Indirect Investments in ISDS & Treaty Shopping

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ASEAN | CHINA | MIDDLE EAST

Investment protection through international treaties

- Investment treaties:
  - Bilateral (BITs)
  - Multilateral –
    - e.g. ICSID Convention, ASEAN Comprehensive Investment Agreement, Comprehensive and Progressive Agreement for Trans-Pacific Partnership (TPP less USA)
- States undertake to refrain from practices prejudicial to investors who are nationals of other contracting parties (e.g. expropriation, fair and equitable treatment, MFN)
- Foreign investors whose rights have been prejudiced by the host state have an external direct remedy in international arbitration.
- Idea is to promote **foreign** investment.
- Example:
  - Singapore-Cambodia BIT
  - Article 3 states: “Investments approved under Article 2 shall be accorded fair and equitable treatment and protection in accordance with this Agreement.”
  - A Cambodian company buys land in Singapore. The Singapore Government passes a law requiring the Cambodian company to sell the land to a Singaporean company without fair compensation.
  - The Cambodian company may pursue a claim against the Singapore Government before an international tribunal.

Indirect investments

- Different forms of “investment”
  - Foreign company directly owns an asset.
  - Foreign company owns shares in a local company (a subsidiary), which in-turn owns an asset.
  - Foreign company holds promissory notes issued by Government of host state?
- Fedax v Venezuela (1997)
  - Fedax (Netherlands) initiated arbitration against Venezuela.
  - Venezuela disputed jurisdiction on the basis that the dispute concerned Fedax’s holding of promissory notes issued by Venezuela. Venezuela argued that Fedax’s holding of the promissory notes did not amount to a foreign direct investment.
  - ICSID Convention Article 25(1):

    > The jurisdiction of the Centre shall extend to any legal dispute arising directly out of an investment, between a Contracting State… and a national of another Contracting State, which the parties to the dispute consent in writing to submit to the Centre…

  - The Tribunal held that the definition of “investment” in the ICSID Convention was broad. As such, it could encompass even investments which were not direct. The Tribunal held that it had jurisdiction.

Indirect investments

- The foreign investor may own shares in a local company, which holds an asset such as land.
- Can the foreign investor's holding of such shares be an "investment"?
- AMT v Zaire (1997)
  - AMT (USA) initiated arbitration against Zaire (now the Republic of Congo).
  - AMT held 94% shareholding in its Zaire subsidiary. AMT was 55% controlled by US citizens.
  - Art 1(c) of the USA-Zaire BIT provided that the term "investment" meant "every kind of investment, owned or controlled directly or indirectly, including equity, debt, and service and investment contracts; and includes:… (ii) a company or shares of stock or other interests in a company or interests in the assets thereof".
  - Zaire argued that the Tribunal had no jurisdiction because any losses were suffered by the Zaire subsidiary, not AMT.
  - Tribunal held that AMT had standing to bring the claim against Zaire.

Indirect investments

- Often, the foreign company may be required by law to set up a local subsidiary in the host state to hold the asset – e.g. if only local companies are allowed to hold land.
- Siemens AG v Argentina (2004)
  - Siemens (Germany) initiated arbitration against Argentina.
  - Siemens wholly-owned SNI (Germany), which in turn wholly owned SITS (Argentina), which was the entity contracted to perform a project.
  - It was a requirement that an Argentinian company be set up for the project.
  - Argentina: No jurisdiction because there was no direct relationship between Siemens and the investment.
  - Tribunal rejected the argument.

Indirect investments

- Tribunals may not accord consistent interpretation to treaties.
- CEMEX v Venezuela (2010)
  - CEMEX (Netherlands) initiated arbitration against Venezuela.
  - CEMEX held an indirect ownership interest in a Venezuelan company.
  - The Tribunal held that CEMEX's indirect investment fell within the scope of the BIT.
  - While the BIT applied to "***investments of***" Dutch nationals, this did not mean that the investment in question must be "directly" owned by those nationals.
- Standard Chartered Bank v Tanzania (2012)
  - SCB (UK) initiated arbitration against Tanzania.
  - Article 8(1) of the BIT: The Tribunal has jurisdiction over a dispute "arising between the Contracting Party and a national or company of the other Contracting Party concerning an **investment *of*** the latter in the territory of the former."
  - Tanzania: "investments **of**" a UK national or company means investments in Tanzania "actually made or directly owned by a national or company of the UK".
  - Tribunal held that "an indirect chain of ownership linking a British company to debt by a Tanzanian creditor did not in itself confer the status of investor under the UK-Tanzania BIT."

Indirect investments

- Further forms of investment:
  - Foreign investor is a national of country X, which does not have an investment treaty with the target host state, Z. Foreign investor incorporates a company in third state, Y, which has an investment treaty with Z.
  - Foreign investor is a national of country X, whose investment treaties with the target host state, Z, confer less protection than those between a third state, Y, and Z. Foreign investor incorporates a company in Y to take advantage of the more favourable investment treaty.
  - National of country Z incorporates a company in country X, in order to avail itself of an investment treaty between X and his own country, Z.
- Treaty shopping?

Indirect investments

- Tokios Tokeles v Ukraine (2004)
  - Tokios (Lithuania) initiated arbitration against Ukraine in respect of its shareholding in a Ukrainian company.
  - Tokios was 99% held by Ukrainian nationals.
  - Ukraine: This was tantamount to allowing Ukrainian nationals to pursue international arbitration against their own government.
  - Ukraine-Lithuania BIT:
    - Art 1(2)(b): "investor" is defined to mean "any entity established in the territory of the Republic of Lithuania in conformity with its laws and regulations"
    - No "denial of benefits" clause
  - Majority: It is "not for tribunals to impose limits on the scope of BITs not found in the text, much less limits nowhere evident from the negotiating history".
  - Minority (Prof Prosper Weil): "[w]hat is decisive in our case is the simple, straightforward, objective fact that the dispute before this ICSID Tribunal is not between the Ukrainian State and a foreign investor but between the Ukrainian State and an Ukrainian investor – and to such a relationship and to such a dispute the ICSID Convention was not meant to apply and does not apply."

Treaty shopping

- The conduct of foreign investors who deliberately seek to acquire the benefits of an investment treaty by making foreign investments or bringing claims from third countries that have more favourable treaty terms with the target host state.
- **"Front end" treaty shopping** - when an investment structure is planned in advance so that the investment may benefit from a favourable regulatory environment.
- **"Back end" treaty shopping occurs** - a corporation restructures an investment after a dispute has arisen or becomes foreseeable, to gain access to favourable investor-state arbitration for that particular dispute.

Treaty shopping

- Phoenix Action v Czech Republic (2009)
  - Czech companies transferred to Phoenix Action (Israel) *after* disputes arose between them and the Czech government.
  - Two months later, Phoenix Action commenced arbitration against the Czech Republic.
  - Czech Republic: Phoenix Action was “nothing more than a ex post facto creation of a sham Israeli entity by a Czech fugitive from justice”.
  - Tribunal: The purpose of the ICSID Convention was not to protect nationals of a Contracting State against their own State. Under ICSID case law, a corporation cannot modify the structure of its investment for the sole purpose of gaining access to ICSID jurisdiction, after damages have occurred.

Treaty shopping

- Philip Morris Asia v Australia
  - Philip Morris Asia (Hong Kong) acquired 100% of the shares in Philip Morris Australia *after* Australia had committed to introduce tobacco plain packaging legislation.
  - Australia: This was an abuse of right because Philip Morris Hong Kong had acquired Philip Morris Australia's shares in full knowledge that Australia intended to introduce plain packaging legislation.
  - Tribunal:

    … Despite the variations in the formulations used in the decisions just quoted, this Tribunal considers that case law has articulated legal tests on abuse of right that are broadly analogous, revolving around the concept of foreseeability... On this basis, the initiation of a treaty-based investor-State arbitration constitutes an abuse of rights (or an abuse of process, the rights abused being procedural in nature) when an investor has changed its corporate structure to gain the protection of an investment treaty at a point in time when a specific dispute was foreseeable. The Tribunal is of the opinion that a dispute is foreseeable when there is a reasonable prospect… that a measure which may give rise to a treaty claim will materialise.

Treaty shopping

- Violation of the principle of reciprocity?
- Creates difficulty for host states, usually developing nations, who want to rebalance investor and state rights?
- Or should it not matter where capital originates?
- Pushback from various states, e.g. Australia in response to Philip Morris claims.

Negotiating more stringent investment treaties

- States may impose in their investment treaties stricter requirements on a company's "seat of business".
- Germany-China BIT Article 2(a)-(b): A company (in respect of Germany) is defined as "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…"
- UK-Philippines BIT Article 1(4): A company shall mean a "corporation, partnership… incorporated or constituted and actually doing business under the laws in force in any part of the territory of that Contracting Party wherein a place of effective management is situated."

Negotiating more stringent investment treaties

- Treaties may incorporate “denial of benefits” clauses.
- US-Rwanda BIT, Art 17:

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

- Transatlantic Trade and Investment Partnership between the EU and US (now discontinued), Art 15:

> **Anti-circumvention**
>
> For greater certainty, the Tribunal shall decline jurisdiction where the dispute had arisen, or was foreseeable on the basis of a high degree of probability, at the time when the claimant acquired ownership or control of the investment subject to the dispute and the Tribunal determines, on the basis of the facts of the case, that the claimant has acquired ownership or control of the investment for the main purpose of submitting the claim under this Section. The possibility to decline jurisdiction in such circumstances is without prejudice to other jurisdictional objections which could be entertained by the Tribunal.

Redefining “investment”

- Comprehensive and Progressive Agreement for Trans-Pacific Partnership (TPP less USA)

  > Investment means every asset that an investor owns or controls, directly or indirectly, that has the characteristics of an investment, including such characteristics as the commitment of capital or other resources, the expectation of gain or profit, or the assumption of risk.

- Salini Construction v Morocco
  - An “investment” under the ICSID Convention requires:
    - Contributions by the investor to the economic development of the host state
    - A certain duration of performance of the contract
    - A participation in the risks of the contract
  - No system of binding precedent in treaty arbitrations.

The way forward