(i) mailbox companies,

(ii) entities controlled by host State nationals, or

(iii) structured entities in anticipation of a claim.

In respect to the **mailbox companies**, the Reform Package suggests actions which either anticipate the inclusion of additional criteria in the definition of investor, or the acceptance of

[237] *Ibid*., 91.

[238] Of 212 BITs terminated as of March 2017, 19 treaties were jointly terminated, without any replacement or consolidation; another 59 were unilaterally terminated, while 134 were replaced by a new treaty.

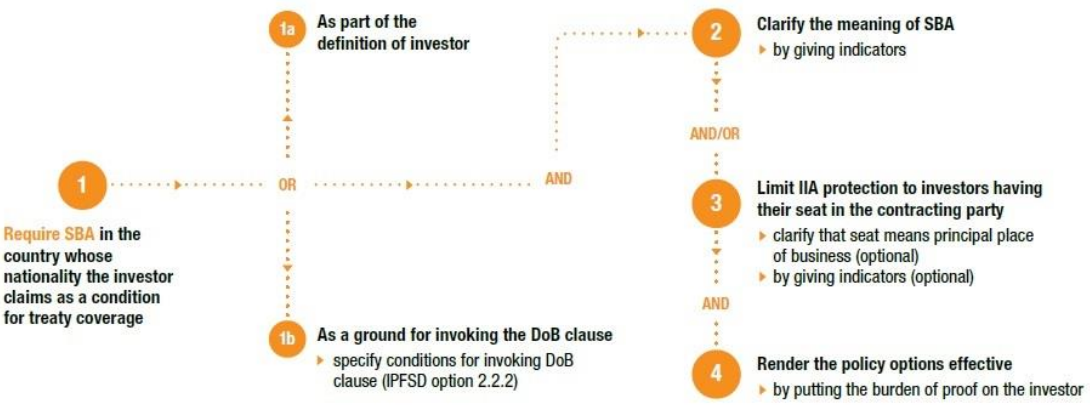
[239] All data presented in this paragraph are taken from *The Reform Package*, 91-92.

[240] *Ibid*., 43.

'denial of benefits' clause (Scheme 2. Mailbox companies)[241]. The first option can be implemented by stipulating that the investor must not only be incorporated but also engaged in 'substantial business activities' in the home State. Needless to say that such criterion should be accompanied by explanations of what might constitute the substantial business activity.

The 'denial of benefits' clause, as an alternative option, allows host States to deny treaty protection to mailbox companies when the particular seat, ultimate ownership or substantial business presence could not be confirmed by the investor.[242] Here due attention needs to be given to the time of invocation. Arbitration interpretation stands on the fact that 'denial of benefits' clause may not be invoked against investor after a formal arbitration claim was initiated.[243]

Scheme 2. Mailbox companies

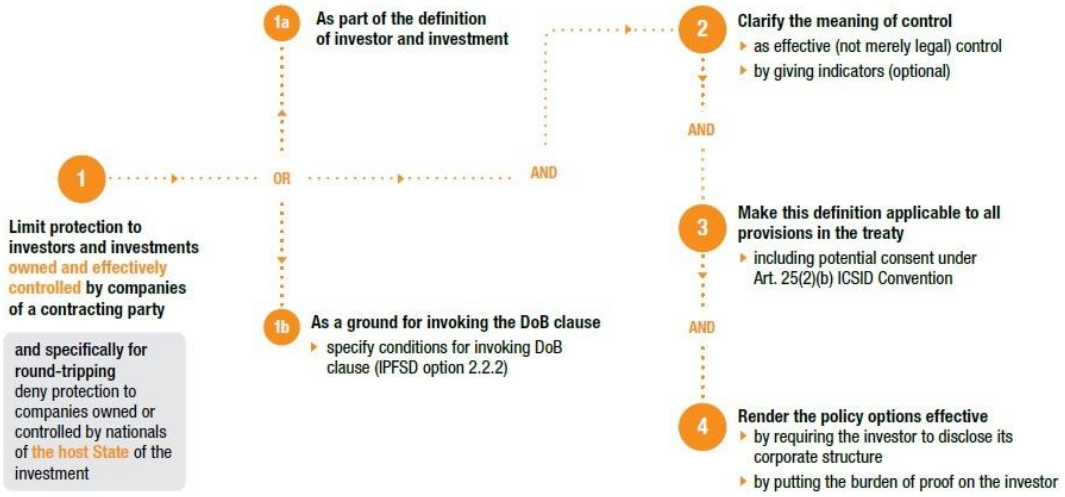



Source: UNCTAD's Reform Package for the International Investment Regime 2018

In relation to the **entities controlled by host State nationals** (i.e. round-tripping), the Reform Package holds out an offer to limit investment protection through more specific definitions of investor and investment, or by retaining the right to deny benefits (Scheme 3. Round-tripping)[244]. For example, this can be done by way of clarifying the meaning of effective control.

[241] Scheme 2. Mailbox companies. See Figure 10. Mailbox companies: IIA options, *ibid*., 44.
[242] Chaisse, *The Treaty Shopping Practice*, 79.
[243] *The Reform Package*, 43.
[244] Scheme 3. Round-tripping. See Figure 11. Indirect investments and round-tripping: IIA options, *ibid*., 44.

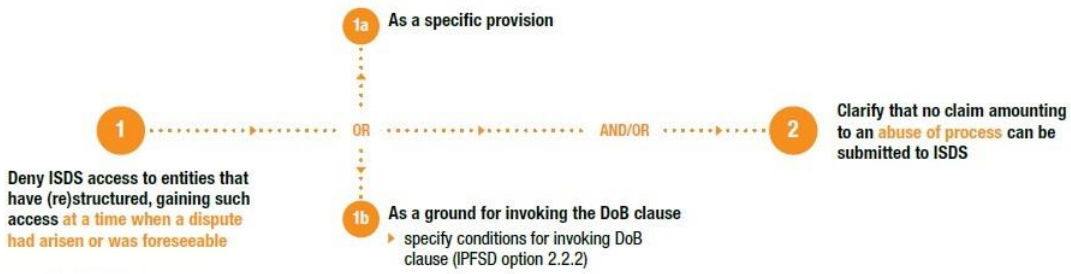
Scheme 3. Round-tripping




Source: UNCTAD's Reform Package for the International Investment Regime 2018

With respect to the **entities structured in anticipation of a claim**, the Reform Package proposes to deny ISDS access for investors, who reorganize their corporate chains at the time when a precise dispute has already arisen or could have been foreseen (Scheme 4. Restructuring in time)[245]. That option can be realized through the inclusion of a new type of treaty provision or through the 'denial of benefits' clause.

Scheme 4. Restructuring in time




Source: UNCTAD's Reform Package for the International Investment Regime 2018

Not only definition of investor qualifies the simplicity of business incorporation. Categories that are covered by 'investment' term are also important. As already mentioned in suchapter 1.2.2, too extensive investment statement may lead to a situation where a wide range of assets (not always genuine) can get protection under IIA. With that in mind it is necessary to determine a list of characteristics that foreign investment must meet. In accordance with the Reform Package, these characteristics can be: the commitment of capital, the expectation of

[245] Scheme 4. Restructuring in time. See Figure 12. Time-sensitive restructuring: IIA options, *ibid*., 45.

profit, the assumption of risk, the duration or the lasting economic relations.[246] Interestingly, there is a debate as to whether an investment's positive contribution to (sustainable) development could be considered as additional criterion.[247]

Apart from that, the established treaty practice has already advanced a bit in this direction. For instance, in some new IIA the definition of investment comprises an exhaustive list of covered assets or expressly excludes their special types.[248] Nevertheless, in any of the above said cases it is important to comply with the requirement of legality. In other words, each and every time the investment should be made in accordance with the laws of the host State.

Concluding the examination of treaty shopping matters in the context of reforming the present IIA network, two more policy options under the Reform Package must be outlined. In essence, they are integral and seem to be more difficult in terms of practical application. The first proposal is **a multilateral engagement**[249]. From the UNCTAD's perspective, a global multilateral reform looks as the most effective way to address the inconsistencies, treaty parallelism and development challenges that now characterize the whole international investment regime. Over the last years several attempts on that front have been made.

As an example, the Mauritius Convention[250] can be named. This document promotes a major application of the UNCITRAL Transparency Rules[251] to IIAs concluded prior to 1 April 2014. The Mauritius Convention efficiently modifies a number of first-generation investment treaties, which turns it into joint IIA reform action.[252] By way of investment-related illustration

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[246] *Ibid*., 42.

[247] The investment's positive contribution to (sustainable) development is one of issues under Indian model BIT, 2015.

[248] Subchapter 1.2.2 contains more specific examples in (iii) 'closed-list' and (iv) 'exclusion' approaches.

[249] *The Reform Package*, 88.

[250] "The United Nations Convention on Transparency in Treaty-based Investor-State Arbitration (the Mauritius Convention)," United Nations Commission on International Trade Law, 2015,accessed on 22 April 2019, https://www.uncitral.org/pdf/english/texts/arbitration/transparency-convention/Transparency-Convention-e.pdf. As of July 2018, 23 States signed and only 4 States ratified the Mauritius Convention, which entered into force on 18 October 2017. It enables States as well as regional economic integration organizations to make the UNCITRAL Transparency Rules applicable to ISDS proceedings brought under their IIAs concluded prior to 1 April 2014 and regardless of whether the arbitration was initiated under the UNCITRAL Arbitration Rules. See *The Reform Package*, 49.

[251] "UNCITRAL Rules on Transparency in Treaty-based Investor-State Arbitration," United Nations Commission on International Trade Law, 2014, accessed on 22 April 2019, https://www.uncitral.org/pdf/english/texts/arbitration/rules-on-transparency/Rules-on-Transparency-E.pdf. These Rules set out procedures for greater transparency in investor-State arbitrations conducted under the UNCITRAL Arbitration Rules and provide for a 'Transparency Registry' as a central repository for the publication of information and documents in treaty-based ISDS cases. The Rules are already applicable to a number of IIAs concluded after 1 April 2014. See *The Reform Package*, 49.

[252] *Ibid*., 88.

the BEPS Multilateral Instrument[253] can be specified. Its implementation contributes to the numerous changes in more than 3000 bilateral tax treaties concluded to date. As a sidenote, quite often corporate restructuring is accompanied by a search for jurisdiction with the most favourable tax climate.

The second and final proposal of the Reform Package, which should be considered in this subchapter, is **a withdrawal from multilateral mechanisms**[254]. This alternative can help to reduce country's exposure to investor claims, but it may create challenges for future multilateral cooperation. Not that long ago, two signatories have withdrawn from the Energy Charter Treaty. In 2009, the Russian Federation declared its intention to terminate provisional application of stated treaty. Soon after, in 2014, the Italian Republic submitted a notice of denunciation of the Energy Charter Treaty, which took effect on 1 January 2016. However, the aforesaid IIA contains two separate 20-year survival clauses that apply both to the provisional signatories (the Russian Federation) to fully fledged parties (Italy).[255]

### 2.2.2 Reformation of ISDS Mechanisms

The discussion in this subchapter mainly responds to the last reason of treaty shopping occurrence – **the popularization of investor-state dispute resolution mechanisms**. According to UNCTAD, dispute settlement through international arbitration is another important issue of the IIA reform debate. The increase in number of investor-state disputes in recent years, together with unexpected and inconsistent interpretations of IIA provisions by arbitral tribunals, has resulted in growing criticism of today's ISDS system.[256] It is already the case when many countries have revised their attitudes towards ISDS by adopting certain reform measures. All of them can be divided into two large groups aimed at:

(a) reforming the existing investor-state arbitration, or

(b) replacing the existing investor-state arbitration.

Further specific options will be considered in this regard.

The first set of actions is devoted to the **preservation of the existing ISDS mechanisms** but with the introduction of some modifications. In other words, investors still reserve the right to initiate arbitration proceedings against host States. Modifications mainly concern the inclusion of new treaty provisions oriented on the (i) improvement of the arbitral

[253] "Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting," OECD, accessed on 22 April 2019, https://www.oecd.org/tax/treaties/multilateral-convention-to-implement-tax-treaty-related-measures-to-prevent-BEPS.pdf

[254] *The Reform Package*, 92.

[255] *Ibid.*

[256] *Ibid.*, 47.

process, (ii) limitation of investors' access to investment arbitration, and (iii) introduction of the local litigation requirements.[257] The greatest point about this is that reform options can be implemented both into pre-existing and future individual investment agreements, and they do not require coordinated activities from a large number of states.

(i) The **'improvement of arbitral process'** option focuses on reforming the way arbitration proceedings are conducted. The main objectives of such adjustments are to enhance the legitimacy of the ISDS system, to increase the contracting parties' control over the interpretation of their treaties, and to make the arbitral process more efficient itself. For that matter the Reform Package suggests specific reform steps, which include granting public access to arbitration documents and arbitral hearings; establishing mechanisms for binding joint party interpretations; requiring tribunals to refer certain matters (e.g. taxation, scheduled reservations) for joint determination in the first instance by the treaty Parties.[258]

(ii) The **'limitation of investors' access to investment arbitration'** option focuses on narrowing the range of situations, in which foreign investors may resort to international arbitration. By doing so, it is assumed that the legal and financial risks caused by ISDS proceedings will be reduced. To this extent, the Reform Package offers to exclude several types of claims from the scope of ISDS.[259] This may comprises particularly sensitive sectors, specific treaty provisions or sensitive policy areas.[260] Apart from that, the limitation of the investors' access can be achieved by prohibiting recourse to dispute settlement after a definite time period has passed from the events giving rise to the claim, for instance, three years.[261]

In addition, the Reform Package directly stipulates the denial of ISDS access to investors who are engaged in treaty shopping or nationality planning through shell companies that channel investments but do not involve in any real business operations in the territory of home State.[262]

(iii) The **'introduction of the local litigation requirements'** option focuses on promoting the recourse of foreign investors to domestic courts, while retaining the

[257] *Ibid.*, 49.
[258] *Ibid.*, 50.
[259] *Ibid.*
[260] The original text of the UNCTAD's Reform Package stipulates that exclusion could apply to certain sectors considered particularly sensitive (e.g. for claims relating to financial institutions and real estate), specific treaty provisions (e.g. pre-establishment obligations) or sensitive policy areas (e.g. measures adopted on national-security grounds).
[261] Without it, claims could be filed at any time, exposing States to uncertainty.
[262] *The Reform Package*, 51.

option for ISDS as a remedy of last resort.[263] Under the logic of the Reform Package, the provisions of investment agreements may require investors to exhaust local remedies before accessing international arbitration, or specify that the recourse to international investment arbitration will be effective only after a certain period of time of litigating the dispute in national courts (e.g. 18 months).[264]

Among other things, with respect to reforming the existing investor-state arbitration, UNCTAD's policy proposes to add appeals facility in course of operating ISDS mechanisms. It is intended that by introducing such an option the competent body within the arbitration mechanism will be authorised to conduct a substantial review of the arbitral tribunals' first instance decisions.[265] However, in this view some accompanying questions need to be resolved.

First of all, it is necessary to determine what kind of nature this appeals body will be – bilateral, regional or multilateral. It seems rational that the easiest way to reach a consensus on appeals body is a bilateral agreement. Secondly, it is also important to identify whether the appeals facility will be permanent or ad hoc.[266] Despite the fact that ad hoc mechanisms are much simpler in their realization, a permanent body can be more capable of ensuring the coherence in arbitral practice.[267] Thirdly, the establishment of appellate body will add another level of proceedings to the arbitration process, therefore a care will need to be taken in order to organise an efficient process, including timelines.[268]

Continuing consideration of appropriate options (in terms of reducing the practice of treaty shopping) in the context of ISDS reform, the second set of actions should be further described. In essence, it is dedicated to the **replacement of existing investor-state arbitration models**. This mainly includes the creation of a standing international investment court, or the reliance on domestic judicial systems of the host State.[269] Interested countries can focus only on one option or can pursue it in combination.

By reference to the creation of a standing international investment court, it is worth mentioning that such alternative retains the right to bring a claim against the host State, but replaces the system of multiple ad hoc arbitral tribunals with a single institutional structure.[270] It

[263] *Ibid.*
[264] *Ibid*., 52.
[265] In so doing, it could serve to enhance the predictability of treaty interpretation and improve consistency among arbitral awards. All this could significantly contribute to enhancing the political acceptability of ISDS and the IIA regime as a whole. See *ibid*., 53.
[266] *Ibid.*
[267] Under the Reform Package is presumed that an appellate body with permanent judges will be able to deliver consistent – and balanced – decisions, which would rectify some of the legitimacy concerns on the current ISDS regime.
[268] The Reform Package gives an example of the WTO Appellate Body. See *ibid*., 54.
[269] *Ibid*., 55.
[270] *Ibid.*

is assumed that a standing international investment court will be a public institution handling the interests of foreign investors, countries and other stakeholders, thereby strengthening the legitimacy of the present investor-state regime. Additionally, it could contribute to increasing consistency and predictability in the treaty interpretation.

Recent developments show that some steps in this direction have been taken. In such a manner, the European Commission launched a public consultation on a multilateral reform of investment dispute settlement, which was open until March 2017. A ministerial-level breakfast discussion on the same issue was co-hosted by the European Trade Commissioner and the Minister of International Trade of Canada in January 2017 on the sidelines of the World Economic Forum in Davos, Switzerland. Later on, on 13 September 2017, the European Commission released a proposal for a new International Investment Court with a view to start negotiations for a relevant Convention. Ultimately, on 20 March 2018, the European Council adopted the negotiating directives, authorising the European Commission to negotiate, on behalf of the EU, the Convention establishing a multilateral court for the settlement of investment disputes.[271]

Regardless of the fact that the creation of a single international investment court is a highly debatable issue, there are a number of political and legal challenges that must be taken into account. Just to name a few of them:

- how to find a consensus on the adoption of the relevant Convention among a large number of countries,
- how to determine the location, financing and staffing of the court,
- how to establish a more universal structure, serving the needs of developing and least developed countries, and
- how to determine the competence of the court regarding the investment agreements and cases.[272]

As an alternative to the above said option, the Reform Package offers the variation, according to which investor's right to bring a claim against host State limits only to the dispute resolution in domestic courts. Under this action, domestic judicial institutions are merely exclusive mechanism for settling disputes between foreign investors and host State.[273] This option is suitable for those jurisdictions, where the national legal systems, good governance and local courts' expertise are at a sufficient level of development and trust. Nevertheless, there are certain kinds of concern regarding the independence, neutrality, efficiency and enforceability of

[271] All information, as an example, in this paragraph is taken from the Box 1. Reforming investment dispute settlement – recent developments. For more details see *The Reform Package*, 49.
[272] *Ibid*., 56.
[273] *Ibid*., 58.

local court decisions, especially in states with a weak governance. Moreover, national judicial institutions can take a long time to settle a dispute or even may not have a legal competence to directly apply provisions of international law.[274]

Summarizing that was mentioned in the previous two subchapters, it should be noted that with respect to combating the expansion of the treaty shopping practice, which is sometimes not entirely bona fide, each country can choose and adopt the various options proposed by the UNCTAD's Reform Package. They are all different in nature and encompass actions that are more technical or rather political, focus on procedure or substance, or imply continuous engagement.[275] Determining which reform option is 'appropriate' for a specific state, it is necessary to carefully and thoroughly conduct a cost-benefit analysis, simultaneously addressing a number of broader challenges. It is essential to recall that proposed alternatives can be implemented in isolation or in combination. In any case, it is important to remember that the issue of the abusive nationality planning is not the matter of provisional modification in investment treaty, more comprehensive reform is needed. This applies equally to ISDS mechanisms and to substantive IIA provisions, because frequently they are the root cause of many problems. In an ideal scenario, the reform steps should apply not only to future treaties, but also affect the mass of already-existing international investment instruments.

[274] *Ibid.*
[275] *Ibid.*, 75.

## CONCLUSIONS

Taking into account the topic of the present Master thesis, the designated aim and the allocated objectives, the following should be concluded hereafter.

1. The subject matter of this study is a concept of treaty shopping (nationality planning), which constitutes a highly debatable issue that is rather interpreted in the practice of investment arbitration, than officially determined by a certain national legislation.
2. Despite the various verbal forms, the general meaning of treaty shopping can be outlined as a conduct of foreign investor, who is intentionally looking for a 'home State of convenience' with a suitable investment agreement with the host State, where a particular investment is or will be made.
3. The concept under investigation became widely known in the early 2000s due to the extensive internationalization of investment activities. The presence of such factors as quantitative increase of IIA network, popularization of investor-state dispute resolution mechanisms, simplicity of business incorporation among the majority of countries also played a significant role in that regard.
4. The principal elements that allow treaty shoppers to maneuver between jurisdictions are broadly or not exactly defined terms of investor and investment in IIAs. The availability of a wide range of criteria in investment agreements for determining the corporate nationality of an investor makes it possible to quite freely resort to the practice of corporate restructuring for the purposes of business optimization at the level of international investment.
5. Regardless of the various forms of existence and methods of implementation, the treaty shopping is neither prohibited nor illegal phenomenon *per se*. It is generally accepted by theorists and arbitral tribunals that searching for a more attractive investment protection under IIAs in force is a normal business management practice until it involves the signs of abusive conduct.
6. Established arbitration practice shows that international tribunals interpret the concept of abusive treaty shopping as an activity aimed at carrying out corporate reorganization with the sole purpose of gaining access to the ISDS mechanisms. This is often accompanied by levelling the true nature of the operation, by neglecting the time limits for restructuring, and by ignoring the foreseeability test of a dispute.
7. The arbitration case law confirmed that the foreseeability test is an algorithm that determines a situation, 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.

8. Since the abusive treaty shopping activity is not recognized by the international community as acceptable, the need to take certain measures to eliminate it seems quite logical. Pursuant thereto, UNCTAD has developed the Reform Package, which constitutes a comprehensive tool for the consistent improvement of the ongoing investment regime. It involves many alternatives that can be used to achieve the goal of reducing the expansion of abuses among foreign investors.
9. The last point to remember is that in the process of choosing the appropriate reform option, it is necessary to carefully balance the substantial modification of treaty provisions, as well as the reformation of the existing mechanisms for settling investment disputes between investors and host States.

## RECOMMENDATIONS

Based on the conducted research, it is proposed to implement the following recommendations in order to balance the legitimate usage of 'treaty shopping' concept.

1. For investors (corporate entities):

- in the event of 'front-end' structuring **(nationality planning)**, it is recommended to plan corporate nationality in advance, by examining the already-existing IIA network of between the target State and host State, their legal environments and national policies in relation to foreign investing activities, for the purpose of obtaining the most beneficial investment protection.

- in the event of 'back-end' restructuring **(treaty shopping)**, it is suggested to use the algorithm, established in the process of adjudication, for the purpose of avoiding the abusive investment behaviour. Pursuant thereto, before doing the restructuring, it is necessary to evaluate (i) the correlation in time between the actual appearance of the alleged breach and the relocation of nationality, and (ii) foreseeability of a dispute within the 'abuse of rights' concept.

2. For states (national legislators): it is recommended to revise its currently effective investment policies and, in order to reduce the expansion of treaty shopping abuse, make appropriate changes at the level of national legislation. In this regard, it is suggested to use the alternatives proposed by the UNCTAD's Reform Package 2018, best balancing the interests of all participants in the investment process.

3. For International Community (supranational organizations, leading governments and associations): it is recommended to continue the cooperation towards the formation of a multinational investment regime.

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## ABSTRACT

The research presents a comprehensive study on ‘treaty shopping’ phenomenon in international investment law. It is mainly dedicated to the analysis of practice of corporate restructuring which is oriented on obtaining the treaty protection under particular investment agreement.

The findings of the Master thesis outline causes and consequences of the existence of ‘treaty shopping’ concept in international investment law, identify core elements of ‘treaty shopping’ manipulations, compare already-existing approaches in the practice of investment arbitration towards treaty shopping treatment, and specify appropriate ways of reducing the treaty shopping expansion in international investment environment. As the final result, the present research clarifies the dividing line between the practice of treaty shopping as a normal business management activity and the abusive behaviour focused on obtaining the treaty protection.



Keywords: treaty shopping, nationality planning, abusive corporate restructuring, investment protection, abuse of rights.

**CORPORATE RESTRUCTURING TRYING TO GAIN INVESTMENT PROTECTION: ABUSE OF RIGHT OR NORMAL BUSINESS MANAGEMENT PRACTICE**

**TETIANA PRYIMAK**

**SUMMARY**

The Master thesis is focused on a problem of 'treaty shopping' phenomenon in international investment law, particularly on how to distinguish the legitimate corporate restructuring, aimed at obtaining the investment protection, and the abuse of rights.

The structure of the present study is mainly determined by the goal and objectives of the research, and therefore it consists of two parts, which are divided into chapters and subchapters. The first part outlines the general statement on the 'treaty shopping' concept in international investment law. It involves the analysis of: the very meaning of discussed phenomenon; the reasons for the occurrence and reaction of different countries towards the treaty shopping expansion; and the most controversial elements of international investment agreements, which investors use to manipulate under the treaty shopping activity.

The second part is concerned with practical significance of the treaty shopping application. Consequently, it introduces the variety of arbitration approaches to the interpretation of corporate restructuring for the purposes of obtaining treaty protection, as well as classifies appropriate proposals for eliminating the misuse of treaty shopping practice in international investment environment.

The main findings are that 'treaty shopping' is neither prohibited nor illegal phenomenon *per se*. It is generally accepted that searching for a more attractive investment protection under effective international investment agreement is a normal business management practice until it involves the signs of abusive conduct. In the process of examination of arbitration case law it was confirmed that practice of abusive treaty shopping constitutes the activity aimed at carrying out corporate reorganization with the sole purpose of gaining access to the investor-state dispute settlement mechanisms.

For the purposes of distinguishing the legitimate nationality planning and abusive corporate restructuring, the 'foreseeability test' for a specific future dispute was proposed. It is assumed that the resort to this algorithm will prevent the extension of abusive investment behaviour. Based on the comprehensive analysis of international initiatives, it was suggested for national legislators to revise its currently effective investment policies and, in order to reduce the expansion of treaty shopping abuse, implement the number of alternatives proposed by the UNCTAD's Reform Package 2018.