

A Thesis submitted for the Degree of Doctor of Philosophy

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**The Bona Fide Investor: Corporate Nationality and Treaty
Shopping in Investment Treaty Law**

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Abstract

This thesis addresses the problem of treaty shopping in investment treaty law. It seeks to illustrate how the problem stems from, and can in part be resolved by, the concept and definition of corporate nationality. It explores whether, and if so how and what, limits ought to be placed on the manipulation of nationality for the purpose of gaining investment treaty protection, to enable a principled basis to utilise nationality to prescribe the extent of rights and obligations in investment treaties.

The importance of nationality requirements in investment treaties cannot be overstated—the definition of “investor” in any treaty defines which entities are entitled to substantive protections contained in the treaty for the benefit of states and investors alike. Entities making an investment need to know whether, and if so how, they can structure their investment to achieve protection of applicable investment treaties. Investors who have suffered damage need to know whether they are entitled to make a claim. States need to appreciate the extent of their potential obligations.

Many investment treaties define qualifying investors in a broad way that includes any entity incorporated in a contracting state. Putative investors, including those from third states, or nationals of the host state of the investment, seek to come within the relevant definition, often by insertion of an intermediary company incorporated in the desired home state into the ownership chain of the investment.

This thesis challenges the view that fulfilment of formalities set out in an investment treaty is sufficient to qualify as an investor where there is no substance behind the corporate form. To some degree, states and investment treaty tribunals have tried to abrogate treaty shopping by manipulation of corporate nationality by reference to the international law concept of genuine connection with the claimant’s state of incorporation, or by way of imposition of criteria for nationality based on the nationality of the corporate entity’s controller or proof of substantial business activity in its state of incorporation. The majority of investment treaty tribunals, however, have eschewed efforts to imply a substantive test or check on the attribution of nationality beyond literal fulfilment of nationality criteria.

This thesis promotes a purposive approach that requires fulfilment of express treaty criteria for nationality, but also subjects the claimant to a substantive economic

reality check in which the inquiry is to determine the reason for existence of the corporate claimant in relation to the relevant investment. Such an approach is required by an interpretative methodology that gives equal weight to the four tenets of art 31(1) of the Vienna Convention: ordinary meaning, good faith, context and object and purpose. If a corporate entity exists primarily to procure treaty rights, then it is not a bona fide investor consistent with the object and purpose of investment treaty jurisdictional provisions, even if it complies with the ordinary meaning of the express formal nationality criteria. If, however, it meets any express criteria and has a genuine ulterior commercial reason to exist in the ownership structure of the investment, then it qualifies as an investor entitled to the protection of an investment treaty.

The approach promoted by this thesis is derived from the treaty shopping antidote crafted by municipal courts assessing the bona fides of corporate applicants for tax relief under double tax treaties. In addition, the thesis analyses municipal law regarding piercing the corporate veil, the law of diplomatic protection, and analogous jurisdictional concepts in investment treaty law including the application of the principle of abuse of right, and identifies that underlying all these areas of inquiry is the central question of the purpose, or commercial reason to exist, of the relevant corporate entity.

Finally, this thesis demonstrates how a substantive approach can be applied in a principled and reasonably certain way.

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1 Introduction

1.1 Treaty shopping, jurisdiction *ratione personae* and corporate nationality

This thesis demonstrates that a substantive interpretative approach which looks to the purpose for the existence of a claimant in the ownership structure of an investment is the correct jurisprudential answer to the problem of treaty shopping by manipulation of corporate nationality in investment treaty law.

Treaty “shopping” is the process by which investors seek to procure coverage of an investment treaty by attainment of a requisite nationality.¹

In the case of investors who are natural persons, nationality is invariably determined by reference to municipal law regarding citizenship. But most countries do not have laws that bestow nationality on corporations. Nationality for corporations exists only as an analogy at international law to the concept for individuals in municipal law.² Indeed, “that corporations have a nationality, is a legal fiction.”³ Accordingly, states include criteria in investment treaties to ascribe nationality—and therefore jurisdiction *ratione personae*—to corporations.

The identification of corporate investors entitled to treaty coverage is of particular importance to contracting states because the vast majority of foreign direct investments are made by corporate entities, rather than natural persons.⁴ Further, the relative ease with which corporate entities can be created and structured creates opportunities for nationality criteria in any treaty to be met in a formal sense so as

¹ A useful exposition of the phenomenon of treaty shopping can be found in Jorun Baumgartner *Treaty Shopping in International Investment Law* (Oxford University Press, Oxford, 2016) at [1.1].

² WE Beckett “Diplomatic Claims in Respect of Injuries to Companies” (1931) 17 *Transactions of the Grotius Society* 175 at 175; Robert Jennings and Arthur Watts *Oppenheim’s International Law: Volume 1 Peace* (9th ed, Longman, London, 1992) at 859–861; Peter Muchlinski “The Diplomatic Protection of Foreign Investors: A Tale of Judicial Caution” in Christina Binder and others (eds) *International Investment Law for the 21st Century: Essays in Honour of Christoph Schreuer* (Oxford University Press, Oxford, 2009) 341 at 348.

³ *Barcelona Traction, Light and Power Company Ltd (Belgium v Spain) (Second Phase)* [1970] ICJ Rep 3 at 195 per Judge Jessup.

⁴ Christoph Benedict and others *The Determination of the Nationality of Investors under Investment Protection Treaties* (Institute of Economic Law (Transnational Economic Law Research Center), Halle-Wittenberg (Germany), March 2011) at 11.

to procure investment treaty benefits.⁵ An “overwhelming consensus”⁶ of investment treaty tribunals have concluded that literal compliance with nationality criteria to meet jurisdiction *ratione personae* is sufficient: no substantive economic role in the investment or other substantive degree of attachment to the corporate’s home state is required unless expressly incorporated in the instant treaty.

Definitions of “investor” or “national” in investment treaties that attribute corporate nationality of a contracting state on the basis of incorporation or formal seat in a jurisdiction has led to “the growing practice of establishing investment vehicles in a jurisdiction which is ‘covered’ by an investment treaty with the host state of the investment”⁷ and thereby “opens up the possibility of a nationality of convenience”.⁸

Arguably, “the nationality of corporate investors has become as fungible as capital in global markets” to the point that “corporate nationality no longer functions effectively as a distinguishing criterion”.⁹ Most controversially, even nationals of a contracting state can manufacture a foreign investment from a domestic one by incorporating a company in the other contracting state and routing its domestic investment through that company.

A strict formal or literal approach to corporate nationality criteria is misguided: to structure an investment only or primarily to procure treaty benefits is an abusive manipulation of the system of international investment protection. A literal approach to corporate nationality facilitates abuse of investment treaties because it broadens the coverage of a treaty between a limited number of states to corporate investors from any jurisdiction. As a result, “virtually any investor from virtually any country is capable of opting into virtually any BIT regime”;¹⁰ hence to

⁵ Baumgartner, above n 1, at [1.2.3].

⁶ Campbell McLachlan, Laurence Shore and Matthew Weiniger *International Investment Arbitration: Substantive Principles* (2nd ed, Oxford University Press, Oxford, 2017) at [5.133].

⁷ Zachary Douglas *The International Law of Investment Claims* (Cambridge University Press, Cambridge, 2009) at [586]. See also to the same point: Stephan W Schill *The Multilateralization of International Investment Law* (Cambridge University Press, Cambridge, 2009) at 221, 200–201, 204–209 and 223–224; and Anthony C Sinclair “The Substance of Nationality Requirements in Investment Treaty Arbitration” (2005) 20 ICSID Rev 357 at 360.

⁸ Frank Berman “The Relevance of the Law on Diplomatic Protection in Investment Arbitration” in Federico Ortino and others (eds) *Investment Treaty Law: Current Issues II—Nationality and Investment Treaty Claims; Fair and Equitable Treatment in Investment Treaty Law* (BIICL, London, 2007) 67 at 70.

⁹ Schill, above n 7, at 238–239. See also 198 and 219.

¹⁰ Schill, above n 7, at 238.

comply with an investment treaty, contracting states must treat their obligations as owed to every state and every company.¹¹

Thereby, a corporation created to fulfil nationality criteria in a formal sense but without any substantive economic role in the investment undermines the balance of benefits and obligations assumed by a contracting state when committing to an investment treaty; upsets the balance of reciprocity inherent in investment treaties concluded between a certain number of states; and impairs the purpose of jurisdiction *ratione personae* provisions to prescribe the circle of beneficiaries of treaty benefits.

The literal approach to corporate nationality is an anomaly compared with analogous jurisdictional concepts in international law generally and investment treaty law specifically. Formal compliance with jurisdiction *ratione personae* criteria is subject to a substantive check to prevent abuse in customary diplomatic protection law, double tax treaty law and in respect of the nationality of natural persons in investment treaty law. Moreover, the nationality of a foreign controller under art 25(2) of the ICSID Convention and the concept of the covered investment—jurisdiction *ratione materiae*—are approached in a substantive, not strictly formal, way by investment treaty tribunals.

There is nothing about the nature of corporate entities that stands in the way of a substantive aspect to the determination of jurisdiction *ratione personae* for corporate investors under investment treaties. A substantive approach accords with limits to the use of separate legal personality in municipal law systems and the role of the principle of abuse of right at international law. Moreover, a substantive aspect to fulfilment of jurisdictional criteria is consistent with all components of the rule of interpretation in art 31 of the Vienna Convention: ordinary meaning must be reviewed in light of context, good faith and object and purpose of the relevant instrument.

Some investment treaties, some international law commentators and some tax treaty jurisprudence identify the concepts of “control” and/or “substantial business activity” as amenable substantive arbiters of bona fide corporate investors.

¹¹ See Barton Legum “Defining Investment and Investor: Who is Entitled to Claim?” (2006) 22 Arb Int’l 521 at 524.

But these concepts suffer from excessive complexity and uncertainty—a principal concern for opponents of a substantive approach to corporate nationality—and are imperfect tests because the existence of control or business activity does not always correlate with abusive manipulation of corporate nationality.

Rather, the correct jurisprudential approach is in two parts: first, fulfillment of criteria for allocation of nationality agreed by the contracting states gives rise to a presumption of jurisdiction *ratione personae*; but, secondly, that presumption must be subject to a substantive assessment of reasonableness as to the criteria selected and the application of those criteria in the particular circumstances of the case as measured against the object and purpose of jurisdictional provisions of the relevant international instrument or instruments.

An apposite substantive check is to inquire as to the commercial reason for the existence of a particular corporate claimant in the ownership of the investment. If the entity has a genuine commercial reason to exist in relation to the investment other than to access treaty benefits, then it is reasonable to conclude that it accords with the general and jurisdictional objects of investment treaties: encouragement of investment and limitation of beneficiaries. It is foreign investment by an entity with a nationality derived from a genuine economic connection with a contracting state. However, if a claimant company exists solely or primarily to attain treaty coverage, it abuses the bargain of the contracting states by operating as a conduit for entities that cannot otherwise claim treaty coverage.

A purposive test of this nature is the basis of existing substantive checks on the literal application of analogous jurisdictional concepts in investment treaty and double tax treaty law. It is derived in those contexts from the underlying principle of good faith or abuse of right, which requires rights to be used reasonably, that is in accordance with the fundamental purpose of the instrument from which the rights are derived.

No substantive test can be as certain as a literal approach, but a purposive reason to exist test is reasonably certain for a putative investor: it must know its commercial purpose. A degree of uncertainty will exist around dual or multi-purposes, one of which is to access investment treaty benefits. The right approach must be to exclude those entities that exist primarily or principally to procure treaty

coverage, but another genuine commercial reason to exist in the ownership chain of the investment is sufficient evidence of a claimant's bona fides.

Chapters 1.2 and 1.3 below introduce the competing philosophies regarding corporate treaty shopping in investment treaty law commentary and jurisprudence and then outline the methodology used in this thesis to analyse the problem and its resolution.

1.2 The “Nationality Controversy”

The phenomenon of treaty shopping or “nationality planning”¹² by manipulation of corporate nationality has been termed the “Nationality Controversy”.¹³

Many commentators consider nationality planning to be a critical issue “for the stability of the regime of investor-state dispute resolution”.¹⁴ Failure “to address treaty shopping at this juncture will stimulate the already politically charged atmosphere surrounding investor-state arbitration”,¹⁵ because dissatisfied states may reconsider their engagement in investment treaty dispute resolution mechanisms.¹⁶ They exhort a concerted effort to address the problem “to support the development of a modern, predictable and balanced law of international investment protection”.¹⁷

Other commentators view corporate nationality planning as “not illegal or unethical as such”¹⁸ and accept it as “part of the current framework within which

¹² See Christoph Schreuer “Nationality Planning” in Arthur W Rovine (ed) *Contemporary Issues in International Arbitration and Mediation: The Fordham Papers 2012* (Martinus Nijhoff, Leiden, 2013) 17 at 17.

¹³ Campbell McLachlan, Laurence Shore and Matthew Weiniger *International Investment Arbitration: Substantive Principles* (Oxford University Press, Oxford, 2007) at [5.01].

¹⁴ John Lee “Resolving Concerns of Treaty Shopping in International Investment Arbitration” (2015) 6 JIDS 355 at 378.

¹⁵ At 378.

¹⁶ McLachlan, Shore and Weiniger, above n 13, at [5.82]. See also Robert D Sloane “Breaking the Genuine Link: The Contemporary International Legal Regulation of Nationality” (2009) 50 Harv Int'l LJ 1 at 41; Paul Michael Blyschak “Access and advantage expanded: *Mobil Corporation v Venezuela* and other recent arbitration awards on treaty shopping” (2011) 4 JWEL & B 32 at 32; Lee, above n 14, at 357; Mark Feldman “Setting Limits on Corporate Nationality Planning in Investment Treaty Arbitration” (2012) 27 ICSID Rev 281; and Verónica Lavista “Corporate Nationality: Principles of Diplomatic Protection, A Beacon for ICSID?” (29 May 2015) Revista Latinoamericana de Derecho Internacional Lavista at 12.

¹⁷ Lee, above n 14, at 379.

¹⁸ Rudolf Dolzer and Christoph Schreuer *Principles of International Investment Law* (2nd ed, Oxford University Press, Oxford, 2012) at 52.

foreign investment is made”.¹⁹ They see the phenomenon as consistent with the utility of an investment treaty as a tool to attract foreign investment.²⁰ If an investment is structured to reduce sovereign risk, they surmise, “then the investment treaty has served its express purpose”.²¹ Economic growth and development of the host state is achieved regardless of the origin of the investment funds.²²

A predominant number of investment treaty tribunals have taken what this thesis terms the “formal” or “literal” approach, wherein absent a specific limitation in a treaty, treaty shopping is not illegal.²³ On the literal approach, the plain words of the treaty are paramount and there is no room for implying additional requirements into the definition of corporate nationality to require a substantive relationship between a claimant and its home state. If contracting states had wished to impose a substantive link between a corporate investor and its state of incorporation, they could have said so in the treaty.²⁴ As the nationality of a corporation is not defined in the ICSID Convention, but rather left to the contracting states in any particular treaty,²⁵ the literal authorities emphasise the importance of party autonomy and say that “any reasonable determination of the nationality of

¹⁹ Norah Gallagher “The Requirement for Substantive Nationality” in Federico Ortino and others (eds) *Investment Treaty Law: Current Issues II—Nationality and Investment Treaty Claims; Fair and Equitable Treatment in Investment Treaty Law* (BIICL, London, 2007) 27 at 32. See, to the same effect: Legum, above n 11, at 526 (footnotes omitted); Douglas, above n 7, at [586]; and Baumgartner, above n 1, at [4.3.1.3].

²⁰ See, for example, the comments of Robert Volterra “Section Two” in Federico Ortino and others (eds) *Investment Treaty Law: Current Issues II—Nationality and Investment Treaty Claims; Fair and Equitable Treatment in Investment Treaty Law* (BIICL, London, 2007) 25 at 25.

²¹ Douglas, above n 7, at [583].

²² Schill, above n 7, at 235. See, to the same effect: *Aguas del Tunari SA v Bolivia (Respondent’s Objections to Jurisdiction)* ICSID ARB/02/3, 21 October 2005 at [332]; and Stavros Michalopoulos and Edward Hicks “Dual nationality revisited: a modern approach to dual nationals in non-ICSID arbitrations” (2019) 35 *Arb Int’l* 121 at 136.

²³ Recent notable cases in this respect include: *Aguas del Tunari*, above n 22, at [330] and [332]; *Mobil Corp v Venezuela (Jurisdiction)* ICSID ARB/07/27, 10 June 2010; *Pac Rim Cayman LLC v El Salvador (Respondent’s Jurisdictional Objections)* ICSID ARB/09/12, 1 June 2012; *Tidewater Inc v Venezuela (Jurisdiction)* ICSID ARB/10/5, 8 February 2013; and *ConocoPhillips Petrozuata BV v Venezuela (Jurisdiction and Merits)* ICSID ARB/07/30, 3 September 2013.

²⁴ See, for example, *Waste Management Inc v Mexico (Award)* (2004) 43 ILM 967 at [85]. See also *Aguas del Tunari*, above n 22, at [330] and [332]; *Saluka Investments BV (The Netherlands) v The Czech Republic (Partial Award)* PCA 17 March 2006 at [229] and [241]; *The Rompetrol Group NV v Romania (Respondent’s Preliminary Objections to Jurisdiction and Admissibility)* ICSID ARB/06/3, 18 April 2008 at [85]; *KT Asia Investment Group BV v Kazakhstan (Award)* ICSID ARB/09/8, 17 October 2013 at [115]–[121]; *Yukos Universal Ltd (Isle of Man) v Russia (Interim Award on Jurisdiction and Admissibility)* PCA AA 227, 30 November 2009 at [411]–[413]; and *Tokios Tokelés v Ukraine (Jurisdiction)* ICSID ARB/02/18, 29 April 2004 at [63].

²⁵ Aron Broches “The Convention on the Settlement of Investment Disputes between States and Nationals of Other States” (1972) 136 *Recueil Des Cours* 331 at 361.

juridical persons contained in national legislation or in a treaty should be accepted by an ICSID commission or tribunal”.²⁶

Other cases have followed the formal approach but also considered issues of abuse of right or process, at least in a limited way.²⁷ These cases have turned on whether the claimant is bona fide in light of the timing of the claimant’s insertion into the ownership chain of the investment compared with the timing of the birth of the dispute. In the seminal case of *Mobil v Venezuela*²⁸ for example, the Tribunal declared it was “a perfectly legitimate goal” to structure an investment to achieve the protection of an investment treaty; what mattered was whether the restructure occurred in advance of the birth of the dispute.²⁹

The abuse of right cases therefore accept the literal meaning of the definition of investor in a particular treaty, but add a timing criterion exception to the wording agreed by the contracting states justified on the basis of the principle of good faith at international law.

Other tribunals, dissenting arbitrators and commentators promote a more comprehensive substantive approach that takes into account a variety of criteria to assess the bona fides of an investor in addition to the literal requirements for corporate jurisdiction *ratione personae* set out in a particular treaty.³⁰ This approach reasons that investment treaties and the ICSID Convention must be interpreted in a way that favours substance over form. These authorities contend that the object of international investment instruments requires a purposive approach that must be met by more than an appearance of nationality which does not exist in substance.

This thesis refers to this teleological approach in general terms as the “substantive” or “purposive” approach. It looks beyond the strict confines of the definition of “investor” in a treaty and seeks to limit treaty benefits only to those entities that can be said to be a national of a contracting state in some substantive way. Accordingly, the literal meaning of strict definitions of investor are moderated

²⁶ Christoph H Schreuer and others *The ICSID Convention: A Commentary* (2nd ed, Cambridge University Press, Cambridge, 2009) at 287.

²⁷ The primary examples are *Mobil*, above n 23, and *Pac Rim*, above n 23.

²⁸ *Mobil*, above n 23, at [204]–[206].

²⁹ At [204].

³⁰ For example, *Tokios Tokelés v Ukraine (Dissenting Opinion of Prosper Weil)* ICSID ARB/02/18, 29 April 2004; *TSA Spectrum de Argentina SA v Argentina (Award)* ICSID ARB/05/5, 19 December 2008; and *Venoklim Holding BV v Venezuela (Award)* ICSID ARB/12/22, 3 April 2015.

by the context and purpose of the treaty and the ICSID Convention and the principle of good faith at international law.

The literal and substantive approaches are discussed in more detail in Chapter 3. To date, the literal approach has prevailed in large part. In 2007, McLachlan, Shore and Weiniger outlined this debate and were of the view that the substantive approach had “by no means been consigned to the dustbin of international law”.³¹ But by the 2nd edition of their eminent text in 2017,³² it had become “a permanent minority position”.³³

Nevertheless, the issue continues to attract considerable academic attention. The “Nationality Controversy” has led Schlemmer³⁴ and Hansen³⁵ to advocate for “another look at the tests to be applied in determining corporate nationality”³⁶ so that investors receive protection only where they are nationals of the relevant contracting states in substance and not merely nationals of convenience.³⁷ Similarly, Sinclair pondered whether, “the object and purpose of investment treaties might be better achieved by a bond of greater *substance* than is captured by some definitions of nationality”,³⁸ and, if so, how that could be achieved.

In the last decade, commentators have suggested the deployment of the principle of abuse of right at international law to constrain treaty shopping, and to varying degrees recognise the importance of the commercial purpose of the prospective claimant in the corporate ownership structure of the investment.³⁹

³¹ McLachlan, Shore and Weiniger, above n 13, at [5.87].

³² McLachlan, Shore and Weiniger, above n 6, at [5.110]–[5.179].

³³ At [5.120]. See also [5.133].

³⁴ Engela C Schlemmer “Investment, Investor, Nationality, and Shareholders” in Peter Muchlinski, Federico Ortino and Christoph Schreuer (eds) *The Oxford Handbook of International Investment Law* (Oxford University Press, New York, 2008) 49.

³⁵ Robin F Hansen “Parallel Proceedings in Investor-State Treaty Arbitration: Responses for Treaty-Drafters, Arbitrators and Parties” (2010) 73 MLR 523.

³⁶ Schlemmer, above n 34, at 87.

³⁷ At 79.

³⁸ Sinclair, above n 7, at 363 (emphasis in original).

³⁹ See, for example, Yael Ribco Borman “Treaty Shopping through Corporate Restructuring of Investments: Legitimate Corporate Planning or Abuse of Rights?” (2011) 24 Hague YB Int’l L 359; Martin J Valasek and Patrick Dumbery “Developments in the Legal Standing of Shareholders and Holding Corporations in Investor-State Disputes” (2011) 26 ICSID Rev 34; Blyschak, above n 16; Feldman, above n 16; Tania Voon, Andrew Mitchell and James Munro “Legal Responses to Corporate Manoeuvring in International Investment Arbitration” (2014) 5 JIDS 41; Xiao-Jing Zhang “Proper Interpretation of Corporate Nationality under International Investment Law to Prevent Treaty Shopping” (2013) 6 Contemp Asia Arb J 49; Lee, above n 14; and most recently, Javier Garcia Olmedo “Claims by Dual Nationals under Investment Treaties: Are Investors Entitled to Sue Their Own States?” (2017) 8 JIDS 695; Duncan Watson and Tom Brebner “Nationality Planning and Abuse

This thesis examines the best way to resolve the Nationality Controversy by analytical and comparative methodology.

1.3 Comparative and analytical examination of the correct approach to corporate nationality in investment treaty law

This thesis is the closer look at corporate jurisdiction *ratione personae* that commentators such as Schlemmer and Sinclair have called for. Most commentators declare the corporate nationality controversy problematic and unresolved, but do little to solve it other than survey the jurisprudence and declare a winner or convey a preference, rather than subject the jurisprudence and the issue more generally to critical analysis.⁴⁰

This thesis provides original insights into the resolution of the issue by analysis of literal and substantive approach authority and by comparison with analogous jurisdictional concepts in general international, double tax treaty and investment treaty law.

The thesis also examines the nature and means of application of a substantive test, including the effectiveness of various criteria to prevent illegitimate or undesirable treaty shopping and the prospective legal mechanisms that may be used to implement a substantive approach.

It concludes that coverage of investment treaties is properly limited by a purposive approach to treaty interpretation—one that gives effect to the principle of good faith at international law and recognises a more refined view of the object and purpose of investment treaties. In particular, it views investment treaties as multi-faceted instruments that encourage investment, but only from limited beneficiaries, and elucidates that treaty shopping can be circumscribed by an assessment as to the purpose for the existence of the corporate claimant in the ownership structure of the investment.

of Process: A Coherent Framework” (2018) 33 ICSID Rev 302; and Michalopoulos and Hicks, above n 22.

⁴⁰ For example, Voon, Mitchell and Munro, above n 39; Matthew Skinner, Cameron A Miles and Sam Luttrell “Access and advantage in investor-state arbitration: The law and practice of treaty shopping” (2010) 3 JWEL & B 260; Lee, above n 14; Sloane, above n 16; Feldman, above n 16; Lavista, above n 16; Schlemmer, above n 34; Hansen, above n 35; Sinclair, above n 7; McLachlan, Shore and Weiniger, above n 6; and Blyschak, above n 16.

The evaluative and comparative approach begins at Chapter 2, which reviews fundamental concepts of treaty terminology and interpretation that shape the debate between the substantive and literal approaches to jurisdiction *ratione personae* including the role of nationality in definitions of ‘national’ or ‘investor’ in investment treaties, the role of denial of benefits clauses, the ICSID Convention, and relevant principles of investment treaty interpretation pursuant to art 31 of the Vienna Convention.

Chapter 3 details the investment tribunal authorities for the literal approach and the substantive approach to corporate nationality as outlined in Chapter 1.2 above, and identifies the critical tenets of the argument for each approach.

The thesis then embarks on a comparative discussion of analogous circumstances external to investment treaty law that support a purposive substantive interpretation of treaty jurisdictional requirements concerning corporate nationality. Three particular topics are addressed.

First, in Chapter 4, the thesis explores the concepts of, and limits to, separate corporate legal personality and the principle of lifting the corporate veil. A substantive approach to corporate nationality looks past the separate legal personality of a company. Accordingly, it is pertinent to explore how the concepts of separate corporate personality and lifting the veil have been treated at municipal and international law.

This Chapter contends that separate corporate personality is disregarded in common and civil law systems where a corporate entity is used solely to avoid obligations or garner rights to which it would not otherwise have been entitled, either by way of application of the principles of agency or trust law, or by the imposition of the principles of lifting the corporate veil or abuse of right. It further contends that international law need not treat separate corporate personality as inviolable either, but rather that the purpose of the use of corporate nationality at international law, and the structure of the system of international law, support a substantive approach to corporate nationality.

Secondly, Chapter 5 explores the concept of nationality in the law of diplomatic protection for jurisdictional purposes. The well-known ICJ decisions in

Nottebohm,⁴¹ and *Barcelona Traction*,⁴² reached apparently opposing positions as to the need for a “genuine link” to claim nationality for individuals (yes — *Nottebohm*) and corporates (no — *Barcelona*). However, in 2006 the International Law Commission’s Draft Articles on Diplomatic Protection reevaluated both decisions and formulated an outcome which requires substance to the connection between a company and the state from which it claims diplomatic protection.⁴³

Thirdly, Chapter 6 explores the law of double tax treaties as a comparison to the phenomenon of treaty shopping in investment treaty law.⁴⁴ Hansen, Schill and Benedict⁴⁵ have briefly observed broad similarities between treaty shopping issues in investment treaty law and tax treaty law, but this thesis uniquely examines and evaluates the substantive approach to corporate nationality in tax treaty law in detail and compares it to the issue in investment treaty law.

Tax treaties, like investment treaties, are international instruments with the overarching object of promoting international commerce interpreted pursuant to the Vienna Convention. In both species of treaty, contracting states define the entities entitled to treaty benefits by reference to the nationality of the entity. Both treaty regimes facilitate treaty shopping by the use of incorporation alone to establish corporate nationality. But, even when substantive considerations are not express in a tax treaty, tax treaty jurisprudence examines the economic reasons for existence of the claimant company in the corporate structure and declines treaty coverage to companies “where the conditions laid down for obtaining [treaty] benefits are created by means of wholly artificial arrangements only set up for the purpose of avoiding tax”.⁴⁶ This approach is a model for the identification of illegitimate treaty shopping in investment treaty law: the correct approach is to recognise that a substantive check is inherent in the application of a treaty so as to exclude artificial arrangements for the purpose of securing investment treaty coverage.

⁴¹ *Nottebohm (Liechtenstein v Guatemala) (Second Phase)* [1955] ICJ Rep 4.

⁴² *Barcelona Traction*, above n 3.

⁴³ Draft Articles on Diplomatic Protection, art 9; and commentary in *Report of the International Law Commission* Supplement No 10 A/61/10 (2006) at 53.

⁴⁴ A comparison recognised, but not explored in depth, by Hansen, above n 35.

⁴⁵ Hansen, above n 35, at 545; Schill, above n 7, at 236; and Benedict and others, above n 4.

⁴⁶ FA Engelen *On Value and Norms: The Principle of Good Faith in the Law of Treaties and the Law of Tax Treaties in Particular* (Kluwer, London, 2006) at 36. See also Vern Krishna “Treaty Shopping and the Concept of Beneficial Ownership in Double Tax Treaties” (2009) 19 *Can Cur Tax* 129 at 141.

In Chapter 7, support for a substantive approach to corporate jurisdiction *ratione personae* is found in investment treaty jurisprudence on three analogous jurisdictional issues: the approach to cases under the second clause of art 25(2)(b) of the ICSID Convention; the approach to the nationality of natural persons; and the approach to the jurisdictional requirement for a qualifying “investment” (jurisdiction *ratione materiae*).

The first clause of art 25(2)(b) seeks to define the nationality of a claimant; the second clause seeks to define the nationality of the claimant by means of the nationality of the claimant’s controller. The former search for nationality has been approached as a strict literal exercise, while the nationality of the controller is approached substantively and holistically. This thesis makes a point that other commentary has overlooked: that nationality is the ultimate question under either clause. Further and accordingly, there is no principled reason for approaching them in different ways.

Next, the approach to nationality of natural persons at investment treaty law is reviewed. While in this area tribunals generally follow proof of nationality according to municipal law in a technical way, analysis reveals that this is not a slavish adherence: a substantive check on the reality of the claimant’s proclaimed nationality can be discerned from the jurisprudence.

Chapter 7 then explores the dichotomy that identification of the twin gatekeepers of jurisdiction in investment treaties—the investment and the investor—are approached differently: the former substantively and pragmatically,⁴⁷ and the latter literally. No tribunal or commentator has recognised, nor rationalised, the reason for this difference in approach. This thesis analyses the substantive approach to jurisdiction *ratione materiae* and contends there is no good reason to approach jurisdiction *ratione personae* differently. Just as the ICSID Convention sets substantive outer limits for an “investment” in art 25(1), so the meaning of “national of a Contracting State” in art 25(2) gives rise to inherent objective substantive limits assessed in light of the object and purpose of the jurisdictional clauses of the Convention.

⁴⁷ The seminal cases are *Fedax NV v Venezuela (Jurisdiction)* (1998) 5 ICSID Rep 183; and *Salini Costruttori SPA v Morocco (Jurisdiction)* (2003) 42 ILM 609.

Finally Chapter 7 illustrates that even the literal cases outlined in Chapter 3 impose a de facto substantive check on the reason for existence of the corporate claimant and its connection to its claimed state of nationality, albeit that the factors considered are not consistent between different tribunals.

In Chapter 8, the case is made that the procurement of investment treaty coverage by a corporation of convenience is contrary to the object and purpose of such instruments. While a literal approach to nationality may be consonant with the broad objective of investment treaties to encourage investment, it is contrary to the specific purpose of jurisdictional provisions to limit the nature of the investment and the character of investors. The latter purpose is often overlooked by tribunals and commentators in favour of the former. This conclusion impacts the interpretation of jurisdictional provisions pursuant to the Vienna Convention and gives a foundation to the concept proposed by recent commentators,⁴⁸ that the nationality controversy can be resolved by an appreciation of the nature and scope of the concept of abuse of right and its proper application to jurisdictional issues in investment treaty law.

A central plank to the formal approach argument is that a substantive approach is impractical because it is too uncertain in application. Chapters 9, 10 and 11 explore how a substantive test could work in investment treaty law. This thesis accepts that clear guiding principles are necessary for reasonable certainty for investors and states as to the boundaries of treaty coverage.

Chapter 9 draws on tax and investment treaty jurisprudence that use concepts of control and substantial business activity to determine qualifying investors. In this respect, this thesis signally rejects the commonly proposed criteria of “control” and “substantial business activity” as effective sole arbiters of substantive reasonableness in respect of corporate nationality because they are too uncertain in scope and application and are inconsistent arbiters of treaty abuse.

Rather, as explained in Chapter 10, this thesis takes a unique approach to the concept of corporate jurisdiction *ratione personae* in investment treaty law by endorsing the solution divined in tax treaty jurisprudence: identification of the purpose of the claimant company in the corporate structure and exclusion of

⁴⁸ Borman, above n 39; Feldman, above n 16; and Watson and Brebner, above n 39.

corporate vehicles that have no objective purpose in that structure other than to enable access to treaty benefits.⁴⁹

The purposive approach in tax treaty law is then compared to the approach to jurisdiction *ratione materiae* in investment treaty law (that is, identification of a bona fide investment) and to the approach of abuse of right cases in investment treaty law. It is observed to be practically identical in nature and application.

Chapter 10 also contends a “commercial reason to exist” test meets the argument that a substantive test for corporate nationality would be too uncertain and explains that a purposive approach is practical, predictable and is the correct approach to jurisdiction *ratione personae* in investment treaty cases.

Chapter 11 considers how a purposive test might be implemented by states and investment treaty tribunals. There are intra-treaty options and extra-treaty options. The intra-treaty options depend on the existence of express terms in a treaty, either by way of the definitions of “national” or “investor”, or through a denial of benefits clause. Express treaty wording that imposes a substantive approach to corporate nationality is a preferable solution because it exists as a record of the parties’ intention on the face of a treaty.

However, existing definitions and denial of benefits clauses which require a substantive connection utilise the “control” and “substantial business activity” criteria. The problematic issues that arise with these criteria explained in Chapter 9 remain.

In addition, denial of benefits clauses suffer from limitations in relation to the timing and substance of notice of denial, and practical issues with the burden of proof of conditions required to deny. Denial of benefits clauses are too narrowly construed by some investment tribunals, but in any event, these practical issues limit their effectiveness to ameliorate treaty shopping.

Absent amendment, those treaties that do not contain express wording requiring a substantive approach to corporate nationality must look to extra-treaty jurisprudence to impose a substantive test. In this situation, this thesis explains how investment treaty tribunals can apply a purposive test by implying a substantive

⁴⁹ Saurabh Jain *Effectiveness of the Beneficial Ownership Test in Conduit Company Cases* (IBFD, Amsterdam, 2013).

commercial reason to exist requirement into the concept of “investor” or “national” in investment treaties, or by application of the principle of abuse of right to exclude investors who exist only to take advantage of investment treaty benefits.

2 Treaty terminology, interpretation and law

2.1 Introduction

This Chapter introduces the framework of treaty terminology, treaty law and principles of treaty interpretation that explain in part why the Nationality Controversy exists and informs the debate in following chapters.

The terminology of investment treaties that relate to treaty shopping are first examined; in particular this Chapter provides an overview of definitions of “national” or “investor” in investment treaties and how they relate to or determine nationality. In doing so, the concepts of incorporation, *siège social*, control, and effective or substantial business activities as criteria for determining nationality are introduced. The role of denial of benefits clauses are also prefaced as provisions permitting withdrawal of treaty benefits for states in certain circumstances.

The relevant terms of two international instruments that impact on the operation and interpretation of investment treaties are then introduced: the ICSID Convention⁵⁰ and the Vienna Convention.⁵¹

These topics reveal the context of the treaty shopping debate briefly described in Chapter 1 and subject to greater explanation and analysis in Chapter 3. First, a predominant number of existing investment treaties utilise broad definitions for the nationality of qualifying investors (for instance, simple incorporation and/or seat). Such definitions facilitate procurement of treaty coverage irrespective of any greater connection between the juridical claimant and its home state. This is the core legal manoeuvre at the heart of treaty shopping.

Secondly, some investment treaties contain (in definitions or denial of benefits clauses) other nationality criteria that require a greater connection between a state and a corporation beyond mere incorporation (e.g. *siège social réel*, control and substantial economic activity-type criteria). However, with reference to later chapters that discuss these concepts in more detail, it is observed that the additional degree of connection is uncertain and does not exclude nationality manipulation.

⁵⁰ Convention on the Settlement of Investment Disputes between States and nationals of other States (opened for signature 18 March 1965, entered into force 14 October 1966) [ICSID Convention].

⁵¹ Vienna Convention on the Law of Treaties 1155 UNTS 331 (signed 23 May 1969, entered into force 27 January 1980) [Vienna Convention].

Thirdly, the concept of “National of [a] Contracting State” in art 25(2) of the ICSID Convention is explained. It is observed that debate over the extent of limits that this phrase imposes on attribution of nationality to corporates runs in parallel to the same debate about corporate nationality in investment treaties. Accordingly, authority and commentary relevant to the concept of nationality in art 25 is integral to the discussion of treaty shopping and corporate nationality that follows.

Fourthly, the general rule of treaty interpretation in art 31 of the Vienna Convention is reviewed as a precursor to analysis at Chapters 3, 8, 10 and 11 of the literal interpretative approach of some investment tribunals to definitions of corporate nationality. The literal approach cases focus on ordinary meaning, compared with those that favour a substantive approach which seeks to temper ordinary meaning with reference to context, good faith and object and purpose. The point made about treaty interpretation in this Chapter is that the correct approach is a holistic one that puts equal emphasis on all four tenets of interpretation.

Lastly, this Chapter recognises that treaties give international significance to aspects of municipal law as allocators of nationality. But by virtue of the interpretative criteria in the Vienna Convention and the principle of abuse of right, international law retains a limiting function as to reasonableness of the results of the application of municipal law as to nationality on the international plane. This point appears in more detail in Chapter 4 in which the concept of separate legal personality is examined, and in Chapters 10 and 11 wherein the role of the principle of abuse of right to circumscribe the limits of legitimate treaty shopping is discussed.

2.2 Nationality criteria in investment treaties for juridical persons

Four principal types of nationality criteria

There are approximately 3,000 investment treaties that contain investor-state arbitration mechanisms. A variety of tests are applied to determine whether a juridical person qualifies as a national of a state party to a treaty.⁵²

⁵² The investment treaties and Model investment treaties cited in this thesis are all available at <www.italaw.com>. For Model Treaties also see Chester Brown *Commentaries on Selected Model Investment Treaties* (Oxford University Press, Oxford, 2013). Each bilateral treaty (BIT) is cited by specifying the contracting states and the date of signature to indicate when its terms were formally agreed. The date of entry into force may be different from the date of signature but is not cited as it has no relevance to this thesis. Multilateral treaties are cited using their abbreviated name (e.g. Energy Charter Treaty or NAFTA or CAFTA). Model treaties are cited as such.

Four predominant criteria are utilised for determination of corporate nationality:⁵³ incorporation, as prevails in Anglo-American common law systems; the seat or place of management (*siège social*), as applied in civil law countries; control, that is, the state of nationality of controlling shareholders; and some investment agreements limit the scope of the treaty by requiring that a juridical person must have substantial or effective economic activities in its state of incorporation.⁵⁴

The predominance of each of the four criteria depends to some extent on the different generations of investment treaties.

Commentators distinguish between bilateral investment treaties (BITs) signed between 1959 and 1988 (the first generation), those signed between 1988 and 1995 (the second generation), and those concluded from 1995 to the present day (the third generation).⁵⁵ The third generation tend to have drawn on a body of investment treaty jurisprudence regarding the interpretation of investment treaties “leading to the evolution of new drafting techniques as nations responded to decisions of arbitral tribunals”.⁵⁶

The first and second generations of investment treaty generally define a qualified investor by reference solely to incorporation.⁵⁷ The third generation shows a greater tendency to limit the definition of investor “to exclude purported strangers to the agreement”.⁵⁸ Third generation treaties often require prospective corporate investors to have some kind of economic connection with the contractual state of

⁵³ See Benedict and others, above n 4, at 13 and 46; AA Fatouros “National Legal Persons in International Law” in Rudolf L Bindschedler and others (eds) *Encyclopedia of Public International Law* (Elsevier, Amsterdam, 1997) vol 3 495 at 495–496; Schreuer and others, above n 26, at 460; Roos van Os and Roeline Kottnerus *Dutch Bilateral Investment Treaties: A gateway to ‘treaty shopping’ for investment protection by multinational companies* (SOMO, October 2011) at 23; and Feldman, above n 16. Schlemmer, above n 34, at 76–77 confines the field to two criteria: incorporation or the seat and considers the control criterion as a device to expand or restrict the application of the two principal criteria.

⁵⁴ Benedict and others, above n 4, at 14.

⁵⁵ Skinner, Miles and Luttrell, above n 40, at 262–263; Andrew Newcombe and Lluís Paradell *Law and Practice of Investment Treaties: Standards of Treatment* (Wolters Kluwer, the Netherlands, 2009) at 46–48; M Somarajah “A Coming Crisis: Expansionary Trends in Investment Treaty Arbitration” in Karl P Sauvant and Michael Chiswick-Patterson (eds) *Appeals Mechanism in International Investment Disputes* (Oxford University Press, New York, 2008) 39; and van Os and Kottnerus, above n 53, at 8.

⁵⁶ Skinner, Miles and Luttrell, above n 40, at 263.

⁵⁷ At 270.

⁵⁸ At 270.

which it claims nationality. It is therefore in these later treaties that one observes an increase in the use of control and other types of economic connection criteria.⁵⁹

Incorporation

Incorporation (or an entity constituted, founded, organised or established) according to the law of a state is the most commonly used criterion for determining nationality in investment treaties.⁶⁰ It is often used as a sole, or stand-alone, criterion.⁶¹

The central tenet of this thesis is most clearly demonstrated by those treaties that adopt incorporation as a stand-alone criterion for nationality of juridical persons because, at least *prima facie* in such cases, a company duly incorporated in a treaty contracting state has standing to submit a claim against another contracting state to the treaty, “regardless of the nationality of its controlling shareholders or the company’s level of economic activity in its state of incorporation”.⁶²

The compass of the use of incorporation as a sufficient test of nationality without more, is apparent from the statistic that three-quarters of all investment treaties in force are based on the Dutch Model BIT 2004,⁶³ which allocates Dutch nationality to any “legal persons constituted under the law of that Contracting Party” as one alternative stand-alone criterion.⁶⁴ It is also a stand-alone alternative in North American Free Trade Agreement (NAFTA),⁶⁵ and the sole criterion for corporate nationality adopted by the United Kingdom’s Model BIT 2008,⁶⁶ which defines United Kingdom companies as “corporations, firms and associations incorporated or constituted under the law in force in any part of the United Kingdom”, the United

⁵⁹ At 270.

⁶⁰ Stanimir A Alexandrov “The ‘Baby Boom’ of Treaty-Based Arbitrations and the Jurisdiction of ICSID Tribunals: Shareholders as ‘Investors’ and Jurisdiction *Ratione Temporis*” (2005) 4 LPICT 19 at 37.

⁶¹ Douglas, above n 7, at [537]. See observations to the same effect in *Autopista Concesionada de Venezuela CA v Venezuela (Jurisdiction)* (2001) 6 ICSID Rep 417 at [107]; and *Société Ouest Africaine des Bétons Industriels v Senegal (Jurisdiction)* (1984) 2 ICSID Rep 175 [SOABI] at [29].

⁶² Alexandrov, above n 60, at 35–36 citing *Autopista*, above n 61, at [107].

⁶³ van Os and Knottnerus, above n 53, at 23.

⁶⁴ Netherlands Model BIT 2004, art 1(b)(ii). The Netherlands Model BIT 2019 introduces a substantive requirement—that as well as incorporation, a Dutch company must have substantial business activities in the Netherlands to qualify as its national: art 1(b)(ii).

⁶⁵ North American Free Trade Agreement (signed 17 December 1992, entered into force 1 January 1994) [NAFTA], art 1139 (to be replaced by the United States-Mexico-Canada Agreement which enters into force on 1 July 2020).

⁶⁶ United Kingdom Model BIT 2008, art 1(d)(i).

States Model BIT 2004,⁶⁷ which defines an enterprise of a party as “an enterprise constituted or organized under the law of a Party”, the Indian Model BIT 2003,⁶⁸ and the Energy Charter Treaty, which refers to “a company or other organization organized in accordance with the law applicable in that Contracting Party”.⁶⁹

Incorporation is also the prevailing criterion in investment treaties concluded by former socialist countries.⁷⁰ Examples include the France-Soviet Union BIT,⁷¹ the Lithuania-Ukraine BIT⁷² and the Czech Republic-Netherlands BIT.⁷³

In the Southern Hemisphere, examples include the Australia-Argentina BIT,⁷⁴ and the Australia-Hong Kong and New Zealand-Hong Kong BITs, which both require simple legal incorporation in either contracting state to meet the definition of an investor.⁷⁵

The advantage of sole use of an incorporation criterion is certainty, but the disadvantage is the potential for manipulation of nationality by “pseudo-foreign corporations”⁷⁶ because the test of incorporation does not on its face admit any detailed analysis of the business reality in which a corporation may be controlled by non-nationals.⁷⁷ Accordingly, the incorporation test “provide[s] respondents with limited protection against claims brought by companies having only a nominal connection to their home State”.⁷⁸

⁶⁷ United States Model BIT 2004, art 1.

⁶⁸ Indian Model BIT 2003, art 1(a). See Lee, above n 14, at 362.

⁶⁹ Energy Charter Treaty 2080 UNTS 100 (opened for signature 17 December 1994, entered into force 16 April 1998), art 1(7)(a)(ii).

⁷⁰ Piero Bernardini “Nationality Requirements Under BITs and Related Case Law” in Federico Ortino and others (eds) *Investment Treaty Law: Current Issues II—Nationality and Investment Treaty Claims; Fair and Equitable Treatment in Investment Treaty Law* (BIICL, London, 2007) 17 at 21.

⁷¹ France-Soviet Union BIT (signed 4 July 1989), art 1.2(b).

⁷² Lithuania-Ukraine BIT (signed 8 February 1994), art 1(2).

⁷³ Netherlands-Czech Republic BIT (signed 29 April 1991), art 1(b)(ii).

⁷⁴ Australia-Argentina BIT (signed 23 August 1995), art 1(e).

⁷⁵ Hong Kong-New Zealand BIT (signed 6 July 1995), art 1(2); and Hong Kong-Australia BIT (signed 15 September 1993), art 1.

⁷⁶ Matthias Pannier “Nationality of Corporations under Domestic Law: A Comparative Perspective” in Federico Ortino and others (eds) *Investment Treaty Law: Current Issues II—Nationality and Investment Treaty Claims; Fair and Equitable Treatment in Investment Treaty Law* (BIICL, London, 2007) 11 at 12 and 14.

⁷⁷ Muchlinski, above n 2, at 348.

⁷⁸ Feldman, above n 16, at 284.

The seat/siège social

Civil law countries often emphasise the seat of management or *siège social* as the defining factor for nationality of corporates. This criterion, which has its origins in French law,⁷⁹ ascribes nationality on the basis of a company's principal place of administration.

The seat criterion is used as the decisive criterion in most German investment agreements.⁸⁰ The German Model BIT 1998, for example, confers German nationality on “any juridical person ... having its seat in the territory of [Germany]”.⁸¹ This terminology can also be found in the Argentina-Germany BIT⁸² and treaties between Germany and Japan, Turkey, Austria and Iran.⁸³ Italy, Spain, Belgium and France also utilise the seat criteria, either alone or in combination with incorporation.⁸⁴

There is debate as to whether in practical terms the seat criterion requires a closer connection or relationship between a corporation and its home state than the incorporation criterion. On the one hand, Feldman⁸⁵ and Schlemmer⁸⁶ consider the seat test to be more substantive than incorporation in that there is some inquiry into whether the corporation is managed from the claimed state of nationality, although the corporate veil remains untouched.

However, other commentators view the seat requirement as a formality fulfilled by a registered office—usually a formal address required as part of incorporation, “thus in most instances applying the incorporation theory also implements the seat theory”.⁸⁷ The ILC commentary on art 9 of the Draft Articles on Diplomatic Protection comes to the same conclusion.⁸⁸ According to Muchlinski, “[i]n the context of multinational corporate groups, [the *siège social* approach] does

⁷⁹ DP O’Connell *International Law* (2nd ed, Stevens, London, 1970) vol 1 at 106–107.

⁸⁰ Benedict and others, above n 4, at 14, where Perkams cites a number of examples.

⁸¹ German Model BIT 1998, art 1(3)(a).

⁸² Argentina-Germany BIT (signed 9 April 1991), art 1(4).

⁸³ See the examples in Feldman, above n 16, at 283–284.

⁸⁴ See, for example, Spain-Cuba BIT (signed 27 May 1994), art 1(1)(b); BLEU-Uruguay BIT (signed 4 November 1991), art 1.1(b); Italy-Ethiopia BIT (signed 23 December 1994), art 1.4; France-Ethiopia BIT (signed 25 June 2003), art 1.3; and France-Mexico BIT (signed 12 November 1998), art 1.2(b). See also Benedict and others, above n 4, at 14–15.

⁸⁵ Feldman, above n 16, at 283.

⁸⁶ Schlemmer, above n 34, at 79.

⁸⁷ Benedict and others, above n 4, at 46.

⁸⁸ See *Report of the International Law Commission* [2006] vol 2, pt 2 YILC 23 at 37.

not offer any significantly superior test of nationality” and is “a less than perfect vehicle for the analysis of corporate nationality outside of the simple case of a uni-national company with its administrative headquarters within the country of incorporation”.⁸⁹

Control

The criterion of control is less widely used in investment treaties, and usually in combination with other criteria such as incorporation or the seat.⁹⁰ While at least one of the incorporation or seat criteria can be found in almost every treaty, the control criterion appears in a limited number of investment treaties and almost always in combination with the incorporation or seat criteria.⁹¹

Control can be used to expand or limit treaty coverage. An example of the former are investment treaties that permit entities that own or control investments to qualify as investors,⁹² or treaties that permit companies incorporated in third states or the host state, but are controlled by entities from a contracting state, to benefit from treaty protections.⁹³ The ICSID Convention (as discussed shortly below) also uses control as a concept to extend investor standing to entities incorporated in a host state but under foreign control if so agreed by the parties to the treaty.⁹⁴

Control is also used as a cumulative limiting factor to exclude companies incorporated in a contracting state but controlled by nationals of a third state or by nationals of a host state. Examples include the China-Peru BIT, which requires a company to be “directly or indirectly controlled by nationals of ... Peru” to qualify as a Peruvian investor;⁹⁵ and the United States-Panama BIT which requires that nationals of the party have a “substantial interest” in a company to qualify as a

⁸⁹ Muchlinski, above n 2, at 349–350. See to the same point Beckett, above n 2, at 496.

⁹⁰ Benedict and others, above n 4, at 13–15 and 46. See also van Os and Knottnerus, above n 53, at 23.

⁹¹ Benedict and others, above n 4, at 13–14.

⁹² For example, Peru-South Korea Free Trade Agreement (signed 14 November 2010), art 9.18; Australia-Chile Free Trade Agreement (signed 30 July 2008), art 10.1(j); and United States-Uruguay BIT (signed 4 November 2005), art 1.

⁹³ For example, Netherlands Model BIT 2004, art 1(b)(iii); Netherlands-Brazil BIT (signed 25 November 1998), art 1(b)(iii); Netherlands-Ethiopia BIT (signed 16 June 2003), art 1(b)(iii); Switzerland-Ghana BIT (signed 8 October 1991), art 1(1)(c); Switzerland-Jamaica BIT (signed 11 December 1990), art 1(b)(i); Australia-Indonesia BIT (signed 17 November 1992), art 1(1)(b); and Sweden-South Africa BIT (signed 25 May 1998), art 1(2)(c). See also the discussion of the definition of investor in the Netherlands Model BIT 2004 by van Os and Knottnerus, above n 53, at 23–24; Benedict and others, above n 4, at 15–16; and Lee, above n 14, at 363–364.

⁹⁴ ICSID Convention, art 25(2)(b).

⁹⁵ Peru-China BIT (signed 9 June 1994), art 1(2)(b).

company of that party.⁹⁶ Incorporation plus a “substantial interest” held by natural persons of the home state’s nationality are the nationality criteria in the United States-Zaire BIT.⁹⁷ Incorporation and control by home state nationals are required in combination in the France-Argentina BIT.⁹⁸

Alternatively, the use of control in a limiting role is achieved through denial of benefits provisions. Denial of benefits provisions do not alter the allocation of nationality to corporate investors. Rather, they seek to mitigate the mischief of treaty shopping by corporates by permitting a host state to deny the benefits of a treaty to to reduce the scope for investment treaty protections to be accessed in a manner contrary to the purpose of a treaty.⁹⁹ For example, art 1113(2) of NAFTA provides that a party may deny the benefits of NAFTA to an investor “if investors of a non-Party own or control the enterprise and the enterprise has no substantial business activities” in its home state.¹⁰⁰ The India Model BIT 2015 permits denial of benefits where an investment is owned or controlled directly or indirectly by persons of a non-party or of the denying party.¹⁰¹

In its limiting role, the test of control incorporates a consideration of the nationality of a company’s shareholders in the assessment of the nationality properly ascribed to the company. The control test of nationality has an affinity with a “genuine link” test and:¹⁰²

... offers something akin to the doctrine of ‘lifting the corporate veil’, in that it is permissible to look behind the corporate person, and the nationality of its incorporation, to the members and controllers

⁹⁶ United States-Panama BIT (signed 27 October 1982), art 1(c).

⁹⁷ United States-Zaire BIT (signed 3 August 1984), art 1(b).

⁹⁸ France-Argentina BIT (signed 3 July 1991), art 1.2(b)(c).

⁹⁹ United Nations Conference on Trade and Development *Scope and Definition: A Sequel* UNCTAD/DIAE/IA/2010/2 (2011) at 92–98. See also Feldman, above n 16, at 284 and 293. The utility of denial of benefits clauses to address illegitimate treaty shopping is discussed in detail in Chapter 11.

¹⁰⁰ Article 1113(1) of NAFTA also permits its parties to deny benefits to entities controlled or owned by nationals of states with whom the party does not maintain diplomatic relations.

¹⁰¹ Article 35.

¹⁰² Muchlinski, above n 2, at 350. Schlemmer makes the same observation: above n 34, at 79.

A small number of investment treaties include guidance as to what control means or how it may be established. For example, Swedish investment agreements implement the control criterion by use of the phrase “predominant Swedish interest”,¹⁰³ or to require “at least 51 percent of the equity interest ... [or] voting rights in respect of shares” to be held by Swedish nationals.¹⁰⁴ The United States-Egypt BIT defines control as having a “substantial share of ownership rights and the ability to exercise decisive influence” and provides that control can be direct or indirect and exercised through subsidiaries or affiliates.¹⁰⁵ The Japan-Peru BIT defines control as the power to appoint a majority of directors of a company “or otherwise to legally direct its actions”.¹⁰⁶

Yet, as will be explored in detail in Chapter 9, defining and demonstrating control is a difficult task, particularly if the burden of doing so rests on a respondent state.¹⁰⁷ The treaty definitions mentioned above are necessarily general because control can manifest in a multitude of different ways and is heavily fact dependent. Issues arise not only as to the nature of control and its directness, but also its susceptibility to change. In Chapter 9, it will be concluded that these uncertainties limit the usefulness of control as a method to prevent abusive treaty shopping.

Effective or substantial business activities/effective or real seat

A significant minority of investment treaties require a bond of economic substance between a claimant and its claimed state of nationality by means of real or substantial economic activity in the home state in addition to incorporation or seat. An example is the Sri Lanka Model BIT, which provides that the juridical entity be “formed and incorporated under the laws of one Contracting Party and have their seat together with their substantial economic activities in the territory of that same Contracting Party”.¹⁰⁸ Similarly, the Romania-Vietnam BIT provides that a juridical national must be constituted under the law of the contracting party and “have their

¹⁰³ Sweden-Argentina BIT (signed 22 November 1991), art 1(3)(c); and Sweden-Egypt BIT (signed 15 July 1978), art 1(3)(a).

¹⁰⁴ Sweden-India BIT (signed 4 July 2000), art 1(d).

¹⁰⁵ United States-Egypt BIT (signed 11 March 1986), art 1(d), protocol [2].

¹⁰⁶ Japan-Peru BIT (signed 21 November 2008), art 1.3(b).

¹⁰⁷ A useful introduction to this topic is provided by Voon, Mitchell and Munro, above n 39, at 55–58.

¹⁰⁸ Sri Lankan Model BIT, art 1(2)(b). To the same effect also see India Model BIT 2015, art 1.5.

seat, together with real economic activities, in the territory of that same Contracting Party”.¹⁰⁹

Other common phraseology that implements this type of criterion include “substantial business activities”,¹¹⁰ “actually doing business”¹¹¹, “real or effective economic activities”,¹¹² or “the place of effective management”.¹¹³ The United States Model BIT 2004, for example, requires incorporation and in addition that “a branch [is] located in the territory of a Party and carrying out business activities there”.¹¹⁴ An Asia-Pacific example is art 1(2) of the ASEAN Agreement, which provides that a company of a contracting party “shall mean a corporation ... incorporated or constituted under the laws in force in the territory of any Contracting Party wherein the place of effective management is situated”.¹¹⁵

Another closely analogous concept to effective business activities is the “effective” or “real” seat (*siège social*, or *siège social réel et sérieux*) approach adopted in some investment treaties from Continental private international law,¹¹⁶ that is, a base from which actual or effective management occurs, as opposed to a mere formal seat.¹¹⁷ For example, in French municipal law, company registration in France gives rise to a presumption of French nationality, rebuttable by evidence that the company’s place of effective management is in another jurisdiction.¹¹⁸

The effective or substantial business activities criterion is also commonly utilised together with the control criterion in denial of benefits clauses. Article

¹⁰⁹ Vietnam-Romania BIT (signed 15 September 1994), art 1(1)(b). To the same effect, another example is the Switzerland-Iran BIT (signed 8 March 1998), art 1(b).

¹¹⁰ Netherlands Draft Model BIT 2018, art 1(b)(ii); India Model BIT 2015, art 1.5.

¹¹¹ Philippines-Vietnam BIT (signed 27 February 1992), art 1(4).

¹¹² Switzerland-Iran BIT, art 1(b); and Indonesia-Chile BIT, art 1(b).

¹¹³ Brunei-Darussalam-Indonesia-Malaysia-Philippines-Singapore-Thailand MIT, art 1(2).

¹¹⁴ United States Model BIT 2004, art 1.

¹¹⁵ Agreement Among the Governments of Brunei Darussalam, Indonesia, Malaysia, the Philippines, Singapore, Thailand for Promotion and Protection of Investments (signed 15 December 1987), art 1(2).

¹¹⁶ Pannier, above n 76, at 12–14.

¹¹⁷ See generally BITs concluded by Italy and France. See also Spain-Cuba BIT, art 1(1)(b); BLEU-Uruguay BIT, art 1(1)(b); and Czech Republic-Slovak Republic BIT (signed 23 November 1992), art 1(2)(b). See also the interpretation of the concept of *siège social* in *Tenaris SA and Talta - Trading e Marketing Sociedade Unipessoal Lda v Venezuela (Award)* ICSID ARB/11/26, 29 January 2016 at [154], [200] and [206]–[216]; *Tenaris SA and Talta -Trading e Marketing Sociedade Unipessoal Lda v Venezuela (Award)* ICSID ARB/12/23, 12 December 2016 at [181]–[182]; and *Capital Financial Holdings Luxembourg SA v Cameroon (Award)* ICSID ARB/15/18, 22 June 2017 [CFHL] at [260]–[262], [264] and [266]–[268] (author’s translation).

¹¹⁸ *SCI de Gaëta v Guinea (Award)* ICSID ARB/12/36, 21 December 2015 at [142] citing *Cass (Ass plen)* 21 December 1990, No 88-15.744, Bull 1990 AP No 12.

1113(2) of NAFTA cited above is a classic example.¹¹⁹ The effectiveness of denial clauses to mitigate treaty shopping is examined in Chapter 11.

The real seat/effective business activity criterion will be addressed in detail in Chapter 9. While this criterion requires a greater degree of connection between a juridical person and its claimed state of nationality, some investment treaty tribunals have accepted a thin veneer of commercial activity to be effective or substantial.¹²⁰ In addition, as with the control criterion, the application of the theory can be problematic. Determining “the place where the basic decisions of the management are effectively implemented into business”¹²¹ may require significant investigation into the affairs of the company.

Moreover, while requirements such as substantial business activity or effective management in the home state make corporate structuring to achieve treaty protection more difficult, they do not exclude the possibility—they just provide a longer list of criteria to be met. It is common for multi-nationals to have subsidiaries in many jurisdictions which may conduct substantial business there, and so provide a convenient vehicle to route an investment and achieve coverage of a BIT.¹²²

As will be discussed in detail in Chapter 9, the existence of substantial or effective business activities in the state of incorporation is not necessarily effective to exclude abusive corporate planning to gain investment treaty protection.

2.3 The ICSID Convention and the Vienna Convention

ICSID Convention

The concept of nationality is at the heart of the jurisdictional provisions of the ICSID Convention. Article 25(1) of the ICSID Convention provides that the jurisdiction of the Centre extends to any legal dispute “between a Contracting State ... and a national of another Contracting State”. Article 25(2) defines “national of

¹¹⁹ Article 17.2 of the United States Model BIT 2004 is to the same effect. Other examples include Energy Charter Treaty, art 17(1); Argentina-United States BIT (signed 14 November 1991), art 1(2); and Jordan-Austria BIT (signed 23 January 2001), art 10.

¹²⁰ See, for example, *Pac Rim*, above n 23, at [4.63]–[4.65]; *AMTO LLC v Ukraine (Award)* SCC 080/2005, 26 March 2008 at [69]–[70]; *Tokios (Jurisdiction)*, above n 24, at [37]; and *Ulysseas Inc v Ecuador (Interim Award)* PCA 2009–19, 28 September 2010 at [122]–[123].

¹²¹ Pannier, above n 76, at 13.

¹²² An example is the restructuring at the heart of the jurisdictional arguments in *Philip Morris Asia Ltd v Australia (Award on Jurisdiction and Admissibility)* PCA 2012–12, 17 December 2015, a decision discussed in detail in Chapter 10.

another Contracting State”. Article 25(2)(a) concerns natural persons. Article 25(2)(b) defines national of another Contracting State in respect of juridical persons in two clauses (split for emphasis):

... any juridical person which had the nationality of a Contracting State other than the State party to the dispute ... [the first clause]; and

... any juridical person which had the nationality of the Contracting State party to the dispute ... and which, because of foreign control, the parties have agreed should be treated as a national of another Contracting State for the purposes of this Convention [the second clause].

Art 25(2) will be analysed in detail in Chapter 7.2. For present purposes, it is apparent that art 25 consists of a positive requirement for a person (juridical or natural) to have the nationality of a contracting state to the Convention, and a negative requirement that it not have the nationality of the state with which it has a dispute.¹²³ These requirements must be met in addition to specific treaty definitions applicable to qualifying claimants in respect of all claims governed by the ICSID Centre.

The purpose of art 25 is “to indicate the outer limits within which disputes may be submitted to conciliation or arbitration under the auspices of the Centre with the consent of the party thereto”.¹²⁴ In the same way that art 25 limits the parties’ autonomy to decide what constitutes a protected investment, it also limits the discretion to attribute nationality to an entity for the purpose of investment treaties under the ICSID regime.

However, art 25 does not prescribe how the nationality of a juridical person is to be determined by contracting states and therefore is silent as to the point at which the outer limits of nationality are to be drawn. Attempts to define “national”

¹²³ Broches, above n 25, at 355.

¹²⁴ Aron Broches *Selected Essays: World Bank, ICSID, and Other Subjects of Public and Private International Law* (Martinus Nijhoff, Dordrecht, 1995).

were abandoned by the negotiating parties to the ICSID Convention in favour of permitting the parties to an investment treaty.¹²⁵

... the widest possible latitude to agree on the meaning of “nationality” and any stipulation of nationality made in connection with a conciliation or arbitration clause which is based on a reasonable criterion ...

Reasonable criteria for nationality includes incorporation and control; indeed, art 25 “implicitly assumes that incorporation is a criterion of nationality”.¹²⁶ Further, a “broader approach ... [that] would give effect to economic reality such as ownership and control” would also be in keeping with the purpose of art 25.¹²⁷

Presently, investment treaty tribunals that take the literal approach to nationality are satisfied as to compliance with art 25 if the parties’ choice of nationality criteria is reasonable in the sense of being common or widely accepted, such as incorporation. However, what is not clear from commentary or investment tribunal decisions is whether art 25 requires the result of the application of an otherwise reasonable criterion to be reasonable in a substantive sense. This thesis contends that the outer limits of art 25 are breached if the common incorporation criterion for nationality permits use of a shell company owned by respondent state nationals to access treaty benefits. That situation is unreasonable because it uses an reasonable criterion to produce an unreasonable result: an abuse of the purpose of the ICSID Convention to protect only foreign investments.

The answer to that issue in the context of ICSID claims must be the same as the wider issue as to whether the concept of nationality in investment treaties is properly approached substantively—that is, essentially requiring an inherent meaning of nationality beyond what the parties to a treaty may have agreed—or

¹²⁵ Broches, above n 25, at 361. See also Broches, above n 124, at 259–260; Schreuer and others, above n 26, at [461]–[462]; and Lavista, above n 16, at 4–6. Both a control test and a requirement for effective nationality were proposed at various stages of the negotiation of the text, but ultimately were not adopted: CF Amerasinghe “Jurisdiction *Ratione Personae* under the Convention on the Settlement of Investment Disputes Between States and Nationals of Other States” (1975) 47 BYBIL 227 at 254–255 and 267; and International Centre for Settlement of Investment Disputes *History of the ICSID Convention* (ICSID, Washington, 1968) vol 2 at 361, 446–448, 538, 581 and 876.

¹²⁶ Broches, above n 124, at 206.

¹²⁷ At 207.

whether the parties' agreement is inviolable so long as the criteria for nationality are reasonable in the sense of being common.

Therefore, the discussion that follows, particularly in Chapters 3, 7, 8, 10 and 11, draws on the ICSID Convention and authority and commentary relevant to the concept of nationality in art 25.

Treaty interpretation and the Vienna Convention

Customary international law as to the interpretation of treaties (including conventions such as the ICSID Convention) is encapsulated in the Vienna Convention.¹²⁸ Most investment treaty tribunals recognise the Vienna Convention as the applicable law for interpreting investment treaties.¹²⁹ The discussion in this thesis focuses on art 31(1):

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.

Article 31(1) is the core—or “golden rule”¹³⁰—of the treaty interpretation exercise. The following sub-sections of art 31—(2), (3) and (4)—assist the operation of art 31(1) in certain circumstances. Article 31(2) elucidates the materials that may provide context for the purpose of art 31(1). Article 31(3) mandates the consideration of subsequent agreement and practice by or between the parties and any rules of international law applicable between the parties. Article 31(4) permits a special meaning if established that the parties so intended.

These latter sub-sections of art 31 refine and explain the central exercise set out in art 31(1): to interpret the treaty terms in *good faith*, in accordance with the *ordinary meaning*, in their *context*, and in the light of its *object and purpose*. But they are far less frequently referred to and relied on by investment tribunals.¹³¹

¹²⁸ As for the Vienna Convention reflecting customary international law, see J Romesh Weeramantry *Treaty Interpretation in Investment Arbitration* (Oxford University Press, Oxford, 2012) at [7.04].

¹²⁹ Weeramantry, above n 128, at [7.02].

¹³⁰ Eduardo Jiménez de Arcega *International Law in the Past Third of a Century* (1978) 159 *Recueil Des Cours* 1 at 43; and Weeramantry, above n 128, at [3.11].

¹³¹ Weeramantry, above n 128, at [3.07]; and Ole Kristian Fauchald “The Legal Reasoning of ICSID Tribunals – An Empirical Analysis” (2008) 19 *EJIL* 301 at 314.

The application of the components of interpretation in art 31(1)—good faith, ordinary meaning, context and object and purpose—and their relative importance in the interpretation exercise is fundamental to this thesis because they impact on the interpretative approach to definitions of corporate nationality in investment treaties. The methodology of interpretation affects profoundly the opportunities for a substantive approach to jurisdictional concepts such as “national” and “investor” where no substantive approach is express in treaty definitions of these concepts.

Accordingly, the components of art 31(1) are introduced below and, in particular, it is observed that there is no primacy accorded to any of the factors in art 31(1); it requires a holistic approach in which all factors have equal weight.

Good faith interpretation¹³²

The tenet of good faith (that is, “obedience to a standard of honesty, loyalty, and fair dealing, in short of morality, in international conduct”¹³³) is rarely mentioned by investment treaties in an interpretation context.¹³⁴ However, some investment treaty tribunals have drawn a link between the requirement of good faith and an approach to interpretation that prevents “gross manipulation” of the language of a treaty,¹³⁵ or dishonesty, untruthfulness or the taking of unfair advantage.¹³⁶ In this respect a good faith interpretation involves consideration of what the parties must “reasonably and legitimately”¹³⁷ have considered to flow from their treaty undertakings.¹³⁸

¹³² See generally Eric de Brabandere and Isabelle Van Damme “Good Faith in Treaty Interpretation” in Andrew Mitchell and others (eds) *Good Faith and International Economic Law* (Oxford University Press, Oxford, 2015).

¹³³ Bin Cheng *General Principles of Law as Applied by International Courts and Tribunals* (Stevens, London, 1953) at 389. Or a duty not to act arbitrarily or capriciously, or abuse rights: Gerald Fitzmaurice “The Law and Procedure of the International Court of Justice, 1951–54: General Principles and Sources of Law” (1953) 30 BYBIL 1 at 53.

¹³⁴ Weeramantry, above n 128, at [3.22] and [3.24]–[3.25]. For an example relevant to this thesis, the Tribunal in *Aguas del Tunari*, above n 22, at [91] overlooked it entirely while discussing the other three tenets in art 31(1). Weeramantry opines that the low incidence of references to good faith in an interpretation context may be due to the overlap between good faith and the principle of effectiveness.

¹³⁵ *Plama Consortium Ltd v Bulgaria (Jurisdiction)* (2005) 44 ILM 721 at [147].

¹³⁶ Weeramantry, above n 128, at [3.25]–[3.26]; *Phoenix Action Ltd v The Czech Republic (Award)* ICSID ARB/06/5, 15 April 2009 at [107]; and *Inceysa Vallisoletana SL v El Salvador (Award)* ICSID ARB/03/26, 2 August 2006 at 230.

¹³⁷ *SOABI*, above n 61, at [4.10].

¹³⁸ Weeramantry, above n 128, at [3.27]; *Amco Asia Corps v Indonesia (Jurisdiction)* ICSID ARB/81/1, 25 September 1983 at [14(i)]; *CeskoSlovenska Obchodni Banka AS v The Slovak Republic (Jurisdiction)* ICSID ARB/97/4, 24 May 1999 [*CSOB (Jurisdiction)*] at [34]; and

Good faith is recognised more readily in its absence, that is when bad faith is evident.¹³⁹ The fundamental reason for interpretation of treaties according to art 31(1) to be “in good faith” is to prevent an interpretation that arrives at a result which permits an abuse of right or abets a breach of honesty, loyalty, fair dealing or morality in international conduct. It is therefore one way in which the principle of abuse of right is found to apply to investment treaty law.

Moreover, and specific to the topic of this thesis, the concept of good faith as an overarching interpretative principle supports a substantive rather than literal approach to interpretation of definitions of corporate nationality because it sanctions the use of the principle of abuse of right to test corporate arrangements which seek to manipulate formalities to achieve access to investment treaty protections. If such arrangements are dishonest or immoral or take unfair advantage of a semantic reading of criteria for corporate nationality in an investment treaty, then, as will be developed further in Chapter 11, good faith interpretation is a means to prevent that outcome.

Ordinary meaning

The ordinary meaning tenet is the “very essence of the textual approach”.¹⁴⁰ Investment treaty tribunals “have tended to favour an emphasis on the text because it gives primacy to the documentary record of the agreement reached by the State parties”.¹⁴¹

There is, however, much discussion in cases and commentary as to whether the ordinary meaning of the words is entitled to primacy and how it relates in relative importance to the other tenets, particularly context and object and purpose.

The primacy of ordinary meaning as the “first general maxim of interpretation” was emphasised in *Asian Agricultural Products Ltd (AAP)*. The Tribunal held that when meaning is evident and does not lead to an absurd conclusion, that meaning must be admitted.¹⁴² The interpretative rules set out in *AAP*

CeskoSlovenska Obchodni Banka AS v The Slovak Republic (Further Decision on Jurisdiction) ICSID ARB/97/4, 1 December 2000 at [25].

¹³⁹ Good faith “can be illustrated but not defined”: *Russell v Russell* [1897] AC 395 (HL) at 436 per Lord Hobhouse.

¹⁴⁰ *Report of the International Law Commission on the work of its eighteenth session* [1966] vol 2 YILC 172 at 221, [12].

¹⁴¹ Weeramantry, above n 128, at [3.32].

¹⁴² *Asian Agricultural Products Ltd v Sri Lanka (Award)* ICSID ARB/87/3, 27 June 1990 at [40].

have been criticised as incomplete and have been eclipsed by the Vienna Convention rules.¹⁴³ Nevertheless, other more recent tribunals have taken a similar interpretative approach whereby plain meaning trumps consideration of other interpretative tools.¹⁴⁴ Particular to this thesis, and as discussed in Chapter 3.2, the literal cases tend to follow the *AAP* approach and place primacy on the ordinary meaning of the words of the treaty.¹⁴⁵

But words do not have a fixed meaning, let alone an ordinary one, without context¹⁴⁶ and the ordinary meaning of words “is not an absolute one”:¹⁴⁷

Where such a method of interpretation results in a meaning incompatible with the spirit, purpose and context of the clause or instrument in which the words are contained, no reliance can be validly placed on it.

Critically, “the Vienna rules are to be applied together, not in bits”, that is the “main reason why the whole of article 31 is described as the (singular) ‘general rule’”.¹⁴⁸ According to Gardiner, “the ordinary meaning is not an element in treaty interpretation to be taken separately” and the sense of equality of influence between these interpretive rules is enhanced by the fact they are placed in combination.¹⁴⁹ The process of interpretation is a unity and the provisions of the article form a single,

¹⁴³ Weeramantry, above n 128, at [6.04]–[6.08].

¹⁴⁴ See, for example, *Romak SA (Switzerland) v Uzbekistan (Award)* PCA AA280, 26 November 2009 at [183]; *Methanex Corporation v United States (Final Award)* J William Rowley, W Michael Reisman and VV Veeder 3 August 2005 at pt 4, ch B, [37]; *Société Générale de Surveillance SA v The Philippines (Jurisdiction)* ICSID ARB/02/6, 29 January 2004 at [114] and [119]; and *Pope & Talbot Inc v Canada (Interim Award)* Lord Dervaird, Benjamin J Greenberg, Murray J Belman 26 June 2000 at [69].

¹⁴⁵ For example, *Rompetrol*, above n 24, at [85]; and *Yukos*, above n 24, at [411].

¹⁴⁶ *Towne v Eisner* 245 US 418 (1918) at 425.

¹⁴⁷ *South West Africa Cases (Ethiopia v South Africa; Liberia v South Africa) (Preliminary Objections)* [1962] ICJ Rep 319 at 336. To the same effect see Isabelle Van Damme *Treaty Interpretation by the WTO Appellate Body* (Oxford University Press, Oxford, 2009) at 50–51; and Ian Sinclair *The Vienna Convention on the Law of Treaties* (Manchester University Press, Manchester, 1984) at 130.

¹⁴⁸ Richard K Gardiner *Treaty Interpretation* (2nd ed, Oxford University Press, Oxford, 2015) at 141–142. See also *Draft Articles on the Law of Treaties with Commentaries* [1996] vol 2 YILC 187 at 220.

¹⁴⁹ Gardiner, above n 148, at 142 and 161–163. Similarly, the International Law Commission cautioned that the “ordinary meaning of a term is not to be determined in the abstract”: *Draft Articles*, above n 148, at 221.

closely integrated rule to be applied as a “single combined operation”¹⁵⁰ with no order of importance implied by virtue of the order of the tenets.¹⁵¹

Context

Context is inherently intertwined with ordinary meaning:¹⁵² “there is no such thing as an abstract ordinary meaning of a phrase, divorced from the place which that phrase occupies in the text to be interpreted”.¹⁵³

Article 31(2) of the Convention details materials from which context can be deduced: the text of the treaty including any preamble and annexes; any agreement between the parties relating to the treaty; and any instrument accepted by the parties as related to the treaty. But this explanation does not assist to guide the interpreter in any particular case as to how context affects the interpretation exercise.

The criteria of ordinary meaning and context are often taken together as an integral part of *contextual* interpretation; the interpretative search is for the “ordinary contextual meaning” of the instant treaty terms.¹⁵⁴ However, it is not usually determinative of meaning on its own.¹⁵⁵ Context alone will not prevail over the general wording of the text.¹⁵⁶

Equally, context often overlaps with or is conflated with the object and purpose criterion discussed below.¹⁵⁷

¹⁵⁰ *Draft Articles*, above n 148, at 220. See also Weeramantry, above n 128, at [3.02]–[3.03].

¹⁵¹ Anthony Aust *Handbook of International Law* (Cambridge University Press, Cambridge, 2005) at 89; and Weeramantry, above n 128, at [3.12].

¹⁵² Although strictly it is limited to context found within the particular treaty (as opposed to the wider legal context of the treaty generally) and the material in art 31(2) of the Vienna Convention: see Weeramantry, above n 128, at [3.55] and [3.60]; *CME Czech Republic BV v The Czech Republic* (*Separate Opinion of Ian Brownlie*) UNCITRAL, 14 March 2003 at [9]; and *Hrvatska Elektroprivreda DD v Slovenia* (*Individual Opinion of Jan Paulsson*) ICSID ARB/05/24, 12 June 2009 at [44].

¹⁵³ Sinclair, above n 147, at 121.

¹⁵⁴ *Plama*, above n 135, at [147]. See also *Competence of the General Assembly for the Admission of a State to the United Nations* (*Advisory Opinion*) [1950] ICJ Rep 4 at 8.

¹⁵⁵ Weeramantry, above n 128, at [3.58] and [3.69].

¹⁵⁶ *Salini Costruttori SPA v Jordan* (*Jurisdiction*) ICSID ARB/0/13, 9 November 2004 at [77]; and *Plama*, above n 135, at [192].

¹⁵⁷ Weeramantry, above n 128, at [3.60]. See also, for example, *Eureko BV v Poland* (*Partial Award*) L Yves Fortier, Stephen M Schwebel, Jerzy Rajski 19 August 2005 at [248]; and *Pope & Talbot*, above n 144, at [77].

Object and purpose

This tenet “adds a teleological element to the interpretation process” the role of which is “to shed light on the ordinary meaning of the terms subject to interpretation”.¹⁵⁸

However, consideration of object and purpose is not a license to re-write treaties or a means to avoid interpretations that may be unsatisfactory from the point of view of investor or state.¹⁵⁹ The text of a treaty falls to be objectively interpreted, not the subjective intentions of the parties ascertained.¹⁶⁰ The latter inappropriately invites the interpreter to alter the text of a treaty “to make it conform better with what he ... considers to be the treaty’s ‘true purpose’”.¹⁶¹

Accordingly, object and purpose should not be used as a device to allow “the general purpose of a treaty to override its text ... [r]ather, object and purpose are modifiers of the ordinary meaning ...”.¹⁶² Weeramantry’s review revealed that, in practice, investment treaty tribunals have generally refrained from using object and purpose to displace the clear meaning of a treaty text.¹⁶³

But as object and purpose must be considered in ascertaining the appropriate meaning of words in the circumstances, this begs the question: what is the object and purpose of the ICSID Convention and investment treaties generally speaking? And, perhaps more importantly, what is the specific role of jurisdictional provisions in advancing that purpose? These questions are central to the debate between the literal and substantive approaches to nationality in jurisdictional provisions. They will be addressed in Chapter 8 and the effect of the object and purpose of investment treaties on the interpretation of nationality criteria will be traversed in Chapter 11.

¹⁵⁸ Weeramantry, above n 128, at [3.70].

¹⁵⁹ The International Court of Justice has stressed it is not the function of interpretation to revise treaties or to read into them what they do not, expressly or by implication, contain: *Nationals of the United States of America in Morocco (France v United States of America) (Judgment)* [1952] ICJ Rep 176 at 199.

¹⁶⁰ *Report of the International Law Commission*, above n 140, at 223, [18]; and KJ Keith *Interpreting Treaties, Statutes and Contracts* (Victoria University of Wellington Legal Research Paper Series, Occasional Paper 19, May 2009) at 5. See also Weeramantry, above n 128, at [3.15]; *Methanex*, above n 144, at [22]; *Salini*, above n 47, at [79]; and *Wintershall Aktiengesellschaft v Argentina (Award)* ICSID ARB/04/14, 8 December 2008 at [78] and [86]–[88].

¹⁶¹ *Wintershall*, above n 160, at [88]. See also *Czech Republic v European Media Ventures SA* [2007] EWHC 2851 (Comm) at [16].

¹⁶² Gardiner, above n 148, at 190.

¹⁶³ Weeramantry, above n 128, at [3.70].

2.4 Application of national and international law to interpretation of corporate nationality in investment treaties

It remains in this contextual Chapter to consider what law applies to the determination of corporate nationality issues with regard to investment treaties: municipal law, international law or both?

As set out earlier in this Chapter, investment treaties set out various criteria to ascertain nationality of individuals and corporations for the purposes of the treaty. Invariably those criteria involve a *renvoi* to municipal law. For individuals, the *renvoi* is to municipal law of the relevant state that ascribes nationality to individuals. For corporations, it is to the municipal corporate law requirements for establishment or incorporation of a juridical person in that state. An aspect of domestic corporate law—the fact and place of incorporation—is given international significance by a treaty as a criterion of nationality. Treaty tribunals monitor fulfilment of the relevant municipal law to ensure proper compliance and the absence of fraud. Thereby the municipal law incorporated by the treaty is applied by an international tribunal.

But the *renvoi* to domestic law is only if and to the extent provided by the treaty. A further role is played by international law. While international law does not contain rules that determine a person's nationality, it may impose limitations on when an international court or tribunal will accept the nationality claimed, even if the claimant can prove compliance with the relevant municipal law.¹⁶⁴ International law polices the result of the application of municipal law criteria to ensure compliance with the object and purpose of the relevant international instrument; that is, it acts to avoid absurdity or abuse of the application of municipal law in the international context.

For example, as will be seen in later Chapters, international law should seek to prevent domestic investment disputes being transformed into international ones by virtue of formal compliance with municipal law criteria for nationality in investment treaties. That is because, as will be discussed in Chapter 8 in particular, the object and purpose of investment treaties and the ICSID Convention is to protect international, not domestic, investment and the purpose of jurisdictional provisions

¹⁶⁴ Schlemmer, above n 34, at 71–72.

is to confine the benefits of treaties to nationals of contracting states, to the exclusion of nationals of the respondent state and investors from non-party states.

In Chapters 10 and 11 it will be explained that tribunals can limit the use of municipal constructs of nationality for treaty shopping by means of a proper understanding and deployment of the principle of abuse of right and/or by interpreting the meaning of “national” and/or “investor” of a contracting state in the ICSID Convention and/or the relevant investment treaty in a substantive purposive sense, rather than relying only on literal fulfilment of municipal law criteria.

2.5 Conclusion

The matters dealt with above are important precursors to the discussion concerning the correct approach to corporate nationality and treaty shopping to come in this thesis.

Moreover, this Chapter illustrates the concatenation of factors that underpin the proliferation of treaty shopping in investment treaty law. Many investment treaties, particularly those from the first and second generations, abet manipulation of corporate nationality because they contain simple incorporation or seat nationality criteria. The rigid approach to application of these definitions in the literal cases is explained in Chapter 3.2.

Treaties which incorporate substantive criteria such as “control” and “substantial business activities” (often in the third generation) go some way to mitigating treaty shopping in a principled way, but as explained in Chapter 9 in particular, these mechanisms have proved problematic to curb treaty shopping.

One remedy for the Nationality Controversy is better drafting of the definitions clauses in investment treaties, but as explained in Chapter 11, it is difficult to amend definitions or replace treaties. A more immediate approach is an interpretative approach by tribunals that recognises two aspects of treaty construction that this thesis argues has been overlooked or under-emphasised by the literal treaty shopping cases.

First, the outer jurisdictional limits prescribed by the ICSID Convention require not just reasonable or commonly used criteria for nationality but also the need for treaty criteria to lead to reasonable results in terms of attribution of

nationality. This raises questions as to the reasonable outer limits of ICSID jurisdiction *ratione personae*, and as to the object and purpose of the Convention. These limits and their application to the interpretation of investment agreements will be addressed in Chapter 8.

Secondly, art 31 of the Vienna Convention requires equal emphasis on the four constituent parts of the (singular) general rule: ordinary meaning, good faith, context and object and purpose. The latter three shed light on the true construction of the ordinary meaning. Good faith requires consideration of what the parties reasonably considered as to the scope of their treaty obligations and whether the claimant has attained nationality honestly and fairly. Context and object and purpose instil a teleological aspect to interpretation. It will be illustrated in Chapter 3 that the literal cases do not apply the parts of the rule equally, but over-emphasise ordinary meaning to the detriment of the other tenets.

It is this flawed approach that ultimately leads these tribunals to reject efforts to interpret nationality criteria substantively by reference to good faith, object and purpose and context. The object and purpose of *ratione personae* jurisdictional provisions in investment treaties and the influence of object and purpose in the interpretative process is discussed in Chapter 8 and the potential for good faith, context and object and purpose to impose a substantive inherent meaning of “national” or “investor” is discussed in Chapters 10 and 11.

Lastly, this Chapter explains that treaties give international significance to aspects of municipal law as allocators of nationality. But by virtue of the interpretative criteria in the Vienna Convention and the principle of abuse of right, international law retains a limiting function as to reasonableness of the results of the application of municipal law on the international plane. This dynamic is further discussed in Chapter 4 and is a theme that arises throughout the thesis as overlooked or under-appreciated by the literal approach cases.

3 The treaty shopping debate in the investment treaty field

3.1 Introduction

This Chapter examines the principal competing approaches to corporate jurisdiction *ratione personae* described in Chapter 1 and identifies the reasoning deployed by each approach. All of the authorities discussed below, other than *Agua del Tunari (AdT)*¹⁶⁵ (which concerns incorporation and control criteria), interpret treaties which include the incorporation criterion as a sole arbiter of corporate nationality.

The literal approach treats the specific wording of a treaty instrument as sacrosanct and permits no inquiry as to the commercial purpose of the corporate investor. In contrast, the substantive/purposive approach is concerned to ensure that a putative corporate claimant not only complies with the terms of the treaty definition of investor, but also exists for a purpose other than as a convenient vehicle to access treaty benefits.

The literal cases are more numerous than those that advocate a substantive approach, to the point where one Tribunal effectively proposed that the literal approach was a *jurisdiction constante*.¹⁶⁶

Ultimately, the principal differences between the literal approach and the substantive approach are their views as to the primacy of the express terms for jurisdiction *ratione personae* set out in investment treaties, the relevance and scope of the object and purpose of investment treaty instruments, the impact of general international law on investment treaty interpretation, and whether a substantive approach would lead to unworkable uncertainty as to treaty coverage for investors.

There are two categories of factual scenarios addressed in the discussion below: the first is the “third-country” cases, in which an entity from a country which is not a party to the relevant investment treaty routes its investment in one treaty state through an entity in the other contracting state. For example, in *Saluka v Czech*

¹⁶⁵ *Agua del Tunari*, above n 22.

¹⁶⁶ *KT Asia*, above n 24, at [104] where it was observed that the literal approach had been followed by investment treaty tribunals on 19 out of 20 occasions. See also McLachlan, Shore and Weiniger, above n 6, at [5.129].

Republic,¹⁶⁷ a Japanese bank set up a special purpose corporate vehicle in the Netherlands to hold the shares representing its investment in a bank in the Czech Republic. The Dutch company, Saluka, was the claimant under the Netherlands-Czech Republic Treaty although the Japanese bank was the ultimate owner of the investment.

The second category is the “domestic” cases, wherein nationals of the respondent host state invest in their own country through a corporate vehicle incorporated in the other contracting state. This maneuver enables host state nationals to gain treaty protections and rights against their own government they would not otherwise have had. The seminal case in this scenario is *Tokios Tokelés v Ukraine*,¹⁶⁸ in which a Lithuanian registered company owned by Ukrainian nationals brought a claim against Ukraine on the basis that the claimant company fulfilled the nationality criterion of incorporation in Lithuania in the Lithuania–Ukraine BIT.¹⁶⁹

Both categories of case involve the same treaty shopping manoeuvre: a person not otherwise entitled to the benefits of a treaty obtains treaty coverage by means of a corporate entity established in a contracting state to the treaty other than the host state of the investment. The principles applied to both categories are therefore largely the same, although they may give rise to different considerations. For example, domestic cases permit the prospect of a host state being sued in an international forum by its own nationals. The sovereignty implications of this situation (discussed more fully in Chapter 8) are not relevant to third-country cases where the putative claimant is owned by nationals of a non-party state.

For present purposes, where the analysis of the jurisprudence below differs as a result of whether the case is a “third-country” case or a “domestic” case, that is indicated.

3.2 The literal approach to jurisdiction *ratione personae*

The literal approach rejects any investigation as to a genuine economic link between the claimant and its country of apparent nationality. It does so on the basis that the natural and ordinary meaning of the relevant treaty definition is consistent

¹⁶⁷ *Saluka*, above n 24.

¹⁶⁸ *Tokios (Jurisdiction)*, above n 24.

¹⁶⁹ Lithuania-Ukraine BIT, art 1(2)(b).

with, and/or has primacy over, the object and purpose of a treaty. Nor is ordinary meaning abrogated by general principles of international law. In addition, the literal approach cautions that a substantive approach would lead to undesirable uncertainty as to treaty coverage for investors which would undermine the purpose of investment treaties to encourage investment.

Treaty text to be applied, so long as reasonable criteria for nationality

The central tenet of the reasoning of literal tribunals is a refusal to look beyond the criteria for nationality expressly set out in any particular investment treaty. Put another way, literal tribunals refuse to imply into a treaty any limitation on the use of intermediary companies to procure treaty protection. The means by which jurisdiction *ratione personae* exists is a matter for agreement by the parties within reasonable bounds; they had the opportunity to express a limitation in the treaty, but did not.¹⁷⁰

For example, the Tribunal in *Saluka* had “some sympathy” for the respondent’s argument that a shell company controlled by a company from a third, non-contracting state should not access the benefits of an investment treaty.¹⁷¹ However it could not:¹⁷²

... in effect impose upon the parties a definition of ‘investor’ other than that which they themselves agreed. That agreed definition required only that the claimant-investor should be constituted under the laws of (in the present case) The Netherlands, and it is not open to the Tribunal to add other requirements which the parties could themselves have added but which they omitted to add.

This reasoning has been repeated in both third-country and domestic cases. *ADC v Hungary*,¹⁷³ is another third-country case in which Canadian nationals established two Cypriot companies to contract with Hungary in relation to the

¹⁷⁰ Christoph Schreuer “Nationality of Investors: Legitimate Restrictions vs. Business Interests” (2009) 24 ICSID Rev 521 at 525.

¹⁷¹ *Saluka*, above n 24, at [240].

¹⁷² At [229] and [241]. See also *Waste Management*, above n 24, at [85].

¹⁷³ *ADC Affiliate Ltd v Hungary (Award)* ICSID ARB/03/16, 2 October 2006.

construction of new facilities at Budapest airport so as to access the Cyprus–Hungary BIT.¹⁷⁴ The Tribunal found that the state parties to the treaty could have included a genuine connection requirement for corporate nationality, but presumably chose not to do so: “[t]he Tribunal cannot read more into the BIT that one can discern from its plain text.”¹⁷⁵

In the domestic-type case of *Tokios*, the Tribunal found that “the only relevant consideration is whether the Claimant is established under the laws of Lithuania”.¹⁷⁶ The Tribunal emphasised the consent of the Contracting Parties, who “are free to define their consent to jurisdiction in terms that are broad or narrow” and once that consent is defined, “tribunals should give effect to it, unless doing so would allow the Convention to be used for purposes for which it clearly was not intended”.¹⁷⁷

Similarly, in *Yukos v Russia*,¹⁷⁸ a domestic-type case in which Russian oligarchs invested in Russia through companies incorporated in the Isle of Man with no substantial business activities other than holding shares,¹⁷⁹ the Tribunal emphasised that according to the Vienna Convention, “a treaty must be interpreted first on the basis of its plain language”.¹⁸⁰ The relevant definition must therefore be read “not as [it] might have been written but as [it] were actually written”.¹⁸¹

In *Venoklim*, a domestic-type case discussed in the following sub-chapter because of the substantive approach taken by the majority, dissenting Arbitrator Pinzón argues that it is not for the Tribunal to redefine the terms of the treaty.¹⁸² Rather, the ICSID Convention does not include a definition of nationality and thereby permits contracting states to define nationality as they see fit.¹⁸³

¹⁷⁴ Cyprus-Hungary BIT (signed 24 May 1989), art 1(3)(b); and *ADC*, above n 173, at [295] and [333].

¹⁷⁵ *ADC*, above n 173, at [359]. See also *Autopista*, above n 61.

¹⁷⁶ *Tokios (Jurisdiction)*, above n 24, at [38].

¹⁷⁷ At [38]–[39]. See also *Rompétrol*, above n 24, at [109]; and *KT Asia*, above n 24, at [123] and [143].

¹⁷⁸ *Yukos*, above n 24.

¹⁷⁹ At [461].

¹⁸⁰ At [411].

¹⁸¹ At [413] and to the same effect at [411], [416] and [435]. The same conclusions were drawn in another Russian case: *Rosinvestco UK Ltd v Russia (Award)* SCC V079/2005, 12 September 2010 at [322]–[323]. See also *Gold Reserve Inc v Venezuela (Award)* ICSID ARB(AF)/09/1, 22 September 2014 at [252] and [255].

¹⁸² *Venoklim Holding BV v Venezuela (Concurring and Dissenting Opinion of Enrique Gomez Pinzón)* ICSID ARB/12/22, 3 April 2015 at [26]–[38].

¹⁸³ At [33]–[35].

Douglas opines that the “decisive factor” in support of the *Tokios*-type cases is that the state parties could have, but did not, provide for additional criteria requiring substantial connections to a contracting state for corporate claimants.¹⁸⁴

The only temper to the strict constructionist approach permitted by the literal tribunals is that the criterion for nationality in a treaty must be a reasonable one, in the sense of common. Given that incorporation as a criterion to establish nationality is common, it follows that its use by parties to investment treaties is reasonable and should be applied without further qualification.¹⁸⁵ To do otherwise, would result in “setting aside the clear language agreed upon by the Treaty parties in favour of a wide-ranging policy discussion”.¹⁸⁶

Schreuer concludes that contracting parties enjoy a broad discretion to define corporate nationality and opines that “any reasonable determination of the nationality of juridical persons contained ... in a treaty should be accepted by an ICSID commission or tribunal”¹⁸⁷ and therefore “[i]t is not permissible to look behind the company nor to examine the existence of a genuine link”.¹⁸⁸

The impact of general international law

Respondent states in many literal approach cases argue that a literal interpretation is tempered by principles of general international law. However, this argument has been rejected in both third-country and domestic cases.

The approach to general principles of international law is well illustrated in *Rompetrol*, in which the Tribunal held that nothing in the diplomatic protection cases of *Nottebohm* and *Barcelona Traction* (as to which see Chapter 5) established a general rule of real and effective nationality in relation to corporations under international law.¹⁸⁹ For that reason also, no recourse could be had to the “relevant rules of international law applicable in the relations between the parties” as provided in art 31(3)(c) of the Vienna Convention.¹⁹⁰

¹⁸⁴ Douglas, above n 7, at [587]. See to the same effect Valasek and Dumberry, above n 39, at 58–59; and Michalopoulos and Hicks, above n 22, at 136.

¹⁸⁵ *Tokios (Jurisdiction)*, above n 24, at [63]; and *Rompetrol*, above n 24, at [78].

¹⁸⁶ *Rompetrol*, above n 24, at [85].

¹⁸⁷ Schreuer and others, above n 26, at 287 and 525.

¹⁸⁸ Schreuer, above n 170, at 525. To the same effect see Benedict and others, above n 4, at 52, 55 and 59–60; and Weeramantry, above n 128, at [6.124]–[6.126].

¹⁸⁹ *Rompetrol*, above n 24, at [88]. See *Nottebohm*, above n 41; and *Barcelona Traction*, above n 3.

¹⁹⁰ *Rompetrol*, above n 24, at [105]. See also [31].

Moreover, the *Rompetrol* Tribunal found that whatever the position at international law, the specific terms of a treaty must prevail and it was not possible for general international law to prevent contracting states from agreeing to rely on the place of incorporation as a sufficient and sole criterion of nationality for the purposes of a BIT.¹⁹¹

In the same way, the *KT Asia* Tribunal refused “to substitute or supplement the test of nationality in a BIT with rules of diplomatic protection” and concluded that:¹⁹²

... rules of customary international law applicable in the context of diplomatic protection do not apply where they have been varied by the *lex specialis* of an investment treaty.

The same conclusion was reached in *Yukos*. Although the parties to the Energy Charter Treaty may not have intended for investments ultimately controlled by nationals of the respondent state to be permitted to access to treaty protections,¹⁹³ the *Yukos* Tribunal found, relying on *Saluka*,¹⁹⁴ that the principles of international law, “do not allow an arbitral tribunal to write new, additional requirements—which the drafters did not include—into a treaty, no matter how auspicious or appropriate they may appear”.¹⁹⁵

The impact of the object and purpose of investment treaties

Respondent states also appeal for a substantive approach derived from the object and purpose of an investment treaty or the ICSID Convention. In this regard, the literal tribunals revert to their central tenet: object and purpose is of no import if the language of the jurisdictional provision is clear. The *Tokios* majority went so far

¹⁹¹ At [90]–[91].

¹⁹² *KT Asia*, above n 24, at [129]. Compare Kazakhstan’s submissions to the contrary at [72]–[73] and [126]. See also Matthew Weiniger and Elizabeth Kantor “KT Asia Investment Group BV v Republic of Kazakhstan: *Ratione Personae* and *Ratione Materiae*” (2015) 30 ICSID Rev 533. See also to the same effect, *Hulley Enterprises Ltd (Cyprus) v Russia (Interim Award on Jurisdiction and Admissibility)* PCA Case No AA 226, 30 November 2009 at [415].

¹⁹³ *Yukos*, above n 24, at [434].

¹⁹⁴ At [414]; and see *Saluka*, above n 24.

¹⁹⁵ *Yukos*, above n 24, at [415].

as to say that where the parties have clearly chosen the criteria to be applied, “arguments of an economic nature are irrelevant”.¹⁹⁶

Some proponents of the formal approach argue that it is consonant with the object and purpose of investment treaties because it broadens the application of the treaty and therefore increases the potential to encourage investment. Douglas opines that if an investment is structured to reduce sovereign risk, “then the investment treaty has served its express purpose”.¹⁹⁷ Similarly, Schill considers that the source of the capital matters little so long as it furthers economic growth in the host state.¹⁹⁸ This view may have originated in *AdT*.¹⁹⁹

The language of the definition of national in many BITs evidences that such national routing of investments is entirely in keeping with the purpose of the instruments and the motivations of the state parties.

This argument was taken a step further in respect of domestic-type cases in *Rompetrol*. In that case, the Tribunal observed that the use of corporate structures for domestic investors to gain access to such protections was not controversial because it was common for states to enter international treaties that apply to their own citizens, such as those relating to human rights.²⁰⁰

The need for certainty

An additional thesis for the application of the literal constructionist approach is a concern that a venture into the territory of substantive connection between corporate and home state would lead to undue uncertainty for investors and thereby undermine the objective of encouraging investment.

The classic expression of this concern is the case of *AdT* in which the parties debated a formal conception of control that equated control with ownership, and a contextual or substantive approach requiring real or ultimate control.²⁰¹ The Tribunal

¹⁹⁶ *Tokios (Jurisdiction)*, above n 24, at [63]. The Tribunal’s comments originate in *Autopista*, above n 61, at [119]–[120].

¹⁹⁷ Douglas, above n 7, at [583].

¹⁹⁸ Schill, above n 7, at 235. See also Bernardini, above n 70, at 23.

¹⁹⁹ *Aguas del Tunari*, above n 22, at [332].

²⁰⁰ *Rompetrol*, above n 24, at [109].

²⁰¹ *Aguas del Tunari*, above n 22, at [222]–[223].

adopted the views expressed in *Autopista* that a substantive inquiry into actual, as opposed to legal, control would be a “thicket” that was:²⁰²

... precisely what the drafters of the ICSID Convention decided to avoid. Finding the “ultimate”, or “effective”, or “true” controller would often involve difficult and protracted factual investigations, without any assurance as to the result.

This inquiry would frustrate the object of investment treaties to stimulate foreign investment if an investor is unable to ascertain whether it will qualify for treaty protection.²⁰³

The undesirability of a difference between ICSID and UNCITRAL cases

The *Rompetrol* Tribunal also rejected a substantive approach on the basis that to create a substantive rule on the basis of the nationality concept in art 25 and the object and purpose of the ICSID Convention would create an undesirable distinction as to jurisdiction *ratione personae* between ICSID arbitration and ad hoc arbitration under the UNCITRAL Rules, as non-ICSID cases would not be subject to substantive limits on nationality of investors based on the object and purpose of the Convention.²⁰⁴

Therefore, the definition of corporate nationality would be approached differently in the context of an ICSID arbitration as compared with an UNCITRAL ad hoc arbitration. Not only did that seem arbitrary to the Tribunal, but in treaties which permitted the claimant a choice of procedure, the test for jurisdiction *ratione personae* would be in the claimant’s hands.²⁰⁵

Accordingly, no substantive approach “of even the most narrowly limited kind would gain a foothold in the interpretation of the BIT” or the ICSID Convention.²⁰⁶

²⁰² At [246], citing *Autopista*, above n 61, at [69].

²⁰³ *Aguas del Tunari*, above n 22, at [247]. To the same effect see *KT Asia*, above n 24, at [142].

²⁰⁴ *Rompetrol*, above n 24, at [105].

²⁰⁵ At [107].

²⁰⁶ At [105].

3.3 The substantive or purposive approach to the definition of “investor”

Investment treaties involve a negotiated balance between hoped for benefits and acceptable sacrifices. States that are party to investment treaties hope to benefit from foreign investment in their economies. In return, they take on obligations: substantive protections for foreign investments and access to neutral arbitration in the event of claims of breach of those protections. These burdens are not inconsiderable. Damages awards can be large,²⁰⁷ proceedings expensive,²⁰⁸ and the prospect of regulatory chill politically unpopular.²⁰⁹

When faced with claims by intermediary conduit companies, respondent states protest that they did not intend to confer treaty benefits on entities controlled by nationals of third states or their own citizens. In addition, many respondent states argue the object and purpose of investment treaties and the ICSID Convention is to protect *foreign* investment derived from the counter-party state, not investment by nationals of the respondent state or nationals of a third state routed through entities in contracting states established for the purpose of achieving treaty protection.

A substantive or purposive approach to the definition of investor looks beyond the literal confines of the definition of “investor” in a treaty by reference to the object and purpose of jurisdictional provisions of the ICSID Convention and the instant treaty instrument, and/or by use of the principle of good faith at international law. It tempers the literal meaning of treaty definitions to exclude corporations of convenience and require a bona fide link between a claimant and its state of nationality.²¹⁰ This functional or purposive substantive approach looks to the nature of actual relationships, to the exclusion of mere instrumentalities or legal technicalities.

²⁰⁷ See, for example, *Occidental Petroleum Corp v Ecuador (Award)* ICSID ARB/06/11, 5 October 2012; and *Yukos Universal Ltd (Isle of Man) v Russia (Final Award)* PCA AA 227, 18 July 2014.

²⁰⁸ See, for example, the costs claimed by Australia in *Philip Morris Asia Ltd v Australia (Final Award on Costs)* PCA 2012–12, 8 July 2017.

²⁰⁹ As one example, the claim concerning plain packaging legislation brought by Philip Morris against Australia (*Philip Morris*, above n 122) resulted in Australia temporarily refusing to conclude treaties containing investor-state dispute resolution clauses (see Luke Nottage “Investor-State Arbitration Policy in Australia” (draft report presented to CIAI Project Symposium, 25 September 2015) at 1).

²¹⁰ Schlemmer, above n 34, at 79.

Decisions in domestic-type cases under the ICSID regime such as Professor Weil's dissent in *Tokios*,²¹¹ the majority decision in *Venoklim*,²¹² and the unanimous decision in *TSA Spectrum*,²¹³ focus on the outer limits that art 25 of the ICSID Convention places on states' discretion to define nationality in a treaty. Their opposition to the literal approach is driven by the view, discussed further in Chapter 8, that the contracting states to the ICSID Convention sought to exclude claims from their own nationals because ICSID was designed to resolve disputes of an international nature, not disputes between a state and its own citizens. They conclude that corporate vehicles controlled by citizens of the respondent state are not international, but domestic investments made foreign with the cloak of a corporate shell.

For example, in *Tokios*, Weil's essential point is that ICSID's jurisdiction is international, not domestic:²¹⁴ "the ICSID arbitration mechanism is meant for *international* investment disputes, that is to say, for disputes between States and *foreign* investors"; not "for investment disputes between States and their own nationals".²¹⁵

Weil assesses the purpose of the ICSID Convention as set out in the Report of the Executive Directors on the Convention:²¹⁶ "to facilitate the settlement of disputes between States and foreign investors",²¹⁷ so as to stimulate the flow of foreign capital—private international investment—to those countries who wish to attract it.²¹⁸ Consistent with this purpose, the ICSID Convention prescribes "international methods of settlement" for disputes,²¹⁹ as described in art 25(1), "between a Contracting State ... and a national of another Contracting State". Such methods of settlement are not available for other types of dispute.

²¹¹ *Tokios (Dissent)*, above n 30.

²¹² *Venoklim*, above n 30. The Award is currently only available in Spanish. The author has had the Award translated.

²¹³ *TSA Spectrum*, above n 30.

²¹⁴ *Tokios (Dissent)*, above n 30, at [3]–[4].

²¹⁵ At [5] (emphasis in original).

²¹⁶ See International Bank for Reconstruction and Development *Report of the Executive Directors on the Convention on the Settlement of Investment Disputes Between States and Nationals of Other States* (18 March 1965) [IBRD].

²¹⁷ *Tokios (Dissent)*, above n 30, at [9].

²¹⁸ At [3].

²¹⁹ IBRD, above n 216, at [11]; and the Preamble to the ICSID Convention.

Weil criticises the majority in *Tokios*²²⁰ for ignoring the role of the Convention in setting the “outer limits” of ICSID jurisdiction.²²¹ While the contracting parties to a BIT are free to confer to an ICSID tribunal a jurisdiction narrower than that provided for by the Convention, it is not for them to extend jurisdiction beyond that proscribed by the Convention.²²² “the silence of the Convention on the criterion of corporate nationality does not leave the matter [entirely] to the discretion of the Parties”.²²³

In particular, Weil says, the contracting parties cannot agree to extend ICSID arbitration to companies controlled by citizens of the host state.²²⁴ Weil explains that “it cannot be assumed that the parties are free to dispose at will of these restrictions and rights by playing with the definition of corporate nationality”.²²⁵ Accordingly, “an investment made in Ukraine by Ukrainian citizens with Ukrainian capital” was not in substance a foreign investment even though effected through the channel of a Lithuanian corporation.²²⁶ The real investor was Ukrainian, not Lithuanian.²²⁷

Weil’s analysis was accepted by a majority in *Venoklim Holding v Venezuela*,²²⁸ a domestic-type case where the claimant company was incorporated in the Netherlands. It owned several Venezuelan companies engaged in the Venezuelan oil lubricants industry. Venoklim Holding, however, was 100 per cent owned by a Swedish company, which in turn was 100 per cent owned by a Venezuelan company, all the shares of which were owned by two Venezuelan individuals.²²⁹ The Netherlands–Venezuela BIT defined nationals of the Netherlands solely by incorporation there.²³⁰

The majority held that the claimant was not in reality a foreign investor, despite the fact Venoklim was a company incorporated in the Netherlands as required by the Treaty.²³¹ They recognised that the ICSID Convention contained no

²²⁰ *Tokios (Dissent)*, above n 30, at [12] where Professor Weil cites the majority opinion: *Tokios (Jurisdiction)*, above n 24, at [36].

²²¹ See Broches, above n 25 as cited in *Tokios (Jurisdiction)*, above n 24, at [25].

²²² *Tokios (Dissent)*, above n 30, at [13]–[16].

²²³ At [19].

²²⁴ At [19].

²²⁵ At [28].

²²⁶ At [19] and [23].

²²⁷ At [21] and [27].

²²⁸ *Venoklim*, above n 30.

²²⁹ At [147].

²³⁰ Netherlands–Venezuela BIT (signed 22 October 1991), art 1(b)(ii).

²³¹ *Venoklim*, above n 30, at [152]–[156].

definition of nationality for juridical persons, but found that it was “evident to the Tribunal that the ICSID guiding principle of jurisdiction *ratione personae* ... seeks to prevent nationals from acting against their own states”²³² and that ICSID was established to “*stimulate private international investments*”²³³ and “facilitate the settlement of investment disputes between States and foreign investors”, not domestic ones.²³⁴

Contrary to the emphasis on ordinary meaning in the literal cases explained above, both Weil in *Tokios* and the majority in *Venoklim* consider that a substantive approach is mandated by the principles of interpretation in art 31(1) of the Vienna Convention: the literal meaning of the words must be interpreted in good faith, in context and in the light of the object and purpose of a treaty.²³⁵ The Convention limits the parties’ discretion when read “in light of its object and purpose” as directed by art 31 of the Vienna Convention.²³⁶ Otherwise, “formalism [would] prevail over reality and betray the object and purpose of the ICSID Convention”.²³⁷ For Weil, “economic and political reality is to prevail over legal structure” otherwise the basic principles and rule of international law would be frustrated by municipal legal concepts and rules.²³⁸

The “spirit” of the ICSID Convention also required that “economic reality should prevail over form” in *CFHL v Cameroon*, another domestic-type case.²³⁹ The Luxembourg incorporated claimant company was owned by a Cameroon national. After many years of dormancy, the claimant company was revived by filing long overdue regulatory papers and holding retrospective company meetings²⁴⁰ to attempt to meet the *siège social* criteria for nationality in the BLEU-Cameroon BIT.²⁴¹

The Tribunal found that a corporate claimant will not qualify for the protection of an investment treaty even if it technically fulfills express nationality

²³² At [154].

²³³ At [155] (emphasis in original). The italicised quotes are as cited from IBRD, above n 216, at [9].

²³⁴ At [154]–[155].

²³⁵ At [156].

²³⁶ *Tokios (Dissent)*, above n 30, at [19].

²³⁷ *Venoklim*, above n 30, at [156].

²³⁸ *Tokios (Dissent)*, above n 30, at [24].

²³⁹ *CFHL*, above n 117, at [272] and [356]–[365]. The Award is only available in French. Quotations are the author’s translations.

²⁴⁰ At [293]–[354].

²⁴¹ BLEU-Cameroon BIT (signed 27 March 1980), art 1(2).

criteria in a treaty if in fact it has a “purely formal existence”.²⁴² On the facts, at the time the dispute arose, CFHL existed in only a technical sense that was insufficient to evidence that its *siège social* was located in Luxembourg.²⁴³

A final domestic-type case deserves separate consideration because it takes a substantive approach to the nationality of the foreign controller of a company incorporated in the host state pursuant to the second clause of art 25 of the ICSID Convention. Ultimately, *TSA Spectrum v Argentina*²⁴⁴ justifies a substantive approach to nationality based on objective inherent limits in art 25 on the state discretion to attribute nationality by treaty. But because the claimant, TSA Spectrum, was a company incorporated in the respondent state, this led to some logical contortions in the reasoning of the Tribunal based on differences in the terminology of the first and second clauses of art 25(2)(b).

The second limb of art 25(2)(b) requires an investigation into the nationality of the foreign controller of a claimant company incorporated in the host state. The issue is the same as the cases reviewed above: the attribution of nationality, although the target is the foreign controller of the claimant company, rather than the claimant company itself. Fundamentally, however, as discussed in Chapter 7.2, the nature of the inquiry into nationality ought to be the same.

TSA Spectrum was owned by a Dutch company, TSI. At the relevant times, Argentine nationals owned TSI. It was a shelf company with a registered office shared with 225 other companies incorporated in Holland. The Netherlands–Argentina BIT defined corporate nationality by incorporation.²⁴⁵ Argentina argued that TSA was not under foreign control because TSI had no substance, but was merely a vehicle for Argentine nationals to sue their own state.²⁴⁶

The *TSA* Tribunal was conscious of the majority decision in *Tokios* and the decision in *Romp petrol* in which the respective Tribunals were unwilling to pierce the corporate veil to assess nationality in a substantive way.²⁴⁷ On that approach, the fact that TSI was owned and controlled by Argentine nationals was irrelevant. But

²⁴² *CFHL*, above n 117, at [356] and [364].

²⁴³ At [356].

²⁴⁴ *TSA Spectrum*, above n 30.

²⁴⁵ Netherlands–Argentina BIT (signed 20 October 1992), arts 1(b)(iii) and 10(6).

²⁴⁶ *TSA Spectrum*, above n 30, at [114]–[123].

²⁴⁷ At [146].

the Tribunal reasoned that it need not directly dispute the *ratio decidendi* of *Tokios* and *Rompetrol* to determine jurisdiction in the present case because these two authorities dealt with jurisdiction under the first clause of art 25(2)(b) rather than the second clause.

To avoid the formalistic interpretative reasoning in the *Tokios* and *Rompetrol* decisions, the *TSA* Tribunal focused on the concept of “foreign control” in the second clause of art 25 as providing “an objective Convention limit beyond which ICSID jurisdiction cannot exist”,²⁴⁸ and serving as a critical distinction between the first and second clauses of art 25(2)(b).²⁴⁹

A significant difference between the two clauses of Article 25(2)(b) is that the first uses a formal legal criterion, that of nationality, whilst the second uses a material or objective criterion, that of “foreign control” in order to pierce the corporate veil and reach for the reality behind the cover of nationality.

In the view of the *TSA* Tribunal, the requirement of “foreign control” in the second clause opened the way for a substantive approach to pursue “objective identification of foreign control up to its real source”.²⁵⁰ It therefore declined jurisdiction on the basis that the Argentine nationals were the “real source of control”²⁵¹ for *TSA*.²⁵²

TSA Spectrum will be revisited in Chapter 7.2. It will be proposed that the Tribunal was correct to take a substantive approach to the second clause, but further that there ought not be a difference in approach to nationality as between first and second clause cases. Both clauses involve an investigation into requisite nationality. There is nothing inherently more material or objective about the phrase “foreign control” in the second clause than there is about the concept of “nationality” in the

²⁴⁸ At [139], where the Tribunal cites *Vacuum Salt Products Ltd v Ghana (Award)* (1994) 9 ICSID Rev 72 at [36]–[38].

²⁴⁹ *TSA Spectrum*, above n 30, at [140]. See also [144].

²⁵⁰ At [147] and see [153].

²⁵¹ At [153].

²⁵² At [160]–[162].

first or second clauses. Both concepts can be approached in either a formal or substantive way.

Third-country substantive approach cases are less numerous and are not motivated by the concern in domestic-type cases that the ICSID Convention is not intended to facilitate the prospect of de facto suit of a state by its own nationals.

Rather, third-country cases such as the dissent of Alberro-Semerena in *AdT*²⁵³ and the decision in *Banro American Resources Inc v Congo*,²⁵⁴ focus on the expansion of prospective investors that results from a literal approach and the consequent imbalance of the treaty bargain for contracting states. But their fundamental concern is the same as the domestic-type decisions: that use of conduit companies by entities that would otherwise not be entitled to treaty protection is contrary to the object and purpose of the jurisdictional provisions of investment treaty instruments.

In *AdT*, although an ICSID case, Alberro-Semerena preferred to see substantive requirements in the instant investment treaty, rather than the ICSID Convention.²⁵⁵ This approach illustrates how a substantive test can apply in non-ICSID cases, and meets the concern in *Rompetrol* that ICSID and non-ICSID cases might be treated differently. This aspect will be discussed further in Chapters 7.4 and 11.5.

Like his majority colleagues, Alberro-Semerena recognised the object and purpose of the investment treaty as a whole was to stimulate the flow of capital and technology. But he supposed that the definition of investor/national in the treaty then limits “the circle of beneficiaries, which is a subset of all existing persons”; the jurisdictional provisions of the treaty therefore had their own distinct purpose.²⁵⁶

In Alberro-Semerena’s view, if the concepts of corporate nationality and control are not approached in a substantive manner, “the universe thereby [becomes] infinite ... [t]here is nothing in the wording of the Bilateral Investment Treaty that

²⁵³ *Aguas del Tunari*, above n 22, per the Declaration of José Luis Alberro-Semerena.

²⁵⁴ *Banro American Resources Inc v Congo* (2002) 17 ICSID Rev 380.

²⁵⁵ Both *Tokios (Jurisdiction)*, above n 24, and *Aguas del Tunari*, above n 22, are ICSID cases. However, there was little discussion in *Aguas del Tunari* about art 25(2)(b) of the ICSID Convention. It appeared to be assumed that if art 1(b)(iii) of the Netherlands–Bolivia BIT (signed 10 March 1992), was satisfied then the claimant also fell within the outer limits set by the Convention. See *Aguas del Tunari*, above n 22, at [280]–[281].

²⁵⁶ *Aguas del Tunari*, above n 22, per the Declaration of José Luis Alberro-Semerena at [29].

narrows its scope.”²⁵⁷ This is the same point made in Chapter 8 in relation to the specific limiting purpose of jurisdictional provisions as opposed to the general object and purpose of a treaty as an instrument to encourage investment.

As a result, a substantive review of “the actual relationships among the parties involved” is necessary and appropriate.²⁵⁸ Like Weil, Alberro-Semerena cites *Banro* as authority to “interpret access provisions past formal interpretations to actual relationships” and to reject the concept that this investigation is “limited by formalities”.²⁵⁹

In *Banro*, a Canadian parent company routed an investment in Congo through a United States subsidiary to access ICSID arbitration.²⁶⁰ The United States is a party to the ICSID Convention; Canada was not at that time.

The Tribunal took a substantive approach to the nationality of the Banro Group as a whole. It considered that ICSID tribunals retained “a certain flexibility regarding the identification of the Claimant for the purpose of determining the jurisdiction of the Tribunal”.²⁶¹ Its competence was “based on a review of the circumstances surrounding the case, and in particular, the actual relationships among the companies involved”.²⁶² In that way, the Canadian company was the “actual investor” and its American subsidiary a mere “instrumentality” used to attempt to gain access to the Convention.²⁶³

Alberro-Semerena also rejects his colleagues’ concern that a “functional” interpretation gives rise to unnecessary uncertainty. He argues that an examination of the motivations and the timing of the corporate structuring upon which a claim to jurisdiction *ratione personae* is based is appropriate and feasible, although he does not elucidate exactly why that is so.²⁶⁴ This debate will be revisited in Chapters 10 and 11.

²⁵⁷ At [9]. This is also Legum’s point: see above n 11.

²⁵⁸ At [34] citing *Banro*, above n 254, at 385 and 391, which was also cited by Professor Weil: *Tokios (Dissent)*, above n 30, at [25].

²⁵⁹ *Banro*, above n 254, at [34].

²⁶⁰ ICSID Convention, art 25(2)(a).

²⁶¹ *Banro*, above n 254, at [9].

²⁶² At [11] and [24]. See also *Tokios (Dissent)*, above n 30, at [25].

²⁶³ At [12].

²⁶⁴ At [17] and [41]–[42].

3.4 Conclusion

The phenomenon of treaty shopping and the debate as to its acceptable limits is perhaps a consequence of a quest for simplicity in defining nationality for service on the plane of international law. Ascribing nationality to juridical entities on the basis of incorporation or seat simplifies (on the face of it) the use of the concept for investment treaty purposes. If that approach to nationality is abandoned, “in the context of investment by multinational enterprises ... such issues acquire additional levels of complexity”.²⁶⁵ The strict application of the incorporation test has the benefit of certainty for investors and states, but admits the possibility of abuse by investors.

For the sake of certainty, the literal cases emphasise the sanctity of the ordinary meaning of treaty provisions without sufficient reference to object and purpose or contextual arguments; states are stuck with the express terms of their bargain. They dismiss any impact of principles of general international law on the express terms of a treaty and take a one-dimensional view of the object and purpose of investment treaties – so long as investment is promoted, the purpose of the treaty is not offended.

The substantive approach shows that the literal approach opens access to an investment treaty to entities that should be strangers to it by use of corporate structures designed to obtain requisite nationality. In domestic-type cases the literal approach allows nationals of the host state to procure rights at international law against their own state; in third-country cases entities from non-party states can facilitate access to treaty coverage in this way.

The substantive approach cases object to widening of the pool of prospective investors. Substantive approach domestic-type cases consider that ownership of the claimant investor by nationals of the respondent state offends the the ICSID Convention’s object to promote *foreign* or *international* investment. Treaty shopping creates an appearance of foreign character which does not exist in reality. Third-country substantive cases say that treaty shopping by manipulation of corporate nationality creates an appearance of a particular nationality when in fact the true investors are nationals of non-contracting states. This manoeuvre offends

²⁶⁵ Schlemmer, above n 34, at 50.

the purpose of jurisdictional provisions to circumscribe qualifying investors as a subset of anyone from anywhere. In both types of cases, the substantive approach says that the literal approach admits the wrong type of investor: one is not foreign at all, and the other is the wrong type of foreigner.

This review of the two approaches reveals certain principal fundamental disagreements.

First, the relevance of object and purpose at all: the literal cases take ordinary meaning as sacrosanct; the substantive cases rely on object and purpose to mollify the meaning of nationality criteria.

Secondly, if object and purpose is relevant to interpretation of nationality criteria, what is the object and purpose of investment treaty instruments? Is it solely to facilitate investment (literal approach) or do jurisdictional provisions in investment treaties and the ICSID Convention have their own specific purpose to circumscribe bona fide investors (substantive approach)? These questions as to purpose also impact on the correct approach to good faith interpretation of jurisdictional provisions in investment treaties.

Thirdly, the competing approaches dispute the relevance of international law in the interpretation exercise. For the literal approach it is irrelevant; for substantive cases it informs the requirement for good faith interpretation.

Finally, the two approaches differ as to whether a substantive approach would lead to a thicket of uncertainty in application which would stymie the effect of a treaty to encourage investment.

This thesis proceeds to test the merits of the respective substantive and literal approaches to corporate jurisdiction *ratione personae* by examining jurisprudential approaches to the sanctity of corporate personality at municipal and international law (Chapter 4), and the relevance of the interpretative approach to analogous jurisdictional concepts in diplomatic protection law (Chapter 5), double tax treaty law (Chapter 6) and investment treaty law (Chapter 7). It then analyses the themes that ultimately divide the literal and substantive approaches: the object and purpose of international investment instruments (Chapter 8), the formulation of a substantive test which is sufficiently certain so as not to undermine the objective of encouraging

investment (Chapters 9 and 10), and finally the jurisprudential basis on which a substantive test can be implemented in investment treaty law (Chapter 11).

4 Comparative 1: corporate personality, corporate nationality, and the corporate veil

4.1 Introduction

This thesis addresses which corporate actors should have rights on the international plane in the investment treaty context. That inquiry entails recognition of the fundamental premise for the existence of a “legal person”: separate legal personality.

Once a company is constituted according to municipal legislative requirements, it is entitled to be treated as its own legal entity, separate from its natural or corporate owners. Separate legal personality gives a company juridical “life” or independence as its own economic actor. As a consequence, *prima facie* at municipal law, its actions and omissions, rights and obligations, are its own and cannot be treated as those of its owners regardless of motive for the formation of the company, unless legislation sanctions treatment of owner and company as one.

As observed at the outset of Chapter 1, corporate entities have no nationality in municipal law; they are attributed a nationality for the purpose of international law. The prevalence of incorporation as a criterion of nationality in investment treaties (whether stand-alone or in conjunction with other concepts) means that international law adopts the municipal law concept of incorporation, and hence separate corporate nationality, for use on the international plane. Corporate personality and the nationality of companies at international law are not identical concepts, rather the former is used as a convenient identifier of the latter.

This situation results in an intersection of corporate legal personality and the concept of corporate nationality which makes it relevant to assess to what degree corporate legal personality is inviolable at municipal and international law so as to prevent any examination of its owners and controllers.

Chapter 4.2 examines substantive or purposive limits to separate corporate personality at common and civil law. Common and civil law systems recognise that separate personality may be disregarded to prevent abuse of the corporate form. In the common law, this process is known as lifting, or piercing, the corporate veil, although most examples of this process are in fact based on principles of trust, tort

and agency law. The common law approach is effectively mirrored by the operation of the principle of abuse of right at civil law, which exists to prevent the use of a right in a manner contrary to its purpose.

Notably, circumscribing corporate personality at common and civil law employs a substantive approach to the relevant corporate entity and its owners and controllers that investigates the purpose for which a corporate entity exists. This question, as explained in Chapters 6, 7 and 10, is the common denominator in substantive approaches to nationality in analogous fields of tax treaty law, the nationality of natural persons, and the principle of abuse of right in respect of jurisdiction *ratione personae* in investment treaty law. It is ultimately the solution to the Nationality Controversy proposed by this thesis.

Chapter 4.3 then considers the extent to which municipal law concepts of separate legal personality are applicable to international law, for:²⁶⁶

... the reception of the notion of the legal person from national law into international law does not occur without serious friction. The concerns of municipal law which have shaped the modern legal institution of the legal person are not the same as those of contemporary international law.

The approach to separate legal personality at international law compared with municipal law depends on the purpose and context of its use in each domain. Municipal law is concerned to maintain limited liability to provide protection for shareholders and encourage entrepreneurship. Investment treaty law cares only to identify the nationality of corporates for the purpose of jurisdiction *ratione personae*. Investment treaty law is not therefore fettered by the limited liability philosophy underlying limits to abrogation of separate legal personality at municipal law; it is free to adopt a more flexible approach to separate legal personality that suits its particular purpose.

Moreover, the context of international law generally requires a flexible approach to the use of separate legal personality: the absence of a central legislative

²⁶⁶ Fatouros, above n 53, at 500.

or judicial source of law justifies a flexible approach to the wielding of rights, especially by private actors who are invited on to the international plane in limited circumstances. In this respect, it is observed that the civil law construct of abuse of right is appropriate as a broad anti-abuse principle that fits well the circumstances of the international law system.

4.2 Corporate personality and national law

The Companies Act 1862 (UK) was the first statute in common law jurisdictions to introduce the concept that a company's legal personality was separate from its shareholders.²⁶⁷ This concept permitted business people to escape the “tyranny of unlimited liability”.²⁶⁸ The protection of wealth by means of limited liability is the primary reason for corporate separate legal personality; the effect of which is to shift the burden of risk from investors to creditors and thereby encourage entrepreneurship.²⁶⁹

The degree to which substantive factors of motive and circumstance of incorporation affect the ability of a shareholder to claim the benefit of separate corporate personality (and, therefore, limited liability) was tested in the 1897 House of Lords' decision in *Salomon v A Salomon & Co Ltd*.²⁷⁰

In the same way as the substantive cases discussed in Chapter 3.3 rely on the object and purpose of a treaty to assess the bona fides of a claim to nationality based on formal fulfilment of treaty criteria, the Court of Appeal in *Salomon* considered the reason for existence of the company must be consistent with the purpose of the company legislation. The Court concluded that Mr Salomon had used the machinery of the Companies Act 1862 “for a purpose for which it never was intended”,²⁷¹ but rather as a “device to defraud creditors”.²⁷²

However, the House of Lords disagreed. Their Lordships took the same approach as the literal cases discussed in Chapter 3.2: if A Salomon & Co Ltd was

²⁶⁷ See Companies Act 1862 (UK) 25 & 26 Vict c 89, s 6; and see Phillip Lipton “The Mythology of *Salomon's* Case and the Law Dealing with the Tort Liabilities of Corporate Groups: An Historical Perspective” (2014) 40 Mon LR 452 at 455–461.

²⁶⁸ FB Palmer *Private Companies* (11th ed, Stevens and Sons, London, 1901) at 6.

²⁶⁹ Arie Freiberg “Abuse of the Corporate Form: Reflections from the Bottom of the Harbour” (1987) 10 UNSWLJ 67; and see *Commissioners of Inland Revenue v Sansom* [1921] 2 KB 492 (CA) at 500.

²⁷⁰ *Salomon v A Salomon & Co Ltd* [1897] AC 22 (HL).

²⁷¹ *Broderip v Salomon* [1895] 2 Ch 323 (CA) at 337 per Lindley LJ. See Companies Act 1862 (UK).

²⁷² *Broderip* at 339 per Lindley LJ. See also 340–341 per Lopes LJ and 345 per Kay LJ.

validly constituted in accordance with explicit legislative requirements, it was entitled to the benefits of its own existence and personality.

Mr Salomon, a bootmaker, sold his business to a newly established company, the shares of which were ascribed to him, with the exception of six individual shares held by members of his immediate family for the purpose of meeting the Companies Act requirement of a minimum seven subscribed members. A loan from Mr Salomon to the company was secured by a debenture over the company's assets in favour of Mr Salomon.

When the company failed, Mr Salomon relied on the debenture to secure priority to the proceeds of the sale of the company's assets. Unsecured creditors were left unpaid. The liquidator of the company sued Mr Salomon, alleging that meeting the requirements of incorporation by use of six related and single share shareholders, together with the debenture over company assets, evidenced an illegitimate scheme to defraud the company's unsecured creditors. The liquidator argued the unsecured creditors ought to be able to look through the company to Mr Salomon for payment.

In the House of Lords, Lord Halsbury explained that it is necessary to look at the requirements of the statute, but only at the statute: "I have no right to add to the requirements of the statute, nor to take from the requirements thus enacted. The sole guide must be the statute itself."²⁷³ Absent fraud, motives or conduct of individual shareholders were not relevant.²⁷⁴

Their Lordships did not go so far as to say the object and purpose of the legislation was irrelevant, but rather that where it could not be plainly deciphered, it was not permissible to read in a requirement for independent or bona fide shareholders where such requirements did not appear on the face of the statute.²⁷⁵

The parallels between the House of Lords approach in *Salomon* and that of tribunals that take a literal approach to jurisdiction *ratione personae* in investment treaty cases are easy to recognise. In such cases, assuming a company is legitimately constituted according to the laws of its home state, and that is all the treaty requires

²⁷³ *Salomon*, above n 270, at 29 per Lord Halsbury LC.

²⁷⁴ At 30-34 per Lord Halsbury LC, 42 per Lord Herschell and 51 per Lord Macnaghten.

²⁷⁵ At 22 and 31-34 per Lord Halsbury LC, 46 per Lord Herschell, 38-39 per Lord Watson and 48 per Lord Macnaghten.

to acquire nationality, then tribunals have declined to look to the object and purpose of a treaty to justify an addition to, or alteration of, jurisdictional requirements.

In the 120 years since *Salomon*, the English courts have treated the *Salomon* principle as sacrosanct; at least in name, if not always in spirit. To depart from it would “blur the fundamental distinction between a company and its shareholders, and thereby create considerable legal and commercial uncertainty”.²⁷⁶

Separate corporate personality can be abrogated by statute or contract.²⁷⁷ Just as a treaty can expressly provide for a substantive approach to jurisdictional thresholds, at municipal law the wording of a statute or contract can justify the treatment of parent and subsidiary as one unit at least for some purposes. A dramatic statutory example is the use of the control test during the World Wars to identify situations in which a locally incorporated company was owned or controlled by enemy aliens.²⁷⁸

A pertinent contract example is the *groupes des sociétés* theory in French law, whereby a contract may justify disregarding separate corporate personality to hold non-signatory companies in a company group to be bound by a contract that another company in the group has signed if it is apparent that the signatory parties intended the non-signatories to be a party. The leading case in that context is the interim arbitral award in *Dow Chemical v Isover Saint Gobain*²⁷⁹ and the decision of the Paris Cour d’appel, which upheld a challenge to that interim award, finding that the involvement of two non-signatory Dow companies were bound by the arbitration clause in a supply contract because the parties had intended them to be.²⁸⁰ The Tribunal and the Court found that there was an economic reality in a group of companies that had to be taken into account when assessing the ambit of the Tribunal’s jurisdiction.²⁸¹

²⁷⁶ Lipton, above n 267, at 480.

²⁷⁷ *Prest v Petrodel Resources Ltd* [2013] UKSC 34, [2013] 2 AC 415 at [16] per Lord Sumption; and *VTB Capital plc v Nutritek International Corp* [2013] UKSC 5, [2013] 2 AC 337 at [130] per Lord Neuberger.

²⁷⁸ In the United Kingdom, see *Daimler Co Ltd v Continental Tyre and Rubber Co (Great Britain) Ltd* [1916] 2 AC 307 (HL); and in the United States, see *Clark v Uebersee Finanz-Korporation AG* 332 US 480 (1947) at 488.

²⁷⁹ *Dow Chemical v Isover St Gobain* ICC Interim Award, 23 September 1982, [1984] Rev arb 137.

²⁸⁰ *Isover Saint Gobain v Dow Chemical* Paris, 21 October 1983, [1984] Rev arb 98.

²⁸¹ *Dow Chemical*, above n 279, at 148; and *Isover*, above n 280, at 100-01. This topic is not explored in detail in this thesis because the theory is only germane to some jurisdictions, concerns enlarging jurisdiction of an arbitration clause, the decision was primarily based on interpretation of the specific contract in the context of the ICC Arbitration Rules and the *lex mercatoria*, and its acceptance in

But absent legislative intervention or contractual provision, *Salomon* has proved an “unyielding rock” on which “complicated arguments” become “shipwrecked”.²⁸² By way of example relevant to this thesis, the *Salomon* approach has been applied to corporate groups. Just as shareholders are separate from the company, so a subsidiary company is separate from its parent or sibling companies within a corporate group, even if they are carrying on the same economic enterprise.²⁸³ It is “impossible to say at the same time that there is a company and there is not”.²⁸⁴

Yet the common law has evolved means by which separate legal personality can be ignored in certain circumstances to elucidate the real actor. The acts of a company will be attributed to its owners to prevent the use of other entities to avoid obligations.²⁸⁵ This process has been referred to as lifting or piercing the corporate veil. However, lifting the corporate veil is not a principle; it describes a process.²⁸⁶ It is merely “a label” to describe the range of situations,²⁸⁷ either by way of statutory language, or existing principles of tort, trust and agency law, “in which the law attributes the acts or property of a company to those who control it, without disregarding its separate legal personality”.²⁸⁸

Illustrative common law cases show that the central question to this end is the purpose for the instant company’s existence.

In *Prest*, the principles of trust law provided the means to outflank separate legal personality. In that case, a husband had transferred a number of investment

investment treaty law is uncertain: see *Khan Resources Inc v Mongolia (Decision on Jurisdiction)* PCA Case No 2011-09, 25 July 2012 at [331]. Regarding the *Dow Chemical* decisions and the *groupes des sociétés* theory generally, see: Serge Gravel and Patricia Peterson “French Law and Arbitration Clauses – Distinguishing Scope from Validity: Comment on ICC Case No 6519 Final Award” (1992) 37 McGill LJ 510.

²⁸² Lord Templeman “Company Law Lecture – Forty Years On” (1990) 11 Co Law 10 at 10.

²⁸³ *Adams v Cape Industries plc* [1990] 1 Ch 433 (CA) at 536 and 539. See also, for example, *The Gramophone and Typewriter Ltd v Stanley* [1906] 2 KB 856 (KB) at 872; and, on appeal, *The Gramophone and Typewriter Ltd v Stanley* [1908] 2 KB 89 (CA) at 95–96. See also *Ebbw Vale Urban District Council v South Wales Traffic Area Licensing Authority* [1951] 2 KB 366 (CA) at 371. The refusal of the courts to disregard the *Salomon* principle and lift the corporate veil can also be seen in *Yukong Line Ltd of Korea v Rendsburg Investments Corp of Liberia (No 2)* [1998] 1 WLR 294 (QB); and *Re Polly Peck International plc (In Admin)* [1996] 2 All ER 433 (Ch).

²⁸⁴ *Salomon*, above n 270, at 31 per Lord Halsbury.

²⁸⁵ *Prest*, above n 277, at [82]–[83]. See also *VTB Capital*, above n 277, at [125] per Lord Neuberger.

²⁸⁶ *Attorney-General v Equiticorp Industries Group Ltd* [1996] 1 NZLR 528 (CA) at 541. See to the same effect, *Prest*, above n 277, at [106] per Lord Walker.

²⁸⁷ *Prest*, above n 277, at [106] per Lord Walker.

²⁸⁸ At [16] and [35] per Lord Sumption.

properties from his personal ownership to corporate entities owned by him. The Supreme Court held that while there was no evidence that the husband had interposed the companies to avoid any obligation to his wife, the fact the properties were transferred to the companies at a significant undervalue revealed that the properties belonged beneficially to the husband; the companies held the properties on trust for him. He could not avoid personal obligations to his wife in these circumstances.²⁸⁹

The potential for the law of agency to sidestep corporate legal personality was considered in *Adams v Cape*.²⁹⁰ In this case, victims of asbestos related illnesses had obtained judgment in the United States against Cape, an English company, and its wholly owned American subsidiaries, NAAC and CPC. The plaintiffs attempted to enforce this judgment against Cape in England. The critical issue was whether, despite separate corporate personality, NAAC and CPC were Cape's agents, in the sense that the subsidiaries were carrying on Cape's business in the United States, rather than their own.²⁹¹

That inquiry necessitated an investigation of the relationship between Cape and its subsidiaries and the commercial functions performed by the respective companies.²⁹² Both subsidiary companies leased premises, employed staff, owned minor assets, earned profits, paid taxes, and returned a dividend sanctioned by their own Board of Directors. The English Court of Appeal concluded that in all respects the corporate form was observed as would be expected of a separate entity and that the subsidiaries were engaged in their own business, rather than as a mere functionary or agent carrying out Cape's business in the United States.²⁹³

Accordingly, separate corporate personality was only recognised after a substantive inquiry into the commercial realities of the corporate structure. Had the subsidiaries been legitimately incorporated but lacked a commercial reason to exist independent of Cape, it appears that the Court would have, effectively, circumvented separate personality by treating them as Cape's agents in the United States.

²⁸⁹ At [44]–[45], [55], [57]–[58], [84]–[85], [96], [97] and [103]–[104].

²⁹⁰ *Adams*, above n 283.

²⁹¹ At 524–526 and 545–549.

²⁹² At 530.

²⁹³ At 545–549.

This approach is akin to that which this thesis avers is the correct approach to a claim to corporate nationality in investment treaty law. A claim to nationality based on separate corporate personality requires an investigation as to the claimant company's commercial reason to exist independently in the corporate structure other than to access treaty rights.

This point is also illustrated well by another aspect of the *Adams* decision. The Court considered that whether use of the doctrine of separate legal personality is an abuse of right depends on the nature of the arrangements implemented and the motive behind those arrangements.²⁹⁴ The substantive commercial activities of the subsidiaries NAAC and CPC negated an inference of abuse of corporate personality.²⁹⁵ However, the result was different in respect of a Lichtenstein company, ANC, that was interposed between Cape and its American subsidiaries to insulate Cape further from liability for tort claims in the United States. The Court found that ANC “was clearly a façade in the relevant sense”,²⁹⁶ as it was “no more than a corporate name”, acted only through employees or officers of other Cape subsidiaries, and was plainly a “creature of Cape”.²⁹⁷

Although ANC was validly incorporated, it had no real reason to exist in the corporate structure in a commercial sense other than to insulate Cape against liability.²⁹⁸ The Court looked through ANC's separate personality to examine the relationship between Cape and its subsidiaries NAAC and CPC without the complication of an intermediary holding company. Again, like the investigation into the allegation of an agency relationship between Cape and its American subsidiaries, this was a substantive inquiry into commercial realities.

Modern commentators have queried whether *Salomon* failed to appreciate the wider ramifications of the concepts of separate legal entity and limited liability in a wider range of circumstances such as corporate groups.²⁹⁹ A particular example is the operation of these principles in respect of actions in tort where the application

²⁹⁴ At 539–540 and 542.

²⁹⁵ At 536.

²⁹⁶ At 543.

²⁹⁷ At 543.

²⁹⁸ At 544.

²⁹⁹ For example, Lipton, above n 267, at 475 observes: “Integrated corporate groups were relatively rare in the 1890s and so it was by no means certain at the time that what became known as the principle in *Salomon* would be applied to company groups as they are understood today.”

of separate legal personality together with limited liability enables a parent company to avoid liability for the subsidiary's debts by quarantining potential liability for tort within an uncapitalised subsidiary.³⁰⁰

Recent cases in Australia and the United Kingdom impose a duty of care on a parent company in respect of employees of a subsidiary.³⁰¹ Whether sufficient proximity to found a duty of care exists depends, as with the agency cases, on the extent to which the subsidiary has an independent commercial existence from its parent.³⁰² While the corporate veil is not pierced, the principle in *Salomon* can be side-stepped by the imposition of a duty of care so as to bring about the same result as if the veil had been lifted.³⁰³

There remains a “very rare” space at common law for the operation of a general anti-abuse principle,³⁰⁴ which retains the moniker of piercing the corporate veil where it is a “mere façade” used for a deliberately dishonest purpose.³⁰⁵ In *Prest*, their Lordships held that “the court only has power to pierce the corporate veil when all other more conventional remedies have proved to be of no assistance”.³⁰⁶

The possibility of piercing the corporate veil exists only to ensure the law is not disarmed in the face of abuse of corporate legal personality,³⁰⁷ and that use of separate legal personality to gain advantage by evasion of the law or to frustrate its enforcement may constitute such abuse.³⁰⁸

The example of this general, anti-abuse, catch-all principle used by Lord Sumption in *Prest* is the well-known case of *Jones v Lipman*.³⁰⁹ Lipman used a shelf company for the illegitimate purpose of attempting to defeat his past employer's

³⁰⁰ At 454 and 470–472.

³⁰¹ *CSR Ltd v Wren* (1997) 44 NSWLR 463 (CA); *CSR Ltd v Young* (1998) 16 NSWCCR 56 (SC); and *Chandler v Cape plc* [2012] EWCA Civ 525, [2012] 3 All ER 640.

³⁰² *Chandler*, above n 301, at [80]; and *CSR v Young*, above n 301.

³⁰³ *Lipton*, above n 267, at 483.

³⁰⁴ *Prest*, above n 277, at [103] per Lord Clarke. New Zealand courts have also taken a sceptical and narrow view of the application of the concept of lifting the corporate veil: see *Equiticorp*, above n 286, at 541; *Re Securitibank Ltd (No 2)* [1978] 2 NZLR 136 (CA) at 158–159 per Richmond P and 171 per Richardson J; *Savill v Chase Holdings (Wellington) Ltd* [1989] 1 NZLR 257 (CA) at 306, 312 and 319.

³⁰⁵ *Woolfson v Strathclyde Regional Council* [1978] SLT 159 (HL) at 161. See also *Adams*, above n 283, at 536 and 539.

³⁰⁶ *Prest*, above n 277, at [103] per Lord Clarke.

³⁰⁷ *Prest*, above n 277, at [27], [35]–[36], [57]–[58], [61], [80]–[82], [96], [97], [103] and [104].

³⁰⁸ At [34]–[35] per Lord Sumption. Lord Neuberger concurred with this formulation of the principle at [81].

³⁰⁹ *Jones v Lipman* [1962] 1 WLR 832 (Ch).

rights to enforce a restraint of trade clause. In such a scheme, the company could not rely on separate legal personality because of the purpose for which it was utilised. It did not have any real commercial purpose, rather it was “a device and a sham, a mask which [Lipman] holds before his face in an attempt to avoid recognition by the eye of equity”.³¹⁰

Lord Sumption concluded that the exercise of the residual discretion to lift the corporate veil to avoid abuse depends on the purpose for which the company is used in the relevant transaction.³¹¹ In *Adams* and in *Lipman*, that question was answered by an examination of the relevant company’s commercial reason to exist. As discussed in the next sub-chapter, that approach is a substantive one akin to the concept of abuse of right in municipal civil law systems and international law.

The principle of abuse of right is not so readily apparent in common law systems because it is subsumed in more specific rules with different labels.³¹² In *Prest*, Lord Sumption points to the variety of equitable principles relating to fraud, agency and trust that do the work of the principle of abuse of right in the common law.³¹³ As Byers puts it, “the principle of abuse of rights ... is not directly employed [at common law]; it instead serves as a matrix from which more specific legal principles grow”.³¹⁴

In civil law systems, corporate legal personality is limited by the principle of abuse of right. Lord Sumption observed that, “[m]ost advanced legal systems recognise corporate legal personality while acknowledging some limits to its logical implications” and that in civil law jurisdictions, the juridical basis of the exceptions is the concept of abuse of right. That concept is a broad one that covers improper or illegal use of a right, and extends to the use of a right for a purpose collateral to that for which it exists.³¹⁵

In contrast to common law jurisdictions in which rights and obligations operate in a more defined way, in civil law systems, rights “have traditionally been

³¹⁰ At 836 as cited in *Prest*, above n 277, at [30] per Lord Sumption.

³¹¹ *Prest*, above n 277, at [35].

³¹² Michael Byers “Abuse of Rights: An Old Principle, a New Age” (2002) 47 McGill LJ 389 at 395–397.

³¹³ *Prest*, above n 277, at [16]–[18].

³¹⁴ Byers, above n 312, at 396.

³¹⁵ *Prest*, above n 277, at [17].

trained in a general and abstract manner”.³¹⁶ Because rights are proclaimed in more generous terms, the limiting doctrine of abuse of right is broader and more prevalent in civil law systems.³¹⁷ General rules require a flexible general limitation mechanism. Abuse of right therefore occupies a crucial role in civil law systems as a general rule “mediating between or otherwise limiting the exercise of rights”,³¹⁸ or as a “legal mechanism designed to ease the inflexibility of the legal relationships derived from statutory, judicial or treaty rules”.³¹⁹

The principle of abuse of right in civil law systems acts as a flexible barometer of the proportionate exercise of rights by use of an implied standard of reasonableness in the context of the purpose for which the rights exist.³²⁰

Accordingly, the principle of abuse of right plays a central, broad and flexible role in civil law systems as a mechanism to balance competing rights and attenuate the interference with rights of others by use of a formal legal right. The principle is not limited to the last ditch catch-all role it plays in the common law; it elevates substance over form whenever circumstances of justice demand.

Accordingly, common and civil law systems attenuate the exercise of rights arising from separate corporate personality; it is not inviolable. The key is whether the corporate entity exists for a legitimate commercial purpose, rather than to avoid obligations or exercise rights for a collateral purpose. The next sub-chapter makes two further points: first, as the purpose for the use of separate corporate personality on the international plane is different from its purpose at municipal law, then its scope and application at international law and investment treaty law can be shaped accordingly. Secondly, the nature of the system of international law is particularly amenable to application of the principle of abuse of right to play a similar role as it does in civil law systems.

³¹⁶ Byers, above n 312, at 415.

³¹⁷ P Catala and JA Weir “Delict and Torts: A Study in Parallel, Part II” (1964) 38 Tul L Rev 221 at 237–238.

³¹⁸ Byers, above n 312, at 391.

³¹⁹ Joseph Voyame, Bertil Cottier and Bolivar Rocha “Abuse of Rights in Comparative Law” in *Abuse of Rights and Equivalent Concepts: The Principle and its Present Day Application* (Council of Europe, Strasbourg, 1990) 23 at 23.

³²⁰ Jennings and Watts, above n 2, at 407.

4.3 Limits on separate corporate personality at international law

A flexible substantive approach to separate corporate personality is justified by its particular role on the international plane and by the nature of state consent to obligations to corporates in investment treaties. Further, the primordial and general nature of international law demands a broad, flexible anti-abuse mechanism such as exists in civil law systems.

The point of embarkation is to identify the points of distinction between national law and international law relevant to separate corporate personality. As Lord Mance pointed out in *La Générale*, “there may not always be a precise equation between factors relevant to the lifting of the corporate veil under domestic and international law”.³²¹ By identifying the concerns of international law and investment treaty law, the shape of a principle of lifting the corporate veil at international law can be divined, as, “[i]n international law as in domestic law, lifting the corporate veil must be a tailored remedy, fitted to the circumstances giving rise [to] it.”³²²

As explained earlier in this Chapter, the rationale for the legal fiction of corporate personality at municipal law is to provide a barrier between the company and its promoters to limit the extent of shareholder losses. The desire to promote entrepreneurship triumphs over the rights of unsecured creditors. At municipal law this allocation of commercial risk is undermined to the extent judicial discretion remains to disregard separate corporate personality.

By contrast, limited liability for shareholders is not pertinent to the issue of jurisdiction *ratione personae* in investment treaty law. Separate corporate personality is part of the mechanism used by corporations to obtain rights that may be wielded against treaty contracting states. The circumstances of deployment of corporate personality for the purpose of investment treaty nationality planning is quite different than the purpose for which the concept was created. It follows that the breadth of the concept of disregarding the corporate veil in investment treaty law may also be different.

³²¹ *La Générale des Carrières et des Mines v FG Hemisphere Associates LLC* [2013] 1 All ER 409 (PC) at [27] per Lord Mance as cited in *VTB Capital*, above n 277, at 385.

³²² *La Générale*, above n 321, at [77].

Different considerations also apply to separate corporate personality in the investment treaty context as a consequence of the nature of states' consent to treaty protection. A state does not contract with any particular entity when it enters a bilateral investment treaty. It contracts with another state. In the bargain, it allows corporates of a particular nationality as defined in the treaty to benefit from certain protections if it invests in its territory. But, it does not know who might take up that offer and what form might be used to do so. A state does not approve individual foreign investors as entities entitled to the benefit of the treaty; it is at the mercy of potential investors as to how treaty coverage is procured.

A state party to an investment treaty does not have the advantage of the unsecured creditors in *Salomon* who could not complain about their situation because the memorandum of association of the company, which was available to the public, gave notice of the shareholding structure and existence of the debenture in favour of Salomon.³²³ Creditors knew (or could ascertain) with whom they were doing business. To the contrary, the blind nature of the formation of states' obligations to a particular investor weighs in favour of a more flexible approach to the sanctity of the corporate form at investment treaty law.

There is affinity in this situation between a state that has entered into an investment treaty and a non-voluntary tort creditor, in that neither can know the substance of the entity with which it enters a legal relationship, and has limited control over the fact that a legal relationship has come into being.

Lipton argues that the development of modern corporate group structures "raises important social and economic questions about the allocation of risk between corporate groups and those harmed by their activities" that require answers determined by contemporary politics, economy and society rather than by the "iron grip" of the 19th century *Salomon* decision.³²⁴

In the same way, the allocation of risk between states and foreign investors in an investment treaty context ought not to be determined entirely by "corporate law principles which developed in a very different context and for entirely different purposes".³²⁵

³²³ *Salomon*, above n 270, at 40 per Lord Watson and 53 per Lord Macnaghten.

³²⁴ Lipton, above n 267, at 473.

³²⁵ At 486.

Rather, what matters in an investment treaty context is the relevance of separate corporate personality to achieve the object and purpose of jurisdictional provisions. There is no reason to permit separate corporate personality to prevent examination of the substance of the corporate claimant if that is required to ensure corporate nationality requirements are consistent with the object and purpose of jurisdictional provisions in investment treaties. Chapter 8 explains that a substantive approach is required in this respect.

The system of international law more generally also supports a flexible approach to separate corporate nationality at international law. In contrast to municipal legal systems, there is no coordinated legislative or jurisprudential body to define corporate law principles generally for international law purposes or to develop universally recognised and applied exceptions to the concept of separate corporate personality.

Rather, international law is declared and administered by institutions, courts and tribunals with limited jurisdiction over specific aspects and absent the principle of stare decisis. International law therefore entails rights which tend to be general and primordial.³²⁶

The ad hoc nature of international law therefore gives, and requires, flexibility to meld broad principles that are common to different legal systems. One of the critical common principles is the principle of abuse of right as part of the requirement for good faith at international law. In the circumstances of international law, principles such as abuse of right provide the ability to develop the law which is “particularly important in the international society in which the legislative process by regular organs is practically non-existent”.³²⁷

Accordingly, akin to its role in civil law systems, the principle of abuse of right is critical at international law to ensure a balance between the interests of disparate actors based on reasonableness and proportionality of rights; its role is to

³²⁶ Byers, above n 312, at 417.

³²⁷ Hersch Lauterpacht *The Development of International Law by the International Court* (Stevens and Sons, London, 1958) at 162. See also Baumgartner, above n 1, at [7.2].

“limit the exercise of rights which are not always well-defined and precise rules in general international law or in the particular instruments which recognise it”.³²⁸

The principle of abuse of right ensures that at international law, just as at municipal law, “each actor’s rights are necessarily limited by the rights and interests of others”³²⁹ and “help[s] to extend legal controls to previously unregulated areas, and to fill new gaps as they appear”.³³⁰

This is particularly so in investment treaty law because investment treaties elevate investors—non-state actors—onto the plane of international law in prescribed circumstances. The use of corporate legal personality to access the protection of international law through an investment treaty must be subject to the overarching international law principle of good faith. In *Barcelona Traction*, the ICJ observed in the context of the existence of the principle of lifting the corporate veil at international law:³³¹

... the law has recognized that the independent existence of the legal entity cannot be treated as an absolute. It is in this context that the process of “lifting the corporate veil” or “disregarding the legal entity” has been found justified and equitable in certain circumstances or for certain purposes. ... [T]he process of lifting the veil ... is equally admissible to play a similar role in international law.

In the context of a claim to a certain nationality by a corporate entity, the right to the recognition of separate legal personality can conflict with the right of contracting states to the ICSID Convention, and contracting states to investment treaties, to preserve the integrity of the Convention and investment treaty system more generally.

³²⁸ *State Responsibility – International Responsibility. Fifth Report by FV García Amador, Special Rapporteur* [1960] vol 2 YILC 41 at [75]. See also *1081st meeting – State responsibility* [1970] vol 1 YILC 223 at [31].

³²⁹ Byers, above n 312, at 431.

³³⁰ At 431. See also Vaughan Lowe “The Politics of Law-Making: Are the Method and Character of Norm Creation Changing?” in Michael Byers (ed) *The Role of Law in International Politics: Essays in International Relations and International Law* (Oxford, Oxford University Press, 2000) 207 at 218.

³³¹ *Barcelona Traction*, above n 3, at [56] and [58]. This decision is discussed in detail in Chapter 5.

The need for a principle of abuse of right to mediate between the rights of the various state and private actors is even more acute because “abuse of rights is most needed ... where the limits of those rights have not yet been defined”.³³² The limits on the exercise of the right to separate corporate personality is a perfect example of a gap to be filled by the principle of abuse of right at international law.

4.4 Conclusion

This Chapter illustrates that separate legal personality is not inviolable at municipal law, nor at international law. It is tempered by a substantive inquiry which focuses on the purpose for the existence, or use or role of, the corporate entity, whether that is effected by specific common law rules such as principles of agency, or by a general anti-abuse principle under the terminology of “lifting the corporate veil”, or the principle of abuse of right.

It will be explained that a similar test is employed in the analogous areas of law addressed in Chapters 6, 7 and 10 and that this inquiry is the correct substantive approach to treaty shopping through corporate nationality in investment treaty law. This substantive inquiry has broad potential import: these principles apply when required to deprive “the company or its controller of the advantage that they would otherwise have obtained by the company’s separate legal personality”.³³³

Factors relevant to when separate legal personality should be disregarded are different at international and investment treaty law than for municipal law because the purpose of the concept is different in each context. The shape of an anti-abuse principle must be tailored to meet the concerns and nature of international law.

At municipal law the purpose of separate legal personality is to limit the liability of shareholders. This concern is not pertinent to investment treaty law. Investment treaty law borrows the concept of separate legal personality from municipal law to help identify the nationality of corporate investors in circumstances where states agree to grant rights to a group of investors defined in a treaty without advance knowledge of the structure of the specific corporate entities that will claim those rights. Further, the use of separate corporate personality at international law is

³³² Byers, above n 312, at 403.

³³³ *Prest*, above n 277, at [35] per Lord Sumption.

not subject to wider institutional limits set by a legislature or by a common judicial system based on *stare decisis*.

In those circumstances, investment treaty law, as a subset of international law, must police the use of separate legal personality to attain corporate nationality. It must do so by disregarding separate legal personality where its use conflicts with the purpose of treaty jurisdictional provisions designed to limit qualifying corporate investors to companies that are genuinely domiciled in their claimed home state.

The principle of abuse of right is particularly amenable at investment treaty law to exclude corporate arrangements which seek to take advantage of separate legal personality to gain rights on the international plane. This principle balances the conflicting rights of different actors and attenuates the effect of the strict imposition of general rights where to insist on a legal right would be unreasonable. It is particularly suitable to legal systems, such as international law, that consist of broad rights which require a flexible limitation mechanism. As discussed in detail at Chapters 10 and 11, abuse of right is a flexible and powerful tool to promote a substantive purposive approach to corporate nationality.

5 Comparative 2: Nationality and the law of diplomatic protection

5.1 Introduction: the relevance of the concept of nationality in the law of diplomatic protection to investment treaty law

This Chapter explains the continuing relevance of diplomatic protection law to the issue of corporate nationality in investment treaty law, reviews diplomatic protection authority in that regard and discusses what can be learned from that authority for the Nationality Controversy at investment treaty law.

The law of diplomatic protection informs the debate regarding nationality of corporate investors in two ways: as part of the wider context of international law concerning foreign investment and the desirability of hegemony in that field; and, because nationality is a mandatory precursor to bring suit in both diplomatic protection law and investment treaty law, diplomatic protection law has grappled with many of the same issues that arise regarding corporate jurisdiction *ratione personae* in the investment treaty field.

Ultimately, diplomatic protection law concludes that a substantive check is appropriate; the conferment of nationality cannot be dictated entirely by municipal laws of states, nor the treaties into which they enter. Literal approach cases in investment treaty law are wrong to disregard the experience and outcome of diplomatic protection law; they ought to reach the same conclusion and exclude entities which adopt a nationality for the purpose of gathering rights to which they would not otherwise be entitled.

The law of diplomatic protection continues to apply in the absence of an applicable investment treaty. It allows a state to claim against another state for harm caused to a national of the claimant state, typically in respect of a foreign investment.³³⁴ The basis for a claim is that injury to a state's national is an injury to the state itself.³³⁵ Diplomatic protection law therefore provides an individual an

³³⁴ Campbell McLachlan "Investment Treaties and General International Law" (2008) 57 ICLQ 361 at 383.

³³⁵ See Yoram Dinstein "Diplomatic Protection of Companies Under International Law" in Karel Wellens (ed) *International Law: Theory and Practice—Essays in Honour of Eric Suy* (Kluwer Law International, The Hague, 1998) 505 at 505–506. This theory goes back to Vattel's work in the 18th century.

indirect means of claiming against a state, so long as its state of nationality is willing to bring the claim and share any proceeds.³³⁶ For this reason, nationality is a central aspect of the law of diplomatic protection, as it is in respect of investment treaty jurisdiction *ratione personae*.

Yet, the relevance and application of diplomatic protection law regarding nationality to the same concept in investment treaty law is controversial.³³⁷ The International Court of Justice³³⁸ (ICJ) and numerous investment treaty tribunals (including many of the literal cases as reviewed in Chapter 3.2),³³⁹ have emphasised that investment treaties should be interpreted without regard to extraneous legal principles or rules, because “investment law is primarily based on international treaties, which specifically delineate the rights and obligations of their parties”.³⁴⁰ To impose limitations upon nationality would be wrong if the treaty parties themselves have not done so.³⁴¹ Therefore, to draw an analogy between the customary international law of diplomatic protection and investment treaties is “to ignore their specific character as *lex specialis* and hence to court error”.³⁴²

Indeed, the International Law Commission (ILC) Draft Articles on Diplomatic Protection recognise that, to the extent they are inconsistent, diplomatic law does not prevail over provisions in an investment treaty.³⁴³

However, this thesis contends that while investment treaty jurisprudence is not bound to apply the approach of diplomatic protection law, it is appropriate to refer to diplomatic protection law when interpreting and applying investment treaties as “the function of investment treaties is to augment (rather than displace) customary

³³⁶ For a discussion of the procedural difficulties facing an investor reliant on a claim of diplomatic protection, see Taylor St John *The Rise of Investor-State Arbitration: Politics, Law, and Unintended Consequences* (Oxford University Press, Oxford, 2018) at 55–57.

³³⁷ See McLachlan, Shore and Weiniger, above n 6, at [5.32]–[5.38].

³³⁸ *Barcelona Traction*, above n 3, at 40.

³³⁹ See, for example, *CMS Gas Transmission Co v Argentina (Jurisdiction)* ICSID ARB/01/8, 17 July 2003 at [43]–[44] and [69]; *Siemens AG v Argentina (Jurisdiction)* ICSID ARB/02/8, 3 August 2004 at [141]; *KT Asia*, above n 24, at [114]; *Waste Management*, above n 24, at [80] and [85]; *Rompetrol*, above n 24, at [111]–[114]; and *BG Group plc v Argentina (Final Award)* UNCITRAL, 24 December 2007 at [200]. See also discussion in Anthony C Sinclair “ICSID’s Nationality Requirements” (2008) 23 ICSID Rev 57 at 61–62; and Schill, above n 7, at 211–212.

³⁴⁰ Michalopoulos and Hicks, above n 22, at 129.

³⁴¹ At 136.

³⁴² *Barcelona Traction*, above n 3, at 40.

³⁴³ Article 17 of the Draft Articles on Diplomatic Protection as cited in Lavista, above n 16, at 11. See also McLachlan, Shore and Weiniger, above n 6, at [5.32].

law by providing a more efficient mechanism for the protection of alien property”,³⁴⁴ and because investment treaties are properly conceptualised “as part of a wider juridical system that integrates rules from other sources of international law”.³⁴⁵ As instruments of international law, investment treaties must be interpreted in a way that promotes consistency and coherence within the international legal system.

This approach draws support from art 31(3)(c) of the Vienna Convention, which requires regard to “[a]ny relevant rules of international law applicable in the relations between the parties” in the interpretation of a treaty.³⁴⁶ The underlying premise of art 31(3)(c) is to achieve systemic integration and avoid fragmentation within international law. Although investment treaties are a more modern construct than diplomatic protection, that does not mean investment arbitration is an entirely separate legal order.³⁴⁷ As treaties form part of the international legal system, they must be interpreted with regard to the wider context of international law³⁴⁸ and not “regarded as inhabiting [their] own watertight compartment”.³⁴⁹

Parties to a treaty can exclude customary international law. Yet, in the absence of express language to that effect, investment treaties “appear more than usually dependent upon their wider context”.³⁵⁰ While investment treaties have provided new avenues to bypass old rules of diplomatic protection to enable investors to bring claims against states directly, there remains limits imposed by customary international law.³⁵¹

In particular, where investment treaties do not address specific jurisdictional issues such as limits to the use of nationality, there may be a residual role for provision of such rules by the law of diplomatic protection as customary international law.³⁵² It is, therefore, inadequate to say that any reference to other

³⁴⁴ Olmedo, above n 39, at 698.

³⁴⁵ At 699.

³⁴⁶ See Campbell McLachlan “The Principle of Systemic Integration and Article 31(3)(c) of the Vienna Convention” (2005) 54 ICLQ 279 at 290.

³⁴⁷ McLachlan, Shore and Weiniger, above n 6, at [5.37].

³⁴⁸ McLachlan, above n 346, at 280.

³⁴⁹ McLachlan, above n 334, at 364.

³⁵⁰ At 374.

³⁵¹ McLachlan, Shore and Weiniger, above n 6, at [5.37].

³⁵² *Société Générale v Dominican Republic (Award on Preliminary Objections to Jurisdiction)* LCIA Case No UN 7927, IIC 366 (UNCITRAL, 2008) at [108].

sources of international law is precluded because investment treaties are *lex specialis*.³⁵³

The concept of nationality and its purpose is the same in diplomatic law and investment treaty law: to determine eligibility for protection of foreign investments.³⁵⁴ A requisite nationality is required whether the claim is “introduced by the individual or company concerned or by the State of nationality on its behalf”.³⁵⁵ Therefore:³⁵⁶

To the extent that ICSID was created to replace — to a certain point — the institution of diplomatic protection, it is not clear why the underlying principles of diplomatic protection could not be useful to investment disputes where there is uncertainty in the terms of their jurisdiction.

The utility of the concept of nationality at diplomatic protection law is further revealed by the way in which it encounters and foreshadows many of the issues with which this thesis later grapples in respect of nationality at investment treaty law. In particular, both fields confront issues concerning the complexity and uncertainty of a substantive approach to nationality; that context, and the object to be achieved through nationality requirements, are critical to the most desirable approach to nationality; the extent to which international law has an overarching check on the use of nationality by those who seek to benefit from it; and that the purpose for which nationality is claimed is the key to setting appropriate limits.

Accordingly, this thesis proceeds to undertake that comparison as an aid to consider the appropriateness of a substantive approach to the nationality of claimant investors under investment treaties.

³⁵³ There is a third perspective to this debate, which is that even if diplomatic protection is relevant to nationality in investment treaty law, it should not be applied as better options are available (such as abuse of right) to deal with familiar problems of abusing nationality: Sloane, above n 16, at 42 and 55. The role of abuse of right is discussed in Chapters 10 and 11.

³⁵⁴ See the comment in *Ahmadou Sadio Diallo (Republic of Guinea v Democratic Republic of the Congo) (Preliminary Objections)* [2007] ICJ Rep 582 at [90]. To the same effect see Arthur Watts “Nationality of claims: some relevant concepts” in Vaughan Lowe and Malgosia Fitzmaurice (eds) *Fifty years of the International Court of Justice: Essays in Honour of Sir Robert Jennings* (Cambridge University Press, Cambridge, 1996) 424 at 425; and Schlemmer, above n 34, at 71.

³⁵⁵ *Société Générale*, above n 352, at [109].

³⁵⁶ Lavista, above n 16, at 11–12 and see 13.

The vanguard case for substantive nationality at international law was the judgment of the ICJ in the 1955 *Nottebohm* case, which proposed a requirement for a “genuine connection” between a state and a natural person claiming its nationality at international law.³⁵⁷ However, 15 years later, the ICJ (by majority) rejected the argument that such a connection be required for corporate persons at international law. That was the controversial outcome in the *Barcelona Traction* case,³⁵⁸ later followed in *Diallo*.³⁵⁹

More recently, commentators have argued that a substantive genuine connection-type test is appropriate for corporate entities at international law. They have re-interpreted *Barcelona Traction* and criticised its reasoning, and promoted the arguments of the minority. The result of this movement has been the introduction of a requirement for a substantive connection between a company and its state of incorporation in the 2006 ILC Draft Articles on Diplomatic Protection.³⁶⁰

These ICJ decisions and the ILC Draft Articles are discussed below. Ultimately, international law sanctions a substantive test for corporate nationality to abrogate claims of nationality based on the municipal laws of states. Such a test is also applicable to nationality in the context of investment treaties.

5.2 The “genuine connection” test: the *Nottebohm* case

Nottebohm concerned recognition at international law of the municipal law nationality of individuals and first propounded the idea at international law that nationality, if it creates rights that may be enforced, must have substance beyond compliance with municipal law.

Nottebohm changed his country of nationality from Germany to Liechtenstein (a neutral country) at the outbreak of WWII in accordance with the relevant municipal laws of Liechtenstein. But his business and adult life were spent in Guatemala. In 1943, Guatemala arrested Nottebohm as an enemy (German) national and seized his property in Guatemala without compensation. After the War,

³⁵⁷ *Nottebohm*, above n 41.

³⁵⁸ *Barcelona Traction*, above n 3.

³⁵⁹ *Diallo*, above n 354.

³⁶⁰ See *Report of the International Law Commission Supplement No 10*, above n 43, at [49] for the Draft Articles.

Liechtenstein brought a claim on behalf of Nottebohm seeking compensation from Guatemala.

The ICJ drew a very clear distinction between domestic and international laws regarding nationality: it is for each state to determine on whom it confers the rights and obligations of citizenship. However, satisfaction of a state's domestic laws regarding nationality is not determinative of nationality at international law.³⁶¹

The majority of the Court held that international law looks to the “real and effective nationality”;³⁶² that “in order to be capable of being invoked against another State, nationality must correspond with the factual situation”.³⁶³ The rules laid down by each state are not entitled to recognition by another state unless, “the legal bond of nationality accord[s] with the individual's genuine connection with the state”.³⁶⁴ The majority found the facts illustrated, “the absence of any bond of attachment between Nottebohm and Liechtenstein and, on the other hand, the existence of a long-standing and close connection between him and Guatemala”.³⁶⁵

Quite what circumstances give rise to the requisite level of genuineness and to what standard it is measured is not well addressed in *Nottebohm*. Indeed, it is not clear whether the majority proposed an absolute or relative standard as to the necessary connection.³⁶⁶

The minority opined that municipal laws as to nationality ought to be respected and recognised via international law,³⁶⁷ and argued that subjective tests of connection would be impossibly uncertain and open the door to arbitrary decisions.³⁶⁸

The issue of calibration of the substantive yardstick and the inherent uncertainty in a genuine connection approach will be examined in Chapter 9, which deals with the potential nature, content and application of a substantive nationality

³⁶¹ The ICJ referred to the Convention on Certain Questions relating to the Conflict of Nationality Laws 179 LNTS 89 (signed 12 April 1930, entered into force 1 July 1937), arts 1 and 5.

³⁶² *Nottebohm*, above n 41, at 22.

³⁶³ At 22.

³⁶⁴ At 23.

³⁶⁵ At 26.

³⁶⁶ David Harris “The Protection of Companies in International Law in the Light of the *Nottebohm* Case” (1969) 18 ICLQ 275 at 289–290.

³⁶⁷ *Nottebohm*, above n 41, at 30–31 per Judge Klaested, 40–41 per Judge Read and 56–57 per Judge Guggenheim.

³⁶⁸ At 46 per Judge Read and 55–56 per Judge Guggenheim.

test in the investment treaty environment. This thesis agrees with the majority that a substantive test for nationality at international law is necessary, but also contends that tests of an intangible nature of genuineness are ill-fitting to the needs of investment treaty law, primarily because they are too uncertain for investors and states. A better way to alleviate the use of municipal nationality laws (by a corporate or individual) to obtain a convenient nationality at international law is to examine the *purpose* for which the nationality is claimed in all the circumstances.

In this respect, it is telling that, in addition to the minimal nature of Nottebohm's connections with Liechtenstein, the majority of the ICJ placed weight on Nottebohm's *purpose* in acquiring Liechtenstein nationality. Nottebohm sought naturalisation in Liechtenstein not for the purpose of being a genuine part of that country's society but rather:³⁶⁹

... to enable him to substitute for his status as a national of a belligerent State that of a national of a neutral State, with the sole aim of thus coming within the protection of Liechtenstein

In other words, Nottebohm sought to obtain a more convenient nationality in terms of rights on the international plane. Recent commentators have identified this observation as the key to appreciating that the principle of abuse of right is a better rationale for the result in *Nottebohm*.³⁷⁰ Sloane, for example, considers the majority saw Nottebohm's change in nationality as "a transparent—but *not* unlawful—abuse of the liberal international legal regulation of nationality by which he sought to evade the consequences of the law of war".³⁷¹ The ICJ implicitly found that Nottebohm's motive for acquiring neutral status through Liechtenstein citizenship was an improper attempt to manipulate nationality to his benefit: i.e. to avoid application of the international law of war and to gain legal rights—the diplomatic protection of Liechtenstein—that he would not otherwise have had.³⁷²

³⁶⁹ At 26.

³⁷⁰ Sloane, above n 16, at 11–12, 14 and 18–22; and Benedict and others, above n 4, at 43–45 and 49.

³⁷¹ Sloane, above n 16, at 18–19.

³⁷² James Crawford *Brownlie's Principles of Public International Law* (8th ed, Oxford University Press, Oxford, 2012) at 518–521.

The ILC also came to the conclusion that the limits placed on Liechtenstein's conferment of nationality on Nottebohm "may be consolidated into a requirement of good faith".³⁷³ It is the *purpose* of his actions which infuse the circumstances with the tenor of bad faith. The municipal formalities of the conferral of nationality, and the strength of bonds of attachment vis-à-vis Nottebohm and Liechtenstein, are relevant only to inform that purpose.

The importance of purpose for the attainment and use of nationality is identified in this thesis, particularly in Chapters 10 and 11, as the critical marker of illegitimate use of nationality in investment treaty law.

5.3 A "genuine connection" test for corporate nationality: from *Barcelona Traction* to the International Law Commission Draft Articles on Diplomatic Protection

The application of the *Nottebohm* "genuine connection" test to corporate nationality was the subject of the ICJ's 1970 decision in *Barcelona Traction*. This decision, the adverse commentary it spawned, and the approach to corporate nationality in the ILC Draft Articles on Diplomatic Protection are set out below. What can be learned for investment treaty law from the approach to corporate nationality in the law of diplomatic protection is then considered.

Barcelona Traction was incorporated in Canada, conducted all its business in Spain, and was owned by Belgian shareholders. The company claimed it was effectively forced into liquidation by Spanish authorities. Litigation in the Spanish courts proved unsuccessful for the company.

Canada would not espouse a claim against Spain on behalf of *Barcelona Traction*. However, Belgium commenced proceedings in the ICJ against Spain, seeking to exercise a right of diplomatic protection over *Barcelona Traction* through its Belgian shareholders. Spain protested that Belgium had no standing to protect a company incorporated in Canada.

A majority of 12 judges rejected the standing of Belgium on the basis that separate legal personality of a company is paramount and that international law is

³⁷³ *Diplomatic Protection – First report on diplomatic protection, by Mr John R Dugard, Special Rapporteur* [2000] vol 2, pt 1 YILC 205 at [108].

bound to recognise this concept.³⁷⁴ Accordingly, just as in municipal corporate law, shareholders cannot seek to bring a claim for damage to the company's interests and rights at international law.³⁷⁵

However, the Court was divided seven to six as to whether the nationality of the company was subject to a "genuine connection" test, in which case Barcelona Traction was arguably a Belgian company, not Canadian. The majority decided that the nationality of a company cannot be equated with the nationality of its shareholders rather than the state of its incorporation.³⁷⁶

It disavowed any application of the *Nottebohm* "genuine connection" test to corporate nationality because such a test, "could create an atmosphere of confusion and insecurity in international economic relations", especially as, "the shares of companies whose activity is international are widely scattered and frequently change hands".³⁷⁷

Having said that, the majority then proceeded to undertake an analysis that examined Barcelona Traction's "close and permanent connection" with Canada. It cites the duration of the company's incorporated life, the presence of its registered office, accounts, share registers and Board meetings, and tax responsibility in Canada. Barcelona Traction's business activities in Spain did not weaken the connection with Canada because those activities were the company's declared object from its inception.³⁷⁸

The discussion of Barcelona Traction's links with Canada may indicate that even if a genuine connection test was applied, the Court's view as to the nationality of Barcelona Traction would remain the same. However, a number of commentators, including FA Mann, interpret the ICJ as distinguishing *Nottebohm*'s case on the facts and endorsing the need for a genuine connection, at least in a narrow sense.³⁷⁹

³⁷⁴ *Barcelona Traction*, above n 3, at 51. See also, for example, 67 per Judge Fitzmaurice, 121 per Judge Tanaka and 256 per Judge Nervo.

³⁷⁵ At 51. See also 67–68 per Judge Fitzmaurice.

³⁷⁶ At 42.

³⁷⁷ At 49.

³⁷⁸ At 42.

³⁷⁹ FA Mann "The Protection of Shareholders' Interests in the Light of the Barcelona Traction Case" (1973) 67 AJIL 259 at 269. Mann was counsel for Belgium. See also Pia Acconci "Determining the Internationally Relevant Link between a State and a Corporate Investor: Recent Trends concerning the Application of the 'Genuine Link' Test" (2004) 5 JWIT 139 at 145–146; Muchlinski, above n 2, at 354; and Dugard, above n 373, at [9].

According to Mann, the lesson to be learned from this part of the ICJ's judgment is the necessary connection is to be found "in relatively few, easily established facts" and does not involve weighing facts to find the state with the most genuine connection to the company.³⁸⁰ In other words, corporate nationality requires a genuine connection, but it is an absolute test, not a relative one.³⁸¹

The minority of the ICJ endorsed the application of the *Nottebohm* effective link principle to companies at international law in its broader substantive sense:³⁸² international law is "not bound by formal conceptions of [municipal] corporation law" and "must look at the economic reality of the relevant transactions"³⁸³ in order to prevent a "citizenship of convenience".³⁸⁴ The strong theme of the minority judgments is that international law is concerned to ascertain "the substance of matters instead of the legal form or technique".³⁸⁵

So far as the majority's concern for certainty of nationality at international law, the minority considered the ability for the nationality of a company to be altered, or hidden in corporate layers, to be even greater reason to apply an effective link principle to corporates.³⁸⁶ The difficulty of determining the effective link creates a complication, not an incapacity.³⁸⁷

In the wake of the *Barcelona Traction* decision, many commentators reached the same view. Watts, for example, pointed out that having given weight at the international level to a "nationality of substance" for natural persons in *Nottebohm*, it is surprising the ICJ felt constrained by formality in respect of corporate nationality; the different context did not justify a different approach.³⁸⁸

³⁸⁰ Mann, above n 379, at 269. To the same effect see Acconci, above n 379, at 146.

³⁸¹ See also Harris, above n 366, at 292.

³⁸² *Barcelona Traction*, above n 3, at 80–81 and 83 per Judge Fitzmaurice, 122–123 and 132 per Judge Tanaka, 169, 182–188 and 205 per Judge Jessup, 254 per Judge Nervo, 281–282 per Judge Gros and 346–348 per Judge Riphagen.

³⁸³ At 170 per Judge Jessup, 127 per Judge Tanaka, 279–280 and 283 per Judge Gros, and 347–348 per Judge Riphagen.

³⁸⁴ At 184 and 188 per Judge Jessup, and 80 per Judge Fitzmaurice.

³⁸⁵ At 127 per Judge Tanaka.

³⁸⁶ At 280 per Judge Gros.

³⁸⁷ At 283. To the same effect see Harris, above n 366, at 295; and George A van Hecke "Nationality of Companies Analysed" (1961) 8 NILR 223 at 235 and 238.

³⁸⁸ Watts, above n 354, at 430, 432 and 438–439. See also Harris, above n 366, at 292 and 295; and Rosalyn Higgins "Aspects of the Case Concerning the Barcelona Traction, Light and Power Company, Ltd." (1971) 11 Va J Int'l L 327 at 336–338, in which it is averred that arguments concerning a genuine connection test were not, but should have been, fully ventilated.

Other commentators considered the majority had failed to take account of the role of corporate groups in the modern world of global commerce, in that an effective link requirement is “particularly appropriate in an era of increasing internationalization of business operations”.³⁸⁹ Metzger argues that states ought not be expected to accept such a tenuous connection as sufficient to ground standing in an international claim.³⁹⁰ This point is equally applicable to investment treaty claims as it is to diplomatic protection.

This commentary influenced Orrego Vicuña’s report for the International Law Association in 2000.³⁹¹ Orrego Vicuña recommended “[t]he link of [corporate] nationality to the claimant State must be genuine and effective” and that the state of nationality of controlling shareholders ought to be permitted to exercise diplomatic protection on their behalf or to consider the company as having the nationality of the controlling shareholders.³⁹²

In 2003, Dugard reviewed the law of diplomatic protection for the International Law Commission as Special Rapporteur.³⁹³ In respect of corporate nationality, he concludes that although “*Barcelona Traction* may be faulted on several grounds ... [n]evertheless, it enjoys wide acceptance on the part of States.”³⁹⁴ He reviews various alternatives—including a genuine link test, or protection by the state of economic control of the corporation.³⁹⁵

As for the “genuine link” alternative, Dugard argued it would run counter to the reasoning of the majority in *Barcelona Traction*, is uncertain in application, and gives rise to the difficulty as to the point in time at which the genuine link must exist (at time of incorporation; at the time of bringing the claim; or continuously from one to the other).³⁹⁶

Dugard considered that there are sound reasons for proposing the state of economic control as the protector of the corporation, as it accords with economic

³⁸⁹ Fatouros, above n 53, at 497–498. See also, Acconci, above n 379, at 148.

³⁹⁰ Stanley D Metzger “Nationality of Corporate Investment Under Investment Guaranty Schemes—The Relevance of *Barcelona Traction*” (1971) 65 AJIL 532 at 541.

³⁹¹ Francisco Orrego Vicuña “Interim Report on ‘The Changing Law of Nationality of Claims’” (2000) 69 ILA Rep 631.

³⁹² At 646–647.

³⁹³ Dugard, above n 373.

³⁹⁴ At [49].

³⁹⁵ At [30]–[48].

³⁹⁶ At [32].

and practical realities and constitutes “recognition of the importance of an effective or genuine link between the protecting State and the injured legal person”.³⁹⁷ However, “[d]efining control is not an easy task” and “will inevitably present problems of proof, ... burden of proof and presumptions of evidence”.³⁹⁸ His conclusion is, “the wisest course seems to be to formulate articles that give effect to the principles expounded in *Barcelona Traction*”.³⁹⁹

The concerns Dugard enumerates with respect to genuine link and control tests are discussed in Chapter 9. It is proposed that while criteria such as control and commercial links with a state may be part of a substantive test, they are insufficient in and of themselves for much the same reasons he identifies.

In its Draft Articles, the ILC adopted the basic rule in *Barcelona Traction* that the state of nationality of a company is the state under whose law the company is incorporated.⁴⁰⁰ However, despite Dugard’s recommendation, the Commission created an exception to that rule in art 9:⁴⁰¹

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

The Commentary to art 9 accepts the basic premise of *Barcelona Traction* that incorporation must ordinarily prevail to determine corporate nationality, but states that “policy and fairness” dictate that there must be an exception in circumstances where there is no other significant link or connection between the state of incorporation and the corporation itself. In the same way as proposed by this thesis for investment treaty law, the ILC Draft Articles take incorporation as a

³⁹⁷ At [35].

³⁹⁸ At [37].

³⁹⁹ At [49].

⁴⁰⁰ Draft Articles on Diplomatic Protection, art 9.

⁴⁰¹ Article 9.

presumptive indication of corporate nationality, subject to a substantive reality check.⁴⁰²

Article 9 is a major departure from the inflexible incorporation rule expounded in *Barcelona Traction*; the minority position has been embraced. While phrased as an exception, a substantive genuine connection requirement is now central to the determination of corporate nationality for diplomatic protection.⁴⁰³

The ICJ returned to issues of nationality in the *Diallo* case.⁴⁰⁴ The ICJ confirmed the *Barcelona Traction* position that the nationality of a company could not be equated with the nationality of its shareholders for the purposes of diplomatic protection. However, in this case, the companies allegedly damaged by actions of the respondent state (Zaire) were incorporated in Zaire and had operated substantial businesses there for many years.⁴⁰⁵ The fact that their major shareholder, Mr Diallo, was a Guinean citizen did not permit Guinea to bring a diplomatic protection claim against Zaire in respect of Mr Diallo's companies unless incorporation in Zaire was a precondition for doing business there.⁴⁰⁶ The ICJ found incorporation in Zaire was not a precondition; it was Mr Diallo's decision.⁴⁰⁷

Therefore, Diallo could not alter the nationality of the Zairean incorporated companies for the purposes of bringing an international claim when they had no connection with Guinea other than his personal citizenship. Although not framed by the Court in such terms, *Diallo* maintained the ratio of *Barcelona Traction* in a narrow sense; that only the state of incorporation had standing to bring a claim on behalf of a company at international law. However, the result implicitly acknowledged that nationality could not be altered for the purpose of bringing an international claim, at least in the absence of a real connection with the claimant

⁴⁰² Mistelis and Baltag view art 9 as a denial of benefits clause, although art 9 is concerned with identification of the state of nationality for a corporation, rather than the denial of rights per se: Loukas A Mistelis and Crina Mihaela Baltag "Denial of Benefits and Article 17 of the Energy Charter Treaty" (2009) 113 Penn St L Rev 1301 at 1309 and 1318. See also Lavista, above n 16, in which the argument is made that investment treaty law ought to follow the approach in art 9.

⁴⁰³ Notably, art 4 of the Draft Articles defines the state of nationality for natural persons strictly as that acquired by a person according to municipal law. The Commentary (at 33) expressly limits *Nottebohm's* application to its own facts. The Commentary explains that a genuine link principle would render expatriates who made their home in a foreign state without giving up their original nationality stateless for the purpose of diplomatic protection.

⁴⁰⁴ *Diallo*, above n 354.

⁴⁰⁵ At 591.

⁴⁰⁶ As set out in art 11(b) of the Draft Articles on Diplomatic Protection.

⁴⁰⁷ *Diallo*, above n 354, at 615–616.

state and a substantive explanation for ignoring nationality determined by incorporation.

5.4 What can be learned from the treatment of corporate nationality in the law of diplomatic protection for the treatment of that concept in investment treaty law?

The law of diplomatic protection recognises that, particularly for corporates, a substantive test must be applicable to limit the recognition on the international plane of conferral of nationality by municipal law.

This approach is consistent with international law more generally. The 1930 Hague Convention provided that “[i]t is for each State to determine under its own law who are its nationals”, but that state determination of nationality under domestic law “shall be recognised by other States in so far as it is consistent with international conventions, international custom, and the principles of law generally recognized with regard to nationality”.⁴⁰⁸ The 1997 European Convention on Nationality followed the same formula.⁴⁰⁹ But neither gave any guidance as to the international custom or principles of law to which they referred.

Crawford emphasises the “need for international law to have its own rules of nationality rather than simply leaving nationality to be defined entirely by municipal law”⁴¹⁰ and that “there must be limitations on the powers of individual states to treat persons as their nationals”.⁴¹¹ This is particularly so where issues on the plane of international law depend on the nationality of corporations, ships, aircraft and other assets.⁴¹² In relation to the nationality of corporations, Crawford considers that while no rule requiring a genuine connection has found general acceptance, “international law has a reserved power to guard against giving effect to ephemeral, abusive and simulated creations”.⁴¹³

⁴⁰⁸ This Draft eventually became the Convention on Certain Questions relating to the Conflict of Nationality Laws, above n 361.

⁴⁰⁹ European Convention on Nationality ETS 166 (opened for signature 6 November 1997, entered into force 1 March 2000), art 3.

⁴¹⁰ Crawford, above n 372, at 527.

⁴¹¹ At 518.

⁴¹² At 527.

⁴¹³ At 706.

Tribunals tend to rely on municipal law in the first instance but “require a guarantee that the grant of personality is reasonable and not a device for limiting the proper sphere of protection of other governments”.⁴¹⁴ Amerasinghe similarly argues that where a person has acquired a nationality either “involuntarily” or promotes a “nationality of convenience”, “international law does to some extent, at least, delimit the power of a State to claim a person as its national”.⁴¹⁵

An overarching limit of reasonableness in respect of a claim of nationality does not seem objectionable in principle. The principle that a real connection must exist to justify conferment of nationality must apply equally to two or more states that agree to a certain allocation of nationality in a treaty, just as it does to the nationality laws of an individual state. If an agreement between states breaches limits set by international law because, speaking generally, it is unreasonable because it is based on an absurd criterion, or if the result of application of the criterion on particular facts is unreasonable in context, then international law is free to intervene.

However, the question remains: to what extent, when and how should international law intervene? What is a reasonable claim to nationality? What the limits are and how they are applied is far from clear. Statements of intent as to a substantive check on the ability for claimants to rely on a certain nationality at international law such as those above say nothing about what form such a check should take.

Diplomatic protection law has countenanced a number of possibilities. In *Nottebohm*, the “genuine connection” test is postulated, but commentators have also divined an abuse of right approach which seeks to prevent the misuse of a nationality of convenience as a better explanation of the circumstances of that case. *Barcelona Traction* arguably applies a “close and permanent connection” test with reference to a narrow list of relatively formal factors. The minority and many commentators contend for a more far-reaching test that promotes substance over form to prevent the misuse of nationality by a corporation of convenience. The ILC Draft Articles cumulatively employ the criteria of substantial business activity, the nationality of controllers and seat of management to define illegitimate claims to nationality.

⁴¹⁴ At 707.

⁴¹⁵ Amerasinghe, above n 125, at 248–249.

Crawford's view is that:⁴¹⁶

... it is possible to postulate a general principle of genuine link relating to the *causa* for conferment of nationality (and the converse for deprivation), a principle distinguishable from that of effective link.

This emphasis on purpose—the reason for adoption or conferment of a particular nationality—is the principle that best explains the result in *Nottebohm*. It is promoted by this thesis as central to an effective substantive approach. The underlying central theme from international law may be that where the purpose of the use of nationality by a claimant (whether state or person) contravenes the purpose for which a nationality requirement exists in a particular field of international law, then the claimed nationality is misused or abused. This will be discussed further in Chapters 8 and 10.

Certainly, the concept of nationality at international law is a flexible one that depends heavily on context. In *Barcelona*, Judge Fitzmaurice concluded that “different tests [for nationality] have been applied for different purposes, and that an element of fluidity is still present in the field”.⁴¹⁷ Nationality is a concept that can be shaped to fit its purpose at international law.

A contextual approach to the limits of nationality may make sense of what appears to be the diametrically opposed outcomes in *Nottebohm* and *Barcelona Traction* so far as the test for nationality is concerned. The tests for nationality in each case are consistent in their conservatism: each approach tends to restrict the pool of nationals for which states may bring claims under the law of diplomatic protection. In the case of individuals, the requirement of a genuine connection with the protecting state removes standing for individuals who are mere citizens of convenience. For corporate entities, the reluctance to look further than the state of incorporation removes potential standing for claims brought by the national states

⁴¹⁶ Crawford, above n 372, at 520.

⁴¹⁷ *Barcelona Traction*, above n 3, at 83. See to the same effect at 183 per Judge Jessup and 121-123 per Judge Tanaka who cites Ernst Rabel *The Conflict of Laws: A Comparative Study* (University of Michigan Press, Ann Arbor, 1947) vol 2 at 21 in favour of a teleological approach. See also 297–298 per Judge Ammoun.

of shareholders or states other than the state of incorporation in which a company may carry out its operations.

The conservatism of the law of diplomatic protection in respect of those individuals and corporations for which a state may bring a claim is rooted in a concern not to impose unexpected obligations on states in respect of their obligations towards other states for protection of foreign nationals. This is particularly so given specific consent of the host state of the investment to obligations relating to it has not been secured in advance by way of treaty or contract.

In this respect, Muchlinski observes that the ICJ has sovereignty concerns requiring judicial restraint uppermost in mind.⁴¹⁸ Rather than seeking to impose investor protection obligations onto the host countries of foreign investments by means of customary international law, the ICJ looks instead to treaty based regimes which have host state consent as an immutable precondition to create its own rules to serve its own purposes, particularly as to the activities of corporations.⁴¹⁹ Hence the diplomatic protection cases can be seen as policy or purpose driven.

The issue of consent of the respondent state to claims by private actors defined by nationality is a critical contextual difference between diplomatic protection law and investment treaty law. Investment treaty law is not concerned about an approach to nationality that may impose unexpected obligations on respondent states, because a treaty is evidence of consent by the state parties to it.

As discussed, in Chapters 1 and 2 above, by mechanisms such as the use of the concept of “control” and the inclusion of shares as a qualifying investment, states have sought through investment treaties to avoid the consequences of the ICJ’s decisions in *Barcelona Traction* and *Diallo* and expand the categories of investors permitted to claim in respect of a breach of an investment treaty.⁴²⁰ An expansive

⁴¹⁸ Muchlinski, above n 2, at 360–362.

⁴¹⁹ *Barcelona Traction*, above n 3, at 47. See also, to the same effect, 57 per President Rivero and 183 per Judge Jessup. In *Diallo*, above n 354, the ICJ confirmed the separate nature of customary international law and investment treaties which permit a remedy for shareholders of an injured company: at 634 per Judge Mampuya.

⁴²⁰ Kenneth J Vandewelde *United States Investment Treaties: Policy and Practice* (Kluwer Law International, Zuidpooslingel, 1992) at 45–46 as cited in Abby Cohen Smutny “Claims of Shareholders in International Investment Law” in Christina Binder and others (eds) *International Investment Law for the 21st Century: Essays in Honour of Christoph Schreuer* (Oxford University Press, New York, 2009) 363 at 372.

approach is desirable on the one hand to states because it widens the pool of potential investors from whom its economy may benefit.

But a broad approach to nationality of investors impacts adversely on the extent of a state's obligations to such investors. As discussed in Chapters 1 and 3 above, states can be faced with claims by corporates that have little or no connection with the contracting state from which they claim to derive. The *Barcelona* minority observed that if a state wishes to have its unilateral acts by way of municipal law recognised and given effect by other states, then those acts must reflect a genuine situation corresponding with reality, not legal fiction.⁴²¹ That point resonates in investment treaty law all the more where the claim to reliance on conformity with municipal law to give rights on the international plane comes from private actors who are strangers to international rights in the absence of an investment treaty concluded by states.

Underlying this tension is a difference of opinion as to how to weigh the rights of investors as against those of states. Where that balance is struck will depend on the purpose for which rules about nationality are utilised in the investment treaty context.

The purpose of investment treaties and the role nationality plays to achieve such purposes is examined at Chapter 8. It will be argued that in circumstances where the cloak of nationality affords significant substantive rights to nationals of certain other contracting states to promote foreign investment, it is appropriate to ensure that the balance of sacrifices in that bargain is not skewed by nationals of convenience.

The law of diplomatic protection makes clear that a substantive check on the use of nationality to found a claim at international law is appropriate. It cannot be dictated entirely by municipal laws of states, nor the treaties into which they enter. But the form and application of such a substantive test depends on the purpose of the concept of nationality in its particular legal context.

⁴²¹ *Barcelona Traction*, above n 3, at 188 and 205–206 per Judge Jessup. See also 279–280 and 283 per Judge Gros and 347–348 per Judge Riphagen.

6 Comparative 3: a substance over form approach to treaty shopping under double taxation treaties

6.1 Introduction⁴²²

The manipulation of corporate nationality for the purpose of obtaining treaty benefits is not a phenomenon known only to investment treaty law. This Chapter explains the substantive approach to treaty shopping in the analogous field of double tax treaties. The general object of the two systems is the same: to promote international investment by encouraging the flow of capital between states. Corporate manoeuvring is accomplished by the same means: incorporation in legally convenient jurisdictions. But the respective approaches to corporate nationality planning are opposed.

Tax treaty jurisprudence takes a substance over form approach as opposed to the literal approach presently favoured in investment treaty law. This Chapter concludes that there is no reason for this dichotomy, that the substantive approach in tax treaty law is preferable, and is a model for investment treaty law.

In 2006, Legum observed that “[f]or decades multinationals have shopped for the jurisdiction with the most advantageous tax treaty”.⁴²³ In tax treaty jurisprudence, as in investment treaty law, “treaty shopping” is a label for a phenomenon where “a person ‘shops’ into an otherwise unavailable treaty through complicated structures”.⁴²⁴ Krishna describes treaty shopping for tax purposes in a manner identical to the experience of investment treaty law:⁴²⁵

... where an MNE [multinational enterprise] interposes an entity — usually a corporation — in a third country to take advantage of the terms of a favourable provision in the country’s treaty that would not be otherwise

⁴²² The author acknowledges the assistance in accessing the intricacies of double tax treaty jurisprudence provided by the work of Dr Saurabh Jain, in his book *Effectiveness of the Beneficial Ownership Test in Conduit Company Cases*, above n 49.

⁴²³ Legum, above n 11, at 525. See also Hansen, above n 35, at 543–545 where Hansen recognised the potential symmetry in the approach to corporate nationality between international tax law and investment treaty law.

⁴²⁴ Reuven S Avi-Yonah and Christiana HJI Panayi *Rethinking Treaty-Shopping: Lessons for the European Union* (Michigan Law Public Law and Legal Theory Working Paper Series, Working Paper No 182, 4 January 2010) at 2.

⁴²⁵ Krishna, above n 46, at 130.

available to the MNE if it structured through a more direct route between two countries.

As double tax treaties only apply to residents of contracting states, to take advantage of a tax treaty necessarily involves measures by individuals and corporate entities to affect their residence for treaty purposes.⁴²⁶ Corporate residence in tax parlance is synonymous with “nationality” in an investment treaty context.⁴²⁷

... tax residence for corporations and other entities typically depends on the place of their effective management or their incorporation in the case of corporations ... the tax residence of a corporation or other entity can be established with little or no economic presence in the relevant state.

Double tax treaty jurisprudence takes a substantive approach to issues of nationality by means of interpretation of tax treaty terms to require a genuine participation in the commercial enterprise and/or the extra-treaty application of a broad anti-abuse principle which looks to commercial realities as opposed to formal compliance with treaty jurisdictional criteria. As explained in this thesis, this is also the correct approach in investment treaty law.

This Chapter first explains the synchronicity of treaty shopping issues in the two fields in more detail. It then traverses the substance over form approach to treaty shopping in tax treaty jurisprudence. Finally, the substantive tax treaty approach is promoted as applicable to the investment treaty law context.

6.2 The parallel treaty shopping issues of double taxation treaties and investment treaties

Double tax treaties are bilateral instruments that allocate the right to tax money flows between contracting states. There are approximately 3,000 such

⁴²⁶ David G Duff “Responses to Treaty Shopping: A Comparative Evaluation” in Michael Lang and others *Tax Treaties: Building Bridges between Law and Economics* (IBFD, Amsterdam, 2010) 75 at 76–77. See also H David Rosenbloom “Tax Treaty Abuse: Policies and Issues” (1983) 15 *Law & Pol Int Bus* 763 at 766.

⁴²⁷ Duff, above n 426, at 76 (citations omitted).

treaties in force,⁴²⁸ most of which are modeled on the OECD Model Convention on Income and on Capital.⁴²⁹ The OECD Model Convention is supplemented by an official Commentary (OECD Commentary), which operates as soft law to guide interpretation of Model tax treaties.

Double tax treaties reduce withholding tax levied by the source state (the state in which the income is earned or derived) on passive income such as dividends, interest and royalties, provided that the income is paid to an entity resident in a state that is a party to a double tax treaty with the source state. Depending on the terms of the particular treaty, income may be remitted offshore without deduction of withholding tax, or it is deducted at a reduced rate; other times withholding tax is paid to the source state and the payee applies to the source state tax authority for a refund in whole or part.

Differences in domestic tax laws and the quantum of withholding tax benefits accessible under various double tax treaties create an incentive for treaty shopping by manipulation of the nationality of the recipient of the passive income. For example, income payable upstream to a parent company in Country A may be channeled through a subsidiary company in Country B because Country B is party to a tax treaty with the source state of the income. Country B will be a jurisdiction that does not levy withholding tax on outgoing payments or has a beneficial tax treaty with Country A. Thereby, the tax incurred by the revenue stream will be less when paid to the parent through the Country B subsidiary than if it was paid direct from the source state to the parent.

There are clear parallels between treaty shopping pursuant to tax treaties and investment treaties. Both exist to encourage international trade and investment by, in turn, ameliorating tax liability and political risk attendant to foreign commercial activity. The foreign nature of the activity is a pre-condition to the benefits offered to investors by tax and investment treaties. That requirement leads to the possibility in both scenarios of manipulation to attain the requisite foreign character, i.e. treaty shopping.

⁴²⁸ At 75. A similar number to current bilateral investment treaties.

⁴²⁹ OECD Committee on Fiscal Affairs *Model Tax Convention on Income and on Capital: Full Version* (OECD Publishing, Paris, 2014).

As in the case of investment treaties, tax treaty shopping is facilitated by the ease of use of incorporation or effective management criteria in tax treaties to establish a convenient corporate nationality. Further, most double tax treaties do not contain specific limitations (denial or limitation of benefit clauses) on the ability of third-country residents to treaty shop.⁴³⁰

The issue arising from corporate maneuvering in the tax field, is therefore the same as that explored in this thesis in respect to investment treaties:⁴³¹

... [w]ho should be entitled to the benefits of a bilateral treaty? Generally, only the residents — and in some cases, nationals and citizens — of a state that is a party to a treaty should derive benefits from the treaty. What happens if the taxpayer interposes an entity that becomes resident in the particular country solely for the purpose of benefitting from its provisions?

In a tax context, there is a tension between the principle that any person may arrange his affairs so that his taxes are as low as possible,⁴³² and the underlying structure of bilaterally negotiated treaties, which reflect the intention of the parties as to who may derive benefits from a particular treaty.⁴³³ In the same way, the liberty to structure the ownership or control of an investment in a foreign country to achieve the protection of a bilateral investment treaty is met by the tension as to whether the contracting treaty states intend benefits to be afforded to holding companies that may exist only to take advantage of the treaty's existence.

The difference between investment treaty and tax treaty approaches to the treaty shopping issue is that, contrary to the literal approach of the majority of investment treaty tribunals, tax courts in several jurisdictions consider the object and purpose of tax treaties to require a substantive approach to the application of jurisdictional provisions. This approach is examined in Chapter 6.3 below, and promoted as the correct approach for investment treaty law in Chapter 6.4.

⁴³⁰ Krishna, above n 46, at 132.

⁴³¹ At 130.

⁴³² A principle enunciated on either side of the Atlantic by Justice Learned Hand in *Helvering v Gregory* 69 F 2d 809 (2d Cir 1934) at 810 and Lord Tomlin in *Inland Revenue Commissioner v Duke of Westminster* [1936] AC 1 (HL) at 16.

⁴³³ See Krishna, above n 46, at 130.

6.3 Substance over form approach to treaty shopping in tax treaty cases

Domestic courts and revenue authorities recognise, expressly or implicitly, the application of an inherent anti-abuse principle to combat treaty shopping by the use of intermediary “conduit” companies. The substantive approach manifests in a number of ways: by purposive interpretation of treaty terms; the application of an implied anti-abuse mechanism; and a search for the real beneficiary of the corporate arrangement.

Purposive interpretation

Aiken Industries,⁴³⁴ and *Revenue Ruling 84-153*,⁴³⁵ illustrate interpretation of existing terms of a tax treaty in a substantive sense. In each case conduit companies that complied with tax treaty incorporation requirements were interposed into revenue streams to access a favourable double tax treaty.

Aiken was a United States company owned by Ecuadorian Limited, a company incorporated in the Bahamas. Ecuadorian loaned Aiken money. Because there was no double tax treaty between the United States and the Bahamas, Aiken was liable for withholding tax on interest payments made to Ecuadorian. To avoid this liability by taking advantage of the United States-Honduras Double Tax Treaty,⁴³⁶ Ecuadorian interposed a Honduran company named Industrias in the loan transaction to receive the interest payments from Aiken and pass them on to Ecuadorian.⁴³⁷

Industrias complied with the Treaty definition of a qualifying Honduran corporation. Nevertheless, the United States Tax Court held that the arrangement was not in accordance with the object and purpose of the Treaty. The Court’s reasoning focused on art 4 of the Treaty which exempted payments “*received by a ... corporation of the other contracting state*”.⁴³⁸ The Court interpreted the words “received by” in a substantive sense to “refer not merely to the obtaining of physical

⁴³⁴ *Aiken Industries Inc v Commissioner of Internal Revenue* 56 TC 925 (1971).

⁴³⁵ United States Internal Revenue Service Revenue Ruling 84-153, 1984-2 CB 383.

⁴³⁶ United States-Honduras Double Tax Treaty (signed 25 June 1956).

⁴³⁷ Article 4 permits remission of interest from the United States to Honduras without deduction of withholding tax.

⁴³⁸ United States-Honduras Double Tax Treaty, art 4 (emphasis added).

possession on a temporary basis ... but contemplate[s] complete dominion and control over the funds”.⁴³⁹

Industrias did not “receive” the interest payments within the meaning of the Treaty because it did not receive the interest in its own right, but only as an agent or conduit obliged to transmit the funds to its parent company in the Bahamas.⁴⁴⁰ Industrias was required to have a commercial reason to exist in the revenue chain, other than access to the tax treaty, to meet that requirement. This reasoning bears close resemblance to the way in which the principles of agency are used at common law to disregard the corporate veil as explained in Chapter 4. The conduit company, although lawfully incorporated, is treated as an agent with no substantive legal effect where it does not conduct its own business in a real economic sense, but rather is a “creature” (as per *Adams v Cape*⁴⁴¹) of its parent.

In much the same way, the United States Revenue Service refused a tax exemption in *Revenue Ruling 84-153* based on the United States-Netherlands Tax Treaty provision,⁴⁴² which exempted revenue from US sources “*derived ... by a resident or corporation of the Netherlands*”.⁴⁴³ In this case, a United States corporation interposed a Dutch subsidiary between it and European bondholders. Interest payments direct from a US company to European bondholders would be taxed. But the same payments through a Dutch subsidiary would not. The US company paid interest to the Dutch subsidiary for distribution to bondholders, less one per cent margin.

The subsidiary met the incorporation requirements of the Treaty to qualify as a corporation of the Netherlands. However, despite the one per cent margin earned by the subsidiary, the transaction lacked “sufficient business or economic purpose to overcome the conduit nature of the transaction”.⁴⁴⁴ As in *Aiken*, the Revenue Service imported the concept of commercial purpose into the Treaty by a substantive interpretation of the words “*derived ... by*”. Temporary possession of interest to be paid to bondholders without a commercial reason other than procurement of tax

⁴³⁹ *Aiken*, above n 434, at 933.

⁴⁴⁰ At 934.

⁴⁴¹ *Adams*, above n 283, at 543.

⁴⁴² United States-Netherlands Income Tax Convention (signed 29 April 1948).

⁴⁴³ Article 8 (emphasis added).

⁴⁴⁴ *Revenue Ruling 84-153*, above n 435, at 384.

treaty benefits was insufficient to have *derived* income for the purpose of the Treaty in a substantive sense.⁴⁴⁵

Double tax treaty jurisprudence achieves a substantive check on jurisdiction by taking a purposive interpretative approach to treaty language, regardless of the absence of any express substantive qualifiers. Terms such as “received” and “derived” are treated as requirements in an true economic sense; a mere conduit which meets nationality criteria formalities for the purpose of obtaining treaty benefits is not sufficient to claim those benefits even though there is nothing express in the tax treaties (in these cases) to exclude such companies.

The same approach is applicable to the investment treaty concepts of “investor”, “national”, or “ownership” and “control” of an investment. As will be further discussed in Chapter 11, these terms are amenable to a purposive interpretative approach in the same way as ‘received’ and ‘derived’ have been in tax treaty law, regardless of the existence of express language requiring a substantive approach.

Implied anti-abuse principle

Other tax treaty cases such as *ApS*,⁴⁴⁶ and *Yanko-Weiss Holdings*,⁴⁴⁷ have imported a substantive approach by reference to an anti-abuse principle found to be inherent in double tax treaties.

ApS involved the application of the Switzerland-Denmark Double Tax Treaty.⁴⁴⁸ A Danish company, A Holding, applied for a refund of withholding tax levied on dividends paid to it by its Swiss subsidiary. A Holding was a shell company. It was 100 per cent owned by a company incorporated in the Channel Islands.

The Federal Court of Switzerland held that A Holding did not carry out a real or active economic activity and was interposed solely for the purpose of obtaining the benefits of the Switzerland-Denmark Double Tax Treaty.⁴⁴⁹ That was an abuse

⁴⁴⁵ At 384.

⁴⁴⁶ *A Holding ApS v Federal Tax Administration* (2005) 8 ITLR 536 (Federal Court of Switzerland).

⁴⁴⁷ *Yanko-Weiss Holdings 1 (1996) Ltd v Holon Assessing Office* (2007) 10 ITLR 254 (District Court of Tel Aviv).

⁴⁴⁸ Switzerland-Denmark Double Taxation Convention (signed 23 November 1973).

⁴⁴⁹ *A Holding ApS*, above n 446, at 560.

of the Treaty, despite the absence of any explicit anti-abuse mechanism. The Court read an anti-abuse doctrine into the Treaty as “part of the principle of good faith”.⁴⁵⁰

This limitation on the literal application of express treaty terms by means of the principle of good faith or abuse of right is the same approach as that recognised in Chapter 4 as akin to the role of the principle of abuse of right in civil law systems, and promoted as appropriate in the de-centralised and primordial circumstances of international law.

Similarly, in *Yanko-Weiss*, a company originally incorporated in Israel changed its place of management to Belgium and registered as a Belgian company to access benefits under the Israel-Belgium Double Taxation Convention.⁴⁵¹ The District Court of Tel Aviv found that tax treaties must be utilised in “good faith and in an acceptable manner”,⁴⁵² whether they include express provisions to that effect or not. Such treaties “are to be read as if they contain limitation on benefits provisions where it is proven that there exists improper use ... according to domestic and international law”.⁴⁵³

The Court’s reasoning in *Yanko-Weiss* is exactly what is ultimately proposed in this thesis in respect of jurisdiction *ratione personae* in investment treaty law. The Court noted that while its approach was consistent with the interpretation of the OECD Model Convention and its Commentary since 2003, it considered that an anti-abuse principle existed “even earlier in light of the language of the provisions of the Vienna Convention and the doctrine of good faith”.⁴⁵⁴

If this is so for tax treaties, there is no reason why the same principle should not apply to investment treaties. The inherent applicability of an anti-abuse principle to investment treaties through the portal of good faith interpretation per the Vienna Convention and international law more generally is discussed further in Chapters 10 and 11.

⁴⁵⁰ At 557.

⁴⁵¹ *Yanko-Weiss*, above n 447, at 545. See the Israel-Belgium Double Taxation Convention (signed 13 July 1972).

⁴⁵² *Yanko-Weiss*, above n 447, at 544.

⁴⁵³ At 545.

⁴⁵⁴ At 546.

Beneficial ownership

A further means by which domestic tax authorities and courts have interpreted tax treaties to import a substance over form analysis of corporate structures designed to access treaty benefits is the concept of “beneficial ownership”. The phrase “beneficial owner” was first included in the OECD Model Convention in 1977 specifically as an anti-abuse mechanism to target treaty shopping by use of intermediate holding companies.⁴⁵⁵

The concept of beneficial ownership appears in the three articles of the OECD Model Convention that concern passive income—arts 10 (dividends), 11 (interest) and 12 (royalties). Each article limits the ability of the source state to levy tax if the beneficial owner of the income is a resident of the other contracting state.⁴⁵⁶

There is no definition of “beneficial owner” in the OECD Model Convention. Unsurprisingly perhaps, there have been numerous cases and commentary concerning what, if anything, the qualifier “beneficial” adds to the requirement of ownership.

The answer that has emerged in several jurisdictions is that *beneficial* ownership requires ownership in a substantive economic sense, as opposed to a formal legalistic sense. In other words, the intent of the concept of “beneficial ownership” is to recognise the recipient of passive income who is a resident of a contracting state only if the recipient is the real or true owner of the income as opposed to a mere nominee, agent or conduit. There is no bright line test; it is a determination of fact as to the real – not merely legal – role of the conduit by examination of the substance of its rights and obligations in the corporate structure.⁴⁵⁷

⁴⁵⁵ OECD Committee, above n 429, at [12] (commentary on Article 10), [9] (commentary on Article 11) and [4] (commentary on Article 12) (emphasis added). See also Jain, above n 49, at 40–41.

⁴⁵⁶ OECD Committee, above n 429, at 31. For example, art 11 reads in part: “interest arising in a Contracting State may also be taxed in that State according to the laws of that State, but if the beneficial owner of the interest is a resident of the other Contracting State, the tax so charged shall not exceed 10 per cent of the gross amount of the interest.”

⁴⁵⁷ Krishna, above n 46, at 140–143; Craig Elliffe “Beneficial Ownership and Double Tax Agreements” (paper presented at the 2012 NZICA Tax Conference, Wellington, 26–27 October 2012) at 18–22; Duff, above n 426, at 86–90; David G Duff “Beneficial Ownership: Recent Trends” in Michael Lang and others *Beneficial Ownership: Recent Trends* (IBFD, Amsterdam, 2013) 1 at 11–22; and Jain, above n 49, at 275–290 and 295–308.

Commentary on arts 10, 11 and 12 of the OECD Model Convention is periodically updated to reflect relevant jurisprudence and to provide guidance for domestic courts and tax authorities applying tax treaties based on the Model Convention.⁴⁵⁸

The Commentary to arts 10, 11 and 12 makes clear that it would be inconsistent with the object and purpose of tax treaties to grant tax relief to an entity which “simply acts as a conduit for another person who in fact receives the benefit of the income concerned” and accordingly.⁴⁵⁹

... a conduit company cannot normally be regarded as the beneficial owner if, though the formal owner, it has as a practical matter, very narrow powers which render it, in relation to the income concerned, a mere fiduciary or administrator acting on account of the interested parties.

Again, the close alignment of this approach at tax treaty law with the way in which agency law at common law and the principle of abuse of right permit disregard of the corporate veil is apparent.

In his analysis of the beneficial ownership test in conduit company cases, Jain concludes that the beneficial ownership clause indicates that courts should apply a substantive analysis and that, “the term ‘beneficial owner’ does not carry a meaning of its own. It simply reminds courts and tax authorities to adopt a substantive approach”.⁴⁶⁰ The breadth of the beneficial ownership test is now such that, according to Jain, it “operates as an anti-avoidance test, not as a test of ownership”.⁴⁶¹ “Beneficial owner” has essentially become a shorthand reference to a substance over form treaty abuse test focused on the economic position and the relationship of the parties involved.⁴⁶²

Recent judicial decisions in various jurisdictions also reflect a practical substantive approach to the concept of beneficial ownership generally and the

⁴⁵⁸ OECD Committee on Fiscal Affairs *Model Tax Convention on Income and on Capital 2017: Full Version* (OECD Publishing, Paris, 2019).

⁴⁵⁹ At [12.2]–[12.3] (emphasis added, citations omitted).

⁴⁶⁰ Jain, above n 49, at 290.

⁴⁶¹ At 306.

⁴⁶² See Elliffe, above n 457, at 19; and Duff “Beneficial Ownership: Recent Trends”, above n 457, at 23.

utilisation of intermediary companies to access benefits of tax treaties in particular. For example, in *Indofood*,⁴⁶³ the English Court of Appeal examined whether an Indonesian company could access the benefits of the Indonesia-Netherlands Double Tax Convention by incorporating a Dutch subsidiary to receive interest payments on bonds from its Indonesian parent company and distribute those payments to European bondholders.⁴⁶⁴ This scenario is the same as the situation in *Aiken*, although the relevant Treaty in *Indofood* included a beneficial ownership requirement.

The principal issue was whether the Dutch subsidiary company was the beneficial owner of the interest received from its Indonesian parent. The Court explained that, “the concept of beneficial ownership is incompatible with that of the formal owner who does not have ‘the full privilege to directly benefit from the income’”.⁴⁶⁵ While the proposed Dutch company might own the funds received in a formal sense, it could not be the beneficial owner because its sole function in “commercial and practical terms” was to gain the tax benefit of the Treaty by acting as a conduit of the interest income.⁴⁶⁶

In *Indofood*, the requirement of beneficial ownership was express in the relevant treaty.⁴⁶⁷ Of particular interest to this thesis, however, are tax courts which have regarded a beneficial ownership concept as implicit in tax treaties in the same way and to the same effect as those cases discussed above which imply an inherent anti-abuse test. Both methods lead to the same ultimate question: whether the intermediary company has a real commercial reason to exist in the revenue chain beyond access to tax treaty benefits. Typical cases are *Re V SA*,⁴⁶⁸ and *N AG*.⁴⁶⁹

In *V SA*, two British companies incorporated V SA in Luxembourg. V SA owned a Swiss company, I SA. Funds from I SA flowed through V SA to the British

⁴⁶³ *Indofood International Finance Ltd v JP Morgan Chase Bank NA London* [2006] EWCA Civ 158, [2006] BTC 8003. Another example that will be related in a separate context (see Chapter 9) is *Ministre de L'Economie, des Finances et de l'Industrie v Société Bank of Scotland* (2006) 9 ITLR 683.

⁴⁶⁴ Netherlands-Indonesia Double Tax Agreement (entered into force 1 January 2004).

⁴⁶⁵ *Indofood*, above n 463, at [42].

⁴⁶⁶ At [43]–[44].

⁴⁶⁷ As it is in many other double tax treaties: see for example in *Bank of Scotland*, above n 463, which concerns the United Kingdom-France Double Taxation Treaty (signed 22 May 1968), art 9(6)–9(7).

⁴⁶⁸ *Re V SA* (2001) 4 ITLR 191 (Swiss Federal Commission).

⁴⁶⁹ *N AG v Regional Tax Officer for Upper Austria* (2000) 2 ITLR 884 (Supreme Administrative Court).

parent companies. The sole purpose of V SA was to take advantage of the benefits of the Switzerland-Luxembourg Double Tax Treaty.⁴⁷⁰

The Swiss Federal Commission (SFC) found that, “the requirement of an effective beneficiary is implicit in double taxation conventions and does not require an express reference”.⁴⁷¹ It then examined the corporate structure, the flow of funds and the reasons for the existence of the arrangement. It noted that V SA’s only significant asset was its shareholding in ISA and that all of the dividend income received by V SA from ISA was paid on to the British companies. The Commission did not allow a tax exemption. V SA was “manifestly only a conduit company”,⁴⁷² because the arrangement was solely motivated by tax mitigation reasons.⁴⁷³

Similarly, N AG was a Swiss company interposed between an Austrian company and the undisclosed owners of N AG who were resident in a third jurisdiction⁴⁷⁴ to access the Austria-Switzerland Double Tax Treaty.⁴⁷⁵

The Austria-Switzerland Double Tax Treaty did not contain an anti-abuse clause. Nor did it specifically require the recipient of the income to be its beneficial owner. However, the Supreme Administrative Court of Austria considered it appropriate to read in the beneficial owner concept to the Treaty,⁴⁷⁶ and the object and purpose of the Treaty required a substantive economic approach to interpretation.⁴⁷⁷

Where a treaty does not contain specific provisions on an economic approach and attribution of economic interests a state accordingly has the right to protect itself against an unjustified exploitation of the tax benefits provided for in the Convention

⁴⁷⁰ Switzerland-Luxembourg Double Taxation Convention (signed on 21 January 1993), art 10(2)(a) and (b). *V SA*, above n 468, at 209.

⁴⁷¹ At 208.

⁴⁷² At 210.

⁴⁷³ At 212.

⁴⁷⁴ *N AG*, above n 469.

⁴⁷⁵ Switzerland-Austria Double Taxation Convention (signed 30 January 1974).

⁴⁷⁶ *N AG*, above n 469, at 899.

⁴⁷⁷ At 901.

As in *Aiken*, the Court concluded that the object and purpose of double tax treaties justified a substantive economic approach to ownership regardless of the absence of specific anti-abuse provisions in a particular treaty.

Jain analyses *NAG* and other cases from various jurisdictions that take the same view.⁴⁷⁸ He concludes:⁴⁷⁹

... because a double tax convention is an agreement between two countries, one of its objects and purposes is to limit its benefits to residents of the contracting states. For this reason, regardless of whether its provisions contain specific anti-abuse clauses, a treaty should be interpreted in a substantive economic sense in order to prevent residents of non-contracting states from improperly obtaining tax benefits it provides.

The above passage is directly applicable to investment treaties in two critical senses. First, as with tax treaties, the object and purpose of investment treaties are not limited to the encouragement of economic activity. There are other objects and purposes, such as to limit the benefits of the treaty to residents or nationals of the contracting states. Treaties must be interpreted in a way that accommodates or balances various purposes. This point will be further discussed in respect of investment treaties in Chapter 8.

Secondly, and accordingly, the beneficiaries of a treaty must be identified by use of a substantive interpretation, irrespective of whether a treaty expressly contains anti-abuse provisions or otherwise limits the circle of entities which may access it. Chapter 6.4 makes the argument that jurisdiction *ratione personae* of investment treaties should be approached in the same way as the jurisdictional approach to tax treaties described above.

⁴⁷⁸ There are several other cases some involving complex and extended corporate structures, which reach the same conclusion. For example, *X-group 1979* (1979) 48 Archives de droit fiscal Suisse 271 (The Federal Tax Administration, Switzerland); *Arabian-group 1984* (1984) BGE 110 Ib 287; *Del Commercial Properties Inc v Commissioner of Internal Revenue* TC Memo 411 (1999); *Del Commercial Properties Inc v Commissioner of Internal Revenue Service* 251 F 3d 210 (DC Cir 2001); and *Lone Star Fund III (Bermuda) LP v Director of Yeok-sam Department of Revenue* (2012) 14 ITLR 953.

⁴⁷⁹ Jain, above n 49, at 39–40.

6.4 A substantive economic approach to abuse of investment treaties: is there symmetry with the substance over form proviso in tax treaty jurisprudence?

The problem addressed by this thesis is the same in respect of investment and tax treaties: entities of non-party states seek to gain access to the benefits of bilateral treaties that lack effective anti-abuse provisions by formal fulfillment of treaty nationality criteria.

This sub-chapter discusses whether there are differences in the considerations concerning treaty shopping in tax treaty law and the Nationality Controversy in investment treaty law which might explain why the solution in the respective fields are diametrically opposed. It concludes that there is close symmetry between the arguments and considerations relevant to treaty shopping in each field and that the substantive approach to jurisdiction *ratione personae* in tax treaty law is applicable to the problem in investment treaty law.

Schill notes in a passing sentence that the considerations regarding shopping for investment treaties “are arguably also different from considerations regarding the taxation of corporate companies” because questions of tax evasion through corporate structuring may create an interest for the company’s home state in such maneuvers, whereas with investment treaties the home state is agnostic, or at least is interested only so far as to ensure its national’s investments are effectively protected.⁴⁸⁰

That may be so in respect of any individual case, but tables may turn when the home state in one case is the respondent host state in the next. All contracting states, host and home alike, have a real interest in ascertaining the parameters of their obligations and the extent to which their treaty can be accessed by corporate maneuvering.

The interest of the host state in any particular case is the same in tax and investment treaty contexts: the proper qualification of a claimant to the benefits of the instrument. A home state may have an interest in potential tax evasion in an individual case as Schill points out, but that depends on which state has the right to

⁴⁸⁰ Schill, above n 7, at 236.

tax under the particular tax treaty. If the home state is not losing tax revenue, then it is in the same position as the home state in an investment treaty context; it has a general interest in treaty construction only.

A review of the arguments concerning the legitimacy of treaty shopping in tax treaty law reveals that in fact the relevant considerations are almost identical to those in investment treaty law.

First, the general purpose of tax and investment treaties are the same. Tax treaties exist to encourage capital flows and international investment by reducing tax barriers;⁴⁸¹ investment treaties encourage the same object by protecting investments from arbitrary regulatory action and providing recourse to a neutral dispute resolution process.

Secondly, the Vienna Convention governs the interpretation of both tax treaties and investment treaties. In particular, cases in both fields refer to and rely on art 31(1) of the Vienna Convention.⁴⁸² While literal approach investment treaty tribunals give primacy to the ordinary meaning of treaty definitions, tax courts limit the ordinary meaning of jurisdictional terms if it offends the object and purpose of jurisdictional provisions to prevent improper access to treaty benefits by third parties.

Thirdly, the prospect of a formal constructionist approach such as taken in the literal investment treaty cases discussed in Chapter 3.2 above has also been ventilated in tax treaty law on the basis that a literal approach is more consistent with facilitating trade than a restrictive substantive approach that seeks to limit treaty benefits to genuine residents of a contracting state.

The 1988 United Nations Tax Treaty Shopping Report suggested there may be public benefits in permitting treaty shopping because one of the general objectives of tax treaties is to promote freer flows of international trade and investment; it should not matter how that object is achieved.⁴⁸³

⁴⁸¹ See OECD Committee, above n 429, at [7]: “The principal purpose of double taxation conventions is to promote, by eliminating international double taxation, exchanges of goods and services, and the movement of capital and persons.”

⁴⁸² Vienna Convention on the Law of Treaties. For example, in the tax treaty field see *Indofood*, above n 463, at [24]; and *V SA*, above n 468, at 208. See also Philip Baker *Double Taxation Conventions and International Tax Law* (2nd ed, Sweet and Maxwell, London, 1994) at 21.

⁴⁸³ United Nations Ad Hoc Group of Experts on International Co-Operation in Tax Matters *Contributions to international co-operation in tax matters: Treaty shopping, thin capitalization, co-*

This may particularly be so for developing countries. The Supreme Court of India declared that tax treaty shopping is a “necessary evil” for developing economies on the basis that “developing countries allow treaty shopping to encourage capital and technology inflows ... [t]he loss of tax revenues could be insignificant compared to the other non-tax benefits to their economy.”⁴⁸⁴

Fourthly, in the same way as the investment treaty Tribunals in *AdT*, *Autopista*, *Saluka*, and *Rompetrol*,⁴⁸⁵ some tax law commentators have expressed concern that a substantive approach leads to excessive uncertainty. Vann argues that such an approach will allow “essentially discretionary” applications of treaty benefits by tax authorities.⁴⁸⁶ The renowned tax academic Philip Baker warned the “broad brush, substance approach [in, for example, *Indofood*] was bound to lead to uncertainty”.⁴⁸⁷

But the answer to that point in tax treaty law has been reference to the need to interpret jurisdictional provisions in light of the object and purpose of tax treaties to prevent circumvention of the bargain struck between treaty partners. This is the approach promoted in the substantive approach investment treaty cases in Chapter 3.3 and discussed further in Chapter 8. According to Vogel, for example:⁴⁸⁸

... if a contracting state need not tolerate a circumvention of a treaty by the other contracting state, it would be absurd for it to be committed to tolerate circumvention by a private person and to apply the treaty in a strictly formal way notwithstanding such circumvention. Consequently, [tax treaties] are subject to a general “substance v. form proviso” based on international law.

Accordingly, considerations of treaty object and purpose, interpretative techniques, and the desirability of reasonable certainty, are evident in the treaty

operation between tax authorities, resolving international tax disputes (United Nations Department of International Economic and Social Affairs, New York, 1988) at 7.

⁴⁸⁴ *Union of India v Azadi Bachao Andolan* (2003) 263 ITR 706 (India SC) at 753.

⁴⁸⁵ See Chapter 3.2.

⁴⁸⁶ Richard Vann *Beneficial Ownership: What Does History (and maybe policy) Tell Us* (Sydney Law School, Legal Studies Research Paper No 12/66, September 2010) at 31.

⁴⁸⁷ Philip Baker “Beneficial Ownership: After *Indofood*” (2007) 7(1) GITC Review 15 at 24.

⁴⁸⁸ Ekkehart Reimer and Alexander Rust (eds) *Klaus Vogel on Double Taxation Conventions* (2nd ed, Kluwer, London, 1990) at [121]. To the same effect see Engelen, above n 46, at 36.

shopping debate in both tax treaty and investment treaty law. Yet, contrary to the predominant investment treaty approach, the prevailing view in tax treaty law is that a substantive approach to treaty shopping and corporate nationality is required.

The OECD views treaty shopping as invidious because access to tax treaty benefits by persons who are not residents of contracting states upsets the reciprocal “balance of sacrifices” that underlies the bargain struck by the contracting states.⁴⁸⁹ The consequences include avoidance and evasion of taxes and a weaker incentive for states to conclude further tax treaties. Li explains that the basis of any treaty is “mutual concessions” and neither contracting state would relinquish its tax revenue without a corresponding benefit. But, “[i]f the benefits of the treaty are deliberately channeled to outsiders, it defeats the bargain.”⁴⁹⁰ The same concerns arise in investment treaty law as will be discussed in Chapter 8.

The 2003 revisions to the OECD Commentary direct that “a proper construction of tax conventions” in the light of their object and purpose, “allows [states] to disregard abusive transactions, such as those entered into with the view to obtaining unintended benefits under the provisions of these conventions”.⁴⁹¹ The OECD Commentary to art 1 concludes that the benefits of tax treaties should not be available “where a main purpose for entering into certain transactions or arrangements” is to access favourable tax treatment, as such would be “contrary to the object and purpose of the relevant provisions”.⁴⁹²

For this reason, Jain contends that while the general objective of tax treaties is to facilitate capital flow by mitigating double taxation, a more specific object of a tax treaty is to “prevent its improper use by limiting its benefits to residents of its contracting states”,⁴⁹³ at least subject to explicit words to the contrary. The existence of general and specific objectives was recognised in the *V SA* case discussed above. In that case the SFC explained that double tax treaties are primarily intended to avoid double taxation, however, only:⁴⁹⁴

⁴⁸⁹ OECD Committee, above n 429, at R(6)-4; and Duff, above n 426, at 79.

⁴⁹⁰ Jinyan Li “Beneficial Ownership in Tax Treaties: Judicial Interpretation and the Case for Clarity” in Anuschka Bakker and Sander Kloosterhof (eds) *Tax Risk Management: From Risk to Opportunity* (IBFD, Amsterdam, 2010) 187 at 192.

⁴⁹¹ OECD Committee, above n 429, at [9.3].

⁴⁹² At [9.5].

⁴⁹³ Jain, above n 49, at 38.

⁴⁹⁴ *V SA*, above n 468, at 210.

... residents of a contracting state are covered by these conventions ...
[d]ouble taxation conventions do not have as their object to permit persons
who are not residents of a contracting state to benefit from the advantages
of the convention.

The Austrian Supreme Administrative Court in *N AG* also considered conduit company arrangements to “be incompatible with the goal and purpose of the convention”. Accordingly, an “economic approach” to the identification of qualifying claimants was essential. A state had the right to protect itself against “unjustified exploitation of tax benefits”.⁴⁹⁵ The specific purpose of jurisdictional provisions in investment treaties is discussed in Chapter 8 and found to mandate the same approach to treaty shopping in investment treaty law.

The international tax jurisprudence reviewed above, together with the OECD Commentary, reveals that the use of conduit companies to access tax treaty benefits is countered by techniques of treaty interpretation to justify a substantive approach despite concerns about uncertainty of application. The terminology used by different national courts in this respect differs. Some refer implicitly or explicitly to an anti-abuse principle inherent in tax treaties; others approach the issue through the tax treaty concept of beneficial ownership; while others look to restrict the meaning of qualifiers within a specific treaty such, as in *Aiken*, that the remitted funds be “received by” the true owner of the income and not an intermediary conduit.

In the context of intermediary “conduit” companies, the substance-over-form approach aims to discern whether an intermediary company has a substantive—that is, genuine or real—commercial purpose in the corporate structure, as opposed to an role predicated on access to tax treaty benefits.

This substantive approach is the correct one to apply to investors seeking to benefit from the provisions of investment treaties also. It is difficult to see why, when it comes to identifying the rightful recipients of treaty benefits, the literal approach of investment tribunals is so different to that employed under double tax treaties. The subject matter of both species of treaty is commercial in nature—tax

⁴⁹⁵ *N AG*, above n 469, at 900.

and investments. Both species of treaty have the same general purpose and offer economic incentives—tax mitigation and investment protection—in return for the hope of increased investment.

Yet, the substantive economic approach used to define legitimate beneficiaries of double tax treaties is in stark contrast to the literal approach taken by tribunals to determining legitimate investors in investment treaty cases. Business people ought reasonably to expect the interpretative approach taken to nationality in these two parallel fields of bilateral treaty law to be the same; fragmentation of international law should be avoided where possible.

The literal approach to the concepts of “investor”, “national” or ownership and control by investment treaty tribunals is an anomaly. Vogel’s “substance-over-form proviso”,⁴⁹⁶ based on international law and art 31 of the Vienna Convention, must also apply to the identification of qualifying investors pursuant to investment treaties. If so, a substantive approach has the *potential* to restore the balance of sacrifices inherent in investment treaties.

This approach would address the criticism that investment treaties provide a portal for corporates from any country (including the host state) to access treaty protections intended to be limited to the genuine residents of contracting states. An economic approach to the identification of qualifying investors provides a contracting state with the right to protect itself against unjustified exploitation of investment treaty benefits.

The word “potential” in the preceding paragraph is used advisedly. If a substantive economic approach is to apply to prospective investors seeking to avail themselves of the protection of a favourable investment treaty, the next question is: what does a substantive approach entail? That is, how is it to be applied in a principled way?

Substance must be provided to a substantive approach if it is to achieve that potential. Again, tax treaty jurisprudence is a helpful comparison. The substantive economic reality of a corporate structure or transaction has been assessed by tax courts on the basis of factors familiar to investment treaty terminology such as substantial business activity, control, or a holistic view taking into account those

⁴⁹⁶ Reimer and Rust, above n 488, at [121].

factors and other criteria. The specifics of these criteria and the way they have been employed as part of the substance-over-form test in double tax treaty cases are examined in Chapters 9 and 10 below.

7 Comparative 4: investment treaty jurisprudence

7.1 Introduction

This Chapter explains that the approach to attribution of corporate nationality is not, but should be, consistent with the way investment treaty jurisprudence has developed in respect of analogous jurisdictional issues, namely: the approach to determination of the nationality of “foreign control” in the second clause of art 25(2)(b) of the ICSID Convention; the nationality of natural persons; and the approach to the concept of “investment”.

In each case, investment treaty jurisprudence has taken literal compliance with the criteria expressed by contracting states in investment treaties as a presumption of fulfilment, but then applied a substantive economic test as a check to ensure the particular circumstances of each individual case comply with the object and purpose of the ICSID Convention and/or the relevant investment treaty.

This Chapter also explains that many of the literal cases reviewed in Chapter 3 expressly or impliedly undertake inquiries to identify the purpose for the existence of the claimant in the relevant corporate structure as a *de facto* substantive check on the legitimacy of the claimed nationality of putative claimants.

None of the analogous jurisdictional issues above (other than the literal cases) complain of or suffer from an unworkable or impracticable uncertainty or complexity in a substantive assessment. And, while the literal cases rely on uncertainty as a reason to oppose a substantive check, they nevertheless undertake such a check, albeit in a cursory fashion. Accordingly, the discussion about these analogous areas of investment treaty jurisprudence reveals that the arguments made against a flexible substantive approach to corporate nationality—uncertainty and complexity in particular—are not insurmountable obstacles.

The attribution of nationality for the purposes of jurisdiction *ratione personae* is not a special case which demands a literal interpretative treatment. It ought to be approached in the same way as these other jurisdictional gatekeepers to investment treaty coverage and the *de facto* check approach in literal cases ought to be recognised, better defined, and routinely applied.

7.2 Article 25(2)(b) “second clause” cases and the approach to corporate nationality

As explained in Chapter 2, art 25 of the ICSID Convention is the central provision regarding the jurisdiction of the Centre. It is well acknowledged that the purpose of art 25 is to set “outer limits” on the jurisdiction of the Centre,⁴⁹⁷ beyond which states cannot utilise the mechanisms of the Convention. Article 25(2)(b) defines two categories of corporate nationals within the ambit of the Convention: a juridical person with the nationality of a contracting state other than the host state (first clause) and any juridical person with the nationality of the host state but which, because of foreign control, the parties have agreed should be treated as a national of another contracting state (second clause).

The inquiry under each clause is the same: the nationality of a juridical person. In respect of the first clause, it is to ensure the nationality of the juridical person is of a contracting state other than the host state of the investment. In the second clause, what is ultimately at issue is not only the objective existence of foreign control, “but the *nationality of this foreign control*”.⁴⁹⁸

Yet the jurisprudential approaches to the determination of nationality in each clause are different. This sub-chapter explains the substantive approach in second clause cases and contends that there is no basis for a difference in approach.

The approach to nationality in the first clause is the formalistic one typified by the majority in *Tokios* and *Rompetrol* as set out in Chapter 3.2: the literal cases discount any inherent meaning or restriction on attribution of corporate nationality arising out of the ICSID Convention’s requirement for “nationality of a Contracting State” so long as the criteria chosen by the state parties to a treaty are reasonable, in the sense of usual or common. No examination of ownership and control, of the source of investment funds, or of the corporate body’s effective seat is required.⁴⁹⁹

In addition, the majority in *Tokios* held that the “use of a control-test to define nationality of a corporation to *restrict* the jurisdiction of the Centre would be

⁴⁹⁷ See, for example, *IBRD*, above n 216, at [25]; *Vacuum Salt*, above n 248, at [36]; *Broches*, above n 25; and *Tokios (Jurisdiction)*, above n 24, at [25].

⁴⁹⁸ *TSA Spectrum*, above n 30, at [149] (emphasis added).

⁴⁹⁹ *Tokios (Jurisdiction)*, above n 24, at [46]–[52]; *Rompetrol*, above n 24 at [77]–[84]; *Saluka*, above n 24, at [241]; *Yukos*, above n 24, at [416]; and *KT Asia*, above n 24, at [112]–[136].

inconsistent with the object and purpose of Article 25(2)(b)” when this provision has been interpreted to expand jurisdiction *ratione personae*.⁵⁰⁰

The first investment treaty tribunal to address the concept of nationality in the second clause took a formal approach akin to the literal first clause cases. In 1983, the Tribunal in *Amco*⁵⁰¹ declared (without authority) that the concept of nationality under the ICSID Convention is “a classical one, based on ... the place of incorporation and the place of the social seat”, and that the concept of foreign control did not sanction an exception when it comes to determining the nationality of that foreign controller.

More recently, however, the approach of tribunals and commentators to the nationality of the foreign controller in the second clause is that fulfillment of reasonable criteria gives rise to a strong presumption of nationality, but subject to an objective appraisal that they lead to reasonable results in the circumstances. In short, the agreement of the parties is respected so long as sensible criteria lead to reasonable results. To be reasonable, the results must accord in a substantive sense with the object and purpose of the ICSID Convention and/or the instant treaty instrument.

The leading second clause decision is *TSA Spectrum v Argentina*⁵⁰² traversed in Chapter 3.3. To recap briefly, TSA was a company incorporated in Argentina owned by two Dutch companies which were in turn owned by Argentine nationals.

The *TSA* Tribunal recognised that art 25 imposed objective limits to the Centre’s jurisdiction.⁵⁰³ But it supposed that a distinction could be drawn between first and second clause cases on the basis that the nationality requirement in the first clause was a “formal legal criterion”, while the requirement for foreign control in the second clause was a “material or objective criterion” which permitted a substantive inquiry into the reality behind apparent nationality.⁵⁰⁴ The Tribunal

⁵⁰⁰ *Tokios (Jurisdiction)*, above n 24, at [46]–[52].

⁵⁰¹ *Amco*, above n 138 at [14].

⁵⁰² *TSA Spectrum*, above n 30.

⁵⁰³ At [139], where the Tribunal cites *Vacuum Salt Products Ltd v Ghana (Award)* (1994) 9 ICSID Rev 72 at [36]–[38].

⁵⁰⁴ At [140], [144], [147] and [153].

found that the Dutch companies were shells and the real controllers of TSA were the Argentine nationals; hence TSA was not under foreign control.⁵⁰⁵

Because the facts in *TSA* engaged the second clause, the Tribunal was content to distinguish the first clause cases rather than examine the rationale for the difference in approach to nationality in each clause. Nevertheless, it observed that a “strict literal interpretation” based on “formal nationality”:⁵⁰⁶

... may appear to go against common sense in some circumstances, especially when the formal nationality covers a corporate entity controlled directly or indirectly by persons of the same nationality as the host State.

That reasoning applies equally to first and second clause scenarios. Other second clause cases and commentators have taken a two stage approach to the identification of “control” and the nationality of the foreign controller which place significant weight on the parties’ consent to ICSID as expressed in their contract, but recognises the vulnerability of that consent to objective substantive outer limits in art 25. They require a test of reasonableness of result, as well as reasonableness of criteria, in the circumstances of each specific case. The decisions in *Vacuum Salt*,⁵⁰⁷ and *Autopista*⁵⁰⁸ are illustrative.

Vacuum Salt was a Ghanaian company the shares of which were 20 per cent owned by a Greek national. It claimed ICSID jurisdiction under a contract with Ghana. However, the Tribunal found that an agreement to treat *Vacuum Salt* as a foreign national did not *ipso jure* confer jurisdiction because the reference in art 25(2)(b) of the ICSID Convention to “foreign control” set an objective limit beyond which ICSID jurisdiction cannot exist and parties lack power to invoke jurisdiction “no matter how devoutly they may have desired to do so”.⁵⁰⁹

To ascertain where the limit lies, “the authorities are unanimous in placing great weight on the fact of the parties’ consent”.⁵¹⁰ Such agreement was “not likely

⁵⁰⁵ At [153] and [160]–[162].

⁵⁰⁶ At [145].

⁵⁰⁷ *Vacuum Salt*, above n 248.

⁵⁰⁸ *Autopista*, above n 61.

⁵⁰⁹ *Vacuum Salt*, above n 248, at [36].

⁵¹⁰ At [37].

to be found to have been ineffective”.⁵¹¹ Nevertheless, the Tribunal concluded that the existence of consent of the parties to ICSID jurisdiction can only raise a rebuttable presumption that the criteria of art 25(2)(b) have been satisfied.⁵¹² In the present circumstances, the Tribunal concluded that the parties’ consent to jurisdiction went beyond the objective outer limits of art 25 and declined jurisdiction because the Greek national’s minority shareholding and sporadic management roles were insufficient to amount, objectively speaking, to foreign control.⁵¹³

There is nothing unreasonable per se in the criteria chosen by the parties in *Vacuum Salt*—shareholding and management responsibilities—to determine foreign control. Indeed, these are common factors relevant to determine corporate control, just as place of incorporation is a common means of establishing corporate nationality. What was unreasonable was the application of these criteria to the particular circumstances of the case. According to *Vacuum Salt*, it is not sufficient to argue that a criterion is reasonable because it is agreed or that it is common. A particular criterion—such as shareholding, management responsibility, or place of incorporation to attribute corporate nationality, may effect a reasonable result in one case and not in another.

As Amerasinghe put it, the parties’ agreement as to foreign nationality and foreign control raises “a strong presumption that there was adequate foreign control on which to predicate a foreign nationality”.⁵¹⁴ But, where the facts belie an agreement to the contrary, then it can be concluded that the parties are purporting to use the ICSID Convention for purposes for which it was not intended.⁵¹⁵

The same approach is apparent in *Autopista*, although it is more apparent from what the Tribunal actually did, rather than the words it used.

Autopista was a company incorporated in the respondent state—Venezuela. A Mexican company, ICA Holding, ultimately owned *Autopista*,⁵¹⁶ but during the life of the investment a United States company called ICA Tech was interposed between *Autopista* and ICA Holding. The Venezuelan authorities approved the

⁵¹¹ At [37].

⁵¹² At [38].

⁵¹³ At [55].

⁵¹⁴ Amerasinghe, above n 125, at 264–266.

⁵¹⁵ At 266. See also *Vacuum Salt*, above n 248, at [54]; and *TSA Spectrum*, above n 30, at [160].

⁵¹⁶ *Autopista*, above n 61.

restructure. The United States is a Convention state. Mexico is not. Venezuela had expressly agreed with ICA Holding that foreign control for ICSID Convention purposes would be determined by a majority shareholding rather than by an inquiry into the nationality of the real, effective or ultimate controller of Autopista.⁵¹⁷ Nevertheless Venezuela argued that the ICSID Convention required identification of the actual controller—the Mexican parent—not simple legal control by shareholding.⁵¹⁸

The Tribunal reasoned that the parties to the ICSID Convention purposely left the concepts of “foreign control”, “nationality” and “investment” to the parties to define and that any reasonable definition of such terms expressed by the parties to a specific agreement should be upheld.⁵¹⁹ Accordingly, “in light of the parties’ agreement on the test of control, there is no reason for the Tribunal to examine different criteria” even if such criteria might be relevant in different circumstances.⁵²⁰ While the Tribunal accepted that “economic criteria often better reflect reality than legal ones”,⁵²¹ in the present case “such arguments of an economic nature are irrelevant” because “the parties have specifically identified majority shareholding as the criterion to be applied”.⁵²² Accordingly, it refused to “take into account the true control relationship”.⁵²³

However, despite these proclamations of strict constructionist reasoning, the *Autopista* Tribunal proceeded to examine in detail whether ICA Tech (the United States company) was in fact a “corporation of convenience” exerting merely fictional control over Autopista. That is, having placed due weight on the treaty terms agreed by the parties, the Tribunal then took a substantive approach to detect possible abuse of the object and purpose of the ICSID Convention.

In this regard, the Tribunal recalled that ICA Tech had twenty subsidiaries in different countries, was subject to economic and social regulations in the United States, and was incorporated several years before the conclusion of the agreement with Venezuela, the restructuring, and the emergence of the dispute. Finally and

⁵¹⁷ At [77]–[79].

⁵¹⁸ At [38]–[41] and [51]–[52].

⁵¹⁹ At [94]–[99].

⁵²⁰ At [62]–[65], [86]–[87] and [117]–[121].

⁵²¹ At [119].

⁵²² At [119].

⁵²³ At [51].

critically, the Tribunal placed considerable weight on the commercial reason for the introduction of ICA Tech into the corporate ownership structure of Autopista: enhancing the ability of Autopista to obtain United States financing during the Mexican currency crisis of 1995–1996.⁵²⁴

The Tribunal concluded it was objectively reasonable pursuant to art 25 to consider Autopista to be a company controlled by ICA Tech,⁵²⁵ and that ICA Tech could not be regarded as a corporation of convenience or a vehicle designed to abuse the ICSID Convention.⁵²⁶

Although the language is different, in that the *Autopista* Tribunal appears to take a stricter approach to the application of the parties' agreed terms, in fact, the approach in application is the same as that in *Vacuum Salt*. The parties' agreement as to the concept of control is respected and presumptively applied so long as the application of the specified criterion (shareholding) is found to be reasonable in the particular circumstances.

Schreuer agrees with the substantive approach to second clause cases and advocates for a search for the true controller to prevent the abusive situation whereby “nationals of non-Contracting States or even of the host State ... set up a company of convenience in a Contracting State to create the semblance of foreign control”.⁵²⁷ The result is that for second clause cases, an agreement on nationality in a contract based on a reasonable criterion will be presumptively upheld, unless “the nationality of the Contracting State which is agreed upon has no relevance to the realities of the situation”.⁵²⁸ Such a case would permit parties to use the Convention for purposes for which it was clearly not intended.⁵²⁹

Lalive counselled caution against stretching the jurisdictional limits of ICSID to the point that they mean little and do not protect states against suit from its own nationals.⁵³⁰

⁵²⁴ At [123]–[124].

⁵²⁵ At [122]–[126].

⁵²⁶ At [126].

⁵²⁷ Schreuer and others, above n 26, at 318 as cited in *TSA Spectrum*, above n 30, at [153].

⁵²⁸ Amerasinghe, above n 125, at 262.

⁵²⁹ At 261–263 citing Broches, above n 25, at 361.

⁵³⁰ Pierre Lalive “The First ‘World Bank’ Arbitration (*Holiday Inns v. Morocco*)—Some Legal Problems” (1980) 51 BYBIL 123 at 141.

... consent to international arbitration between a State and a juridical person which is, legally or formally speaking, its 'national' needs to be unequivocal and not open to doubt. Too liberal an interpretation of Article 25(2)(b) would hardly contribute to a wider acceptancy by States of ICSID arbitration and, therefore to the protection of foreign investors.

Lalive's comments are not restricted to second clause cases. If it is objectively unreasonable for a respondent state to face a claim from a company that is in reality a shell controlled by the state's own nationals under the second clause, then this must also be true for claims under the first clause.

However, the primary point is that it is incongruous if the approach to nationality in the second clause is different from the inquiry in the first clause, because the ultimate inquiry under both clauses is as to nationality. In respect of the first clause it is the nationality of the claimant; in respect of the second clause it is the nationality of the controller. There is no principled reason for approaching them in different ways. To do so results in a difference in approach to jurisdiction *ratione personae* based arbitrarily on whether an investment in the respondent state is made by a national of the other contracting state directly, or indirectly through a locally incorporated company.

The two situations are the same side of the same coin and should be approached the same way. So long as the host state agrees, the second clause simply operates to extend the same principles as the first clause to permit local companies to be claimants. Justifications for diametrically opposed approaches to nationality and control on the basis of differences in terminology between the first and second clauses are legal contortions that have no logical basis.

That this observation is correct is revealed by the observation that there is no difference in the corporate structures at issue in first clause cases such as *Tokios* and *Rompetrol* and the second clause case of *TSA*. In all cases, the investment was a company incorporated in the respondent state. In *TSA*, the claimant was a locally registered company owned by two upstream foreign holding companies ultimately owned in turn by Argentine nationals. In *Tokios* and *Rompetrol*, the companies incorporated in the respondent state were owned by companies incorporated in the

other contracting state which in turn were owned by the respective respondent states' own nationals.

The corporate structures are the same. The only difference is that because of the terms of the relevant investment treaties, in *TSA* the claimant had to be the local company incorporated in the respondent state and therefore claim ICSID jurisdiction through the second clause, while in *Tokios* and *Rompetrol* the first clause applied because it was sufficient for the foreign incorporated companies to be claimants and the local company in the host state was simply the investment owned or controlled by those companies.

The necessary elements for jurisdiction under art 25 in these cases are the same: an investment in the respondent state (comprising shares in a local company) controlled by a foreign investor of the nationality of the other treaty partner. The only difference is that the requirement for control of the investment emanates in the first clause cases from the relevant treaty, while in the second clause cases it is imposed by art 25. In those circumstances it is arbitrary to have the test of nationality applied in two different ways.

The rationale for the second clause of art 25(2)(b) was to allow an exception to the general rule of international law that citizens are not permitted to sue their own state, as a result of the concern that some host states require incorporation of a local company by foreign investors through which to conduct an investment,⁵³¹ thereby circumventing the investor's access to the Centre by transforming an international investment into a domestic one.⁵³²

Two important points arise out of the purpose of the second clause that rebut arguments which seek to justify interpretation of the first clause literally and the second clause substantively. The first is to answer the reasoning in *Tokios* to the effect that the second clause is meant to expand jurisdiction and therefore cannot be used to restrict it by justifying the imposition of a control test to first clause cases.⁵³³

It is true that the second clause expands jurisdiction to allow for locally incorporated companies to be treated as foreign if so agreed by the host state, but that expansion says nothing about the nature of the test to be applied to determine if

⁵³¹ Broches, above n 124, at 191.

⁵³² See, for example, *SOABI*, above n 61, at 182.

⁵³³ *Tokios (Jurisdiction)*, above n 24, at [46]–[52].

the investor under the first clause or the foreign controller under the second clause has the requisite nationality. The fact that the second clause expands jurisdiction in one respect has no relationship to the boundaries of other jurisdictional concepts in the same article. Nationality can be approached in either a technical or substantive sense in relation to both clauses and the expansion in the second clause still has effect.

The second point addresses the argument that the inclusion of the requirement for “foreign control” in the second clause is of a nature that mandates a substantive approach, while its absence in the first clause requires a technical approach, otherwise, the second part of art 25(2)(b) would not make sense. This is the *TSA* reasoning explained above.⁵³⁴ However, the requirement for agreement as to foreign control in the second clause says nothing about whether that concept should be approached substantively or technically, and nothing about the correct approach to the concept of nationality in each clause.

Which is the correct approach is the ultimate question with which this thesis grapples. But there is nothing inherent about the concept of nationality in the first clause that compels it to be judged in a formal manner. Equally, there is nothing about the concept of control in the second clause that requires the search for the foreign character of the controller to be approached in a substantive rather than literal way.

As will be discussed further in Chapter 8, Broches’ admonition that the parties’ agreed criteria for nationality must be reasonable,⁵³⁵ applies to the results of the application of the criteria in both clauses as well as to the criteria in and of themselves.

If this is right, then a first clause situation involving agreement under a treaty that nationality be determined by incorporation (for example) may be unreasonable if the allocation of nationality by this means bears no resemblance to the realities of the situation. A substantive review of the economic realities of each particular situation under either clause of art 25(2)(b) is then required, just as it is in respect of the use of separate corporate personality in municipal law as explained in Chapter

⁵³⁴ See also, for example, Amerasinghe, above n 125, at 255 and 257.

⁵³⁵ Broches, above n 25, at 361.

4, in respect of the concept of nationality in diplomatic protection law as reviewed in Chapter 5 and in relation to entities seeking to qualify for the benefits of double tax treaties as set out in Chapter 6.

7.3 The nationality of natural persons

The concept of nationality in respect of natural persons is governed by art 25(2)(a) of the ICSID Convention, which contains positive and negative requirements: a natural person must be a national of a Convention Contracting State (positive), but may not be a national of the respondent host state (negative).⁵³⁶

A nationality requirement for natural persons is also found in every bilateral and multi-lateral investment treaty.⁵³⁷ The nationality of an individual in investment treaty law is determined by legislation of the relevant state,⁵³⁸ although a certificate of nationality does not preclude a decision at variance with its contents if, for example, it has been procured by fraud or otherwise issued in breach of municipal law.⁵³⁹

While investment treaty tribunals have refused to import a *Nottebohm*-type genuine connection test for the nationality of individuals into investment treaty law,⁵⁴⁰ the leading cases concerning the nationality of natural persons have adopted a purposive approach to check the bona fides of claims to jurisdiction *ratione personae* over and above the application of nationality requirements in investment treaties and the ICSID Convention. The approach taken is that application of nationality criteria agreed by states in investment treaties gives rise to an effective presumption of nationality for international purposes that is subject to an objective

⁵³⁶ Broches, above n 124, at 202, Exhibit C-66. See also *Fakes v Turkey (Award)* ICSID ARB/07/20, 14 July 2010 at [60].

⁵³⁷ Rudolf Dolzer and Margrete Stevens *Bilateral Investment Treaties* (Martinus Nijhoff, The Hague, 1995) at 31–33; and Schreuer and others, above n 26, at 267–269.

⁵³⁸ See Schreuer and others, above n 26, at 267–269.

⁵³⁹ *Soufraki v The United Arab Emirates (Award)* ICSID ARB/02/7, 7 July 2004 at [55] and [63] citing Schreuer and others, above n 26, at [433]. Mr Soufraki's certificate of Italian nationality was not recognized by the Tribunal because it was obtained contrary to Italian citizenship laws: see [53], [66]–[69] and [86(a)]. See also Schreuer and others, above n 26, at 268; and KVSK Nathan *ICSID Convention: The Law of the International Centre for the Settlement of Investment Disputes* (Juris, Huntington, 2000) at 86–87.

⁵⁴⁰ *Siag v Egypt (Award)* ICSID ARB/05/15, 1 June 2009 at [195] and [198]; *Champion Trading Co v Egypt (Jurisdiction)* ICSID ARB/02/9, 21 October 2003 at 15–16; and *Fakes*, above n 536, at [61]–[76].

substantive reasonableness check to exclude the adoption of a nationality convenient for the purpose of investment treaty coverage.

This approach is not based on the text of a particular treaty or the ICSID Convention, but rather is prefaced on the overriding need to prevent unreasonable outcomes that offend the object and purpose of the ICSID Convention and the investment treaty regime more generally.⁵⁴¹ This is the same approach as taken to control the nationality of the controller in the second-clause cases *Vacuum Salt* and *Autopista* examined above.

There are three principal examples. In *Champion Trading v Egypt*, the Tribunal accepted that nationality properly conferred by municipal law might be disregarded if the result was manifestly absurd or unreasonable.⁵⁴² It might:⁵⁴³

... for instance be questionable if the third or fourth foreign born generation, which has no ties whatsoever with the country of its forefathers, could still be considered to have, for the purpose of the Convention, the nationality of this state.

However, while the claimants' Egyptian nationality was involuntarily acquired through their father's nationality,⁵⁴⁴ it was not unreasonable to determine that the claimants held Egyptian nationality in a substantive sense because they had utilised that nationality to facilitate the investment at issue.⁵⁴⁵ They could not disown the nationality they had previously used to their advantage.

In *Siag v Egypt*, the majority found the claimants, Mr Siag and Ms Vecchi, were not dual nationals because pursuant to Egyptian law they had lost Egyptian nationality.⁵⁴⁶ The claimants were Italian citizens, and therefore *prima facie* investors entitled to the benefits of the Italy-Egypt BIT. But a substantive enquiry as to the circumstances of the claimants' acquisition of Italian nationality was

⁵⁴¹ *Fakes*, above n 536, at [77]–[80]; and *Siag*, above n 540, at [200].

⁵⁴² *Champion Trading*, above n 540, at 16–17.

⁵⁴³ At 17.

⁵⁴⁴ At 9–11 and 16.

⁵⁴⁵ At 17.

⁵⁴⁶ *Siag*, above n 540, at [199].

nevertheless required to ensure that nationality was not a “mere expedient in order to bring claims before ICSID”.⁵⁴⁷

The Tribunal observed that the claimants acquired Italian nationality “a long time before these claims were brought” and for “recognized reasons”—Mr Siag married an Italian; his co-claimant, Ms Vecchi, re-acquired Italian citizenship following the death of her Egyptian husband. Accordingly, “the Claimants possess genuine links to Italy”.⁵⁴⁸

While the *Siag* Tribunal majority does not say so in such terms, what it effectively does is to apply a substantive check on the bona fides of the claimants’ nationality that goes beyond an examination of compliance with municipal law. The Tribunal applies a genuineness test by examining the purpose for which the nationality was acquired as determined by the timing of its attainment compared with the commencement of the claim, and the claimants’ professed reasons for acquiring the nationality.⁵⁴⁹

The case of *Fakes v Turkey* further illustrates how the approach to nationality of individuals is more nuanced than the literal approach to corporate nationality, in that the strict application of treaty definitions regarding the nationality of individuals is checked with a substantive reasonableness test, focusing on the purpose for which the claimant’s nationality was obtained.⁵⁵⁰

Fakes was a dual national of Jordan and the Netherlands⁵⁵¹ who brought a claim against Turkey under the Netherlands-Turkey BIT. Turkey accepted the fact that Mr Fakes held Dutch nationality legitimately, but submitted that such nationality must be “effective” for a claimant to procure the protection of the BIT.⁵⁵²

The BIT defined an investor to include, “a natural person who is a national of a Contracting Party under its applicable law”.⁵⁵³ The Tribunal held that this definition did not require an investor’s nationality to be effective in a *Nottebohm*

⁵⁴⁷ At [200].

⁵⁴⁸ At [200].

⁵⁴⁹ Note also the Partial Dissenting Opinion of Professor Francisco Orrego Vicuña at 62 and 63, in which Vicuña argues that because the ICSID Convention does not define nationality, the international law principle of effectiveness as described in *Nottebohm* must be applicable to prevent “uncontrollable abuse arising from acquisition or loss of nationalities”.

⁵⁵⁰ *Fakes*, above n 536.

⁵⁵¹ At [54].

⁵⁵² At [54]–[55].

⁵⁵³ Netherlands-Turkey BIT (signed 27 March 1986), art 1(a)(i).

sense for him to bring a claim against the host State and that specific treaty provisions overrode general principles of international law that require a genuine link between individual and state.⁵⁵⁴ The approach of the Tribunal is, initially at least, *ad idem* with the reasoning of corporate nationality literal decisions.

However, the *Fakes* Tribunal did not dismiss the relevance of substantive nationality—in all situations. It cautioned:⁵⁵⁵

This is not to say that the effective nationality test never has any bearing in the context of ICSID arbitration. One might envisage several instances when its application could be justified in light of the particular circumstances of a given case.

The Tribunal cited Broches who explained that in the course of the negotiation of the Convention, there was a “general recognition” that Tribunals “might have to decide whether a nationality of convenience ... could or should be disregarded”.⁵⁵⁶ The *Fakes* Tribunal agreed that:⁵⁵⁷

... one might argue that a nationality of convenience, acquired “*in exceptional circumstances of speed and accommodation*”, for the purposes of bringing a claim before the Centre should not be considered to satisfy the nationality requirements of a BIT and Article 25(2)(a) of the Convention.

Thereby, the Tribunal—following commentary by the father of the ICSID Convention and echoing the terminology of the ICJ’s effectiveness test in

⁵⁵⁴ *Fakes*, above n 536, at [61]–[64] and [68]–[70] citing *Micula v Romania (Jurisdiction and Admissibility)* ICSID ARB/05/20, 24 September 2008 at [101]. The *Fakes* Tribunal observed that during the negotiations of the ICSID Convention a delegate from Guatemala suggested the concept of nationality ought expressly to be effective, but the drafters did not adopt this suggestion. See also *Casado v Chile (Award)* ICSID ARB/98/2, 8 May 2008 at [241].

⁵⁵⁵ *Fakes*, above n 536, at [77].

⁵⁵⁶ At [77] citing Broches, above n 124, at 204–205. Similarly but separately, Broches explained that involuntary nationality was not addressed in the Convention, “feeling that it would be up to the Tribunals concerned to decide whether forced nationality would have to be taken into account or could be disregarded” (see Broches’ reference to Documents Concerning the Origin and the Formulation of the Convention, Volume II, Part II, Doc 106 (SID/LC/SR – January 5, 1965); and Summary Proceedings of the Legal Committee Meeting (10 December 1964) at 868, Annex C14).

⁵⁵⁷ *Fakes*, above n 536, at [78] (emphasis in original).

Nottebohm—approved the application of a substantive check on the literal approach to nationality.

That check is based on the purpose of the acquisition of a certain nationality: the *Fakes* Tribunal examines the circumstances in which Mr Fakes acquired his Dutch nationality. The relevant factors it weighs in this regard are familiar: timing and purpose. Mr Fakes’ Dutch nationality was acquired as a child while living in the Netherlands with his parents and he spent many years living and studying in the Netherlands. Accordingly, the Tribunal concluded, “the Claimant’s links to the Netherlands are genuine and effective”,⁵⁵⁸ and “[h]is nationality is not one of convenience, obtained for the purposes of bringing his claim against the Respondent.”⁵⁵⁹

As with the decision in *Siag*, the reasoning of the *Fakes* Tribunal leads to the conclusion that had Mr Fakes adopted Dutch nationality as a matter of convenience for the purpose of bring a claim against Turkey, that nationality, although legitimately conferred pursuant to municipal law and strictly in fulfillment of the relevant investment treaty, would have been ineffective for jurisdiction *ratione personae*.

A purposive inquiry is required as a check on the presumptive application of treaty definitions of the nationality of juridical persons also, regardless of the absence of an express requirement for substantive nationality in an investment treaty or in art 25 of the ICSID Convention. A purposive check is all the more pertinent in respect of corporate persons given the relative ease (compared with individuals) with which corporations can attain and manipulate nationality by incorporation, and the consequent opportunity for abuse by the attainment of convenient nationality.⁵⁶⁰

For Sinclair, the “disparity between the jurisdictional requirements for individuals and those applicable to corporations in investment treaty arbitration” poses the following question:⁵⁶¹

⁵⁵⁸ At [80].

⁵⁵⁹ At [78].

⁵⁶⁰ Schlemmer, above n 34, at 74–75. See also Anthony C Sinclair “Nationality of Individual Investors in ICSID Arbitration” (2004) 7 Int ALR 191 at 194.

⁵⁶¹ Sinclair, above n 7, at 366 (footnotes omitted).

Is the mischief aimed at in seminal cases such as *Nottebohm* (which concerned a nationality acquired ... “in exceptional circumstances with speed and accommodation”) not broadly similar to the situation where an investor seizes upon a US\$100 shelf company in a foreign jurisdiction to use as an investment vehicle so that it might attract investment treaty protection?

The answer is yes, it is similar, and the approach of investment treaty law should be consistent. There is no reason of logic or policy why the restraint of a substantive purposive approach to nationality ought not apply equally to corporate investors as it does to natural persons.

7.4 The investment/investor dichotomy

An apposite analogy to the formalistic versus substantive debate regarding identification of a qualifying investor is hinted at by Weil in *Tokios* when he observes that while the Convention does not provide a precise and clear-cut definition of the concept of *international* investment, neither does it provide a precise and clear-cut definition of the concept of *investment*.⁵⁶²

Weil does not elaborate, but the observation exposes the dichotomy between the respective jurisprudential attitudes to the concepts of “investment” on the one hand and “investor” or “national” on the other. Investment tribunals take a purposive and substantive approach to the former, but not to the latter; an incongruous position for the twin gatekeepers of jurisdiction in investment treaty law.

The ICSID Convention treats the related concepts of investment and investor consistently: it leaves them to be defined by states, subject to undefined outer limits.⁵⁶³ The parties to an investment treaty therefore have discretion to agree and define the type of investments and investors covered by an investment treaty.⁵⁶⁴

In relation to “investment”, states almost invariably adopt a boilerplate definition that includes “every kind of asset” or “any kind of asset” and sets out a

⁵⁶² *Tokios (Dissent)*, above n 30, at [20].

⁵⁶³ IBRD, above n 216, at [27].

⁵⁶⁴ Broches, above n 25, at 360–361.

non-exhaustive list of examples including property, shares, contractual rights, intellectual property rights and rights conferred by law.

On the natural and ordinary meaning of this boilerplate definition, it is difficult to conceive of a commercial transaction that would not fall within its bounds. However, when it comes to determining whether a certain investment qualifies for protection under the ICSID regime, the matter is not left entirely to the discretion of the parties. The ICSID Convention has supremacy over a treaty and states are not free to qualify any transaction as an investment.⁵⁶⁵ In *Phoenix Action*, the Tribunal explained:⁵⁶⁶

There is nothing like a total discretion, even if the definition developed by ICSID case law is quite broad and encompassing. There are indeed some basic criteria and parties are not free to decide in BITs that anything – like a sale of goods or a dowry for example – is an investment.

While there are no basic criteria for an investment enunciated in the ICSID Convention or in the vast majority of investment treaties, limits are fashioned and imposed by tribunals. Beginning with the decision in *Fedax*, investment treaty tribunals have proceeded to impose criteria to evidence the economic materialisation of an investment (a contribution to an economic enterprise in the host state with the assumption of risk).⁵⁶⁷ Such criteria (contribution, duration and risk) have now found their way into the text of investment and free trade agreements.⁵⁶⁸

What are now known as the *Salini* criteria do not seek to override definitions of investment in a treaty or agreement.⁵⁶⁹ An agreed definition of investment remains an important element to determine jurisdiction *ratione materiae*. Fulfillment of treaty criteria agreed by the parties creates “a strong presumption” that the parties

⁵⁶⁵ *Mitchell v Democratic Republic of the Congo (Application for Annulment)* ICSID ARB/99/7, 1 November 2006 at [31] (emphasis in original). See also, for example, *TSA Spectrum*, above n 30, at [134].

⁵⁶⁶ *Phoenix Action*, above n 136, at [82].

⁵⁶⁷ *Fedax*, above n 47, at 199.

⁵⁶⁸ For example, United States-Morocco Free Trade Agreement (signed 15 June 2004), art 10.27; United States-Singapore Free Trade Agreement (signed 6 May 2003), art 15.1.13; and Trans-Pacific Partnership Agreement (signed 4 February 2016) [TPP], art 9.1.

⁵⁶⁹ See *Salini*, above n 47.

consider the investment to be within the ambit of the ICSID Convention.⁵⁷⁰ But, as per the approach to party definitions of nationality in art 25(2)(b) second clause cases and natural person nationality cases, it is a presumption that can be rebutted. Cases such as *Fedax* and *Salini* limit the freedom of the parties to define an investment for their own purposes, to preserve the “outer limits” of art 25(1) as interpreted in light of the object and purpose of the Convention: in this context to encourage substantive lasting investments in the contracting states.

The parties’ choice is limited by the purpose of the ICSID Convention to promote “international co-operation for economic development”.⁵⁷¹ This expression of object and purpose infers that an investment must be of an international character and be designed to promote or contribute to the economic development of the host state to be deemed as an investment pursuant to the Convention.⁵⁷²

The boundaries and exact definitions of each of the *Salini* criteria is not settled; it “has given rise to many awards, many theses, many discussions and many colloquiums”.⁵⁷³ The point for present purposes is to observe that arbitral tribunals have filled the definitional lacuna in regard to the concept of “investment” by subjecting the ordinary and natural meaning of the definition used by the contracting parties to substantive considerations designed to protect the object and purpose of the investment treaty regime.

While the same restriction of state autonomy is recognised in principle in respect of the nationality requirement in art 25(2)(b),⁵⁷⁴ definitions of nationality or investor in investment treaties are approached by tribunals in a strict literal way and without application of inherent limits imposed by the object and purpose of the ICSID Convention or the relevant investment treaty.

The importance of the reasoning adopted by investment treaty tribunals in relation to the outer limits of the concept of investment to the related concept of investor is threefold.

⁵⁷⁰ *CSOB (Jurisdiction)*, above n 138. See also, for example, *Generation Ukraine Inc v Ukraine (Award)* ICSID ARB/00/9, 16 September 2003 at [8.2].

⁵⁷¹ Preamble to the ICSID Convention.

⁵⁷² *CSOB (Jurisdiction)*, above n 138, at [64], [73] and [76].

⁵⁷³ Brigitte Stern “The Contours of the Notion of Protected Investment” (2009) 24 ICSID Rev 534 at 534.

⁵⁷⁴ For example, *CFHL*, above n 117, at [281].

First and most importantly, it is apparent that the twin gatekeepers of jurisdiction (*ratione materiae* and *ratione personae*) are approached differently: one substantively and the other literally. This dichotomy ought not exist. There is no logical reason why the approach to an “investment” in art 25(1) is objective and substantive, while the approach to “nationality” in the same article eschews the application of substantive criteria; indeed it is undesirable that different interpretative approaches apply to different terms in treaties to which the Vienna Convention applies.

It is useful to pinpoint where the departure in reasoning occurs as between the literal “investor” cases and the “investment” cases reviewed above. In both cases, the treaty requires consideration of formal criteria. In the case of investment, the treaties offer a list of types of legal structures that will qualify as investments. But this does not exclude the substantive or material aspect – in the “investment” context, the “economic materialization” of the investment. The literal cases regarding the nationality of an investor consider the relevant definition agreed by the parties and stop if the definition uses reasonable criteria, such as incorporation. They do not subject the *outcome of the application of the criteria* in the particular factual situation to any objective reasonableness test on the basis of the object and purpose of the Convention or treaty. To the contrary, the “investment” cases take this additional step.

As a result, for example, contractual rights to purchase coal were found not to be a substantive investment, despite technically meeting the common “contractual rights” criterion for an investment in the Canada-Venezuela BIT.⁵⁷⁵ The same result was reached in *Romak* in relation to contractual rights to shipments of wheat.⁵⁷⁶

Accordingly, the investment cases require that not only must the definition of investment be satisfied in a literal sense—that is, a defined type of property such as a contractual right—but also that the relevant property constitutes an investment in economic terms—that is, that it involves a transfer of capital and an element of risk. It is not enough to hold up a legal right which technically fits the treaty definition of investment if that legal right is not a substantive investment in economic terms.

⁵⁷⁵ *Nova Scotia Power Inc (Canada) v Venezuela (Award)* ICSID ARB(AF)/11/1, 30 April 2014.

⁵⁷⁶ *Romak*, above n 144.

The literal “investor” cases permit a corporate investor to present a nationality based on incorporation compliant with municipal law to meet a treaty definition of investor, even if the investor has no substantive connection with the state or the investment in an economic sense. The methodology adopted in respect of the concept of investment would reject a claim to nationality which otherwise met treaty criteria if the legal right to the claimed nationality is not supported in a substantive economic sense that accorded with the purpose of the Convention and/or the instant investment treaty.

Secondly, the investment cases illustrate how substantive considerations can be imported into the ICSID Convention and to investment treaties despite their absence from the formal text of those instruments. Essentially, the *Salini* criteria are *implied* into the notion of investment. They constitute an arbitral gloss or refinement on the meaning of investment to define reasonable limits to that concept in the context of the purpose of the Convention or investment treaty.

The literal nationality cases conclude that no additional qualifications can be read into the definition if the ordinary and natural meaning of the words used is clear. *Rompetrol* raised the further issue as to how any additional substantive criteria relevant to nationality in the context of the Convention could be applied to non-ICSID investment treaties (or treaties with a choice of process). The investment cases illustrate answers to these related concerns.

The gloss on the concept of “investment” is justified on the basis of an inherent or intrinsic meaning of the term “investment” as used in the instant treaty and in spite of the broad inclusive definitions employed by contracting states.

The *Phoenix* Tribunal utilised a “teleological test”.⁵⁷⁷ It determined that the interpretative principles in art 31(1)(a) of the Vienna Convention required a “*factual ... and contextual analysis of the existence of a protected investment*” and the Tribunal “must also take into consideration *the purpose of the international protection of the investment*”.⁵⁷⁸ It expressly acknowledged that reliance on the

⁵⁷⁷ Stern, above n 573, at 544–555. See also Utku Topcan “Abuse of the Right to Access ICSID Arbitration” (2014) 29 ICSID Rev 627 at 646.

⁵⁷⁸ *Phoenix Action*, above n 136, at [79] (emphasis in original).

ordinary meaning of the definition of “investment” was insufficient to protect an economic operation which is:⁵⁷⁹

... objectively an investment, but which is not a protected investment because, for one reason or another, it is not the purpose of the multinational or bilateral treaty ... to extend protection through international arbitration to such an investment.

Applying the same reasoning to the definition of a national of a particular state, compliance with the express criteria in a treaty should not be accepted to transform a corporate entity into an “investor” if the result is contrary to the object and purpose of the treaty. Words can have an inherent meaning arising from the context in which they are used. As explained in Chapter 2, that is why art 31(1) of the Vienna Convention requires context and the object and purpose of the treaty to be considered in the interpretative process.

Therefore, a substantive approach to the claimed nationality of any particular investor could arise from the inherent meaning of “a national of another Contracting State” in art 25 of the ICSID Convention, or from the concepts of “national” and “investor” in an investment treaty.

This interpretative approach can apply equally to investments and investors in non-ICSID cases. For example, in the UNCITRAL case *Romak*, the Tribunal held that the term “investment” under the BIT has an inherent meaning irrespective of whether the ICSID Convention applies.⁵⁸⁰ While the investment “hallmarks” of contribution, duration and risk did not appear in the BIT at issue, nevertheless:⁵⁸¹

... if an asset does not correspond to the inherent definition of ‘investment’, the fact that it falls within one of the categories listed in Article 1 [the treaty definition of ‘investment’] does not transform it into an ‘investment’.

⁵⁷⁹ At [79].

⁵⁸⁰ *Romak*, above n 144, at [207].

⁵⁸¹ At [207]. See also *Phoenix Action*, above n 136, at [74] and [82].

This observation answers the concern expressed in *Rompetrol* (explained in Chapter 3.2) that a substantive approach to nationality based on art 25 would not apply to non-ICSID cases, leading to an arbitrary difference in jurisdiction *ratione personae* requirements.⁵⁸²

Thirdly, it is instructive for the discussion in Chapters 10 and 11 as to the practicality of a purposive nationality test to note the manner in which the substantive approach to investment has been employed. Investment tribunals and commentators have been careful to prescribe the substantive criteria or characteristics of an investment as guidelines rather than mandatory rules.⁵⁸³ This flexibility “is important because foreign investment takes continuously new economic and legal form”.⁵⁸⁴ This comment applies equally to corporate structures as it does to the nature of an investment.

Although there is debate about the best analysis,⁵⁸⁵ investment tribunals and commentators favour a “flexible and pragmatic” view of the *Salini* criteria of an investment, taking into account the relevant instrument and the particular factual scenario in a teleological assessment with a considerable margin of appreciation.⁵⁸⁶

It is notable that despite this flexible and global approach to the concept of “investment”, there is no concern expressed in the relevant tribunal decisions about consequent uncertainty, which pervades any suggestion of a substantive approach to corporate nationality. It will be explained in Chapter 10 that the concern about uncertainty for investors as expressed in some literal corporate nationality cases is unsubstantiated if fulfilment of treaty definitions is subject to a substantive check which focuses on the purpose for the inclusion of the claimant vehicle in the

⁵⁸² *Rompetrol*, above n 24, at [105].

⁵⁸³ See, for example, *Jan de Nul NV v Egypt (Jurisdiction)* ICSID ARB/04/13, 16 June 2006 at [91]; and *RSM Production Corp v Grenada (Award)* ICSID ARB/05/14, 13 March 2009 at [240]–[241].

⁵⁸⁴ Roberto Bruno and Joseph HH Weiler *Access of Private Parties to International Dispute Settlement: A Comparative Analysis* (Jean Monnet Center for International and Regional Economic Law and Justice, Working Paper No 1397, 16 May 1997).

⁵⁸⁵ David AR Williams and Simon Foote “Recent developments in the approach to identifying an ‘investment’ pursuant to Article 25(1) of the ICSID Convention” in Chester Brown and Kate Miles (eds) *Evolution in Investment Treaty Law and Arbitration* (Cambridge University Press, Cambridge, 2011) 42.

⁵⁸⁶ A good example is *Biwater Gauff (Tanzania) Ltd v Tanzania (Award)* ICSID ARB/05/22, 24 July 2008 at [316]. See also *Salini*, above n 47, at [52]; Happ and Rubins’ review of ICSID Awards between 2003–2007: Richard Happ and Noah Rubins *Digest of ICSID Awards and Decisions: 2003–2007* (Oxford University Press, Oxford, 2009) at 341–342; and Schreuer and others, above n 26, at 172.

ownership structure of the relevant investment. This test is reasonably certain for an investor because purpose is a matter which must fall within the knowledge of the claimant.

7.5 Substantive considerations in literal cases

Some of the literal cases reviewed in Chapter 3 also implicitly admit to a substantive check on the bona fides of the investor that goes beyond the formal fulfillment of nationality criteria expressly set out in a treaty.

The *Saluka* decision is often cited as one of the leading authorities in support of a formalistic approach to corporate nationality. It will be recalled that despite having “sympathy” for the respondent’s state’s objection to the use of a shell company by Japanese investors for the purpose of gaining access to the Netherlands-Czech Republic BIT, the Tribunal concluded that it could not look further than compliance with the incorporation criterion in the Treaty.⁵⁸⁷

However, it did not rule out a substantive approach in all circumstances. The Tribunal recognised that where in reality the claimant is a mere shell company with no real connection to a state party to the relevant treaty:⁵⁸⁸

Such a possibility lends itself to abuses of the arbitral procedure, and to practices of “treaty shopping” which can share many of the disadvantages of the widely criticised practice of “forum shopping.”

The *Saluka* Tribunal allowed that an equitable remedy might exist if corporate structures have been utilised to perpetrate fraud or other malfeasance, although it concludes that no such fraud or malfeasance was made out in the circumstances of that case.⁵⁸⁹ What was critical to the absence of malfeasance in *Saluka* was “that it was always apparent to the Czech authorities” that it was Nomura’s intention to transfer the shares to “a special-purpose vehicle set up for the specific and sole purpose of holding those shares”.⁵⁹⁰ Accordingly, the Czech

⁵⁸⁷ *Saluka*, above n 24, at [240]. See also the Netherlands-Czech Republic BIT.

⁵⁸⁸ At [240].

⁵⁸⁹ At [230].

⁵⁹⁰ At [226] and [242].

Republic could not complain when it knew about the claimant's corporate structure at the outset of the investment. Had those particular circumstances not existed, the *Saluka* Tribunal may have examined the particular circumstances of the shell company investor more closely.

In *ADC v Hungary*, Hungary was aware of and “manifestly approved” the corporate structure of the investment.⁵⁹¹ The Tribunal took a literal approach to the definition of corporate nationality in the Cyprus–Hungary BIT and considered there was no scope for consideration of customary law principles of nationality.⁵⁹² Despite that finding, the Tribunal was prepared to look behind the fact of incorporation to determine whether the claimants' Cypriot nationality was appropriate in the circumstances of the case.

The evidence showed that the two Cypriot claimant companies were not mere shell companies, but paid taxes, engaged auditors, entered into contracts, provided billing and project management services, and made loans to facilitate the project. One of the companies managed a Hungarian subsidiary which employed eight people in roles relating to the operation of the airport terminals.⁵⁹³ Accordingly, the Tribunal found the claimants had “a perfectly lawful and legitimate role in the project”.⁵⁹⁴ The claimants had valid commercial reasons to exist other than to gain access to treaty benefits.

In *Autopista*, the United States claimant, ICA Tech, had substantial business activity in the United States, but moreover, its ability to facilitate financing in the United States for the Venezuelan investment was a genuine reason for its existence in the ownership structure of Autopista. This legitimate commercial purpose in the corporate structure led the Tribunal to observe that ICA Tech was not a corporation of convenience.⁵⁹⁵

Neither did the majority in *AdT* entirely eschew a substantive approach. The majority examined the substance behind the Dutch claimant company and found it “was not simply a corporate shell set up to obtain ICSID jurisdiction over the present

⁵⁹¹ *ADC*, above n 173, at [358] and [360].

⁵⁹² At [357]–[359]. See Cyprus–Hungary BIT.

⁵⁹³ At [353].

⁵⁹⁴ At [353].

⁵⁹⁵ *Autopista*, above n 61, at [123]–[126].

dispute”,⁵⁹⁶ because it was the embodiment of the joint venture between its two independent parent companies. This structure required “the two entities to work together in order to direct [AdT]”.⁵⁹⁷ Further, the Tribunal found the evidence showed the Dutch claimant company was engaged in substantial and substantive commercial activities beyond its activities in Bolivia.⁵⁹⁸ The Dutch claimant was not a shell; it had a valid commercial purpose in the corporate structure.

Alberro-Semerena disagreed with the *AdT* majority’s finding of jurisdiction, but only because he desired more information about the claimant’s commercial role in the Bolivian investment, including: the decision to migrate the claimant to the Netherlands; the nationality of the board members; the frequency of monitoring and financial support of AdT by the claimant; and the practicalities of operations in the claimant’s new corporate structure.⁵⁹⁹

In the same vein as Alberro-Semerena in *AdT*, further analysis was called for by Pinzón in his dissenting literal approach opinion in *Venoklim*. He describes an activist role for and purposive approach to the doctrine of abuse of right and sanctions a search for the ultimate owners if “the incorporation of Venoklim was done in order to avoid requirements or legal obligations, or if there was fraud, loss or damage to third parties or to the shareholders”.⁶⁰⁰

What Pinzón suggests is a substantive approach that looks to the reason for existence of Venoklim in the corporate structure. It is not enough to presume abuse of the corporate form “because of the existence of nationals of the respondent State within the structure of a Claimant’s corporate group”.⁶⁰¹ A more detailed analysis is required to justify piercing of the corporate veil.⁶⁰²

Even in the seminal case of *Tokios*, a substantive analysis of the commercial reasons for existence of the claimant was part of the acceptance of jurisdiction *ratione personae*. Valasek and Dumbery conclude that *Tokios* suggests that “the actual goal for the creation of a shell corporation is what truly matters when deciding

⁵⁹⁶ *Aguas del Tunari*, above n 22, at [321].

⁵⁹⁷ At [321].

⁵⁹⁸ At [322].

⁵⁹⁹ *Aguas del Tunari*, above n 22, per the Declaration of José Luis Alberro-Semerena (dissenting) at [17] and [41]–[42].

⁶⁰⁰ *Venoklim* (dissent), above n 30, at [38]. See also [33]–[36].

⁶⁰¹ At [38].

⁶⁰² At [38].

whether a certain set of facts represent non-*bona fide* treaty shopping”, and the aim of incorporation in a certain jurisdiction must be shown not to be solely to gain access to international arbitration.⁶⁰³ It is often overlooked in analyses of the majority decision that despite its ultimate reliance on compliance with the formalities of incorporation set out in the Treaty definition, the Tribunal accepted that the Ukrainian nationals, “manifestly did not create Tokios Tokéles for the purpose of gaining access to ICSID arbitration”.⁶⁰⁴

Rather, Tokios had substantial business activities in Lithuania based on financial statements, employment information, and a catalogue of other materials produced during the relevant period.⁶⁰⁵ Moreover, the majority found that the Lithuanian claimant was not created for the purpose of gaining access to treaty benefits because it was founded six years before the relevant BIT entered in force.⁶⁰⁶ If the Treaty was not in existence at the time the company was incorporated, the Tribunal reasoned there must have been some real commercial purpose for its existence, other than to attract the protection of the Treaty.

In all these cases, the tribunals buffered their literal approach to jurisdiction *ratione personae* on fulfillment of stated treaty criteria with a substantive examination of the reasonableness of the claim to jurisdiction by assessing the bona fides of the claimant’s commercial purpose.⁶⁰⁷

7.6 Conclusion

The categories of cases discussed above all take the same approach: fulfillment of formal treaty criteria gives rise to a *presumption* of compliance, checked by an objective substantive assessment as to whether the application of the criteria in the particular circumstances of the case conforms with the object and purpose of the ICSID Convention and/or investment treaty.

Article 25 second clause cases, the nationality of natural persons cases, and the substantive check undertaken in some literal cases, indicate the means to apply an objective substantive check as to the reality of nationality: the reason or purpose

⁶⁰³ Valasek and Dumberry, above n 39, at 65.

⁶⁰⁴ *Tokios (Jurisdiction)*, above n 24, at [56].

⁶⁰⁵ *Tokios (Jurisdiction)*, above n 24, at [37].

⁶⁰⁶ At [56].

⁶⁰⁷ As noted by Schreuer, above n 170, at 524 citing *Autopista*, above n 61, at [122]; and *Tokios (Jurisdiction)*, above n 24, at [24]–[52].

for the acquisition of the claimed nationality. This is the same approach applied by various means in tax treaty jurisprudence as discussed in Chapter 6 and is the fundamental inquiry in respect of various means by which separate legal personality may be disregarded in municipal law as explained in Chapter 4.

Literal compliance with the definition of “investment” chosen by the parties to a treaty is not sufficient for jurisdiction *ratione materiae*. The “investment” cases take an unabashed substantive approach in which criteria that indicate a genuine investment for investment treaty purposes are implied into the ICSID Convention and/or the relevant investment treaty by way of an inherent meaning of the term “investment” and justified by the overarching consideration of the object and purpose of the system of investment treaty protection. The same approach is justified for jurisdiction *ratione personae*.

Only the literal cases are concerned by the uncertainty or complexity in a substantive assessment. However, while they rely on uncertainty as a reason to oppose a substantive check, many of the literal cases nevertheless undertake such a check.

The following Chapters in this thesis advance an argument that the substantive approach evident in these analogous areas of investment treaty law is the correct approach also in respect of jurisdiction *ratione personae*. An objective examination of the commercial reason for involvement of the claimant in the ownership structure is required to protect against literal interpretation outcomes contrary to the object and purpose of the ICSID Convention and individual investment treaties. Chapter 8 will explain that it is contrary to the object and purpose of jurisdictional provisions in investment treaties to promote a claimant which exists only to procure investment treaty coverage. On that basis, the thesis turns to examine more closely the nature of a potential substantive check on claims to corporate nationality in Chapters 9 and 10 and the means to implement such a test in Chapter 11.

8 The objects and purposes of investment treaties and the role of jurisdictional provisions

8.1 Introduction

The comparative analysis in the previous four Chapters has illustrated how the rights attendant with corporate personality and nationality and analogous jurisdictional concepts are limited when used for the sole purpose of garnering additional rights or avoiding obligations. The correct jurisprudential approach to corporate nationality in investment treaty law is the same. Compliance with treaty criteria for corporate nationality provides presumptive coverage, but must be subject to a substantive check to ensure that coverage of the particular corporate claimant accords with the object and purpose of the investment treaty and/or the ICSID Convention. That raises a central issue: what are the objects and purposes of investment treaties generally and jurisdictional provisions in particular?

This Chapter addresses that question and poses a further one: is the manipulation of corporate nationality to obtain treaty coverage *prima facie* contrary to the object and purpose of investment treaties?

The literal approach allows states full autonomy to define who is considered a national and by what means. It supposes that the purpose of investment treaties is to facilitate greater investment and goes no further. While this is correct in a general sense, it ignores the specific purpose of jurisdictional provisions to delineate from anything and everyone the particular investments and investors entitled to access the benefits of a treaty. Accordingly, the literal approach gives too little weight to, or erroneously perceives, the application of object and purpose and good faith to the interpretative exercise pursuant to art 31(1) of the Vienna Convention as explained in Chapter 2.

The reasons for jurisdiction *ratione personae* in the investment treaty context are threefold. First, to establish the position of the investment treaty regime at international law as a mechanism specifically aimed to provide protection for foreign, not domestic, investors. Secondly, to balance the rights of investors and the extent of contracting states' obligations under a treaty by prescribing a certain class of qualifying investor. This balance is sometimes referred to as the balance of

obligations or sacrifices. Thirdly, investment treaties are a bargain between two states for their respective benefit and for the benefit of their investors. Each state expects their obligations to the nationals of other contracting states to be reciprocated by the benefits extended by those states to its own investors. The corresponding bilateral nature of investment treaties is known as the balance of reciprocity: what one party gives is reflected equally by the other's obligations.

The manipulation of corporate nationality takes the investment treaty regime outside the scope of protection of foreign investment, leaves the extent of state obligations at large, and skews the balance of reciprocity. Accordingly, treaty shopping *prima facie* contravenes the object and purpose of the jurisdictional provisions in a treaty. A substantive approach to interpretation of jurisdictional provisions is therefore necessary and accords with good faith at international law.

8.2 The object and purpose of jurisdictional provisions in investment treaties

The purpose of investment treaties is a phrase often posed in the singular. The reality is more complex. An investment treaty may have more than one purpose. While an investment treaty seeks on one level to increase foreign investment in the contracting states, equally the purpose of jurisdictional provisions in such treaties is to limit the nature and source of foreign investment.

This sub-chapter examines the existence of these two purposes and asks how they co-exist. In doing so, the view that investment from any source is consistent with the purpose of an investment treaty is critiqued. Indeed, as will be explained, the purpose of the jurisdictional provisions in investment treaties and art 25 of the ICSID Convention is to identify from all potential investors those investors entitled to investment protections and access to neutral arbitration under a particular instrument.

There is no shortage of authority for the observation that an important purpose of the ICSID Convention and investment treaties more generally is to encourage and protect international investments.⁶⁰⁸ The Report of the Executive Directors proclaims one of the purposes of ICSID is to “facilitate the settlement of

⁶⁰⁸ Weeramantry, above n 128, at [3.83].

disputes between States and foreign investors” with a view to “stimulating a larger flow of private international capital into those countries which wish to attract it”.⁶⁰⁹

Focus on the purpose of promoting investment enables the literal tribunals and associated commentators to conclude that use of corporations of convenience by nationals of the respondent state or of non-contracting states is consistent with the object and purpose of investment treaties.

This approach is too one-dimensional. It ignores the “international” character of the intended investment. Treaties are complex instruments with every provision playing a distinct part to make up a whole: “most treaties have no single, undiluted object and purpose but a variety of differing and possibly conflicting objects and purposes”.⁶¹⁰ A single provision or a chapter may have its own object and purpose “that may not be evident if the object and purpose of the whole treaty is considered”.⁶¹¹

Preambles of investment treaties invariably refer to promotion of foreign investment from particular states, as opposed to foreign investment in general.⁶¹² It is the role of the jurisdictional provisions to promote capital flow, but within certain limits. A more nuanced picture must account for two related roles of jurisdictional provisions: the micro role of balancing treaty obligations and benefits for states; and the macro role of delineation of investment treaties as the mechanism for protection and resolution of disputes about foreign investment between investors and states in international law.

Taking the micro-role first, state parties to investment treaties and the ICSID Convention have competing interests: to encourage foreign investment (inwards and also outwards by their own nationals) by providing some security of treatment for investors on the one hand, and limiting cost of compliance (abrogation of sovereignty, cost of foregoing regulation, and risk of suit) on the other. The terms of such treaties must straddle these competing goals.

⁶⁰⁹ IBRD, above n 216, at [9]. To the same effect for investment treaties generally, see Sinclair, above n 7, at 363. See also Jeswald W Salacuse and Nicholas P Sullivan “Do BITs Really Work? An Evaluation of Bilateral Investment Treaties and Their Grand Bargain” (2005) 46 Harv Int’l L J 67.

⁶¹⁰ Sinclair, above n 147, at 130.

⁶¹¹ Weeramantry, above n 128, at [3.82].

⁶¹² Benedict and others, above n 4, at 39–40.

There are two primary levers for setting the balance between these competing interests: the breadth of the protections; and the jurisdictional provisions. The former proscribes the extent of the benefits received by qualifying investors. The latter sets the circle of third party beneficiaries⁶¹³—it is the job, or purpose, of jurisdictional provisions in the Convention and investment treaties to define the investors and investments that are covered. The limiting role of jurisdictional provisions may be viewed as *lex specialis* in contrast to the *lex generalis* statements of intent found in a treaty preamble.⁶¹⁴

As explained in Chapter 6, Jain makes the same observation about tax treaties:⁶¹⁵ while the general object of a tax treaty is to assist international commerce, a specific purpose of jurisdictional provisions is to limit the benefits of the treaty to bona fide residents of the contracting state.

As for the macro-role played by jurisdictional provisions, a signal feature of investment treaties is that they are negotiated and concluded by states, but confer the benefit of treaty protection on investors. Similarly, the ICSID Convention is a state instrument designed to structure dispute mechanisms accessible by investors in relation to disputes against states.

The ICSID Convention was designed to remedy the inherently international problem of the impracticality of diplomatic protection claims.⁶¹⁶ It sought, by consent of states, to fill a gap in the array of fora available to settle international investment disputes: that of a dispute between a foreign investor and a host state.⁶¹⁷

Other sets of protagonists already had available fora. Where both parties are states, they can resort to the International Court of Justice or the Permanent Court of Arbitration. Where both parties are private persons from different states, they are not the concern of international law, but may resort to the courts of their choice, or as defined by conflict of laws principles, or alternatively to the dispute resolution mechanisms of international arbitration institutions such as the ICC. Domestic

⁶¹³ To enlarge the phrase used by Alberro-Semerena in dissent: see *Aguas del Tunari*, above n 22, at 84.

⁶¹⁴ *ADF Group Inc v United States (Award)* ICSID ARB(AF)/00/1, 9 January 2003 at [147].

⁶¹⁵ See Chapter 6.2; and Jain, above n 49, at 38–40. See also *V SA*, above n 468, at 210.

⁶¹⁶ Campbell McLachlan *Equality of Parties before International Investment Tribunals* (Institut de Droit International, 18th Commission, Annuaire 79, 10 December 2018) at [98].

⁶¹⁷ Paul C Szasz “A Practical Guide to the Convention and Settlement of Investment Disputes” (1968) 1 Cornell Int’l LJ 1. See also St John, above n 336; and Amerasinghe, above n 125.

investors submit disputes between themselves and their own government to national courts and accordingly “fall outside the scope of an international convention intended to deal with foreign investment”.⁶¹⁸

Szasz’s analysis of the history of the negotiation of the Convention shows the reluctance of governments to accede to jurisdiction “beyond the absolutely essential minimum”⁶¹⁹ and in particular that governments wished to preclude “any possibility that they might later be pressured into settling disputes under the Centre with another government, or with one of their own nationals”.⁶²⁰ Broches confirms that the requirement in art 25 that the investor may *not* have the nationality of the State with which it has a dispute, is required because there is “no reason to have these international procedures be a substitute ... for domestic procedures for the settlement of disputes between a State and its own citizens”.⁶²¹

The jurisdictional provisions of the ICSID Convention were therefore designed to limit the jurisdiction of the Centre to international disputes as opposed to domestic ones, by reference to the nature of the dispute and the disputants.⁶²² The result is that “the services of the Centre are not available in connection with disputes between private individuals, between States ... or between a State and its own nationals”.⁶²³

The title of the ICSID Convention emphasises the point: it is the Convention on the Settlement of Investment Disputes between States and *Nationals of Other States*. As Schreuer explains, “[t]he basic idea of the Convention, as expressed in its title, is to provide for dispute settlement between States and foreign investors.”⁶²⁴ The text of the Convention reinforces that purpose. Articles 1(2) and 25(1) of the Convention both emphasise that arbitration will be conducted between the host state and a national of another contracting state (with a limited exception for domestic investors in the second clause of art 25(2)(b)).

The History of the Convention explains that the ICSID Convention intended to remove “some of the uncertainties and obstacles [facing] investors in any foreign

⁶¹⁸ Amerasinghe, above n 125, at 229.

⁶¹⁹ Szasz, above 617, at 10.

⁶²⁰ At 10.

⁶²¹ Broches, above n 124, at 202.

⁶²² IBRD, above n 216, at [25].

⁶²³ Amerasinghe, above n 125, at 228.

⁶²⁴ Schreuer and others, above n 26, at 160. To the same effect see Stern, above n 573, at 548.

country”.⁶²⁵ Doing so was especially important in the 1970s, as foreign investment began to flow into newly independent states. Therefore, in principle, states attempted to promote foreign investment by creating “a favourable investment climate for greater economic cooperation”, usually by extending substantive rights and procedural mechanisms to foreign investors through investment treaties.⁶²⁶ Recourse to those rights and remedies, which existed outside the domestic legal system of the host state, was to attract foreign investors that might not otherwise have been prepared to invest in that state.

In this light, it might more accurately be said that the purpose of investment treaties is to promote international investment—but only by a prescribed set or circle of investors corralled by nationality. The Tribunal in *SCI de Gaëta* explained this balance of purposes in investment treaties well:⁶²⁷

As for investment protection, it is fundamental that one’s nationality is clearly defined and proven. The idea is not to provide all investors in general with additional protection, but to fully guarantee foreign investors additional protection which they could not benefit from according to the national institutions.

8.3 Is treaty shopping by manipulation of corporate nationality prima facie contrary to the object and purpose of jurisdictional provisions in investment treaties?

If the purpose of art 25 is to exclude domestic investors from suing their own states, then, the use of corporate entities with convenient nationality for the purpose of access to the Convention and/or investment treaties is contrary to the purpose of jurisdictional provisions. It is unlikely that parties to the ICSID Convention strove to exclude suit by their own nationals directly, but were prepared to be subject to claims from a corporation of convenience owned and controlled by their own

⁶²⁵ International Centre for Settlement of Investment Disputes *History of the ICSID Convention* (Washington, DC, 1970) vol 1 at 2.

⁶²⁶ Sinclair, above n 7, at 363.

⁶²⁷ *SCI de Gaëta*, above n 118, at [181] (author’s translation).

nationals. If it were otherwise, the purpose of jurisdictional provisions is rendered impotent by corporate maneuvering.⁶²⁸

In *Phoenix Action*, the Tribunal emphasised its obligation:⁶²⁹

... to ensure that the ICSID mechanism does not protect investments that it was not designed to protect, because they are in essence domestic investments disguised as international investments for the sole purpose of access to this mechanism.

The same reasoning in relation to the purpose of art 25 of the Convention applies to investment treaties generally. Just as with the ICSID Convention, parties to investment treaties intend to benefit and encourage certain *foreign* investors to invest, not their own nationals, nor nationals of non-contracting states.

Furthermore, if jurisdictional provisions in investment treaties are interpreted to allow the benefits of investment treaties to be accessed by domestic investors and the nationals of third non-party states, the pool of potential claimants is increased to the point where jurisdiction *ratione personae* has little meaning. Moreover, the increased risk of claims can have practical consequences for contracting states and risks undermining the international investment treaty system. For instance, greater risk of claims promotes regulatory chill, while the costs of defending claims brought by domestic and third-party investors (and potentially satisfying awards) adds additional unanticipated burdens to a state's finances.⁶³⁰

There are two principal arguments to the contrary: first, that investment treaties ought not to discriminate between domestic and foreign investors; secondly, that a substantive approach to jurisdiction *ratione personae* unduly limits the utility of an investment treaty to encourage investment. These two arguments are addressed below.

⁶²⁸ See Lavista, above n 16, at 12.

⁶²⁹ *Phoenix Action*, above n 136, at [144]. To the same effect see *Loewen Group Inc v United States (Award)* ICSID ARB(AF)/98/3, 26 June 2003 at [223].

⁶³⁰ Lavista, above n 16, at 12.

Contrary argument 1: investment treaties ought not to discriminate between domestic and foreign investors

The Tribunal in *Rompetrol* reasoned that the object of encouraging investment was not abrogated by use of corporate structures for domestic investors to gain access to treaty protections, as it was not controversial for states to enter into international treaties, such as in respect of human rights and the environment, that apply to their own citizens. A trade treaty should be the same.⁶³¹

This analogy is questionable. It cuts across the apparent desire of contracting states to the ICSID Convention to avoid exactly that. The history of the ICSID Convention as reviewed above shows that states did not want to face claims from their own nationals. States have regularly made the submission to arbitral tribunals that allowing domestic investors to claim against them as a consequence of nationality planning would be improper.⁶³²

However, the *Rompetrol* argument poses an issue as to why foreign and domestic investors are treated differently. While a principle of international law is that domestic investors cannot bring international claims against their state of nationality,⁶³³ the rationale for that principle is opaque. Substantive treatment protections in investment treaties prohibit differential treatment of foreigners compared with domestic citizens, yet jurisdictional provisions do just that if interpreted to exclude foreign-incorporated corporates owned by citizens of the host state.⁶³⁴

During the drafting of the ICSID Convention, a number of states expressed concerns about the differential treatment of domestic and foreign investors, particularly due to constitutional rights of equality.⁶³⁵ Granting foreign investors substantive and procedural rights conferred privileges upon them that were not available to domestic investors. Broches dismissed this concern on the basis that states already granted foreign investors additional rights in order to attract foreign

⁶³¹ *Rompetrol*, above n 24, at [109].

⁶³² See Weiniger and Kantor, above n 192, at 535; Watson and Brebner, above n 39, at 316 and 318; and Valasek and Dumberry, above n 39, at 65 and 67–68. See also *Vacuum Salt*, above n 248, at 84.

⁶³³ See generally Sinclair, above n 339, at 92; and Michalopoulos and Hicks, above n 22, at 132–133.

⁶³⁴ Schreuer contends that the corollary of this situation is that treaty protections should be available to all investors but acknowledges this is not likely without an overarching multi-lateral investment treaty: above n 12.

⁶³⁵ St John, above n 336, at 165–166.

investment.⁶³⁶ In the same way, McLachlan points out that the ICSID Convention was deliberately drafted to exclude domestic investors⁶³⁷ and that the limitation to foreign investors “bears a direct relationship to the object of investment treaties, which is to promote and protect *foreign* investment”.⁶³⁸

Concerns about differential treatment of foreign and domestic investors based on the principle of equality were more recently dismissed in the context of the Comprehensive Economic and Trade Agreement (CETA) between Canada and the European Union. In September 2017, Belgium requested an opinion from the Court of Justice of the European Union (CJEU) as to whether the investment dispute provisions were compatible with the general principle of equal treatment.

Advocate-General Bot considered the equality principle was not engaged because “one category of undertakings referred to above is making international investments, whereas the other is making intra-Community investments”.⁶³⁹ Canadian investors in Europe were only comparable to European investors in Canada, not to intra-EU domestic investors.⁶⁴⁰ Bot cited three reasons for the distinction: investors in a foreign territory were operating in an unfamiliar environment; the mutual trust existing between members of the European Union did not apply to states outside the Union; and the purpose of the CETA dispute mechanisms was to promote foreign investment.⁶⁴¹ The CJEU agreed with the Advocate-General for what appear to be the same reasons, albeit expressed more briefly.⁶⁴²

The object of CETA to promote foreign, not domestic, investment is familiar to all investment treaties.⁶⁴³ The “mutual trust” point is perhaps particular to the European Union. The “unfamiliar environment” rationale is explained on the basis that foreign investors face additional challenges to domestic investors.⁶⁴⁴ Domestic

⁶³⁶ At 165.

⁶³⁷ McLachlan, above n 616, at [91]–[94].

⁶³⁸ At [108] (emphasis in original). See also St John, above n 336.

⁶³⁹ Opinion of Advocate-General Bot (29 January 2019) ECLI:EU:C:2019:72 at [203].

⁶⁴⁰ At [203].

⁶⁴¹ At [206]–[209].

⁶⁴² Opinion C-1/17 *EU-Canada CET Agreement* ECLI:EU:C:2019:341 at [179]–[186].

⁶⁴³ The *Institut de Droit International* adopted the point that the reciprocal nature of investment protection conforms to the equality principle in Campbell McLachlan *Equality of Parties before International Investment Tribunals: Resolution* (Institut de Droit International, 18 Res En, 31 August 2019), art 2(3).

⁶⁴⁴ Opinion of Advocate-General Bot, above n 639, at [84] and [87]–[88]. See also to the same effect Michalopoulos and Hicks, above n 22, at 122.

investors need not surmount the same geographic, cultural, logistical and regulatory hurdles (such as overseas investment approval) faced by foreign investors. Moreover, domestic investors have direct recourse to the political apparatus of the host state, while foreign investors can only influence the political system of the host state indirectly.

Fundamentally, the rationale for distinction between foreigners and domestic investors rests on the concept of sovereignty of a state over its own citizens, and the absence of any benefit to the state from the extension of protections to domestic investors. The latter is straightforward: states assume that they are likely to benefit from investment by domestic investors regardless of the existence of treaty protections. In any event, a treaty with another state would be an unusual means to provide investment protections to domestic investors, when a state can simply legislate appropriately.

Extension of treaty protections to domestics would also impact upon a state's sovereignty by upsetting the flexibility states ordinarily have over domestic legal and economic matters. If the benefits of an investment treaty were conferred on a state's own nationals, a state's ability to enact economic and regulatory laws over its own populace by legislation in the usual way is impaired. All fiscal policy would be subject to the constraints of a treaty which can only be altered by agreement with another contracting state or states. This would result in *de facto* influence for contracting states over the domestic affairs of their treaty partners.

Sovereignty would be further eroded by state consent to suit by its own nationals before an international tribunal supervised by the courts of a third state. This situation results in *de facto* influence by foreigners (the tribunal) and a third state's courts over domestic affairs of the respondent state. It is understandably more desirable for a state to adjudicate disputes with its citizens in municipal courts steeped in the legal, political and cultural context of the state.

Although states already face the same sovereignty consequences with regard to foreign investors, there is no *quid pro quo* with respect to their own investors. As they are not promoting foreign investment, there is therefore nothing gained.

Customary international law supports a principled distinction between domestic and foreign investors in this context, by reference to state sovereignty and

its associated connection with nationality. One corollary of state sovereignty is “a jurisdiction, prima facie exclusive, over a territory and the permanent population living there”.⁶⁴⁵ A state’s jurisdiction over its nationals falls within its domestic jurisdiction;⁶⁴⁶ the state is free to enact civil and criminal laws that apply within its territory, including in respect of investments.

The concept of nationality emphasises the connection between state and individual.⁶⁴⁷

Nationality serves above all to determine that the person upon whom it is conferred enjoys the rights and is bound by the obligations which the law of the State in question grants to or imposes on its nationals.

Nationality therefore invokes “principles of responsibility and protection”.⁶⁴⁸ “in a conservative state-dominated system, [a national’s] primary public allegiance is to their own state, and they are defined in significant part by reference to their state”.⁶⁴⁹ A natural consequence of the relationship between a national and its state is that domestic matters, including treatment of domestic investments, should be resolved by that state’s courts. Access to international courts would be an impermissible incursion into sovereignty and diplomatic jurisdiction.⁶⁵⁰

The relationship between a state and a foreign national is different. A state does not usually exercise jurisdiction over foreign nationals, except by agreement with their state of nationality or in certain other circumstances.⁶⁵¹ States admit foreign nationals into their territory by consent (sometimes with conditions),⁶⁵² and they can also remove those same nationals once admitted.⁶⁵³

⁶⁴⁵ James Crawford *Brownlie’s Principles of Public International Law* (9th ed, Oxford University Press, Oxford, 2019) at 431.

⁶⁴⁶ At 495. See Charter of the United Nations 1 UNTS XVI (opened for signature 26 June 1945, entered into force 24 October 1945) [UN Charter], art 2(7).

⁶⁴⁷ *Nottebohm*, above n 41, at 20.

⁶⁴⁸ Crawford, above n 645, at 591.

⁶⁴⁹ At 520.

⁶⁵⁰ With rare permissible exceptions in respect of human rights or humanitarian law.

⁶⁵¹ Crawford, above n 645, at 441.

⁶⁵² At 593.

⁶⁵³ Although that right is not unfettered, as the ICJ held in *Ahmadou Sadio Diallo*, above n 354, at 663.

However, once admitted to the state, the legal position in respect of the foreign national is more complicated than domestic investors. The host state exercises territorial jurisdiction over the foreign national, who must conform to that state's laws,⁶⁵⁴ but the foreign national is not deprived of the protection of its state of nationality, which maintains an interest in its nationals when abroad.⁶⁵⁵ The requirement in diplomatic protection law that the alien exhaust local remedies before seeking diplomatic protection reflects the tension between the interests of its state of nationality and the host state of its investment.⁶⁵⁶ Any dispute between the host state and the foreign national is therefore of an international flavour, whereas the same is not true for domestic disputes.

The consequence of these distinctions is that, “[d]isputes between a State and its own nationals are settled by that State’s domestic courts.”⁶⁵⁷ This same factor motivates Weil’s dissent in *Tokios*; a domestic dispute should not be converted into an international one. The flexibility of capital does not change the fundamental requirement to preserve the international element of a dispute.⁶⁵⁸

Contrary argument 2: a substantive approach to jurisdiction *ratione personae* unduly limits the utility of an investment treaty to encourage investment

The second argument which promotes a broad view of the purpose of investment treaty instruments that would extend coverage to domestic and third-state investors is that limiting treaty coverage of investors equally limits the utility of a treaty as a tool to encourage foreign investment. To recall, by way of example, the Tribunal majority in *AdT*, Schill, and Douglas argue that a broad definition of “national” in investment treaties is entirely consistent with the goal of encouragement of foreign investment.⁶⁵⁹ The assumption is that all investment is good investment.

⁶⁵⁴ Crawford, above n 645, at 596.

⁶⁵⁵ At 596.

⁶⁵⁶ At 596.

⁶⁵⁷ At 596. To similar effect see Valasek and Dumbery, above n 39, at 42.

⁶⁵⁸ Compare, for example, Robert Wisner and Nick Gallus “Nationality Requirements in Investor-State Arbitration” (2004) *J W Inv & Tr* 927 at 944–945; and Francisco Orrego Vicuña “Changing Approaches to the Nationality of Claims in the Context of Diplomatic Protection and International Dispute Settlement” (2000) 15 *ICSID Rev* 340 at 349.

⁶⁵⁹ *Aguas del Tunari*, above n 22, at [332]. To the same effect see Schill, above n 7, at 235; and Douglas, above n 7.

However, such an approach is “not principally or even apparently driven by any clear concepts of international law”⁶⁶⁰ and may have adverse commercial implications:⁶⁶¹

... there can be little doubt that the very real possibility of ‘treaty forum shopping’ by investors, as permitted by international law, will cause more than a few States – and not merely those which are commonly thought of as capital-importing States – to reconsider the renewal (at least in current form) of their network of BITs.

Several commentators doubt that states knew what they were signing up for by agreeing to permissive definitions of investor in investment treaties. Guzman, for example, challenges the notion that treaty negotiators fully grasp the implications of investment agreements at the time of execution, particularly so far as capital-importing countries are concerned,⁶⁶² and in circumstances where until the mid-1990s there was a paucity of investment treaty jurisprudence regarding the interpretation of such treaties.⁶⁶³

Yet other states encourage investment vehicles owned by third party nationals to gain access to investment treaties on the basis that a “network of bilateral investment treaties is seen as being an important part of the country’s ability to attract investment and be a commercial centre”.⁶⁶⁴ An example is the Netherlands, which:⁶⁶⁵

⁶⁶⁰ McLachlan, Shore and Weiniger, above n 13, at [5.81]. See also the backlash by developing states which have terminated or refused to renegotiate investment treaties with the Netherlands partly due to treaty shopping concerns as reported by Kabir AN Duggal and Laurens H van de Ven “The 2019 Netherlands Model BIT: riding the new investment treaty waves” (2019) 35 *Arb Int’l* 347 at 352.

⁶⁶¹ At [5.82].

⁶⁶² Andrew T Guzmán “Why LDCs sign Treaties That Hurt Them: Explaining the Popularity of Bilateral Investment Treaties” (1998) 38 *Va J Int’l L* 639.

⁶⁶³ Lee, above n 14, at 360.

⁶⁶⁴ Volterra, above n 20, at 25. To the same effect see Sinclair, above n 7, at 363.

⁶⁶⁵ van Os and Knottnerus, above n 53, at 38. Although as noted in Chapter 11 the Netherlands Model BIT 2019 has introduced restrictions on treaty shopping. See also information about the Netherlands’ “dense BIT-network” and involvement in investment disputes in Duggal and van de Ven, above n 660, at 349–351.

... prides itself on the scope of application of its BITs, which expressly aim to include indirectly controlled investors and allows entities with no substantial ties to a contracting state to avail themselves [of treaty protections].

In this paradigm, the network of mainly bilateral investment treaties “to all intents and purposes functions as a multilateral system of investment protection”.⁶⁶⁶

The underlying philosophical objections to acceptance of corporations of convenience as portals for access to investment treaties are that it extends the scope of the obligations of treaty states in an almost limitless way by expanding the potential class of claimants, and, moreover, does so in the absence of reciprocity.

The principle of reciprocity contends that treaties establish reciprocal rights and obligations between contracting states. The bargain struck by states who are party to a BIT confers certain advantages upon the nationals of the contracting states. This bargain is reciprocal: both states confer procedural and substantive advantages upon the other’s nationals, with the hope of promoting foreign investment in their own territory.⁶⁶⁷

Treaty shopping cuts across this principle because an entity with no substantive connection to a contracting state may avail itself of treaty protections that the state of its controllers is not prepared to reciprocate to investors from the host state.⁶⁶⁸ Treaty shopping may also permit multinational companies to circumvent obligations in less favourable investment treaties that require, for example, reciprocal obligations by investors in relation to sustainable development or human rights.⁶⁶⁹ Lee contends that “many states complain that [treaty shopping] violates the principle of reciprocity, abuses their consent and negatively impacts their sustainable development”.⁶⁷⁰ The same view was reached by the OECD

⁶⁶⁶ At 11.

⁶⁶⁷ A useful discussion of reciprocity in this context is Baumgartner, above n 1, at [2.3.1].

⁶⁶⁸ Lee, above n 14, at 358. To the same effect see M Sornarajah *The International Law on Foreign Investment* (2nd ed, Cambridge University Press, Cambridge, 2004) at 8.

⁶⁶⁹ Sornarajah, above n 668, at 12. See also Peter Muchlinski “Corporations and the Uses of Law: International Investment Arbitration as a ‘Multilateral Legal Order’” (2011) 1 Onati Socio-Legal Series; and Luke Eric Peterson *Human Rights and Bilateral Investment Treaties: Mapping the role of human rights law within investor-state arbitration* (Rights & Democracy (International Centre for Human Rights and Democratic Development), 2009).

⁶⁷⁰ Lee, above n 14, at 357.

Committee regarding treaty shopping for double tax treaties as discussed in Chapter 6.⁶⁷¹

Arguably, the principle of reciprocity is violated in a more extreme sense when a corporation of convenience is used as a vehicle to gain investment protection for domestic capital re-invested in the host state. This is because in this situation, no new capital has been attracted by the treaty; that capital has simply procured new rights that it did not have before, while.⁶⁷²

Reciprocity dictates that the host state ought to receive some converse benefit for submitting themselves to arbitration. This is unlikely to be the case where the dispute is *de facto* a wholly domestic matter.

In the same way, the bargain struck between contracting states to an investment treaty is similarly upset if a third-state investor is permitted to access that treaty by routing an investment through a company incorporated in a contracting state for the main purpose of procuring treaty benefits.⁶⁷³ The balance of reciprocal rights and obligations is upset when entities from a third non-party state piggy-back their way into the benefits of a treaty without their real state accepting any of the corresponding obligations owed to investors of other contracting states.⁶⁷⁴ The loss to the home state is twofold: it is potentially subject to claims from third state investors, while its own nationals do not gain treaty benefits in the third state.

Something similar to third party piggy-backing was considered and rejected during the drafting of the ICSID Convention. In response to a proposal that would allow investors whose states of nationality were not party to the ICSID Convention to be party to arbitrations conducted under the Convention,⁶⁷⁵ Broches explained that would undermine the “essential reciprocal obligations between the host State and the investor’s home State under the Convention”, including renouncement of diplomatic protection and reciprocal protection for one’s own nationals (as well as

⁶⁷¹ OECD Committee, above n 429, at R(6)-4. See also Duff, above n 426, at 79; and Li, above n 490, at 192.

⁶⁷² Lee, above n 14, at 359.

⁶⁷³ At 358. To the same effect see Sornarajah, above n 668, at 8.

⁶⁷⁴ Sinclair, above n 7, at 358.

⁶⁷⁵ Schreuer and others, above n 26, at 164.

enforcement challenges).⁶⁷⁶ Broches' comment supports the point made above; this would allow a benefit to be achieved without anything being given in return.

As noted in Chapter 3.3, in his dissent in *AdT*, Alberro-Semerena argues that unfettered use of corporations of convenience would leave "the balance between the benefits and obligation of the host State ... broken".⁶⁷⁷ If the concepts of corporate nationality and control are not approached in a substantive manner, "the universe thereby [becomes] infinite ... [t]here is nothing in the wording of the Bilateral Investment Treaty that narrows its scope."⁶⁷⁸ This view is supported by the respondent's expert witness in that case, Dolzer: "such a [formalistic] system would not be compatible with the basic concepts of appropriate reciprocity" which requires a relationship of identical and equivalent treatment.⁶⁷⁹

The purpose of the ICSID Convention and investment treaties generally requires that a balance be maintained between the competing interests of states and between the interests of states and investors. Broches declared that "[t]he drafters [of the Convention] have taken great care to make it a balanced instrument serving the interests of host States as well as investors."⁶⁸⁰

The need for a "true balance between the interests of the investors and the rights of the States in the international system of investment protection"⁶⁸¹ is destabilized by corporations of convenience that "are understood not to contribute economically or socially to the fabric of the State in which they are incorporated."⁶⁸²

Accordingly, use by claimants of corporations of convenience as a mechanism to bypass the restrictive purpose of jurisdictional provisions in a treaty violates the boundaries that contracting states seek to set on their obligations and abrogation of sovereignty. In the case of domestic investors, no reciprocation is received in terms of additional investment, and in the case of third-state investors, no reciprocation is received for the respondent state's nationals in terms of treaty protections in the third state. In both circumstances, treaty shopping is contrary to the object and purpose of jurisdictional provisions.

⁶⁷⁶ At 164.

⁶⁷⁷ *Aguas del Tunari*, above n 22, at [8].

⁶⁷⁸ At [9].

⁶⁷⁹ At [8].

⁶⁸⁰ Broches, above n 124, at 197. To the same effect see IBRD, above n 216, at 5.

⁶⁸¹ Stern, above n 573, at 549–550.

⁶⁸² Sinclair, above n 7, at 385.

8.4 Conclusion

Literal interpretation of definitions of nationality can lead to situations where jurisdiction *ratione personae* becomes a meaningless formality that opens the potential pool of beneficiaries to the World, including nationals of the respondent state. Such scenarios emasculate the object and purpose of jurisdictional provisions such as art 25(2) of the ICSID Convention and in investment treaties. In doing so, the legitimacy of ICSID and the investment treaty regime more generally is endangered by upsetting the balance of obligations and principle of reciprocity inherent in the investment treaty regime.

The encouragement of investment is not the only or unfettered object of the ICSID Convention or investment treaties. Article 25 of the ICSID Convention is designed to prevent use of corporate nationality to permit nationals effectively to sue their own states. Jurisdictional provisions in treaties have the same purpose as art 25—to prescribe the beneficiaries of treaty benefits to maintain an appropriate balance between the competing interests of states, and between the interests of states and investors.

The object of stimulating capital flow ought not to be taken to an extreme that assumes that contracting states to the Convention, or to investment treaties, intend benefits to be accessible to entities of third non-contracting states, or their own domestic investors, through corporate nationality planning. States could permit such treaty shopping if unambiguous words to that effect were used in a treaty and ad hoc arbitration, rather than ICSID arbitration, were specified. But in the absence of such express permission, the assumption should be that states intend jurisdictional provisions to be interpreted holistically, not literally, where corporations of convenience are used to manipulate the nationality of outsiders to the bargain.

A substantive approach is supportive of the object and purpose of investment treaties and the Convention in a more nuanced and balanced sense: it seeks to encourage foreign investment, but only from entities that are genuine nationals of the contracting parties in a substantive sense. This is the approach taken in tax treaty law as explained by Jain and illustrated in *V SA* and *N AG* (see Chapter 6): the object

and purpose of the treaty requires a substantive approach to bona fide nationality of treaty beneficiaries.⁶⁸³

Conservatism in respect of qualifying beneficiaries of investment treaties is appropriate: contracting states shoulder the obligations of the treaty as well as hoped for benefits, while foreign investors stand to benefit from protections without obligation. Accordingly, access to those benefits must be limited to genuine investors of contracting parties only. Having chosen to negotiate and conclude an investment treaty with a particular state, rather than with the World at large, the irresistible conclusion is that each contracting state means only to enter into this bargain with investors that are *in reality* from the other contracting state or states, as opposed to investors from third countries that seek to attain nationality of a contracting state so as to acquire the benefits of treaty protections.⁶⁸⁴

This approach fits with the way in which the jurisdictional provisions of the Convention were envisaged to prescribe outer limits beyond which the discretion of contracting states was not effective. As explained in Chapter 2, parties to the Convention have the “widest possible latitude” to agree on nationality so long as it is “based on a reasonable criterion”.⁶⁸⁵

However, in regard to nationals of the host state, Broches was adamant that the ICSID Convention was not intended to create procedures for the settlement of disputes between a State and its own citizens.⁶⁸⁶ For these two principles to co-exist, the “reasonable criterion” caveat must apply not only to the reasonableness of a particular criterion, but also to whether, in the circumstances of a particular case, the criterion provides a reasonable result in light of the object and purpose of the Convention.

At essence, the literal approach does not query whether the use of the incorporation criterion (or any other criterion) is reasonable in the circumstances of a particular case; rather it adopts a circular argument that a criterion must be reasonable because the parties have agreed on it, or that a criterion is reasonable because it is common. The failure to assess the reasonableness of the *application* of

⁶⁸³ Jain, above n 49, at 38; *V SA*, above n 468, at 210; and *N AG*, above n 469, at 900.

⁶⁸⁴ Wisner and Gallus, above n 658, at 944–945. See also Feldman, above n 16, at 301–302.

⁶⁸⁵ Broches, above n 25, at 361.

⁶⁸⁶ Broches, above n 124, at 202.

nationality criteria in the circumstances of each case is what leads the literal cases to pronounce results that offend the object and purpose of the jurisdictional provisions of the Convention.

A substantive approach therefore has an important role to play to avoid unreasonable consequences of a formalistic approach to corporate nationality. State discretion is fettered by the object and purpose of the ICSID Convention and/or investment treaties. The nationality criteria set out in a treaty or agreement must be applied, unless the result is unreasonable in a substantive sense based on the object and purpose of the relevant treaty instrument, for example where mere instrumentalities are used to gain access to treaty benefits.

How a substantive analysis might operate in a way that provides reasonable certainty for states and investors and avoids unworkable complexity for tribunals is addressed in Chapters 9 and 10. It will be argued that while some approaches to substantive nationality, such as control, suffer in some cases from undue complexity and uncertainty, an inquiry into the *purpose* for which nationality is obtained and relied on in the context of the particular investment is not overly complex. Neither is it unduly uncertain for an investor because it must know its purpose in the ownership chain of the investment. Chapter 11 will then explore the various means by which a purposive substantive approach can be adopted into investment treaty jurisprudence.

9 Giving substance to a substantive approach 1: the problems with control and substantial business activity

9.1 Introduction

The allocation of nationality agreed by the parties to a treaty for jurisdictional purposes is properly interpreted in a two-stage process. First, the application of the literal criteria which, if fulfilled, results in a presumption of jurisdiction, and secondly, an objective substantive assessment of reasonableness as to: the criteria selected by the parties; and the application of those criteria in the particular circumstances of the case to ensure consistency with the object and purpose of the Convention and/or the relevant investment treaty.

This method permits a presumption that the criteria agreed by states in a treaty are generally effective to determine nationality and jurisdiction *ratione personae*, but recognises the parties' discretion is not boundless.⁶⁸⁷ Agreed criteria may give rise to a “strong presumption” that a certain situation affords an entity the status of a national of a contracting state.⁶⁸⁸ But, as explained in Chapter 8, the exercise of the discretion must be consistent with the object and purpose of the instant treaty instrument (and, if applicable, the ICSID Convention) that does not permit the use of a nationality of a formal nature to provide access to ICSID and/or investment treaties.

This thesis will now examine how a substantive test can work in investment treaty law by evaluating the criteria relevant to a substantive approach to corporate nationality and exploring the means by which a serviceable purposive test can be implemented in a principled practical way.

While commentators and some tribunals promote a substantive approach to corporate nationality in investment treaty law (as canvassed in the Chapters 3.3 and 8), a paucity of jurisprudence or commentary grapples with the *substance* of a substantive approach to corporate nationality.

An important aspect of this discussion is the issue of certainty. The prospect of a substantive approach to nationality threatens to lead to the “thicket” of which

⁶⁸⁷ See *Phoenix Action*, above n 136, at [82].

⁶⁸⁸ *CSOB (Jurisdiction)*, above n 138, at [64].

the Tribunals in *AdT* and *Autopista* warned: “[f]inding the ‘ultimate’, or ‘effective’, or ‘true’ controller would often involve difficult and protracted factual investigations, without any assurance as to the result.”⁶⁸⁹

Some judges and commentators regard the complexities of international corporate structures as creating “a complication, but not an incapacity”⁶⁹⁰ and that a substantive approach “would catch the company that has adopted a nationality of convenience”, even though there would be “practical difficulties in working out the details”.⁶⁹¹

But these declarations say nothing as to how that might happen. They also approach the issue from the perspective of a tribunal weighing factors in retrospect, as opposed to that of a putative investor assessing treaty protection prospectively. Taken too far, uncertainty as to treaty coverage has the potential to frustrate the object of investment treaties to stimulate foreign investment because, “the critical issue of whether the investment of the putative investor is covered by the treaty will be incapable of resolution at the investment planning stage”.⁶⁹² On the other hand, the legal certainty inherent in the incorporation theory of corporate nationality comes with the “disadvantage” of the “existence of pseudo-foreign corporations”.⁶⁹³

Accordingly, a solution must strike a balance between competing purposes—to encourage investment, but not to the point that the rights available under investment treaties are appropriated so as to be readily available to every investment from anyone anywhere.⁶⁹⁴

This Chapter considers the merits of the two traditional contenders as substantive test yardsticks: control and substantial business activity. As discussed in Chapter 2, the third generation of investment treaties have shown a greater tendency “to exclude purported strangers to the agreement” by requiring some kind of substantive economic connection with the contractual state of which it claims

⁶⁸⁹ *Aguas del Tunari*, above n 22, at [246] citing *Autopista*, above n 61, at [69].

⁶⁹⁰ *Barcelona Traction*, above n 3, at 283 per Judge Gros.

⁶⁹¹ Harris, above n 366, at 295.

⁶⁹² Douglas, above n 7, at [556]. This point was also made in *Aguas del Tunari*, above n 22, at [247]: “[i]f an investor cannot ascertain whether their ownership of a locally incorporated vehicle for the investment will qualify for protection, then the effort of the BIT to stimulate investment will be frustrated.”

⁶⁹³ Pannier, above n 76, at 12.

⁶⁹⁴ See the comments about balancing these objectives in *El Paso Energy International Co v Argentina (Jurisdiction)* ICSID ARB/03/15, 27 April 2006 at [70].

nationality.⁶⁹⁵ This is often achieved using an express control test and/or a requirement for substantial business activity (also known as “effective economic activity”,⁶⁹⁶ or substantive or real economic activity) in the definition of “investor”, “national” or in a denial of benefits clause.⁶⁹⁷

In addition, and conveniently, control and substantial business activity are common tests applied by tax courts to assess the bona fides of claimants of tax credits under double tax treaties.⁶⁹⁸ For this reason, this Chapter draws on tax treaty jurisprudence to assess the utility of these criteria as substantive tests.

However, control and substantive business activity criteria are not effective arbiters of substantive nationality, at least not as stand-alone tests. This Chapter will illustrate the concerns about uncertainty that attach to these tests are well-founded and reliance on these tests in isolation may undermine the encouragement of foreign investment. Specifically, identification of the ultimate controller can be a complex and byzantine exercise that is subject to change and the question of what is substantial or effective so far as business activity is concerned is too malleable to provide any reasonable certainty to putative investors.

Further, while the degree of business activity undertaken by the putative corporate claimant in its home state and the extent of actual control it has over the investment will be relevant to a purposive inquiry as to nationality—particularly if these factors are absent—their presence does not necessarily exculpate a corporate structure from abusive behaviour. While the substantive business activity and control criteria are relevant to a substantive economic approach to jurisdiction *ratione personae*, reliance on one factor to the exclusion of others can lead to error.⁶⁹⁹

9.2 Control

Control is a familiar concept to investment treaty law. It appears in various contexts: by virtue of art 25(2)(b) of the ICSID Convention (as discussed in Chapters 2 and 7.2); as a link between an investor and an investment in many investment

⁶⁹⁵ Skinner, Miles and Luttrell, above n 40, at 270.

⁶⁹⁶ See, for example, Chile-Indonesia BIT, art 1(1)(b); and see Benedict and others, above n 4, at 14.

⁶⁹⁷ For example, these criteria are identified as substantive tests by Hansen, above n 35.

⁶⁹⁸ See, for example, *A Holding ApS*, above n 446.

⁶⁹⁹ Jain, above n 49, at 77–124.

treaties (as set out in Chapter 2); as part of art 9 of the ILC Draft Articles on Diplomatic Protection (as explained in Chapter 5); and as a common component of denial of benefits provisions (see Chapter 2 and to be discussed in Chapter 11.3).

Control is the central philosophical difference between the nationality of natural persons and corporates. Corporations are inherently different to natural persons:⁷⁰⁰

... in that they can exist only through extraneous ownership and control, both of which attributes may be held or exercised in a range from single to multifarious and multi-levelled in contrast to a natural person who ... is always and only him - or herself.

It is therefore not surprising that some commentators identify the concept of control as the antidote to the perceived excesses of treaty shopping made possible by the formal approach to corporate nationality. Schlemmer, in particular, advocates control as “the only criterion that requires a real connection”.⁷⁰¹ Similarly, Hansen contends that to be entitled to the benefits of an investment treaty, a putative claimant must have real control or substantive dominion over the investment and its proceeds as opposed to mere formal or legal control.⁷⁰²

The logic to this approach is that truly to own or control property connotes the ability to do with it as one pleases; to have dominion or control over it. Dominion/control in a substantive sense is the very essence of ownership of an asset; the owner has the right to use and enjoy a thing as against others who have a duty not to do so.⁷⁰³

If the entity that has overwhelmingly dominant control in the sense of the enjoyment of these liberties in respect of an investment could be specified, then that may relocate the search for the relevant nationality to that of the ultimate controller, or so the argument appears to go. However, this is supposition, because while

⁷⁰⁰ Benedict and others, above n 4, at 45.

⁷⁰¹ Schlemmer, above n 34, at 87. Schlemmer highlights Judge Jessup’s determination to look to “economic reality” in *Barcelona Traction*, above n 3, at 169. See also Zhang, above n 39, at 53.

⁷⁰² Hansen, above n 35, at 543–545.

⁷⁰³ John William Salmond and PJ Fitzgerald *Salmond on Jurisprudence* (12th ed, Sweet & Maxwell, London, 1966) at 246.

Schlemmer, Hansen and others promote a control test, they do not opine as to how that test might be formulated or applied. An investigation as to the practicalities of a control test reveals that it may raise as many issues as it solves.⁷⁰⁴

Legal or actual control?

A primary issue is whether the requisite control required is legal control—the legal ability or capacity to control an asset—or evidence of actual control of an asset.

There is a distinct division between cases that favour legal capacity to control over actual or ultimate control. For example, the majority in *AdT* found that the relevant treaty requirement to control the investment directly or indirectly refers simply to “the legal capacity to control an entity” rather than “actual day-to-day or ultimate control”.⁷⁰⁵ Similarly, other literal cases such as *Yukos*,⁷⁰⁶ *Mobil Corporation*,⁷⁰⁷ and *Autopista* disregard evidence of actual control in favour of the legal formalities that evidence the legal potential to control the relevant investment.⁷⁰⁸

Conversely, the Tribunals in *AMTO*,⁷⁰⁹ *TSA Spectrum*,⁷¹⁰ *Vacuum Salt*,⁷¹¹ and *Sedelmayer*,⁷¹² investigate factual elements to identify foreign control objectively through layers of formal corporate structures, thereby implicitly rejecting the notion that control refers simply to legal capacity to control.

The primary observation of this thesis about the legal and actual control theories is that neither is serviceable as a principle to guide a substantive approach to the identification of a bona fide investor.

Legal control is not apposite to the problem of corporate manipulation of nationality because it does not delineate between conduit holding companies and companies with more substantive connections to a particular state. If all is required

⁷⁰⁴ See the discussion in Baumgartner, above n 1, at [4.3.4] and [4.4].

⁷⁰⁵ *Aguas del Tunari*, above n 22, at [264].

⁷⁰⁶ *Yukos*, above n 24, at [508]–[511].

⁷⁰⁷ *Mobil*, above n 23, at [159]–[160].

⁷⁰⁸ *Autopista*, above n 61, at [119]–[121].

⁷⁰⁹ *AMTO LLC*, above n 120, at [67].

⁷¹⁰ *TSA Spectrum*, above n 30, at [160]–[162].

⁷¹¹ *Vacuum Salt*, above n 248, at [35] and [41]–[54].

⁷¹² *Sedelmayer v Russia (Award)* Staffan Magnusson, Jan Peter Wachler, Ivan S Zykin, Hakan Sandesjo 7 July 1998 at [225] and [227].

is the holding of a certain number of shares, or shares with certain rights, so as to demonstrate the capacity to control an asset in a legal sense, then that test can be met equally by a shell company with no substantive connection to its state of incorporation as it can by an entity with, for instance, substantial business activities in its home state. Failure to look beyond legal control undermines the purpose of a control test.⁷¹³

Presumably then, Schlemmer and Hansen are referring to evidence of actual control: that for the purpose of investment treaties, corporate nationality is to be determined by the nationality of the ultimate actual controller of the investment; the ultimate decision maker in reality. As examined below, the primary problem with this approach is that of complexity leading to excessive uncertainty.

The uncertain quest for ultimate control

As long ago as 1931, Beckett's review of the doctrine of control as a method to establish the nationality of companies concluded that it "would be extremely difficult to work in practice".⁷¹⁴ His principal concerns were that:⁷¹⁵

... as the control of the company may pass from one hand to another, the application of the doctrine of control means that the nationality of the company may also change, and it may require a considerable investigation of the actual facts of the management of any given company to ascertain what its nationality is at any given time.

These comments reveal two aspects to the uncertainty issue: identifying the ultimate controller in complex corporate structures, and the fact that the controller(s) may change at any time.

For the same reasons, van Hecke observed in the 1960s that the "control test is particularly incapable of giving a positive answer to the question of nationality".⁷¹⁶ By 1970, the majority of the ICJ in *Barcelona Traction* warned a control test might

⁷¹³ See recognition of this point by Voon, Mitchell and Munro, above n 39, at 57.

⁷¹⁴ Beckett, above n 2, at 182.

⁷¹⁵ At 182.

⁷¹⁶ van Hecke, above n 387, at 233.

“create an atmosphere of confusion and insecurity in international economic relations”.⁷¹⁷

More recently, Schill echoed these concerns noting that the control theory becomes increasingly difficult as layers of corporate structures are added and numbers of shareholders and their nationalities increase. He adds that determining nationality on a control basis is likely to entail significant, if not prohibitive, cost.⁷¹⁸

These difficulties with the control theory of nationality have not escaped investment treaty tribunals. In *TSA Spectrum*,⁷¹⁹ pursuing objective control up to its real source was described as problematic because ultimate control must always lie in natural persons, being the shareholders of the ultimate corporate vehicle in any corporate structure. These shareholders can be liable to change and issues of control may also be relevant to these ultimate shareholders because of beneficial ownership arrangements and/or the particular rights attaching to different classes of shares. The Tribunal in *Amco* recognised that such a test requires identification of “control at the second, and possibly third, fourth, or xth degree”.⁷²⁰

When the control test was discussed at the consultative meetings of legal experts during ICSID Convention negotiations, numerous difficulties were identified with the application of the control test including problems in establishing control with diverse shareholdings, the standing of bearer shares, shareholding by holding companies and nominees, the details of voting rights attaching to shares, ownership of shares by trusts, and various other forms of disguised ownership.⁷²¹ There was also controversy about the amount of control required: does the nationality of the juridical entity follow the nationality of the shareholders with the most control, or does it suffice to exhibit merely an exercise of a reasonable amount of control?⁷²² A precise definition of control did not emerge from these discussions.⁷²³

In other words, control over a corporate entity is not a straightforward phenomenon and complexity is likely to rise with the number of corporate layers

⁷¹⁷ *Barcelona Traction*, above n 3, at 214.

⁷¹⁸ Schill, above n 7, at 234–235.

⁷¹⁹ *TSA Spectrum*, above n 30, at [147].

⁷²⁰ *Amco*, above n 138, at [14].

⁷²¹ Amerasinghe, above n 125, at 227.

⁷²² At 264–265.

⁷²³ At 264. See also to the same effect, Schreuer and others, above n 26, at 864.

within which the putative claimant is embedded. At each level, the corporate structure may fragment and involve any number of shareholders of various nationalities, potentially with diverse shareholder rights, and the shareholders (and hence the nationality of the shareholders) can change at any time.⁷²⁴

Different levels of actual control are also likely to exist in multiple level corporate structures, as management and decision-making processes are delegated throughout the organisation. The CEO or general manager of one subsidiary may have actual control up to a certain level of decision, with decisions of larger magnitude reserved for the parent company. Thus, problems “might arise in constellations with multiple levels of ownership by people/companies from various states”.⁷²⁵ The globalised commercial world.⁷²⁶

... makes it very complicated and often impossible to define through academic legal formulas how a control relationship can actually be expressed, especially if this relationship is at the base of participation and aggregation links between different companies.

Not every case may be complex, and even complex cases may be able to be worked through. The heart of the problem, however, is not complexity per se, but its consequence: that the uncertainty to which a control test would give rise would.⁷²⁷

... run counter to the object and purpose of investment promotion and protection treaties, which seek to stimulate investment flows by giving investors the confidence of knowing whether their capital and investment vehicles [will] qualify for treaty protection.

⁷²⁴ For the same reasons, Rabel rejected the control theory as impracticable and unjust as a basis for the determination of the personal law of a company in conflicts law: see Rabel, above n 417, ch 19 at 60–62.

⁷²⁵ Benedict and others, above n 4, at 65 (emphasis in original).

⁷²⁶ Acconci, above n 379, at 139. See also Pannier, above n 76, at 12.

⁷²⁷ Sinclair, above n 7, at 373.

This is the same point made by Douglas and the majority in *AdT* mentioned in the introduction to this Chapter.⁷²⁸ The more uncertain the definition of control and the more complex the corporate structure, the more difficult it is for an investor to know whether the definition of investor in a specific treaty is met.⁷²⁹ This practical issue undermines one purpose of investment treaties: to encourage foreign investment, for the sake of another: to limit coverage to bona fide nationals of a contracting state other than the respondent state.

When the search is for the ultimate controller, these objectives are at direct odds. One goal should not be at the expense of the other; ideally a more balanced outcome is required.

A further limitation on the utility of control

In tax treaty law, the concept of control is focused on whether the entity seeking tax relief under a tax treaty has actual control (in the sense of substantive dominion) over the income-producing asset and the income received from it. If it does not, then that will be determinative of an impermissible use of a conduit company to attempt to access tax treaty benefits.

However, Jain points out that it does not necessarily follow that an entity with substantive actual control over assets/income is necessarily a bona fide entity entitled to the benefits of a tax treaty.

Double tax treaty jurisprudence has recognised the importance of the concept of control as a tool to identify the beneficial owner of income since the 1977 Commentary to the OECD Model Convention expressly excluded agents and nominees from qualifying as the beneficial owner of income on the basis that agents and nominees are bound in law to pass on income to their principal or nominator. That is, an agent or nominee has no substantive control or dominion over funds that are temporarily, although legally, in their possession. The OECD's Conduit Companies Report of 1987 explained that the requirement for control also applies to a conduit company, which will not be regarded as the beneficial owner of funds

⁷²⁸ Douglas, above n 7, at [556]; and *Aguas del Tunari*, above n 22, at [247].

⁷²⁹ See also Benedict and others, above n 4, at 78–79.

despite legal control where, in fact, it has limited powers to deal with the funds and acts as a mere fiduciary for others.⁷³⁰

Therefore, absence of control over income producing assets in the nature of a nominee or agent will disqualify an entity claiming tax relief in respect of income received from that asset. The reason is that a claimant in those circumstances exists solely to proffer formal ownership of income for the purpose of claiming tax treaty benefits, not for any substantive commercial purpose. As discussed in Chapter 6, tax treaty law views such arrangements as abuse of a treaty by manipulation of the corporate form.

However, the criterion of control is not an adequate criterion for the application of a substance over form test of ownership.⁷³¹ While the absence of dominion or control over an asset by a claimant will indicate the existence of an abusive arrangement, the converse is not necessarily true: the existence of dominion or control does not exclude the possibility of an abusive arrangement. That is a matter that must be measured against other circumstances in the light of the object and purpose of a treaty.⁷³²

The *Bank of Scotland* case illustrates the point.⁷³³ Bank of Scotland purchased the dividends of French company Marion SA from its American parent, Pharmaceuticals Inc by way of an usufruct agreement. On the face of it, that purchase could be characterised as an ordinary commercial one where Bank of Scotland sought to make a profit by paying Pharmaceuticals less than what the Bank hoped to receive in dividends from Marion. However, France's Supreme Administrative Court viewed this arrangement, in reality, as a loan to Pharmaceuticals from the Bank of Scotland, the repayment of which was delegated by Pharmaceuticals to its French subsidiary.

This reality was exposed by the fact that Pharmaceuticals guaranteed the payment and quantum of the dividends payable by Marion to the Bank. Accordingly, the Bank's level of risk depended on the financial health of Pharmaceuticals, not Marion.

⁷³⁰ See the Report reproduced in OECD Committee on Fiscal Affairs *Model Tax Convention on Income and on Capital: Full Version* (OECD Publishing, Paris, 2010) at R(6), R(16)-8 and [14(b)].

⁷³¹ See Jain, above n 49.

⁷³² At 183 and 217.

⁷³³ *Bank of Scotland*, above n 463.

The Court concluded that the usufruct agreement was motivated solely by the arbitrage opportunity arising from the tax advantages available under the United Kingdom-France Double Tax Treaty and the Bank was denied a tax credit in respect of the dividends it received from Marion.

There could be no argument that the Bank had dominion/control over the dividends received from Pharmaceuticals' French subsidiary. It paid Pharmaceuticals for the right to receive these dividends by way of the usufruct agreement. Once the dividends were received, the Bank could do as it willed with the income. However, the Supreme Administrative Court considered the arrangement was inconsistent with the object and purpose of the Tax Treaty and accorded no significance to the presence of dominion over the funds.

The *Bank of Scotland* case illustrates that even if a company has substantive dominion/control over an asset, it can nevertheless be a part of an arrangement that is abusive in the sense that it is contrary to the object and purpose of a tax treaty.⁷³⁴ The same dynamic is illustrated in investment treaty law in the recent *Philip Morris Asia* decision⁷³⁵ discussed below and reviewed in detail in Chapter 10.

Whither a control test?

When all that is required is legal control, no great difficulty arises, but this approach serves no utility as a substantive yardstick for bona fide nationality. An ultimate control test has been almost universally dismissed as too uncertain and unworkable. And, in any event, the existence of control does not necessarily mean that an entity is a bona fide claimant.

However, instead of searching for the ultimate controller, a substantive control test that aims to assess the degree of actual control exerted by the claimant company over the relevant investment could play a part in a wider purposive test that focuses on the commercial rationale of the existence of the claimant, as discussed in Chapter 10 below. As will be discussed in that Chapter, the Tribunal in *Philip Morris Asia* undertook this type of exercise to assess whether the Hong Kong incorporated claimant controlled Philip Morris' Australian assets in a substantive sense.

⁷³⁴ Jain, above n 49, at 188–191.

⁷³⁵ *Philip Morris*, above n 122, at [496]–[509].

This question is simpler than examining the degree of control at each level of ownership in a corporate structure. It looks only to the claimant company's role rather than the different levels of control held and exercised by the wider shareholder diaspora. In other words, the question becomes: does the claimant actually do something commercial and practical in terms of the control or management of the investment, and if so, what?

If a putative claimant entity has no substantive control over the investment and any funds it might receive, then this inquiry is likely to reveal a conduit company with no substantive claim to the nationality of its home state so far as investment treaty coverage is concerned. However, if some degree of control is evidenced, that would assist a wider purposive inquiry as to the reason for existence of the claimant entity in the chain of ownership of the investment.

9.3 Substantial business activity

Like “control”, substantial or substantive business activity (in its various guises) is a familiar concept in investment treaty law used as an arbiter of sufficient connection to a state to permit a corporate entity to be a national of that state and to qualify for protection by a relevant treaty. To recall Chapter 2, many investment treaties include criteria focused on a substantive or real economic presence in a state, either as part of the definition of a qualifying investor, or as an element, which in its absence, may justify denial of treaty benefits by the host state.

In these contexts, investment treaties employ various phraseologies: substantive, substantial⁷³⁶ or real business activity;⁷³⁷ effective economic activity,⁷³⁸ effective management;⁷³⁹ actually doing business in the place of incorporation;⁷⁴⁰ and suchlike.

The civil law concept of *siège social* at international law is another example. Often translated to English as “head office”, at international law *siège social* is

⁷³⁶ See, for example, Energy Charter Treaty, art 17(1); ILC Draft Articles on Diplomatic Protection, art 9; and Dominican Republic–Central American Free Trade Agreement (signed 5 August 2004), art 10.12.2.

⁷³⁷ See, for example, Switzerland Model BIT, art 1(1)(b).

⁷³⁸ See, for example, Indonesia–Chile BIT, art 1(1)(b).

⁷³⁹ See, for example, ASEAN Comprehensive Investment Agreement (signed 26 February 2009), art 1(2); and Netherlands–Argentina BIT, art 1(b)(ii).

⁷⁴⁰ See, for example, United Kingdom–Philippines BIT (signed 3 December 1980), art 1(4).

synonymous with the place of “central administration” or “actual or effective management”⁷⁴¹ and has a wider scope than the concept of a registered address.⁷⁴²

All of these phrases are formulations of the same concept: that a juridical entity has a genuine commercial connection with the state of which it claims nationality.

In straightforward cases, substantive business activity tests may function adequately to identify bona fide nationality for juridical entities. However, their use, both in investment treaty and double tax treaty jurisprudence, has resulted in haphazard outcomes. In much the same way as the use of a control test, the utility of substantive business activity type tests, particularly on their own, is compromised by two flaws.

First, there is no logical link between business activity in a state and the genuineness of a claim to coverage under an investment treaty. The presence or absence of business activity in the entity’s home state, and the degree of such activity, does not necessarily reveal whether a multi-national corporate group has manipulated nationality in an abusive way to access an investment treaty. Secondly, substantive economic activity tests have a high degree of uncertainty in application. These two issues are examined in turn below.

The lack of connection between business activity and treaty abuse by manipulation of corporate nationality

The first flaw—a lack of logical connection between business activity and treaty abuse—is well illustrated by double tax treaty cases. While tax courts have considered “substantive business activity to be a surrogate of the abuse of law doctrine”,⁷⁴³ Jain explains that substantive business activity should not be the sole criterion for determining treaty abuse “because the presence of business activity does not necessarily show that an interposed company should not be categorised as a conduit company”.⁷⁴⁴

⁷⁴¹ *Tenaris* (29 January 2016), above n 117, at [154], [200] and [206]–[216]; *Tenaris* (12 December 2016), above n 117, at [181]–[182]; and *CFHL*, above n 117, at [237], [242]–[243], [260]–[262], [264] and [266]–[268].

⁷⁴² *Tenaris* (12 December 2016), above n 117, at [181]; and *CFHL*, above n 117, at [255] and [261]–[262].

⁷⁴³ Jain, above n 49, at 127. See, for example, *A Holding ApS*, above n 446, at 560–561.

⁷⁴⁴ Jain, above n 49, at 128.

Jain's point is that while "business activity may be a useful element of the substance over form approach embodied in the abuse of rights doctrine",⁷⁴⁵ at best it can only work as a one-way test.⁷⁴⁶

That is, the absence of business activity may establish that the interposition of an intermediary lacks substance; however, the fact that an interposed company has business activity does not necessarily show that the interposed company is not a conduit.

In other words, a company engaged in substantive business activity in its home state may nevertheless be interposed in a corporate structure or contractual arrangement to access the benefits of a treaty in circumstances that amount to an abuse of a treaty.

The facts in the *Bank of Scotland* case can also be used to illustrate this point.⁷⁴⁷ The Bank of Scotland is without argument a substantial enterprise providing banking and financial services both in the United Kingdom and around the World. The arrangement with Pharmaceuticals and its French subsidiary was of that nature.

Accordingly, if substantive business activity was the sole criterion to determine an abuse, the French Court would have sanctioned the usufruct arrangement between the Bank, Marion and its parent, Pharmaceuticals. The fact that the Bank carries on substantial business activity in the United Kingdom does not prevent the arrangement being an abuse of the treaty; indeed, substantial business activity is irrelevant to the issue of treaty coverage in those circumstances.

This hypothetical reveals there is no logical connection between business activity and abuse of a treaty. An abuse is no less simply because an arrangement has been put in place that utilises a company with other bona fide business activities as a conduit for procurement of treaty coverage.

⁷⁴⁵ At 128.

⁷⁴⁶ At 148.

⁷⁴⁷ *Bank of Scotland*, above n 463.

The same point can be made in the investment treaty context by reference to the facts of *Philip Morris Asia* concerning the alleged expropriation of Philip Morris's intellectual property by virtue of enactment of Australia's tobacco plain packaging legislation.⁷⁴⁸ In that case, Philip Morris Asia, a Hong Kong company, was interposed in the corporate chain of ownership of Philip Morris's Australian assets in February 2011—some 11 months prior to the passage of the plain packaging legislation, but after the Government's intention to pass such legislation was announced.⁷⁴⁹

Philip Morris Asia was incorporated in Hong Kong in 1994, and in 2011 had approximately 180 employees marketing and distributing tobacco products in Hong Kong and China. It also provided management services to Philip Morris subsidiaries in the Asia Pacific region, including Australia.⁷⁵⁰ Australia contended that this restructuring was an abusive attempt to gain the protection of the Hong Kong-Australia BIT. The Tribunal agreed.

However, as with the *Bank of Scotland* case, had the *Philip Morris* Tribunal considered the restructuring and the consequent attempt by Philip Morris Asia to benefit from the Hong Kong-Australia BIT solely on the criterion of substantive business activity, Philip Morris Asia would have passed with flying colours because it could readily demonstrate a genuine economic connection with its home state. The existence of substantial business activity does not preclude the possibility that the particular corporate or business arrangement in question is a means by which to benefit improperly from a treaty.

The converse is also true: while the absence of substantial business activity in a company's home state may show an abusive *raison d'être*, that does not necessarily follow. Minimal commercial activity might not indicate an abusive purpose, for example if the lack of activity in an investor's home state is a tangential consequence of the investment activity.

⁷⁴⁸ *Philip Morris*, above n 122.

⁷⁴⁹ *Philip Morris Asia Ltd v Australia (Australia's Response to Notice of Arbitration)* PCA 2012-12, 21 December 2011 at [6]. These documents are available at Investment Treaty Arbitration "*Philip Morris Asia Limited v The Commonwealth of Australia*" <www.italaw.com>.

⁷⁵⁰ See, for example, *Philip Morris Asia Ltd v Australia (Notice of Arbitration)* PCA 2012-12, 21 November 2011 at [1.3].

An investment treaty example is *Yaung Chi Oo Trading*.⁷⁵¹ This case concerned the expropriation of a brewery enterprise in Myanmar. Madam Win, a Singaporean entrepreneur, incorporated a company in Singapore that entered into a joint venture with Myanmar in respect of the Mandalay Brewery. Win relocated to Myanmar and ran the brewery business until the Government seized the brewery, froze her bank accounts and the joint venture company was summarily wound up.⁷⁵²

Win's Singapore company sued Myanmar pursuant to the ASEAN Investment Guarantee Agreement which provided that for a company to be a qualifying investor, its "effective management" had to be located in a contracting state.⁷⁵³ Myanmar objected to the claimant company's standing on the basis that while it was incorporated in Singapore (a contracting state), it was not effectively managed there; its effective management or primary activities took place in Myanmar.

As a matter of fact, this was correct. While the claimant met the minimum requirements for incorporation in Singapore (a resident director, filing of audited annual accounts and annual meeting of directors) it had otherwise become "a post-box used to make payments to third parties and to organise trans-shipments of supplies".⁷⁵⁴ The Tribunal held that effective management required something more than the fulfilment of minimum requirements of incorporation under the law of this contracting party—there was no justification for ignoring the additional requirement of effective management.⁷⁵⁵

Arguably the claimant did not come within the formal jurisdictional requirements of the ASEAN Agreement. Had the Tribunal focused on the requirement for effective management as a sole criterion, jurisdiction would have been declined, even though the reason the claimant's activities in Singapore were minimal related to the need to operate and manage the investment in the host state. Instead, the Tribunal took a purposive approach. Because the requirement of "effective management" was included in the ASEAN Agreement to counter treaty shopping, and there was no evidence of such a scheme in this case, the Tribunal

⁷⁵¹ *Yaung Chi Oo Trading Pte Ltd v Myanmar (Award)* (2003) 8 ICSID Rep 452.

⁷⁵² At [7]–[8].

⁷⁵³ ASEAN Agreement (signed 15 December 1987), art 1(2).

⁷⁵⁴ *Yaung Chi*, above n 751, at [46].

⁷⁵⁵ At [47].

interpreted the effective management requirement as applying only at the time the investment was made and thereby upheld jurisdiction.⁷⁵⁶

The facts in *Yaung Chi* illustrate that the absence of effective management in the home state is not always an accurate determinant of illegitimate treaty shopping arrangements. If minimal business activity in the home state *ipso facto* led to a conclusion of behaviour that offended the object and purpose of investment treaties, then it “could lead to arbitrary results and would disfavour small investors who may play a significant role in intra-[state] investment”.⁷⁵⁷

Sole focus on a substantive business activity-type criterion also permits considerable potential for business activity to be manufactured to meet the criterion. Tax treaty cases such as *Northern Indiana Public Service Co* illustrate the potential for a significant grey area.⁷⁵⁸

Northern Indiana was a United States company which incorporated a subsidiary in the Netherlands Antilles. The Netherlands Antilles charges no tax on interest, whether flowing inwards to residents or outwards to non-residents.

The Antilles subsidiary sold bonds offering an interest rate of 17.5 per cent, then on-lent the proceeds of the bond sales to Northern Indiana, at 18.5 per cent. The subsidiary therefore made a profit on the interest rate differential, which it invested to produce more income. This arrangement avoided the payment of United States withholding tax on interest payments to the bondholders. Once the principal was repaid to the bondholders, Northern Indiana liquidated the Antilles subsidiary.

The United States-Netherlands Double Tax Treaty did not contain a beneficial owner requirement, nor a specific anti-abuse provision.⁷⁵⁹ Accordingly, although it was undisputed that the corporate and contractual arrangements were put in place solely to qualify for a withholding tax exemption under the United States-Netherlands Double Tax Treaty,⁷⁶⁰ the United States Tax Court considered the one per cent margin earned by the Antilles subsidiary to be a sufficient business

⁷⁵⁶ At [49]–[52].

⁷⁵⁷ At [49].

⁷⁵⁸ *Northern Indiana Public Service Co v Commissioner of Internal Revenue* 105 TC 341 (1995); and *Northern Indiana Public Service Co v Commissioner of Internal Revenue* 115 F 3d 506 (7th Cir 1997).

⁷⁵⁹ United States-Netherlands Income Tax Convention.

⁷⁶⁰ *Northern Indiana* (TC), above n 758, at 353.

activity—the borrowing and lending of money at a profit—to overcome the Commissioner’s allegations of artificiality.⁷⁶¹

Again, this case illustrates that the existence of business activity does not logically relate to the absence of abuse of a treaty, especially if that activity is part of the arrangement under question. A marginal amount of business activity cannot turn what would otherwise be an abusive arrangement into an acceptable one. It also shows that a related danger of relying on a sole criterion as determinative of bona fide nationality is that it can create opportunities for fulfillment of jurisdictional requirements by manipulation of that criterion.

The Ruling of the United States Internal Revenue Service in *Revenue Ruling 84-153* illustrates a better and more nuanced approach.⁷⁶² The facts in *Revenue Ruling 84-153* are identical to the *Northern Indiana* case. The Dutch Antilles company took a one per cent profit on the interest charged to its United States parent company compared with the interest paid to its foreign bondholders. Therefore, it earned a profit.

However, the IRS refused withholding tax exemption under the United States-Netherlands Double Tax Treaty.⁷⁶³ It found that the arrangements for the sale of the bonds including the use of the Antilles subsidiary was tax motivated and that the Antilles subsidiary lacked “sufficient business or economic purpose to overcome the conduit nature of the transaction, even though it could be demonstrated that the transaction might serve some business or economic purpose”.⁷⁶⁴

In this case then, the IRS did not treat the interest profit spread as determinative of the bona fides of the arrangement, but rather was concerned to consider the circumstances more broadly to decide whether the arrangement was abusive.⁷⁶⁵

This thesis considers that in the same way, a substantive business activity-type criterion is not a logical indicator of a bona fide claim to investment treaty coverage because neither its presence, nor absence, definitively confirms nor

⁷⁶¹ At 347–348.

⁷⁶² Revenue Ruling 84-153, above n 435.

⁷⁶³ United States-Netherlands Income Tax Convention.

⁷⁶⁴ Revenue Ruling 84-153, above n 435, at 383.

⁷⁶⁵ At 383.

dismisses treaty abuse. Substantial business activity may, in some cases, indicate a bona fide claim to corporate nationality, but its relevance in any case must be assessed on a case-by-case basis and, as will be set out in Chapter 10, through the prism of the reason or purpose for the claimant company's role in the ownership structure of the investment.

The uncertainty of substantial business activity

The prospect of a substantive check on nationality that rests on substantial or substantive business activity type terminology begs the questions: what is substantive, or substantial or genuine or effective? Compared with what? And what is the yardstick by which substantiality is to be measured? No treaty defines the relative markers of substantiality, effectiveness or genuineness.⁷⁶⁶ Investment treaty and tax treaty jurisprudence reveal few answers to these issues and raises more difficult questions.

A substantial, or effective, or genuine, economic activity test is of the same fundamental nature as the genuine connection test first applied in *Nottebohm* in respect of individuals.⁷⁶⁷ However, unlike a natural person, who may have emotional ties to a state (family, friends, community), the “essential economic nature” of companies means that “connection” must be seen “largely in economic terms”.⁷⁶⁸

The first issue facing an economic connection test is whether it is an absolute or relative standard; that is, whether a company's relationship with its home state is genuine once it reaches a set level (absolute), or whether its connection with its home state is compared to its connection with any other state (relative).⁷⁶⁹ The genuine connection for natural persons in *Nottebohm* was appraised as a relative test and if the *Nottebohm* genuine connection test was applied to companies then the same approach would be required.⁷⁷⁰

It follows, as Harris points out, that if indeed the genuine connection test is a relative one, this begs the question as to whether a company's connection with its home state is to be compared with the respondent host state alone, any single state

⁷⁶⁶ Zhang, above n 39, at 58.

⁷⁶⁷ *Nottebohm*, above n 41.

⁷⁶⁸ Harris, above n 366, at 294.

⁷⁶⁹ At 289.

⁷⁷⁰ At 289; and see *Nottebohm*, above n 41, at 24.

other than the company's home state, or as against the company's connection with all other states put together.⁷⁷¹ Each of these alternatives is problematic.

As to the first, the answer as to whether a company had a sufficiently genuine connection with its home state might vary depending on the identity of the respondent state.

As to the second option, the question becomes which other single state is the right one for comparison and, in addition, creates the possibility that a company's nationality would change depending on the level of involvement in any particular state at any particular time.

As to the third, a comparative approach may also mean that a company's nationality changes depending on the level of its investment outside its home state at any particular time. It also seems counterintuitive in circumstances of a multinational corporation, with headquarters in its claimed home state of nationality and subsidiaries in many countries around the World. In that case, it is conceivable that none might individually involve greater levels of economic activity than headquarters, but put together cumulatively leaves the company without the nationality of its headquartered state and no particular nationality of any other state—that is, this approach gives rise to the distinct possibility of a stateless company.

The above analysis suggests that an absolute test makes more sense. Indeed, that appears to be the approach taken by investment treaty tribunals, although they have done so without analysis as to the various options. The absolute approach requires consideration as to: the requisite level of genuineness or substantiality required in order to endorse a claim by a company to the nationality of a particular state; the factors relevant to determining the existence of substantial business activities; and the weight to be given to each factor. No investment treaty tribunal has grappled with these questions as a matter of general principle.

One can imagine some obvious candidates to illustrate attachment of a corporate to a particular jurisdiction: incorporation and compliance with other municipal laws so as to register as a company; the centre of business activities identified by the location of management and/or manufacturing activity; location of

⁷⁷¹ Harris, above n 366, at 290.

board and shareholder meetings; nationality of managers and directors and stakeholders; source of revenue in absolute and relative terms; place of liability for tax; number of employees; length of time in business; and perhaps involvement in the community beyond the company's core business activities.⁷⁷² But this is not an exhaustive list and the relative importance of each would change depending on each circumstance. Some, such as the nationality of directors and stakeholders would be liable to change and sometimes difficult to ascertain.⁷⁷³

When all of the considerations above are contemplated, the contention of commentators that there is no reason the genuine connection requirement could not be used to determine the nationality of companies and that the practical difficulties are not a fundamental obstacle to its application to companies is over-optimistic.⁷⁷⁴

These apparent complexities have not been uncluttered by more recent investment treaty jurisprudence or commentary. According to Happ and Rubins, no clear criteria exist in academic literature or arbitral decisions to distinguish “substantial” or “real” activities from insubstantial or unreal ones.⁷⁷⁵ In cases where the issue has arisen as a matter of fact, claimants have either conceded that they do not conduct substantial business activities in their state of incorporation, or activities have been found to be substantial without any analysis as to how the yardstick of substantiality has been calibrated.

Well-known examples of admitted absence of substantive business activity are *Yukos*,⁷⁷⁶ and *Plama*.⁷⁷⁷ Conversely, in *Pan American Energy*, evidence that BP employed 37,000 people and maintained offices in 50 states of the United States was accepted as substantial activity, but without further analysis.⁷⁷⁸ In *Tokios*, the Tribunal noted without explanation that financial statements, employment information, and a “catalogue of materials” produced during the period 1991–1994 constituted substantial business activities in Lithuania.⁷⁷⁹ Similarly, in *Petrobart*, a

⁷⁷² Harris, above n 366, at 293.

⁷⁷³ At 294–295.

⁷⁷⁴ At 292. See also Philip C Jessup “The United Nations Conference on the Law of the Sea” (1959) 59 Col LR 234 at 256; and Harris, above n 366, at 295.

⁷⁷⁵ Happ and Rubins, above n 586, at 64.

⁷⁷⁶ *Yukos*, above n 24, at [461]; and *Veteran Petroleum Ltd (Cyprus) v Russia (Interim Award)* PCA AA 228, 30 November 2009 at [517].

⁷⁷⁷ *Plama*, above n 135, at [31].

⁷⁷⁸ *Pan American Energy LLC v Argentina (Preliminary Objections)* ICSID ARB/03/13, 27 July 2006 at [203]–[204] and [221].

⁷⁷⁹ *Tokios (Jurisdiction)*, above n 24, at [37].

company incorporated in England with its registered office in London “handling many of Petrobart’s strategic and administrative matters” was sufficient evidence to amount to substantial business activity under the Energy Charter Treaty.⁷⁸⁰

Two decisions illustrate the difficulty of divining a line between substantial business activities and insubstantial ones. In *Pac Rim*,⁷⁸¹ the claimant was a holding company incorporated in the United States. It had no office, no bank account, board of directors or employees, and its only activity was the holding of shares. The Tribunal found that this level of activity was not substantial and upheld El Salvador’s notice of denial of benefits under the CAFTA Treaty.⁷⁸²

Conversely, in *AMTO*,⁷⁸³ the Tribunal agreed with the claimant’s submission that the denial of benefits provision in the Energy Charter Treaty was intended to exclude mailbox companies from treaty protections.⁷⁸⁴ Nevertheless, it considered that the substantial business activity criterion in the denial of benefits clause was met in that case by maintenance of an office with two fulltime employees, tax liability and banking relations within the state of incorporation.⁷⁸⁵

While the business activities in *Pac Rim* could not be described as substantial, *AMTO* shows that not much more in the way of business activity may be required to meet the substantiality test. Moreover, *AMTO* is not an outlier in accepting modest commercial activity as substantial or effective. In *Yaung Chi* (discussed above), the Tribunal noted that the claimant had complied with the requirements of incorporation under Singaporean law including a resident director (the claimant’s owner’s sister) and auditing of the company’s accounts in Singapore. The Tribunal found that effective management equated simply to the requirements of incorporation.⁷⁸⁶

... since Singapore law emphasizes incorporation and ensures effective management in Singapore through duties imposed under the Companies

⁷⁸⁰ *Petrobart Ltd v Kyrgyzstan (Award)* SCC 126/2003, 29 March 2005 at 63.

⁷⁸¹ *Pac Rim*, above n 23.

⁷⁸² At [4.63]–[4.68].

⁷⁸³ *AMTO*, above n 120.

⁷⁸⁴ At [17].

⁷⁸⁵ At [43].

⁷⁸⁶ At [47].

Act, companies incorporated under Singaporean law should be deemed to be effectively managed in Singapore.

The same minimisation of what suffices to amount to genuine or substantial business activity has occurred in tax treaty law. In *G-group 2005*, the German Bundesfinanzhof found the mere activity of holding shares in a number of different companies was sufficient to entitle Dutch companies to the benefit of the German-Netherlands Double Tax Treaty,⁷⁸⁷ even though there were no strong economic or other relevant reasons for the existence of the Dutch subsidiaries in the G-group's corporate structure.⁷⁸⁸

The extreme cases—where there is no activity at all or large levels of activity—are easy. But there remains a large grey area. At least in some instances, what is required to meet a test of economic substantiality may be quite insubstantial. Voon, Mitchell and Munro conclude one of the shortcomings of denial of benefits clauses is that an investor is likely to be regarded as having substantial business activities in its home state unless it is a shell company that exists solely on paper without any employees, commercial operations or a physical existence.⁷⁸⁹

Zhang's review also concludes that the threshold for substantial business activities is not high: "investors ... are not required to engage in large-scale or in-depth business activities to be qualified as having engaged in 'substantial business activities'".⁷⁹⁰ Substantial can mean minimal. If compliance with basic regulatory requirements are sufficient to satisfy a substantial business activity criterion, then the requirement becomes meaningless.

Moreover, even if substantial business activity requires something more than fulfillment of municipal law requirements for maintenance of a registered company, no tribunal has as yet laid down criteria or guidelines for determining what business activities are sufficiently substantial: "it is quite clear that no unified criteria can be

⁷⁸⁷ Germany–Netherlands Double Tax Treaty (signed 16 June 1959).

⁷⁸⁸ *G-group 2005* (31 May 2005) IR 74 88/04 (The Bundesfinanzhof, Germany) at [30]–[32].

⁷⁸⁹ Voon, Mitchell and Munro, above n 39. The authors cite *Pac Rim*, above n 23, at [4.63]–[4.65]; *Plama*, above n 135, at [168]–[169]; *AMTO*, above n 120, at [69]–[70]; *Tokios (Jurisdiction)*, above n 24, at [37]; and *Ulysseas*, above n 120, at [122]–[123].

⁷⁹⁰ Zhang, above n 39, at 59. See also Lee, above n 14, at 366.

inferred from [current jurisprudence]” and “there is no clear distinction of ‘genuine’ and substantial’ activities from ‘counterfeit’ and ‘insubstantial’ activities”.⁷⁹¹

As a result, flexibility in the requirement for substantiality “provides scope for inconsistent application by arbitral tribunals and creates some unpredictability in the limits [denial of benefits] clauses place on Treaty Shopping”.⁷⁹²

Conclusion as to the utility of substantial business activity tests

This overview of tests of economic substance in a home state reveals two critical points. First, substantiality is not a sufficient substantive test on its own because it is not a logical determinant of abusive treaty shopping by way of manipulation of corporate nationality. It may, but also may not, identify abusive treaty shopping.

At best, the absence of substantive business activity in the company’s home state may raise a presumption that an investor is a conduit incorporated only to access investment treaty protections. The opposite is also true: substantial business activity in the home state may raise a presumption that the claimant is a bona fide national of its home state. But as cases such as *Bank of Scotland*, *Philip Morris Asia*, and *Yaung Chi* illustrate, those presumptions may not hold.

Accordingly, substantial economic activity is not fit for purpose—at least if applied as the sole factor—as a substantive test to identify abusive manipulation of corporate nationality.

Secondly, economic activity tests suffer from similar problems with uncertainty as revealed with the control test. No tribunal or commentator has addressed the Gordian knot of factors that might apply in different circumstances and how the yardstick of substantiality should be calibrated. At best, some factors can be imagined or deduced from straightforward cases, but commentators have proverbially thrown up their hands at the complexity of the task.

The reason is that criteria such as “substantive” or “substantial” or “genuine” or “effective” or “real” are not absolute measures, while the test portends to be an absolute measure of economic connection so as to justify a claim of nationality. The

⁷⁹¹ Zhang, above n 39, at 58–59.

⁷⁹² Lee, above n 14, at 368.

result is that in some cases, a requirement for substantial business activity is fulfilled by minimal business activity.

Potential investors cannot be expected to fare better. They are left to guess at what may be required to fulfil such criteria, and the ability of an investment treaty to encourage foreign investment will thereby be diminished.

The following Chapter proposes that the extent of a company's economic connection to its home state may assist as one factor in investment treaty law to illuminate a broader purposive test, as indicated in the *A Holding* case in the tax treaty context:⁷⁹³

It follows that the objection of an abuse of a [tax] convention is unfounded if the company demonstrates that its main purpose ... is primarily based on valid economic grounds and not aimed at the obtaining of advantages of the applicable double tax convention

⁷⁹³ *A Holding ApS*, above n 446, at 560–561.

10 Giving substance to a substantive approach 2: purpose

10.1 Introduction: purpose is fundamental

Rather than focus on relative, often complex and nebulous factors such as identification of ultimate controllers and substantial business activity in the claimed home state, the better approach to a substantive inquiry is to focus on the purpose of the claimant entity and ask: what is its purpose in the ownership chain of the investment? Or more pointedly, does the entity have a genuine commercial reason to exist in the ownership chain other than to procure investment treaty coverage?

This Chapter proceeds to examine the use of a purposive test of this nature in tax treaty law and in investment treaty cases that have approached treaty shopping and corporate nationality issues via the principle of abuse of right. The tax treaty examples help define how a test focused on purpose for existence can operate by expressly or implicitly taking a holistic approach that examines the substantive reasons for existence of the claimant/taxpayer in a particular corporate structure.

The investment treaty “abuse of right” cases profess a purpose-based approach but often look no further than the timing of the adoption of the claimed nationality. While timing is an important, and often critical, indicator of purpose, more recent cases are on the verge of embracing a fully-fledged purpose test by virtue of a better appreciation, and broader application, of the doctrine of abuse of right.⁷⁹⁴

The search for the purpose or reason for a claimant to exist is not novel. It is the same question that has come to identify companies permitted to access the benefits of double tax treaties as reviewed in Chapter 6. It is also fundamental to the discussion in Chapter 4 regarding a substantive approach to lifting the corporate veil in municipal law and the attribution of nationality in diplomatic protection law reviewed in Chapter 5. In addition, many of the investment treaty cases reviewed in Chapters 3 and 7 expressly or impliedly undertake inquiries to identify the purpose for the existence of the claimant in the relevant corporate structure as a substantive check on the legitimacy of the nationality of putative claimants.

⁷⁹⁴ Watson and Brebner, above n 39, also discern the emergence of the application of the principle of abuse of right using a test based on the “dominant purpose” for the claimant’s existence in the ownership structure. See in particular at 317–329.

However, the scope and working of a purposive test for jurisdiction *ratione personae* is not clear. As illustrated in Chapter 9, purpose is side-lined or overlooked in the course of investigation of criteria such as business activity or control. These criteria are better appreciated as factors indicative of the presence (or absence) of a commercial purpose or reason to exist. The focus of this purposive inquiry is not to find an ultimate controller through which to attribute nationality to the claimant or to assess the level of business activity in the home state against a pliable yardstick of substantiality—but to derive the commercial *raison d'être* for that entity to exist as part of the ownership structure of the investment.

If the dominant purpose of the putative corporate investor to exist in the ownership chain of the investment is to attract investment treaty coverage, it cannot be regarded as having a sufficient connection with its home state to claim its nationality for investment treaty purposes. This approach is not a test for nationality as such, but rather a test as to whether nationality as determined by the literal interpretation of criteria in a treaty is appropriately used in the sense of consistency with the object and purpose of investment treaties as discussed in Chapter 8. As Weil outlines in *Tokios*, the purpose of jurisdiction *ratione personae* is to exclude entities used to create an appearance of foreign ownership which does not exist in substance.⁷⁹⁵

A purposive approach of this kind is the same as that which underpins Crawford's postulation of "a genuine link relating to the *causa* for conferment of nationality".⁷⁹⁶ It is not the effectiveness of a bond of nationality (evidenced, for example, by business activity in the case of companies and wider bonds of attachment for natural persons) that is important per se, but the motivations for the acquisition of, and reliance on, a certain nationality that is important.

This Chapter will explain that a purposive test in this sense is holistic in that it takes account of whether a company has substantive business activities in its claimed home state and whether it actually and actively controls and benefits from the investment, so far as these factors shed light on the commercial purpose for the claimant to exist in the ownership structure and claim a certain nationality for investment treaty purposes in a bona fide sense. It also looks to the timing of the

⁷⁹⁵ *Tokios (Dissent)*, above n 30.

⁷⁹⁶ Crawford, above n 372, at 520.

adoption of that nationality and/or inclusion in the ownership structure of the investment because that may indicate a genuine commercial purpose, or conversely reveal that the primary purpose of the adoption of nationality is to enable treaty coverage.

This Chapter also demonstrates that a commercial purpose test can be applied so as to mitigate the uncertainty concern that hampers the control and business activity criteria discussed above. No purposive analysis can be as predictable as the sole use of technical criteria such as incorporation. The analysis must be case by case, just as it is with the assessment of a claimed investment, or where investment treaties expressly require consideration of substantial business activity or control.

However, a purposive approach that focuses on the commercial rationale of the putative claimant permits reasonable certainty at the investment planning stage because the putative corporate claimant must know why it exists in the corporate structure and be able to illustrate its purpose in the chain of ownership of the investment. To illustrate this point, some of the investment treaty cases discussed in this thesis will be reviewed to illustrate the hypothetical operation of a purposive test as to nationality in the investment treaty field.

10.2 Contours of a holistic purpose test in tax treaty law

Tax treaty cases in a number of jurisdictions (some of which were discussed in Chapter 6) have taken a holistic purposive approach to identify the proper recipients of the benefits of double tax treaties. This holistic approach seeks to determine whether there is a substantive economic reason for the existence of an intermediary company in the tax planning structure in question. Jain calls this the “reasons for existence” approach.⁷⁹⁷

The “reasons for existence” approach does not rely on or promote to prominence any single criterion, but looks at the arrangement, both corporate and contractual, in the round including, but not exclusively relying on, the criteria of substantive business activity and dominion/control. If the reason for existence of the intermediary company or the particular contractual arrangement is found primarily to exist for obtaining the benefits of the treaty, then the arrangement is an abuse of

⁷⁹⁷ Jain, above n 49, at 83–84, 112–116 and 294.

the treaty because it is inconsistent with its object and purpose and its benefits are denied to the claimant taxpayer.⁷⁹⁸

For example, in *Aiken Industries*,⁷⁹⁹ the United States Tax Court focused on the “economic or business purpose” of Industrias,⁸⁰⁰ a Honduran company interposed in a loan transaction between the United States incorporated Aiken Industries and its Bahamian parent to obtain withholding tax exemptions under the United States–Honduras Double Tax Treaty.

The lack of substance of the loan transaction by which Aiken Industries remitted income to Industrias was revealed by its obligation to pass on the funds received and that Industrias was left with the same inflow and outflow of funds if all parties complied with the contractual arrangement. In those circumstances, the transaction had no valid economic or business purpose and was an improper use of the treaty.⁸⁰¹

Similarly, in *Indofood*,⁸⁰² the English Court of Appeal was concerned to have regard to “the substance of the matter” in the light of the object and purpose of Indonesia’s Double Tax Treaties with Mauritius and the Netherlands⁸⁰³ and proceeded to analyse the “legal, commercial and practical structure behind the loan notes” between Indofood and its Mauritius subsidiary.⁸⁰⁴ Like *Aiken*, the contractual arrangement was of little significance,⁸⁰⁵ because in practical terms, Indofood’s subsidiary was not permitted to use interest payments from Indofood for any purpose other than for meeting its liabilities to bondholders. The subsidiary’s sole function in “commercial and practical terms” was to avoid Indonesian withholding tax by use of the Indonesia-Mauritius Double Tax Treaty and therefore it was not entitled to its benefits.⁸⁰⁶

⁷⁹⁸ At 113–114.

⁷⁹⁹ *Aiken*, above n 434.

⁸⁰⁰ At 934.

⁸⁰¹ At 934.

⁸⁰² *Indofood*, above n 463.

⁸⁰³ At [43]–[44].

⁸⁰⁴ At [43].

⁸⁰⁵ At [44]–[45].

⁸⁰⁶ At [43]–[44].

In *V SA*⁸⁰⁷ and in *X-group 1979*,⁸⁰⁸ the SFC concluded that intermediary companies which paid out funds exactly matched by their income up and down the chain of ownership had no “serious economic justification”⁸⁰⁹ and only existed in the corporate structure to access tax treaty benefits. Accordingly, they were not permitted to do so.⁸¹⁰

The timing and corporate activities of intermediary companies were critical in assessing commercial purpose in the *Arabian-group 1984* case⁸¹¹ and *Y-group 1990*.⁸¹² In both cases intermediaries were found to constitute an abuse of double tax treaties because they were of no practical commercial significance.

In *Arabian-group*, the Dutch subsidiary had had no office, personnel or business activity and it rendered no substantial services to the Swiss company from whom it received dividends. Two apparent personnel of the Dutch company were managing directors of one of its parents, their salaries were paid by the parent company, and the intermediaries’ purchase of the shares of its downstream company was funded by the ultimate parent company.⁸¹³ In *Y-group*, the intermediary company was a letterbox company created and inserted in the ownership chain shortly after the declaration of a dividend which was subsequently paid through the intermediary to the Canadian parent to elicit tax treaty benefits.⁸¹⁴ Accordingly, the arrangement was treated as if the intermediary company did not exist.⁸¹⁵

All these cases conclude that corporate structures implemented solely to access treaty benefits are abusive and ineffective to gain treaty rights because they exist only to create a formal appearance of nationality at odds with commercial reality.

Jain concludes that the holistic “reasons for existence” test is the best approach in cases where abuse of a treaty by use of a conduit company is at issue because the single criterion tests—substantive business activity and

⁸⁰⁷ *V SA*, above n 468.

⁸⁰⁸ *X-group 1979*, above n 478.

⁸⁰⁹ *V SA*, above n 468, at 212; and *X-group 1979*, above n 478, at 277.

⁸¹⁰ *V SA*, above n 468, at 210 and 212–213.

⁸¹¹ *Arabian-group 1984*, above n 468. See also Jain, above n 49, at 110–111.

⁸¹² *Y-group 1990* (28 June 1989) Case no 25 451, BNB 1990/45 (the Hoge Raad, The Netherlands).

⁸¹³ *Arabian-group 1984*, above n 468, at 293–295.

⁸¹⁴ *Y-group 1990*, above n 812, at [7.2].

⁸¹⁵ At [4.2].

dominion/control—operate as “one-way tests”.⁸¹⁶ That is, as explained in Chapter 9, the absence of substantial business activity or control may well reveal an abusive arrangement; but the opposite “does not necessarily show that a company was not interposed for improper use of a convention”.⁸¹⁷

In contrast, the reasons for existence approach goes beyond technical compliance with the definition of an investor in a treaty and, “involves an examination of an arrangement in its entirety with the objective of determining reasons for the existence of an interposed company in a specific corporate structure”.⁸¹⁸ If there is a commercial reason other than to access treaty benefits, the claimant is bona fide; while if there is “no practical reason for the existence of the interposed company in the corporate structure” the claim is an abuse of the right to access the treaty.⁸¹⁹

Since the 2003 amendments to the OECD Commentary, which cemented a substantive approach generally, tax treaty law commentators have coalesced around an approach that considers the whole of the arrangement to determine the real purpose for the existence of the interposed company. For example, Krishna concludes:⁸²⁰

One must examine each factual pattern to determine the real — and not merely legal — relationship of the conduit in the context of its actual obligations and duties between the subsidiary and the ultimate parent company. The determination is essentially one of fact.

Given the infinite nature of human imagination—and therefore corporate structures and contractual arrangements—a flexible approach that takes account of a range of factors rather than placing primacy on any particular factor or factors is sensible and, as demonstrated in Chapter 10.3 and 10.4 below, is practical and applicable in the context of investment treaties, just as it is in tax treaty jurisprudence.

⁸¹⁶ Jain, above n 49, at 294.

⁸¹⁷ At 294.

⁸¹⁸ At 294.

⁸¹⁹ At 294.

⁸²⁰ Krishna, above n 46, at 141. To the same effect, see Elliffe, above n 457, at 19.

10.3 The purposive approach of abuse of right cases in investment treaty law

The above review of tax treaty jurisprudence shows how the purpose test is used to identify treaty abuse: the absence of a legitimate commercial reason for the existence of the interposed company in a corporate structure, other than to access the benefits of the treaty at issue. The same approach can be identified in investment treaty law by close analysis of cases where state respondents have argued that the manipulation of corporate nationality by a claimant to gain access to a treaty constitutes an abuse of right.

The principle of abuse of right has been variously termed “good faith”,⁸²¹ “abuse of the arbitral process”,⁸²² “integrity and security of international investment arbitration”,⁸²³ “equitable doctrine of ‘veil piercing’”,⁸²⁴ “abuse of the Convention”,⁸²⁵ “abuse of corporate form”,⁸²⁶ and “abuse of the ICSID mechanism”.⁸²⁷ All of these terms have at their heart the principle of abuse of right, sometimes referred to in a jurisdictional context as abuse of process.⁸²⁸

The utility of the principle of abuse of right as a means by which a purposive substantive check can be applied to treaty shopping in investment treaty law is discussed in Chapter 11.

For present purposes, the investment treaty abuse of right cases are analysed below to assess the degree to which they evidence a purposive test in the sense of that applied in tax treaty cases. Although the analysis of various tribunals has been somewhat divergent,⁸²⁹ a number of investment treaty cases have professed an approach to treaty abuse akin to that taken in tax treaty law: one that inquires as to the whole circumstances of the case and particularly looks to the motivation for the particular corporate arrangement relied on by the claimant.

⁸²¹ *Tidewater*, above n 23, at [50]–[51].

⁸²² *Rompetrol*, above n 24, at [59].

⁸²³ *Alpha Projektholding GmbH v Ukraine (Award)* ICSID ARB/07/16, 8 November 2010 at [340].

⁸²⁴ *Tokios (Jurisdiction)*, above n 24, at [53].

⁸²⁵ *Autopista*, above n 61, at [122].

⁸²⁶ *Aguas del Tunari*, above n 22, at [330].

⁸²⁷ *Rompetrol*, above n 24, at [27].

⁸²⁸ *Phoenix Action*, above n 136, at [93] and [143]; and *Tidewater*, above n 23, at [146]–[147]. In *Abaclat v Argentina (Jurisdiction and Admissibility)* ICSID ARB/07/5, 4 August 2011 at [647], abuse of process was described as a subset of abuse of right, which refers to the abuse of a *procedural* right, including rights that permit an investor to initiate a treaty claim seeking protection for an investment.

⁸²⁹ As described in Feldman, above n 16, at 282.

However, despite articulating a holistic test, some cases have treated the timing issue—whether the relevant nationality was obtained before or after the dispute was reasonably in contemplation—as determinative of purpose. While in many cases that may be so, timing is but one important indicator of purpose, and reliance on timing alone may lead to error in the same way as focus solely on criteria such as business activity and control can be logically problematic. As a result, the timing test does not go far enough to identify treaty abuse by manipulation of corporate nationality.⁸³⁰

Ordinarily, inclusion of a corporate entity with the requisite nationality to benefit from an investment treaty after a dispute is in contemplation will be clear evidence of an abuse of process. However, recent cases such as the decision in *Philip Morris Asia v Australia*⁸³¹ show that while timing of the claimant’s insertion into the ownership chain of the investment may indicate abuse, it is not necessarily decisive.

A purposive approach must consider all circumstances of a case to expose the critical issue: whether the claimant has a commercial reason to exist in relation to the investment other than to attract the coverage of an investment treaty.

The timing cases: *Mobil*; *Pac Rim*; *Tidewater*; and *ConocoPhillips*

Four prominent investment treaty cases since 2010 have emphasised the importance of the timing of acquisition of a nationality as an indicator of abuse of right.⁸³²

In each of these cases, the claimant was a shell company inserted into the ownership chain of the investment around the time that the regulatory environment in the relevant host state became adverse to the investment. In each case, the inclusion of the claimant company within the corporate ownership structure fulfilled a nationality by incorporation criterion in an investment treaty and thereby provided access to investment treaty rights as against the host state that would not otherwise have been available.⁸³³

⁸³⁰ Schill, above n 7, at 226–228 recognises the reference to the principle of good faith and its narrow application in a number of investment treaty cases.

⁸³¹ *Philip Morris*, above n 122.

⁸³² *Mobil*, above n 23; *Pac Rim*, above n 23; *Tidewater*, above n 23; and *ConocoPhillips*, above n 23.

⁸³³ *Mobil*, above n 23, at [147]–[150]; *Pac Rim*, above n 23, at [2.21]; *Tidewater*, above n 23, at [152]–[181]; and *ConocoPhillips*, above n 23, at [139]–[140], [163]–[165], [183], [268], [272] and [276].

In all four cases, the host state challenged jurisdiction *ratione personae* on the basis that the claimant was “a legal fiction to gain access to international arbitration to which they had no right of access”⁸³⁴ and thereby an abuse of right.⁸³⁵ In three of the four cases—*Mobil*, *Pac Rim*, and *ConocoPhillips*—it was acknowledged by the claimant and/or determined by the tribunal that the main or sole purpose of the insertion of the claimant in the ownership structure of the investment was to enable access to investment treaty rights and protections, rather than for any other commercial purpose.⁸³⁶

Mobil and *ConocoPhillips* profess a holistic approach to the identification of abuse of right, but then focus largely or entirely on the issue of timing of insertion of the claimant company into the corporate structure. Both Tribunals embraced the concept of abuse of right at international law.⁸³⁷ The *Mobil* Tribunal considered that “abuse of right is to be determined in each case, taking into account all the circumstances of the case”,⁸³⁸ to give effect to and preserve the integrity of the object and purpose of the ICSID Convention.⁸³⁹

Similarly, the *ConocoPhillips* Tribunal looked past the formal requirements of treaty definitions “to consider whether the objection to jurisdiction should be upheld on a distinct broader basis”⁸⁴⁰ to “avoid the misuse of power conferred by law”.⁸⁴¹ This broader inquiry was justified as an inherent part of identifying the boundaries of the contracting states’ consent to ICSID arbitration. To maintain the relevance of consent, the *ConocoPhillips* Tribunal considered it was necessary to look further than treaty language, and to “plac[e] some limits on the investor’s choice of corporate form, even if it complies with the relevant technical definition in the

⁸³⁴ *Tidewater*, above n 23, at [65].

⁸³⁵ *Mobil*, above n 23, at [144]; *Pac Rim*, above n 23, at [2.16]–[2.20]; *Tidewater*, above n 23, at [47] and [60]–[61] and [65]; and *ConocoPhillips*, above n 23, at [268].

⁸³⁶ *Mobil*, above n 23, at [190] and [204]; *Pac Rim*, above n 23, at [2.21]–[2.22] and [2.41]–[2.42]; and *ConocoPhillips*, above n 23, at [138] and [279]. In *Tidewater*, above n 23, at [183], the Tribunal found it unnecessary to make a finding regarding the purpose for inserting Tidewater Barbados in the ownership chain of Tidewater’s Venezuelan investments.

⁸³⁷ *Mobil*, above n 23, at [169]–[185]; and *ConocoPhillips*, above n 23, at [273].

⁸³⁸ *Mobil*, above n 23, at [177] and [191].

⁸³⁹ At [184] citing Weil’s dissent in *Tokios (Dissent)*, above n 30.

⁸⁴⁰ *ConocoPhillips*, above n 23, at [272].

⁸⁴¹ At [273].

treaty test”.⁸⁴² Whether those limits have been breached, “must turn on a close examination of all of the circumstances of the case”.⁸⁴³

The *ConocoPhillips* Tribunal accepted that “it could not discard the criterion which the parties had established, [but that proposition is qualified] in the event that *the criterion proved ‘unreasonable’*”.⁸⁴⁴ The phraseology “*proved unreasonable*” appears to support the point made in Chapter 8: it is not just the criterion in and of itself that must be reasonable, but also its application in the circumstances of a particular case.

This approach to the application of the principle of abuse of right to jurisdiction *ratione personae* is consistent with the argument advanced in this thesis. It is a holistic approach that looks to discern whether use of the corporate form to access treaty benefits contravenes the object and purpose of the relevant treaty by examining all the circumstances of the case and the outcome of the application of treaty criteria, not just the reasonableness of the criteria in and of themselves.

However, in the application of these principles to the facts, the *Mobil* and *ConocoPhillips* Tribunals took a narrow approach and found only the timing factor to be relevant.

Although the *Mobil* Tribunal professed to be concerned about the purpose of the claimant in the ownership structure—that is, whether it was a mere shell company—and the object, purpose and integrity of the ICSID Convention, it found the unabashed motivation of Mobil to gain access to arbitration by use of a Dutch shell company was “a perfectly legitimate goal” so long as the relevant disputes on which the claims were based were not pre-existing at the time of the restructure.⁸⁴⁵ On this reasoning, the purpose of the restructure does not affect the result. All that matters is whether the restructuring takes place on the right side of the dividing line marked by the birth of the dispute.

In the same way, the *ConocoPhillips* Tribunal found that although “the only business purpose of the restructuring ... was to be able to have access to ICSID

⁸⁴² At [274].

⁸⁴³ At [275].

⁸⁴⁴ At [272] (emphasis added). The Tribunal cited *Autopista*, above n 61, at [120].

⁸⁴⁵ *Mobil*, above n 23, at [199]–[205].

proceedings”, no abuse was apparent because none of the disputed measures had been taken or were in prospect at the time of the restructuring.⁸⁴⁶

The *Pac Rim* and *Tidewater* Tribunals also focused on the timing of the restructure compared with knowledge of a probable dispute. Neither claimant had any apparent reason to exist other than to access investment treaty protections.⁸⁴⁷ The *Pac Rim* Tribunal’s view was “before that [timing] dividing-line is reached, there will be ordinarily no abuse of process; but after that dividing-line is passed, there ordinarily will be”.⁸⁴⁸ As for *Tidewater*:⁸⁴⁹

... it is a perfectly legitimate goal, and no abuse of an investment protection treaty regime, for an investor to seek to protect itself from the general risk of future disputes with a host state in this way.

The *Pac Rim* variant of the timing test allows that the timing issue is not necessarily determinative of abuse of process: only that it “ordinarily will be”. This wording appears to leave room for other factors to play a part in the issue of abuse of process. However, there is no indication in the award as to what other factors or circumstances might affect the abuse of process issue. Like *Mobil* and *ConocoPhillips*, *Pac Rim*⁸⁵⁰ and *Tidewater* found without further inquiry into other circumstances, that there was no abuse of process because the restructures pre-dated the crystallisation of the respective disputes.

Pac Rim, *Mobil* and *ConocoPhillips* appear to acknowledge that timing will not always be determinative, but then treat it as such. The timing test is not a holistic view that looks at all the circumstances as professed in *Mobil* and *ConocoPhillips*; instead it views abuse of the treaty as determined by one mechanism.

Timing is a relevant and important factor in the assessment of abuse of process, particularly when an adoption of a convenient nationality for treaty

⁸⁴⁶ *ConocoPhillips*, above n 23, at [270], [276]–[277] and [280].

⁸⁴⁷ In *Tidewater*, above n 23, at [70]–[71], [144]–[147] and [193]–[198], the claimant denied it was a shell company, but the Tribunal sidestepped the issue of commercial purpose by approaching the issue of abuse of right exclusively through the timing criterion.

⁸⁴⁸ *Pac Rim*, above n 23, at [2.99]. See also [2.47] where the same point is made.

⁸⁴⁹ *Tidewater*, above n 23, at [183]–[184].

⁸⁵⁰ *Pac Rim*, above n 23, at [2.44]–[2.52] and [2.110].

coverage occurs after a specific dispute is foreseeable. However, restructuring on the right side of the timing line—that is prior to any specific legislative action over which a claim is brought—is not conclusive of absence of abuse. The emphasis on the timing factor ignores the core objection of the respondent states: that manipulation of corporate nationality by use of shell companies created for the main purpose of achieving protection of an investment treaty is an abuse of jurisdiction *ratione personae* regardless of the timing factor because it offends the object and purpose of the relevant treaty and the ICSID Convention.

If a holistic purposive approach akin to that in tax treaty cases was taken in *Mobil*, for example, the result might well be different. Mobil's investment in Venezuela began several years before the restructure. While the restructure predated the birth of the specific expropriation dispute, it did so only by a matter of two months in the context of rising enmity with Venezuela (disputes about tax and royalties had already come into focus and the possibility of expropriation by some means was already recognised by Mobil).⁸⁵¹ The Dutch claimant company acknowledged it had no business activity in the Netherlands (its state of incorporation) and that its sole reason to exist in the ownership structure of Mobil's Venezuelan assets was to procure coverage of the Netherlands-Venezuela BIT.

A holistic purposive approach which seeks to distinguish between corporations that are utilised for their convenient nationality, and corporate entities that play a real role in the investment, would conclude that this last-minute arrangement for the sole purpose of accessing treaty protection was not in good faith. As canvassed in Chapter 8, the use of corporations of convenience are abusive of the object and purpose of investment treaties and the ICSID Convention as the claimant is a simulated or ephemeral creation existing to piggy-back on the rights afforded to genuine investors from the contracting states.

The error in the *Mobil* reasoning is analogous to that of the tax cases that have focused exclusively on the criteria of business activity or control. The timing factor is plainly relevant to a substantive inquiry, but the Mobil Tribunal's reasoning treats it as determinative, even where the circumstances as a whole point to misuse of the relevant treaty. The wisdom of maintaining a holistic approach is that focus

⁸⁵¹ *Mobil*, above n 23, at [200]–[204].

on one criterion can detract from a substantive approach because that criterion then tends to be approached in a formalistic way.

The same argument is relevant to the outcomes in the *Pac Rim*, *ConocoPhillips* and *Tidewater* cases. Having found that the restructurings at issue occurred prior to the point at which the arbitrated disputes were foreseeable, the Tribunals simply conclude that restructuring at that point of time was legitimate. This approach is too definitive. The timing test ordinarily works when the prospective claimant comes into ownership of the investment after the dispute has arisen. However, it ought not to be assumed so readily that no abuse exists if the timing of these events is reversed.

The holistic cases: *Phoenix Action*, *Cementownia*, *CFHL*, and *Philip Morris Asia v Australia*

Some investment treaty decisions do not treat the timing factor as being decisive, but rather look to ascertain the commercial purpose of the claimant in respect of the investment by a broader assessment of the circumstances including the timing of adoption of the relevant nationality. The starting point is the seminal investment treaty case *Phoenix Action*,⁸⁵² which takes a holistic approach to the inquiry into abuse of right closely analogous to the identification of entities entitled to tax treaty benefits.

Phoenix Action was an Israeli company. It was inserted into the ownership chain of two Czech companies two months prior to advising the Czech Government of a dispute under the Israel-Czech Republic BIT.⁸⁵³ At the time of their acquisition, one of the Czech companies was involved in litigation in the Czech Courts against the Czech State concerning a criminal investigation against the owner of the Czech companies, a Mr Beno. Beno was also the owner of *Phoenix Action*.⁸⁵⁴

As discussed more briefly in Chapter 7.4, the *Phoenix* Tribunal approached jurisdiction in these circumstances primarily through jurisdiction *ratione materiae*—that is, whether an *investment* existed pursuant to the Treaty and the ICSID

⁸⁵² *Phoenix Action*, above n 136. *Phoenix Action* was followed on substantially similar facts in *ST-AD GmbH v Bulgaria (Award on Jurisdiction)* PCA 2011-06, 18 July 2013.

⁸⁵³ Czech Republic-Israel BIT (signed 23 September 1997).

⁸⁵⁴ *Phoenix Action*, above n 136, at [22]–[33].

Convention. But its approach was akin to that taken to jurisdiction *ratione personae* issues in the tax treaty cases reviewed in Chapter 6 and this Chapter.

The *Phoenix* Tribunal emphasised the requirements of art 31(1) of the Vienna Convention to interpret the words of a treaty in “good faith”, “in their context”, and “in the light of its object and purpose”.⁸⁵⁵ The express words of the Treaty and the ICSID Convention were subject to “the requirements of *general principles of law*, such as ... the principle of *good faith*”, and not to be read “in clinical isolation from public international law”.⁸⁵⁶ Good faith, the Tribunal observed, is a “supreme principle”⁸⁵⁷ of “utmost importance”⁸⁵⁸ in accordance with which both the ICSID Convention and the instant treaty must be construed.⁸⁵⁹ These principles required a “*factual ... and contextual analysis of the existence of a protected investment*”, and:⁸⁶⁰

... in order to conclude that an economic operation, which by its nature is or looks like an investment, is indeed an investment deserving international protection, the Tribunal must also take into consideration *the purpose of the international protection of the investment*, whether it is the specific purpose of the ICSID system or the general purpose of the protection granted by international law.

The Tribunal therefore took a substantive purposive approach to the definition of investment. Reliance on the ordinary meaning of the term “investment” was insufficient to protect an economic operation which fit that definition but for which coverage was contrary to the purpose of the relevant treaty.⁸⁶¹

⁸⁵⁵ At [76] (emphasis in original).

⁸⁵⁶ At [77] (emphasis in original). The Tribunal’s reference to “clinical isolation” cites *United States – Standards for Reformulated and Conventional Gasoline* WT/DS2/AB/R, 29 April 1996 (Report of the Appellate body) at 18.

⁸⁵⁷ *Phoenix Action*, above n 136, at [111] citing *Inceysa*, above n 136.

⁸⁵⁸ *Phoenix Action*, above n 136, at [106].

⁸⁵⁹ At [109].

⁸⁶⁰ At [79] (emphasis in original).

⁸⁶¹ At [79].

Accordingly, the Tribunal found that while the corporate structure could have supported an investment on the bare terms of the Treaty,⁸⁶² it proceeded to assess the bona fides of the investment by taking into account a number of purposive factors: the timing of the investment and the claim; the nature of the initial request to ICSID; Phoenix Action's reason for bringing the claim; the substance of the transaction by which Phoenix purchased the Czech companies; and the true nature of the operation in which Phoenix was engaged with respect to the Czech companies.⁸⁶³ The Tribunal concluded "the operation was not an economic investment" but rather, "a rearrangement of assets ... to gain access to ICSID jurisdiction to which the initial investor was not entitled".⁸⁶⁴

Therefore, "all the elements analyzed lead to the ... conclusion of an abuse of rights" because the investment was "not for the purpose of engaging in economic activity"—as per the object of the treaty and the ICSID Convention—"but for the sole purpose of bringing international litigation against the Czech Republic".⁸⁶⁵

This process of analysis could have been scripted as a perfect example of a substantive economic holistic approach to treaty shopping in the tax treaty field:⁸⁶⁶ reference to art 31(1)(a) of the Vienna Convention to subjugate the ordinary terms of a treaty to its object and purpose and the good faith principle at international law; and a holistic, contextual approach to the particular facts to determine whether the arrangement had economic substance or was an abuse because it sought to gain the benefit of the treaty through an artificial arrangement.

However, in respect of jurisdiction *ratione personae*, the *Phoenix* Tribunal took a formalistic literal approach to the identification of the "investor". It relied on the majority decision in *Tokios* to conclude that investors have free choice to structure their investments "*upstream*" of a dispute.⁸⁶⁷

⁸⁶² At [117]–[134].

⁸⁶³ At [135]–[139].

⁸⁶⁴ At [140].

⁸⁶⁵ At [142]–[143]. The Tribunal in *Transglobal Green Energy LLC v Panama (Award)* ICSID ARB/13/28, 2 June 2016 at [102]–[103] (which included Profs Jan Paulsson and Christoph Schreuer) agreed with this approach.

⁸⁶⁶ It also mirrors the argument of Professor Weil as to the correct approach to jurisdiction *ratione personae* in *Tokios* as reviewed in Chapter 3.3.

⁸⁶⁷ *Phoenix Action*, above n 136, at [94] citing *Tokios (Jurisdiction)*, above n 24, at [56] (emphasis in original).

As illustrated in Chapter 7.4, there is no logical justification for the difference of approach to abuse of jurisdiction *ratione personae* compared with jurisdiction *ratione materiae*. If treaties must be interpreted in light of their object and purpose, and good faith is a supreme principle of “utmost importance”,⁸⁶⁸ then the question of a bona fide investor should be approached in the same fashion as a bona fide investment.

The outcome in *Phoenix Action* could have been equally justified on the basis that Phoenix Action was not a bona fide investor. Phoenix was a company incorporated in Israel as prescribed by the Israel-Czech Republic Treaty, but it could not be said to be a bona fide investor in light of the object and purpose of the treaty because in a substantive economic sense it was not a genuine investor: it was incorporated immediately before the purchase of the Czech companies; it filed a claim with ICSID less than two months after the purchase; the claim essentially involved disputes that had arisen prior to the purchase; it had no business activity of its own in Israel; it had no intent to carry on economic activity in the Czech Republic or elsewhere; and it was controlled by the same person who owned the Czech companies.

In the terminology of two of the tax treaty decisions discussed above, Phoenix Action had no “valid economic or business purpose”,⁸⁶⁹ or “serious economic justification”.⁸⁷⁰ Its sole reason for existence was to access the benefits of the Israel-Czech Republic Treaty. Phoenix Action was not included in the ownership structure of the investment for “the purpose of engaging in economic activity”, but rather, “for the purpose of bringing international litigation against the Czech Republic”. The same teleological purposive approach should be used and the same result achieved whether through the prism of the investment or the investor.

The absence of commercial purpose of the claimant was the divining factor in an assessment of abuse of right in two domestic investor-type cases: *Cementownia v Turkey*,⁸⁷¹ and *CFHL*.⁸⁷² In *Cementownia*, shares in Turkish electricity companies owned by the Turkish Uzan family were transferred to Cementownia, a Polish

⁸⁶⁸ *Phoenix Action*, above n 136, at [114].

⁸⁶⁹ *Aiken*, above n 434, at 934.

⁸⁷⁰ *V SA*, above n 468, at 212.

⁸⁷¹ *Cementownia “Nowa Huta” SA v Turkey (Award)* ICSID ARB(AF)/06/2, 17 September 2009.

⁸⁷² *CFHL*, above n 117.

company controlled by the same family, just 12 days before concessions held by the Turkish companies were cancelled by the Turkish government. The transfer, *prima facie*, enabled a claim against Turkey by Cementownia under the Energy Charter Treaty. The protection offered by the ECT was the motivation for the share transfer.⁸⁷³

The Tribunal found that treaty shopping, while not *per se* abusive, will amount to an abuse of right where the claimant is “found to be a mere artifice employed to manufacture an international dispute out of a purely domestic dispute”.⁸⁷⁴

In this case, the shares were transferred before the dispute arose. While arguably the dispute was in contemplation, the artificiality arose from use of Cementownia’s Polish nationality as a device to gain rights under the ECT that the Turkish Uzan family did not possess. The Tribunal was frank that use of a claimant’s legal personality, not for legitimate commercial purposes, but rather for the “sole purpose of gaining access to international jurisdiction” is not *bona fide*: “a party’s creation of a legal fiction so as to gain access to an international arbitration procedure to which it was not entitled is an abuse”.⁸⁷⁵

Similarly, in *CFHL*,⁸⁷⁶ a dormant company which had no commercial activity for many years was “revived” by retrospective compliance with meeting, accounting and taxation regulations. The revival was for the sole purpose of supporting “the reality of its Luxembourg *siège social* in order to satisfy the nationality conditions imposed by the Treaty” and thereby to pursue a claim against Cameroon on behalf of CFHL’s ultimate owner, a Cameroon national.⁸⁷⁷

Following *Phoenix Action*, the Tribunal emphasised two aspects of this arrangement that rendered it abusive: first, the timing of the “sudden awakening” of the claimant company;⁸⁷⁸ and secondly the purpose for doing so—to “give the dispute an international appearance” when in fact there was none.⁸⁷⁹ While the timing of the revival was important, the finding of abuse of right turned on the

⁸⁷³ *Cementownia*, above n 871, at [117].

⁸⁷⁴ At [117].

⁸⁷⁵ At [154]–[156].

⁸⁷⁶ *CFHL*, above n 117.

⁸⁷⁷ At [365] (author’s translation).

⁸⁷⁸ At [364].

⁸⁷⁹ At [362].

“orchestrated developments after years of lethargy”,⁸⁸⁰ and the purpose of these developments: to create the appearance of an active Luxembourg company.⁸⁸¹

The *Cementownia* and *CFHL* decisions illustrate the importance and emphasis placed on the legitimacy of the commercial purpose for which the claimant exists in the ownership structure of the investment, regardless of whether the relevant corporate structure is orchestrated before or after the dispute is born. An abuse of right may exist even if the claimant is inserted in the ownership structure of the investment prior to the alleged breach of the relevant treaty.

The final decision to be discussed in this ilk, *Philip Morris Asia v Australia*,⁸⁸² shows that a genuine commercial purpose may avoid a finding of abuse even when the restructure affords the requisite nationality to the claimant after the dispute is reasonably foreseeable. Again, the timing test is not determinative. Rather, what matters is the underlying question of commercial purpose as informed by matters of timing, but also by other relevant circumstances.

As set out in Chapter 9, the claimant, Philip Morris Asia (PM Asia) was inserted into the chain of ownership of Philip Morris’ Australian subsidiaries after Australia had announced its intention to enact plain packaging legislation, but before draft legislation was introduced into the Australian House of Representatives.⁸⁸³ Philip Morris publicly opposed the policy from its announcement.⁸⁸⁴

At the time of the restructure, PM Asia was a long established Hong Kong company with substantial business activities.⁸⁸⁵ Its owner was a Swiss company. The restructure permitted PM Asia to claim investor status under the Australia-Hong Kong BIT, which defines corporate nationality solely by place of incorporation.⁸⁸⁶ It is therefore a third-country-type case.

Australia argued that Philip Morris’ restructuring was an abuse of right because it took place when the dispute about plain packaging had already arisen, or at least was foreseeable.⁸⁸⁷ The Tribunal found that a dispute about the legality of

⁸⁸⁰ At [365].

⁸⁸¹ At [362].

⁸⁸² *Philip Morris*, above n 122.

⁸⁸³ At [97], [119], [141]–[163] and [165]–[177].

⁸⁸⁴ At [113]–[177].

⁸⁸⁵ At [1] and [95]–[96].

⁸⁸⁶ Articles 1(b)(i) and 1(f)(i)(B) of the Hong Kong-Australia BIT.

⁸⁸⁷ *Philip Morris*, above n 122, at [9], [184], [400]–[410], [420]–[430] and [536].

plain packaging had been foreseeable from the time it was announced as Government policy,⁸⁸⁸ and, “it may amount to an abuse of process to restructure an investment to obtain BIT benefits in respect of a foreseeable dispute”.⁸⁸⁹ But, as the use of the term “may” indicates, its analysis did not stop there. The Tribunal considered that timing was not necessarily a decisive factor; if legitimate commercial reasons existed for the restructure, then:⁸⁹⁰

In the view of the Tribunal, it would not normally be an abuse of right to bring a BIT claim in the wake of a corporate restructuring, if the restructuring was justified independently of the possibility of bringing such a claim.

In other words, the claimant’s motivations for the restructuring may excuse what would otherwise be an abuse of right in circumstances where treaty protection was “merely an ancillary consequence of the restructuring”.⁸⁹¹

PM Asia submitted that the restructuring was implemented partly to obtain protection under the BIT, but that its primary motivations for restructuring were tax-minimisation, cash flow optimisation and streamlining of management reporting.⁸⁹² However, after a “close examination of the evidence” the Tribunal was “not persuaded that tax or other business reasons were determinative factors for the claimant’s restructuring”. Rather, 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”.⁸⁹³

Accordingly, the claim was an abuse of process. PM Asia could not claim rights as an investor under the Australia-Hong Kong BIT despite its status as a company incorporated in Hong Kong in compliance with the formal requirements

⁸⁸⁸ At [555]–[569].

⁸⁸⁹ At [545]. At [540]–[545], the Tribunal observed that the mere fact of restructuring an investment to obtain treaty benefits is not per se illegitimate, citing *Tidewater*, above n 23, at [184]; *Mobil*, above n 23, at [204]; *Agua del Tunari*, above n 22, at [330]; and *Renée Rose Levy and Gremcitel SA v Peru (Award)* ICSID ARB/11/17, 9 January 2015 at [184]. The requisite test for foreseeability is discussed in *Philip Morris*, above n 122, at [550]–[554].

⁸⁹⁰ *Philip Morris*, above n 122, at [570].

⁸⁹¹ At [570].

⁸⁹² At [572]–[581].

⁸⁹³ At [582] and [584].

of the BIT, nor (as noted in Chapter 9.3) as a result of its substantive business activities in Hong Kong.

The *Philip Morris* decision illustrates the application of a holistic purposive test in keeping with the approach of tax treaty jurisprudence. It examines the timing aspect because it is a powerful indicator of purpose. But it goes on to test the assumption that a restructure at a point when a dispute is foreseeable is an abuse, by assessing other evidence as to the legitimacy of the commercial purpose of the claimant in the corporate structure.

The Tribunals in *Mobil*, *Pac Rim*, *Tidewater* and *ConocoPhillips* do not do this. Despite (with the exception of *Tidewater*) professing a holistic approach taking into account all circumstances, those decisions treat the timing test as determinative. *Philip Morris* recognises that although timing “ordinarily will be” determinative,⁸⁹⁴ it is in fact part of a holistic purposive test.⁸⁹⁵

The importance of this observation, is that if timing is one part of a broader purposive test, then just as a restructure with a legitimate commercial purpose can be permitted even if it takes place *after* a dispute is foreseeable, a restructure completed *before* a dispute is foreseeable may also be abusive if the claimant company lacks a genuine commercial purpose other than to procure treaty protection.

The ultimate question is, and should be, that which has ultimately gained acceptance in tax treaty law: is there a genuine commercial rationale for the existence of the claimant in the ownership structure of the investment, other than the desire to procure rights pursuant to a treaty? The answer is informed by the motivation for the transaction as revealed, *inter alia*, by the timing and the nature of the transaction.

10.4 The practicality and certainty of a purposive test

This review of investment treaty decisions illustrates that investment treaty tribunals are incrementally moving to conform with the purposive tax treaty “reason

⁸⁹⁴ *Pac Rim*, above n 23, at [2.99].

⁸⁹⁵ This point is recognised by Watson and Brebner, above n 39, at 319, where they state that the dispute remains a genuine one if the restructure occurred for genuine reasons even after the existence of a dispute, although in practice it will be a rare case where a claimant could show that the restructure and a subsequent claim about an existing dispute were not linked.

to exist” approach through the concept of abuse of right. However, they evidence inconsistency in the application of those principles, particularly as to whether restructuring undertaken solely to gain access to treaty protections in respect of future disputes is permissible or an abuse of process.⁸⁹⁶

In 2011, Borman reviewed some of the then available decisions (*Tokios, Mobil, Phoenix*, and *AdT*) and concluded it was an abuse to restructure solely to gain protection of an investment treaty and that this inquiry should be conducted in a holistic purposive way.⁸⁹⁷ He discerned that the dividing line between abuse and legitimate planning is not entirely circumscribed by the timing of the dispute compared with the timing of the relevant corporate restructure.⁸⁹⁸

... although the temporal aspect may be the most important when determining whether a corporate restructuring constitutes legitimate corporate planning or abuse of rights, when assessing the existence of abuse, due regard should be paid to the whole structure of the transaction, including its motives, scope and strategy.

Yet, Borman concludes, “no absolute test can be proposed, as the determination of abuse will depend, as stated by the Tribunal in *Mobil*, upon the circumstances of each specific case”.⁸⁹⁹ This is the approach taken in *Philip Morris* four years later.

In 2015, Lee identified abuse of process as placing an important limit on treaty shopping, but on his analysis it had only been effective to prevent the “most objectionable” cases.⁹⁰⁰ He considered the timing issue to be a “predictable workable test” but observed that *Phoenix Action* also placed considerable weight on the motives for and substance of the restructuring transaction.⁹⁰¹ He “could find no

⁸⁹⁶ Feldman, above n 16, at 288–292 reviews some of these abuse of right cases and makes a similar observation. See also to the same effect, Valasek and Dumberry, above n 39, at 60–65.

⁸⁹⁷ Borman, above n 39, at 361–362. See to the same effect Voon, Mitchell and Munro, above n 39, at 65.

⁸⁹⁸ At 389.

⁸⁹⁹ At 389.

⁹⁰⁰ Lee, above n 14, at 376–378.

⁹⁰¹ At 377.

unifying criteria”,⁹⁰² and considers “the precise contours of the principle remain elusive”.⁹⁰³

More recently, Jagusch, Sinclair and Wickramasooriya⁹⁰⁴ and Watson and Brebner⁹⁰⁵ question the workability of a test based on the principle of abuse of right, although they (like Lee) approach the issue primarily through the prism of the temporal aspect as per the timing cases above. Watson and Brebner highlight in particular uncertainty as to when a dispute can be said to arise, the degree to which a dispute must be foreseeable, when it must be foreseeable, and whether foreseeability of a dispute and the purpose of a restructure is assessed subjectively or objectively (although they generally support a “dominant purpose” test).⁹⁰⁶

This thesis concurs with the headline conclusion of these commentators: that abuse of right has an important, and to a degree unrealised, part to play in curbing illegitimate treaty shopping. But it goes further to identify a holistic purposive approach which includes, but does not necessarily start or rely on, the timing aspect as the key denominator of treaty abuse. It does so by examining the purpose of treaty jurisdictional provisions, and conducting a conclusive analysis of investment treaty cases relevant to jurisdiction *ratione personae*.

This thesis also illustrates that a holistic purposive approach is consistent with and derives from the use of the concept of commercial purpose in analogous and related areas of municipal, investment treaty, international, and tax law. Further, as discussed immediately below and contrary to the above commentators’ provisional views, this thesis shows that a test focused on the claimant’s purpose to exist can be a reasonably predictable and practical test.

It will be recalled that the literal authorities warn against the uncertainty inherent in a functional interpretation, which, they argue, would result in investors unable to anticipate whether they will have treaty protection in respect of an investment and thus be discouraged to commit capital in a foreign jurisdiction.

⁹⁰² At 376–377.

⁹⁰³ At 378.

⁹⁰⁴ Stephen Jagusch, Anthony Sinclair and Manthi Wickramasooriya “Restructuring Investments to Achieve Investment Treaty Protection” in Meg Kinnear and others (eds) *Building International Investment Law: The First 50 Years of ICSID* (Kluwer Law International, the Netherlands, 2015) 175 at 175–176 and 189–190.

⁹⁰⁵ Watson and Brebner, above n 39, at 317–329.

⁹⁰⁶ At 321–329. To the same effect see Lee, above n 14, at 377–378; and Borman, above n 39, at 370–382.

But a purposive test as proposed in this thesis is reasonably predictable for investors because the investor will know why it exists in a corporate structure. The test is straightforward if it is recognised, as Borman and the Tribunals in the holistic cases discussed above do, that an entity included in a corporate structure only or primarily to gain jurisdiction when otherwise there would be none, is an abusive manipulation of the system of international investment protection.

The subjective intention of a claimant as to its commercial purpose would be relevant, but it could not be conclusive; as in *Philip Morris*, the claimant's professed intention would be subject to an objective assessment as to its validity. But an objective viewpoint does not remove sufficient certainty. A claimant ought to have evidence to illustrate the bona fides of its purpose in the ownership structure of the investment. In *Philip Morris*, it was the absence of such evidence and the claimant's failure to call relevant executives as witnesses that, in part, led to the Tribunal's rejection of the claimant's professed commercial reasons for the restructure.⁹⁰⁷

Many cases will be clear. In *Mobil*, *Pac Rim*, *ConocoPhillips*, *TSA Spectrum*, *Phoenix*, *Cementownia* and *CFHL* for example, it was either acknowledged by the claimant, or it was plainly evident, that the claimants were inserted in the corporate structure solely to procure investment treaty coverage. Accordingly, such companies cannot qualify as a national of their states of incorporation for investment treaty purposes. They are not bona fide investors of the home state to whom the host state could reasonably have intended to extend treaty protection.

The claimants in *KT Asia*, *Yukos* and *Rompetrol* are also likely to fall foul of a purposive test on this basis. The decision in *Tidewater* may have been different, although the Tribunal did not assess whether the claimed commercial reasons for the restructure (unification of the corporate structure and tax efficiencies) were legitimate.

On the other hand, *Autopista* and *ADC* are examples of intermediary company claimants that demonstrated genuine commercial reasons to exist and real roles in the investment. As described in Chapter 8, the *Autopista* and *ADC* Tribunals began their analysis with a formal literal approach to the relevant treaties which

⁹⁰⁷ *Philip Morris*, above n 122, at [582].

required mere incorporation, but then conducted a check on the bona fides of the claimants in a holistic purposive way, much as that advanced by this thesis.

Some uncertainty is an inevitable consequence of a rule with sufficient flexibility to address corporate structures that can be as diverse as the ingenuity of people motivated by profit. In particular, there may be debate as to what circumstances will be sufficient to evidence a commercial reason other than treaty protection to exist in an ownership structure; and to what degree the alternative commercial reason (or reasons) must motivate the existence of the claimant compared with the desire for treaty protection.

In respect of the former, there will be occasions that require a detailed assessment of commercial justifications put forward by the claimant. But these are essentially questions of fact that tribunals are equipped to answer, just as tax courts have done as illustrated in Chapter 6 and Chapter 10.2. Sworn evidence from executives, cross-examination and disclosure can be weighed by tribunals to test claims to a genuine purpose beyond treaty protection. Manufactured or artificial commercial purposes are able to be identified as shown, for example, by the investment treaty tribunals in *Philip Morris* and *Phoenix Action*, and in the tax case *Revenue Ruling 84-153* where the one per cent margin paid to the claimant subsidiary was found to be an insufficient business purpose to overcome the conduit nature of the transaction.⁹⁰⁸ Complex transactions can be unpicked and analysed as shown in *Indofood* and *Bank of Scotland*.

Guidance is available as to relevant factors which indicate purpose (and would become more so as time goes on) from existing jurisprudence. For example, it is apparent from the existing cases reviewed above that timing is important, but not conclusive. Restructuring after a dispute is foreseeable will ordinarily point to an illegitimate purpose. But in *TSA Spectrum*, *CFHL* and *Cementownia*, abuse was found even though the claimants were part of the chain of ownership before the dispute arose. On a purposive approach, restructuring in circumstances of general enmity with state authorities—as in *AdT*, *Tidewater*, *Cementownia* and *Mobil*—may also give rise to suspicions of an improper purpose, subject to a genuine commercial explanation other than treaty coverage.

⁹⁰⁸ Revenue Ruling 84-153, above n 435, at 384. See Chapter 6.3.

Substantial or effective business activity may corroborate a claim to a genuine role in a corporate structure, such as in *ADC*. But, as in *ADC*, the activity must relate to the investment. Cases such as *Philip Morris* and *Bank of Scotland* illustrate the point well. They were undoubtedly substantial companies, but if their reason for existence in the ownership chain of the investment is only related to the fact that their nationality by incorporation permits access to treaty benefits, then their other business activity is irrelevant. So far as the investment at issue is concerned, they are no different than a shell company.

Conversely, the lack of any, or minimal, business activity in the claimed state of nationality ordinarily weighs against a genuine reason to exist other than treaty coverage, but not necessarily. The purposive test allows for a bona fide claimant, as in *Yaung Chi*, with minimal business activity in its home state because its principal activity takes place in the host state operating the investment. In such cases, the claimant may still have a genuine commercial reason to exist as an owner of the investment.

Control of the investment—that is, taking an active role in its management and direction—might also evidence a claim to a genuine role. This appears to be the primary substantive factor relevant to genuine purpose in *AdT* where the majority found that the claimant was the fulcrum company through which the multinational joint venture partners controlled the Bolivian investment. Accordingly, although the migration of the claimant to the Netherlands was undertaken only shortly before the alleged expropriation of the water concession and during public protests about it, it may have been a restructure for commercial purposes other than treaty protection, albeit that Alberro-Semerena supported further disclosure by the claimant to investigate the circumstances surrounding the restructure more fully.

The Tribunal need not investigate ultimate control of the investment, so long as *the claimant* exercises a managerial or directive role. The more actual control of the investment demonstrated by the claimant, the more cogent a claim to a genuine commercial role in the investment. The focus on the claimant's role and exercise of control eliminates the uncertainty that comes with the potential for ultimate control to be fragmented among diffuse shareholders or for nationality and therefore treaty coverage to change with changes to shareholding at any time.

The terms of the restructure transaction may suggest genuineness or artificiality. For example, in the same way as the sale of property at an undervalue revealed a spurious transaction in *Prest* (see Chapter 4), the value paid by the interposed company for its investment may be indicative of whether a restructure is implemented for commercial reasons other than treaty protection.

Further investment by the claimant post-restructure may indicate a genuine purpose. That was a factor that influenced the Tribunal's finding of bona fide investors in *ConocoPhillips* and *Mobil*, where the claimants continued to invest hundreds of millions of dollars after the relevant restructure.⁹⁰⁹

Another factor mentioned by Borman and in cases such as *ADC*, is the specific consent of the host state (for example, in a contract or through a regulatory process) to investment by an entity with a particular nationality.⁹¹⁰ *Saluka* is an example. As explained in Chapter 3.2, the Czech Republic approved the use of a Dutch shell company by the Japanese bank Nomura to hold the shares of the local investment vehicle. If a holistic purposive type test is used to set the outer limits of party consent, then consent by the host state may be overridden if in all the other circumstances the arrangement was an objective abuse of the ICSID Convention.

However, it would be difficult for the host state to argue that a particular structure (and attendant corporate nationalities) was an abuse of a treaty (as opposed to the Convention) if it complied with the formal requirements in the treaty and the state had given fully informed consent to that corporate structure. This was the determinative point made in *Saluka* as explained in Chapter 7.5. The same view was expressed in *ADC*, although, as discussed above, the Tribunal found that in any event the claimants had legitimate and substantial roles to play in the investment.

In *Philip Morris*, Australia consented to the restructure via its Foreign Investment Review Board, but Philip Morris did not make the investment treaty protection implications express in its application to the regulator.⁹¹¹ Accordingly, the regulatory approval of the restructure did not prevent a finding of abuse. This decision appears to support the view that consent must be informed as to nationality

⁹⁰⁹ *ConocoPhillips*, above n 23, at [280]; and *Mobil*, above n 23, at [196]. See also Watson and Brebner, above n 39, who are sceptical as to the relevance of this factor in all situations at 328–329.

⁹¹⁰ Borman, above n 39, at 389.

⁹¹¹ *Philip Morris*, above n 122, at [312].

and consequences in terms of treaty protection to protect an otherwise abusive corporate structure.

These various factors illustrate how a holistic purposive approach can accommodate diverse circumstances by looking past formal criteria where appropriate to determine whether the claimant is used as a corporation of convenient nationality or has a commercial reason to exist as an owner of the investment.

There will inevitably be difficult cases. *Tokios* remains a troubling case, even on a purposive approach. There is too little detail in the decision as to the relevant factors to suppose a result under a purposive test. The fact that the claimant was incorporated in Lithuania years before the relevant Treaty came into force indicates that it must have had a commercial reason to exist separate from investment treaty access, but none is mentioned. Notably, however, the investment in the Ukraine was made after the Ukraine-Lithuania BIT was signed (but before it came into force), so there may have been some intent by the Ukrainian national owners to use their existing Lithuanian company to achieve treaty protection.⁹¹²

Tokios' economic activities in Lithuania, were accepted by the majority as substantial, but were not described in detail in the decision. There is nothing else in the decision to indicate whether the claimant exercised actual control over the investment, although as the only corporate entity upstream of the Ukrainian subsidiary, it might well have done. On the other hand, as Weil pointed out, the claimant's shareholders were Ukrainian nationals and the capital invested was of Ukrainian origin.

On the facts available, it may well be that the existing Lithuanian company was used by its Ukrainian owners as a conduit for the investment in Ukraine only to achieve investment treaty protection, just as Philip Morris utilised PM Asia for that purpose. Although it may be that the claimant could have demonstrated some other commercial reason for its role as owner of the investment at issue.

This hypothetical discussion regarding the facts in *Tokios* highlights two important points about a purposive test. First, a purposive test may permit nationals of a host state to achieve treaty protection by investing in their own country through a vehicle in a convenient foreign state if they can show a genuine commercial reason

⁹¹² *Tokios (Jurisdiction)*, above n 24, at [1]–[3].

for doing so. This is because the focus of the test is the claimant company's commercial reason to exist vis-à-vis the investment, not the nationality of its shareholders or controllers. While this may seem an anathema to Weil and the promoters of the substantive approach in cases such as *TSA Spectrum* and *Venoklim* it simply highlights a signal point: no one factor has a monopoly on treaty abuse.

The central problem with treaty shopping is the use of corporate nationality as a gossamer cloak, insubstantial and easily donned or discarded, to access treaty benefits at will without a genuine interest in the investment at issue. The gist of the reciprocal promises in an investment treaty is that entities of substance that have some real role to play in the investment may qualify for protection. The shareholders of such an entity might conceivably be from anywhere, including the host state, so long as the entity itself has a real commercial purpose to be involved in the investment.

It may be difficult for a claimant controlled by nationals of the respondent state to demonstrate that the claimant entity has a real commercial purpose in the structure rather than acting as a loop-around to access treaty benefits. The point illustrated by the *Tokios* hypothetical is it is possible to imagine there might be a genuine commercial reason for such a structure, particularly if the shareholder has a distant relationship with his country of nationality. For example, it is common for people to retain their citizenship of birth while living and working in foreign jurisdictions for many years. That scenario might explain the legitimate use of a foreign vehicle for an investment in an expatriate's home country.

The factual scenario in *Champion Trading v Egypt* discussed in Chapter 7.3 serves as an example. The Wahba brothers had no connection with Egypt other than Egyptian citizenship inherited from their father and the investment at issue. They set up corporate vehicles in the United States to invest in Egypt because that is where they had lived their whole lives, not to take advantage of an investment treaty to which they would otherwise be strangers. In these circumstances, a purposive test would not serve to render the companies' investment an abuse of the United States-Egypt BIT solely because their shareholders were nationals of the respondent state.

The second point that arises from the *Tokios* hypothetical is the point in time at which the purpose of the claimant in the structure is assessed. In *Tokios* the

contenders might be the time of incorporation of the claimant (1989), the time the investment was first made (1994), or the time the dispute arose or was reasonably foreseeable (2002).

One of the advantages of the purpose test is that the commercial purpose of an entity is not easily—and genuinely—altered, as can be achieved with corporate nationality measured solely by incorporation. Conceivably however, an entity’s role in an investment structure may develop or be altered. The time at which purpose is critical must be the point at which the dispute is reasonably foreseeable.⁹¹³

Prior to that point, the commercial role fulfilled by the claimant company will be relevant to assess the bona fides of its purpose in the corporate structure at the point the dispute became foreseeable. But up to that point its role in the ownership structure might conceivably change. However, a change in purpose to adopt a legitimate role after that point, when previously there was none, will ordinarily be ineffective. Presumably also, the longer the history of a real commercial role in the investment, the more cogent the evidence of genuine commercial purpose in respect of the investment. Conversely, a last-minute change to the functions and purpose of a claimant (as in *CFHL* and *Philip Morris*) will give rise to suspicions of artificiality.

Finally, the degree to which evidence of commercial purpose other than treaty coverage is necessary to avoid a finding of treaty abuse requires determination. What happens if a claimant has dual or multi-purposes for existence, one of which is to procure treaty coverage?

To date, tribunals have addressed situations where treaty coverage is the “sole purpose”⁹¹⁴ or the “only business purpose”⁹¹⁵ of the corporate restructure, but have also allowed that restructures which have treaty coverage as its “main” purpose⁹¹⁶ or “one of the principal purposes”⁹¹⁷ may be abusive. This test is the same as the OECD Committee wording which recognises an abuse where the main purpose of the claimant entity is to access treaty benefits as discussed in Chapter 6.

⁹¹³ Discussions as to exactly how the foreseeability test should operate are found in Jagusch, Sinclair and Wickramasooriya, above n 904; and Watson and Brebner, above n 39.

⁹¹⁴ For example, *Mobil*, above n 23, at [27]; and *Phoenix Action*, above n 136, at [93].

⁹¹⁵ *ConocoPhillips*, above n 23, at [279]. See also *Gremcitel*, above n 889, at [191].

⁹¹⁶ *Mobil*, above n 23, at [190].

⁹¹⁷ *Pac Rim*, above n 23, at [2.41].

Some cases approach the issue in the language of an agency relationship, the exercise being to identify abuse of the corporate form when the claimant is a mere “instrumentality” as per *Banro*, a “functionary” as per *Adams v Cape*, “expedient” as per *Siag*, or “artifice” as per *Cementownia*, for the purpose of gaining treaty benefits.⁹¹⁸ In *Philip Morris*, the approach was expressed as identification of the “main and determinative” reason for the restructuring, and that if treaty coverage was merely “an ancillary consequence” of a transaction motivated by other legitimate commercial reasons, it would not be abusive.⁹¹⁹

Watson and Brebner, and Jagusch, Sinclair and Wickramasooriya suggest a dominant purpose test which looks to the principal or main reason for the existence of the claimant in the corporate structure.⁹²⁰ This accords with the *Philip Morris* approach and provides a reasonable balance that protects the object of jurisdictional provisions in treaties, but permits a claimant to show that the investor is of real commercial substance in respect of the investment, rather than a fiction designed to procure protections to which the investor would not otherwise be entitled. The factors enunciated above will provide guidance in any particular case as to the real principal purpose of the claimant’s involvement in the investment structure.

Regardless of the wording of a test—whether it be dominant purpose or main purpose, or the identification of a mere artifice—the fundamental inquiry is to weed out those entities with an artificial (or no) commercial reason to exist other than treaty coverage. Conversely, where an entity can show that it has a real—that is, genuine and not fabricated—role to play in the investment so that treaty coverage is ancillary to that purpose it should not be necessary to weigh it in fine scales as to the dominance of one purpose over another.

It cannot be boiled down to a percentage type formula. As recognised by tax treaty commentators there can be no bright line; the issue will essentially be a question of fact.⁹²¹ A claimant should be able to show why it has a real commercial reason to exist other than treaty coverage and be able to illustrate that purpose.

⁹¹⁸ See Chapters 3, 4, 7 and 10. Respectively: *Banro*, above n 254, at 12; *Adams*, above n 283 at 545; *Siag*, above n 540, at [200]; and *Cementownia*, above n 871, at [117].

⁹¹⁹ *Philip Morris*, above n 122, at [584].

⁹²⁰ Watson and Brebner, above n 39, at 327–328; and Jagusch, Sinclair and Wickramasooriya, above n 904.

⁹²¹ See above n 457.

Tribunals and respondent states have the tools to test that evidence as is evident from *Philip Morris*.

While there will remain the possibility that investors can manufacture a reason to exist, as some tax claimants have been found to do, it will not be straightforward given the rigours of disclosure and evidence on oath in a largely public forum. And even if some succeed, it is surely better to have excluded some abusive corporate structures than allow them all on the basis that some may slip through the net of inquiry as to a genuine reason to exist other than treaty coverage.

10.5 Conclusion

This Chapter has demonstrated the existence and workings of a holistic purposive test that focuses on the claimant's commercial reason to exist in tax treaty jurisprudence and in abuse of right cases in investment treaty law. The analysis shows that a holistic approach that assesses all factors relevant to the claimant's commercial reason to exist, rather than relying solely on one factor—be it control, business activity or timing—is the best approach to ameliorate treaty shopping that contravenes the object and purpose of investment treaties.

A “reason to exist” test of this nature cannot be as certain as the fulfillment of technical criteria. The result will depend on the circumstances of each case. Yet it is a workable and reasonably predictable test. The assessment of substantive economic relationships and activity are matters that investment treaty tribunals are able to navigate in areas including jurisdiction *ratione materiae*, treaty definitions requiring control or effective management, denial of benefits clauses, and in respect of merits arguments. The *Philip Morris* and *Phoenix Action* decisions show a willingness and ability to grapple with assessments of economic motivation for restructuring and, to the extent relevant to that motivation, issues of timing, business activity and control.

Further and importantly, not only are the factors relevant to the assessment of commercial purpose familiar to the work of investment treaty tribunals, they are not unknown to the claimant: they are all within its knowledge. A claimant can provide evidence of its business activity, its ownership, its actual control of the investment and the reasons for which, and when, it came to be included in the ownership chain of the investment. If it has a genuine commercial reason to exist in

relation to the investment at issue other than to procure treaty protection, it should be able to demonstrate it.

It could be argued that a purposive approach would reward accidental nationals and penalise planners. But that is not the case. Planning an investment to ensure investment treaty coverage would be permissible under a purposive test so long as there is *also* a legitimate commercial reason for the claimant company to exist in the ownership structure of the investment. The claimant's economic connection to a jurisdiction must be more than skin deep; there must be substance evidenced by a purpose to exist in the chain of ownership beyond the mere harvesting of treaty rights. The purposive approach rewards those who plan to have a nationality for a commercial reason that provides a genuine link to the state of claimed nationality; it does not reward those who plan to use corporate nationality through companies of convenience primarily to garner additional rights they would not otherwise have.

The object of this holistic purposive approach is to weed out those enterprises that claim treaty protection but exist only (or primarily) to procure it. In those circumstances, such an entity is operating as a conduit for entities that cannot claim treaty coverage (that is, nationals of the host state or nationals of third-party states) to nevertheless piggy-back on the bargain of the contracting states. If, on the other hand, the putative claimant is shown to exist in the ownership chain for reasons independent of treaty coverage, then its investment in the host state will be consistent with the objects of both the substantive and jurisdictional aspects of investment treaties—encouragement of investment and limitation of beneficiaries respectively—because it will be foreign investment by an entity with a genuine economic connection with the investment.

This Chapter has articulated the shape and application of the specifics of a purposive approach. Chapter 11 now examines the various means by which a purposive approach to treaty shopping could be integrated into investment treaty jurisprudence.

11 Implementation of a substantive approach: by what means?

11.1 Introduction

This Chapter addresses how a purposive test might be integrated into, or adopted or imposed by, investment treaty law; that is, by what principled means might it be applied?

It is suggested that both “States and the arbitrators have a role to play”.⁹²² So far as states are concerned, purposive tests can be expressly incorporated into the language of existing and new investment treaties by means of definitions of “national of a contracting state” and “investor” and by virtue of denial of benefits clauses.⁹²³

These state-derived textual solutions are part of the answer. But the shortcomings of these approaches must be recognised, in particular the difficulty of amending existing treaties and the complications surrounding the interpretation and application of denial of benefits clauses (as to which see below).

Jurisprudential, or tribunal-derived, solutions are more immediate than changes to the wording of treaties over time. The first tribunal-based solution has been canvassed in Chapters 6 and 7: the recognition of an inherent limit in the meaning of “nationality” or “national” or “investor” either by way of art 25(2) of the ICSID Convention, or the terms of specific investment treaties, in the same manner as an inherent meaning of “investment” is recognised in investment treaty law.

The second jurisprudential solution is prefaced in Chapters 4, 6, 8 and 10: the recognition of a purposive test as an integral aspect of the principle of abuse of right recognised at general international law and expressly by the requirement for good faith interpretation per art 31(1) of the Vienna Convention. This is not a radical revision of the concept or boundaries of the concept of abuse of right. A purposive test, which examines the role or purpose of an entity—its reason to exist—is already a primary aspect of the doctrine. However, as illustrated in Chapter 10, investment tribunals either have not needed to investigate purpose, or given it little weight in

⁹²² Stern, above n 573, at 550.

⁹²³ Baumgartner, above n 1, at [8.2].

determining claims of treaty abuse. This thesis argues that a purposive enquiry plays a more prominent role in abuse of right jurisprudence and enables the doctrine to act as an effective substantive check on treaty shopping by manipulation of corporate nationality.

These intra-treaty and extra-treaty approaches have, to a greater or lesser extent, been prefaced in earlier text. This Chapter examines the scope for each option to impose a purposive test and the advantages and limitations of each in this regard.

11.2 Treaty definitions

The most direct and effective means by which to import a purposive test into treaty jurisprudence is to include a purposive requirement in the express words of the definitions of “national of a contracting state” or “investor”. Just as statute or contract can abrogate separate corporate personality in municipal legal systems,⁹²⁴ the terms of a treaty can do the same at international law.

For instance, a national of a contracting state or an investor may be defined as an entity incorporated according to the laws of a contracting state and which can demonstrate a commercial purpose to exist as a direct or indirect owner of an investment other than to procure the benefits of a treaty.

A non-exhaustive list of considerations as to purpose could be included such as: the timing of the inclusion of the entity in the ownership chain; the actual management or control exerted by the entity over the investment; the role of the entity in providing capital it has earned or sourced to the investment; its role in the receipt of revenues from the investment and what it does with those revenues; whether any legitimate tax benefit is accrued by the claimant’s existence in the ownership chain; whether the host state has consented to the existence of the entity as an owner of the investment; and whether the entity has business activities in its home state that relate to the management of the investment.

Incorporation of a purposive test as part of a jurisdictional definition would place the onus of proof of compliance on the claimant. This would avoid arguments

⁹²⁴ See generally Peter Watts, Neil Campbell and Christopher Hare *Company Law in New Zealand* (2nd ed, Wellington, LexisNexis, 2016). More specifically, see *Adams*, above n 283; and Lord Cooke of Thorndon *Turning Points of the Common Law* (Sweet & Maxwell, London, 1997) at 13.

that arise in the context of denial of benefits provisions and the doctrine of abuse of right as to where the onus lies.

Express incorporation of a purposive test in relevant treaty definitions is a straightforward way of permitting access to bona fide investors in the sense that they are attached to their home state in a formal way (by incorporation) and have a genuine reason to exist in the ownership structure of the investment.

The drawback to this solution is that while such definitions may be able to be incorporated into new treaties, amendment of existing treaties faces “enormous practical and legal hurdles”.⁹²⁵ While states have the power to amend or terminate investment agreements,⁹²⁶ that power is tempered by legality and practicality.⁹²⁷

There are practical diplomatic hurdles involved in renegotiating or terminating any treaty. Particularly where an investment treaty exists between developed and developing countries, with investment flowing largely in one direction, there is little incentive for the developed country to negotiate limitations to existing treaties,⁹²⁸ and the sheer number of BITs in force means that renegotiating on a wide scale “amounts to a long and arduous task” unlikely to be achieved in the short term.⁹²⁹

Neither is termination of treaties, at least unilaterally, a realistic option. First, termination may solve a problem, but destroys the benefits of investment treaties. Secondly, investment treaties have “immune systems”⁹³⁰ such as restrictions on unilateral termination and survival clauses.

Even after the expiry of a treaty, many treaties provide that they remain in force in respect of investments made before the date of termination. Often these “survival clauses” extend the period of coverage for such investments for a further defined period.⁹³¹ Hence, a new treaty with more robust anti-treaty shopping

⁹²⁵ Lee, above n 14, at 356.

⁹²⁶ Benedict and others, above n 4, at 77.

⁹²⁷ See discussion by St John, above n 336, at 241–248.

⁹²⁸ Lee, above n 14, at 373.

⁹²⁹ At 374.

⁹³⁰ At 371–372.

⁹³¹ For example, “the survival clause” in the Netherlands Model BIT 2004 extends coverage for a further 15 years: art 14(3).

provisions will have no effect on investments made during the life of the old treaty.⁹³²

In addition, MFN clauses mean that if a state has a network of investment treaties, then amendments to one treaty may be ineffective either because MFN clauses require the imposition of more favourable provisions from other investment treaties, or because the nationality of a claimant of convenience can be modified by reincorporation in a state with a treaty which is yet to be re-negotiated. In other words, piecemeal treaty renegotiation is not entirely effective until all treaties to which a state is a party contain similar provisions to prevent treaty shopping.

The prospects of a multilateral solution—either by way of a substantive multilateral investment treaty or a multilateral protocol including a restrictive definition of “investor”—are not bright: “numerous attempts at a global substantive investment protection treaty have ended in failure”⁹³³ and a multilateral consensus regarding nationality planning “is not likely to be reached any time soon”.⁹³⁴

Schreuer suggests that the solution to this problem is to do away with distinctions placed on nationality in the jurisdictional sphere in the same way as “distinctions on the basis of nationality are taboo” when it comes to the merits.⁹³⁵ He points to the application of international human rights law regardless of nationality. However, as mentioned in Chapter 8, states are resistant to the idea of suit under investment treaties in an international tribunal by their own nationals. If the end of nationality as a jurisdictional gatekeeper is “the future of investment arbitration ... we are still a long distance from that”.⁹³⁶

Amendment and reformulation of treaty definitions is a sensible approach and does appear to be gaining traction. For example, the Netherlands has recently retreated from its reputation as a popular “base camp” or “treaty haven” for holding

⁹³² van Os and Kottnerus, above n 53, at 11. The authors candidly observe, “[t]o exit a BIT is a lot more difficult than to enter one.” See also the discussion of the practical difficulties of termination or renegotiation in Federico M Lavopa, Lucas E Barreiros and M Victoria Bruno “How to Kill a BIT and not Die Trying: Legal and Political Challenges of Denouncing or Renegotiating Bilateral Investment Treaties” (2013) 16 J Intl Econ L 869.

⁹³³ Lee, above n 14, at 374 citing Martins Paparinskis *Basic Documents on International Investment Protection* (Hart, West Sussex, 2012) at 6.

⁹³⁴ Skinner, Miles and Luttrell, above n 40, at 283.

⁹³⁵ Schreuer, above n 170, at 527.

⁹³⁶ At 527.

companies.⁹³⁷ As noted in Chapter 2, the Netherlands Model BIT 2019 introduced a substantial business activity criteria into its definition of corporate nationality and included a denial of benefits clause where a claimant enters the ownership structure after a dispute is reasonably contemplated.⁹³⁸ The intent is to exclude mailbox companies.⁹³⁹ The Dutch Model BIT 2004 did not feature these limitations for investors. Indeed, only one of the Netherlands' 104 concluded investment treaties had previously included a "substantial business" requirement.⁹⁴⁰

Similarly, the India Model BIT 2015 introduced a substantial business activity requirement as part of the definition of investor and a denial of benefits provision, both of which were absent from the 2003 India Model BIT.⁹⁴¹ The denial of benefits clause adopts the test promoted in this thesis: a party may deny an investor that has been "established or restructured with the primary purpose of gaining access to the dispute resolution mechanisms provided in this Treaty."⁹⁴²

Other recent investment treaties have incorporated "substantial business"-type requirements.⁹⁴³ But treaty language is a slow ship to turn.⁹⁴⁴ For example, no new treaties have been signed based on the recent Dutch and Indian Model BITs. So, what of the application of the other express jurisdictional treaty obstacle to corporations of convenience: denial of benefits provisions? By their very moniker, denial of benefits clauses are intended to permit contracting states to exclude certain entities from the benefits of treaty protection.

⁹³⁷ van Os and Knotnerus, above n 53, at 4–5.

⁹³⁸ Articles 1(b) and 16(2), respectively.

⁹³⁹ Duggal and van de Ven, above n 660, at 354 citing their translation of Ministerie van Buitenlandse Zaken *Investeren in Perspectief* (18 May 2018) at 71 and 359.

⁹⁴⁰ Netherlands-Chile BIT (signed 30 November 1998), art 1(b).

⁹⁴¹ Articles 1.5 and 35.

⁹⁴² Article 35.

⁹⁴³ For example, Slovakia-Iran BIT (signed 19 January 2016), art 1; Morocco-Nigeria BIT (signed 3 December 2016), art 22; Colombia-UAE BIT (signed 12 November 2017), art 25; Japan-Israel BIT (signed 1 February 2017), art 1; Rwanda-UAE BIT (signed 1 November 2017), art 24(1); Comprehensive Economic and Trade Agreement (signed 30 October 2016) [CETA], art 8.1; TPP, art 9.15; ASEAN-Hong Kong Free Trade Agreement (signed 12 November 2017), art 19; and PACERPlus (negotiations concluded 20 April 2017), art 18. See generally Duggal and van de Ven, above n 660, at 359.

⁹⁴⁴ See Lavopa, Barreiros and Bruno, above n 932.

11.3 Denial of benefits provisions

Denial of benefits clauses seek to address the mischief with which this thesis is concerned:⁹⁴⁵ to “limit investors’ use of corporate restructuring as a means of ‘treaty shopping’”,⁹⁴⁶ and maintain the principle of reciprocity by excluding treaty benefits to nationals of third states which have not accepted any of the obligations of the treaty.⁹⁴⁷ They exist to assuage the concern that “free riders” from third parties could gain protection of such treaties via the infiltration of a shell or mailbox company.⁹⁴⁸ They are one means “states have devised ... to counteract strategies that seek the protection of particular treaties by acquiring a favourable nationality”.⁹⁴⁹

Denial clauses operate to exclude an investor which is “simply an intermediary for interests substantially foreign”,⁹⁵⁰ and permit a state to “deny the benefits of the treaty to a company that does not have an economic connection to the State on whose nationality it relies”.⁹⁵¹ The requisite “economic connection consist[s] in control by nationals of the state of nationality or in substantial business activities in that state”.⁹⁵²

Denial of benefits clauses have been adopted in numerous investment treaties including those entered into by the United States,⁹⁵³ Canada,⁹⁵⁴ China,⁹⁵⁵ as well as a number of multi-lateral treaties such as the Energy Charter Treaty,⁹⁵⁶ the ASEAN

⁹⁴⁵ For a brief history of denial of benefit clauses, see Mistelis and Baltag, above n 403.

⁹⁴⁶ Lindsay Gastrell and Paul-Jean Le Cannu “Procedural Requirements of ‘Denial-of-Benefits’ Clauses in Investment Treaties: A Review of Arbitral Decisions” (2015) 30 ICSID Rev 78 at 81.

⁹⁴⁷ Jeswald W Salacuse “BIT by BIT: The Growth of Bilateral Investment Treaties and Their Impact on Foreign Investment in Developing Countries” (1990) 24 Int’l Law 655 at 665; Gastrell and Le Cannu, above n 946, at 81; Mistelis and Baltag, above n 403, at 1302–1303; Sinclair, above n 7, at 385; and Feldman, above n 16, at 281.

⁹⁴⁸ Herman Walker Jr “Provisions on Companies in United States Commercial Treaties” (1956) 50 AJIL 373 at 388. See also Mistelis and Baltag, above n 403, at 1302.

⁹⁴⁹ Dolzer and Schreuer, above n 18, at 55. To the same effect see: Gastrell and Le Cannu, above n 946, at 78, 81 and 96; and Mistelis and Baltag, above n 403, at 1302 and 1311. The term “free-riders” was first used in the context of denial of benefits of United States Friendship, Commerce and Navigation Treaties by Walker, above n 948, at 388.

⁹⁵⁰ *Waste Management*, above n 24, at [80].

⁹⁵¹ Dolzer and Schreuer, above n 18, at 55; and *Ampal-American Israel Corp v Egypt (Jurisdiction)* ICSID ARB/12/11, 1 February 2016 at [125].

⁹⁵² Dolzer and Schreuer, above at 18; and see Schreuer, above n 170, at 523. For a list of examples of denial of benefits clauses, see Happ and Rubins, above n 586, at 63.

⁹⁵³ United States-Rwanda BIT (signed 19 February 2008), art 17. See further examples of similar clauses in United States investment treaties and free trade agreements listed in Gastrell and Le Cannu, above n 946, at 80.

⁹⁵⁴ Canada-Costa Rica BIT (signed 18 March 1998), Annex 1 SIII(7).

⁹⁵⁵ New Zealand-China Free Trade Agreement (signed 7 April 2008), art 4.

⁹⁵⁶ Energy Charter Treaty, art 17.

Agreement,⁹⁵⁷ NAFTA,⁹⁵⁸ and CAFTA.⁹⁵⁹ For example, a CAFTA party can deny the benefits of the treaty to an investor:⁹⁶⁰

... if the enterprise has no substantial business activities in the territory of any Party, other than the denying Party, and persons of a non-Party, or of the denying Party, own or control the enterprise.

Similar denial of benefits clauses appear in the United States Model BIT 2012,⁹⁶¹ Trans-Pacific Partnership Agreement,⁹⁶² and the United States-Australia Free Trade Agreement.⁹⁶³

As a treaty based protection against undesirable treaty shopping by manipulation of corporate nationality, denial of benefits clauses have the potential to “contribute significantly to the establishment of clear, predictable limits on corporate nationality planning in investor-State arbitration”.⁹⁶⁴ As an express limitation on claims to corporate nationality, a denial clause ought to be “a respondent’s first choice of defence” against treaty shopping.⁹⁶⁵ Feldman observes that the incidence of denial of benefits clauses in investment treaties and chapters of free trade agreements has “increased significantly in recent years”.⁹⁶⁶ However, for a number of substantive and procedural reasons, denial of benefits clauses have not (yet) become the panacea to illegitimate treaty shopping they promise to be.⁹⁶⁷

First, while the incidence of denial of benefits clauses is apparently increasing, many investment treaties (particularly those in the first and second

⁹⁵⁷ ASEAN Comprehensive Investment Agreement, art 19.

⁹⁵⁸ NAFTA, art 11.13(2).

⁹⁵⁹ Dominican Republic–Central American FTA, art 10.12.2.

⁹⁶⁰ Article 10.12.

⁹⁶¹ United States Model BIT, art 17. For a history of United States’ denial of benefits clauses, see Mistelis and Baltag, above n 403, at 1302–1309.

⁹⁶² TPP, art 9.15. A range of other examples from treaties to which countries in Europe, Asia, the Pacific and the Americas are parties are set out in Feldman, above n 16, at 294.

⁹⁶³ Australia–United States FTA (signed 18 May 2004), art 11.12.

⁹⁶⁴ Feldman, above n 16, at 302.

⁹⁶⁵ At 293.

⁹⁶⁶ Feldman, above n 16, at 294 (published in 2012). Feldman claims the inclusion of denial of benefits clauses are appearing with “increasing frequency” at 302, and “rapidly increasing” at 281 and 282, the latter cited by Gastrell and Le Cannu, above n 946, at 96.

⁹⁶⁷ See generally, Baumgartner, above n 1, at [4.3.3].

generations) do not include denial of benefits clauses.⁹⁶⁸ Amendment to treaties to include such clauses are possible but face the same issues regarding renegotiation outlined in the previous sub-chapter.

Secondly, where they do exist, denial of benefit clauses do not presently approach the identification of an undesirable investor in a purposive way. Rather, as is apparent from the CAFTA example above, denial of benefits clauses utilise the control and substantial business activity criteria discussed in Chapter 9.

Accordingly, the efficacy of denial of benefits clauses as a remedy for illegitimate treaty shopping suffers from the drawbacks that attach to the use of these concepts to identify and prevent illegitimate treaty shopping. Indeed, some of the cases cited in Chapter 9 as examples of the inefficacy of control and substantial business activity—for example, *AMTO* and *Pac Rim*—arise in the context of interpretation and application of denial of benefits clauses. This thesis suggests that denial of benefits clauses should rely on a purposive analysis of the existence of the claimant company, as opposed to the criteria of control and substantial business activity. However, amendment to mandate a purposive approach faces the same practical restrictions to renegotiation as where no denial clause exists at all.

Thirdly, the potential for denial of benefits clauses to inhibit treaty shopping is impaired by practical difficulties arising from the onus of proof of the conditions to deny benefits and issues relating to notice of denial.⁹⁶⁹ These issues require some explanation and comment.

Some tribunals reason that if a state wishes to invoke a denial of benefits clause, the burden of proving that the circumstances exist so as to entitle it to do so, rests on the state, not on the claimant. Accordingly, they have been reluctant to compel the claimant to prove substantial business activity, or to provide information about ownership and control of the claimant and the nationality of the relevant owners or controllers.⁹⁷⁰

⁹⁶⁸ Feldman, above n 16, at 284; and Gastrell and Le Cannu, above n 946, at 80.

⁹⁶⁹ As identified for example by Lee, above n 14, at 367; Gastrell and Le Cannu, above n 946, at 82–94; Mistelis and Baltag, above n 403, at 1318–1320; Feldman, above n 16, at 296–301; James Chalker “Making the Energy Charter Treaty Too Investor Friendly: *Plama Consortium Limited v. the Republic of Bulgaria*” (2006) 3(5) TDM 1 at 8; and Holger Essig “Balancing Investors’ Interests and State Sovereignty: The ICSID-Decision on Jurisdiction *Plama Consortium Ltd. v. Republic of Bulgaria*” (2007) 4(5) TDM 1 at 4.

⁹⁷⁰ See, for example, *Generation Ukraine Inc.*, above n 570, at [15.8]. See also Mistelis and Baltag, above n 403, at 1310–1311; and Feldman, above n 16, at 297–298.

Pac Rim took a more pragmatic approach to proof of ownership and control issues. Once El Salvador had shown that the parent company of Pac Rim was incorporated in Canada (a non-party to CAFTA), the Tribunal shifted the burden of proof in respect of the claimant's response that the ultimate owners of the Canadian parent were United States citizens. Nevertheless, it was incumbent on the respondent state to discharge the burden of proving immediate ownership by a non-party state.⁹⁷¹

Justifying the imposition of a denial of benefits clause can be problematic. Multinational corporations often have "complex and opaque shareholding structures",⁹⁷² and information about those structures is usually in the domain of the claimant, not the respondent state. Accordingly, it can be difficult for a state to prove "who owns or controls an investor when ownership or control might involve a number of entities in different jurisdictions".⁹⁷³ Nevertheless, "the relative accessibility of evidence [to the claimant] would not seem to justify any modification to the normal rules regarding burden of proof".⁹⁷⁴

This procedural aspect of denial clauses weakens the ability of such provisions to counteract treaty shopping,⁹⁷⁵ although the pragmatic shifting the burden approach demonstrated in *Pac Rim* may alleviate the issue by lightening the burden on the respondent state.⁹⁷⁶

Timing of notice of denial is a further complication to the invocation of denial of benefits provisions. Some denial of benefits provisions can only be invoked prospectively rather than retrospectively.⁹⁷⁷ Others require compliance with pre-conditions including consultation with the non-respondent state and/or notice of denial during the dispute negotiation period.⁹⁷⁸

⁹⁷¹ *Pac Rim*, above n 23, at [4.14] and [4.80]–[4.81]. See also Feldman, above n 16, at 297.

⁹⁷² Lee, above n 14, at 369.

⁹⁷³ *AMTO*, above n 120, at [65].

⁹⁷⁴ At [65]. See also Mistelis and Baltag, above n 403, at 1318–1320; and Feldman, above n 16, at 296.

⁹⁷⁵ Lee, above n 14, at 369. To similar effect see Feldman, above n 16, at 298.

⁹⁷⁶ Feldman, above n 16, at 298.

⁹⁷⁷ Voon, Mitchell and Munro, above n 39, at 54–55; Gastrell and Le Cannu, above n 946, at 83–89; Mistelis and Baltag, above n 403, at 1320–1321; Feldman, above n 16, at 298–301; Chalker, above n 969, at 15–18; and Essig, above n 969, at 10–12.

⁹⁷⁸ Gastrell and Le Cannu, above n 946, at 84–85 and 89–94; and *Ampal*, above n 951, at [124]–[173].

All the decisions requiring prospective notice concern the denial of benefits clause in art 17(1) of the Energy Charter Treaty.⁹⁷⁹ They began with the decision in *Plama v Bulgaria*.⁹⁸⁰ The Tribunal found the denial of benefits clause was not retrospective; notice of denial of benefits had to be given by the respondent state to the claimant before the investment was made.⁹⁸¹ Retrospectivity would mean the investor could not plan in the long term because its legitimate expectation of protection could later be rendered nugatory by invocation of the denial clause.⁹⁸²

The Tribunals in *Yukos*,⁹⁸³ *Petrobart*,⁹⁸⁴ *Liman*,⁹⁸⁵ *Ascom*,⁹⁸⁶ and *AMTO*⁹⁸⁷ reached the same conclusion, although these post-*Plama* ECT cases contemplate that effective notice could be given up to the birth of the dispute, rather than only up to the time the investment was made.

The ECT decisions are informed by the particular wording of the ECT's denial of benefits provision, which is expressed in the "present tense" suggesting that any denial of benefits is required to be notified at the outset of the investment.⁹⁸⁸ Further, the *Plama* and *Yukos* tribunals reasoned that prospective notification of any denial of benefits was consistent with the ECT's purpose of long term co-operation between contracting states because it enabled an investor to plan its investment with certainty.

The approach of the ECT cases to the timing of notice is controversial. Chalker offered a withering critique of the *Plama* decision, particularly what he describes as the elevation of investor planning above other important considerations relating to the object and purpose of the ECT.⁹⁸⁹ Anti-*Plama* commentators contend

⁹⁷⁹ The relevant decisions are well summarised in a table by Gastrell and Le Canu, above n 946, at 84–85 and then discussed further at 85–94. Since then, the Tribunal in *Ampal*, above n 951, has also considered the issue with reference to the same cases. See also Mistelis and Baltag, above n 403, at 1320–1321; and Feldman, above n 16, at 298–301.

⁹⁸⁰ *Plama*, above n 135.

⁹⁸¹ At [159]–[162].

⁹⁸² At [162]; and *Yukos*, above n 24, at [457]. For support of this reasoning see Essig, above n 969, at 10–12.

⁹⁸³ *Yukos*, above n 24, at [457].

⁹⁸⁴ *Petrobart*, above n 780, at 58–59.

⁹⁸⁵ *Liman Caspian Oil BV v Kazakhstan (Award)* ICSID ARB/07/14, 22 June 2010 at [227].

⁹⁸⁶ *Ascom Group SA v Kazakhstan (Award)* SCC 116/2010, 19 December 2013 at [745].

⁹⁸⁷ *AMTO*, above n 120, at [61]–[62].

⁹⁸⁸ *Plama*, above n 135, at [159].

⁹⁸⁹ Chalker, above n 969, at 1–2 and 15–18.

that, “the Denial of Benefits Clause could practically become irrelevant if it requires the host state to notify the investors before any dispute actually arises”.⁹⁹⁰

It is impossible or unlikely for the host state of an investment to know when every investment in its territory is made, let alone whether the criteria relevant to the denial of benefits clause in a treaty are met. This difficulty was met by the *Plama* Tribunal with the assertion that acceptable forms of notice could be given to investors prospectively by way of general declaration in the state’s official gazette, by legislation or a direct exchange of letters with a particular investor or class of investors.⁹⁹¹ Essig reasons that a state could provide prospective notice by passing a law containing an abstract and general denial provision.⁹⁹²

The *Plama* suggestions as to forms of prospective notice are inefficacious. In the absence of knowledge of the activities and ownership of a particular prospective investor, a notice in an official gazette or in national legislation can only point to the terms of the denial of benefits clause. It must be the case that a prudent putative investor would pay careful attention to the provisions of the ECT, and that accordingly art 17(1) itself operates as fair notice that structuring an investment through a shell company may permit the host state the option of denying the advantages of the treaty.⁹⁹³

Further, as Russia pointed out with some force in *Yukos*, the *Plama* approach sets an “impossible standard” in that it converts something that the investor knows with certainty—whether it has substantial business activity in its state of incorporation and the identity and nationality of its controllers—into a burden which a state must divine and act on before it is aware of an investment or a dispute.⁹⁹⁴

The *Plama* approach to art 17(1) of the ECT creates an “unrealistic”⁹⁹⁵ or “impossible task” for states, “especially since states usually become aware of the

⁹⁹⁰ See, for example, Zhang, above n 39, at 60.

⁹⁹¹ *Plama*, above n 135, at [157].

⁹⁹² Essig, above n 969, at 10.

⁹⁹³ Laurence Shore “The Jurisdiction Problem in Energy Charter Treaty Claims” (2007) 10(3) Int’l Arb L Rev 58 at 69.

⁹⁹⁴ *Yukos*, above n 24, at [451].

⁹⁹⁵ Feldman, above n 16, at 302.

circumstances justifying the denial of benefits only when faced with a claim from a presumptive investor”.⁹⁹⁶ The better view is that:⁹⁹⁷

The very purpose of the denial of benefits is to give the Respondent the possibility of withdrawing the benefits granted under the BIT to investors who invoke those benefits. As such, it is proper that the denial is “activated” when the benefits are being claimed.

To date, most cases other than those under the Energy Charter Treaty have determined that denial of benefits can be exercised retrospectively at any time up to the statement of defence under the UNCITRAL Arbitration Rules or counter-memorial pursuant to r 41 of the ICSID Arbitration Rules.⁹⁹⁸

The *Pac Rim* Tribunal acknowledged the force of submissions by the United States and Costa Rica (as interveners) that a time limit for the invocation of the denial of benefits clause at the point of the investment or the dispute would impose an “untenable burden” on States to monitor the changing structures of foreign corporate investors without access to the information necessary to do so.⁹⁹⁹ Accordingly, the Tribunal distinguished the ECT cases “given their different wording, context and effect”.¹⁰⁰⁰ Notice by Ecuador to the claimant one year after the request for arbitration was registered with ICSID¹⁰⁰¹ was effective.¹⁰⁰²

In *Guaracachi*, the Tribunal found the denial clause could be invoked up to provision of the statement of defence in accordance with the UNCITRAL Arbitration Rules.¹⁰⁰³ UNCITRAL tribunals reached the same conclusion about the timing of denial in the United States–Ecuador BIT¹⁰⁰⁴ in *Empresa Electrica*,¹⁰⁰⁵ and

⁹⁹⁶ Mistelis and Baltag, above n 403, at 1315.

⁹⁹⁷ *Guaracachi America Inc v Bolivia (Award)* PCA 2011-17, 31 January 2014 at [376]. See also Gastrell and Le Cannu, above n 946, at 96; and Feldman, above n 16, at 300.

⁹⁹⁸ See the useful summary by Gastrell and Le Cannu, above n 946, at 84–85.

⁹⁹⁹ *Pac Rim*, above n 23, at [4.53]–[4.56].

¹⁰⁰⁰ At [4.3].

¹⁰⁰¹ At [2.24] and [4.41].

¹⁰⁰² At [4.83]–[4.91].

¹⁰⁰³ *Guaracachi*, above n 997, at [376]–[384].

¹⁰⁰⁴ United States–Ecuador BIT (signed 27 August 1993), art 1(2).

¹⁰⁰⁵ *Empresa Eléctrica del Ecuador Inc (EMELEC) v Ecuador (Award)* ICSID ARB/05/9, 2 June 2009 at [71].

Ulysseas.¹⁰⁰⁶ In *Ulysseas*, the Tribunal specifically characterised denial of benefits as a jurisdictional objection, able to be raised up to the filing of the statement of defence.¹⁰⁰⁷ The Tribunal found the risk denial of benefits may occur was known to the investor from the terms of the Treaty at the time of the investment.¹⁰⁰⁸

The recent *AMPAL v Egypt* decision,¹⁰⁰⁹ however, brings a further factor to bear in respect of the timing of denial: art 25(1) of the ICSID Convention. Article 25(1) states unequivocally that “no Party may withdraw its consent unilaterally”. Egypt purported to exercise the denial of benefits provision in the United States-Egypt BIT after the filing and registration of a request for arbitration at ICSID by AMPAL.¹⁰¹⁰

The *AMPAL* Tribunal concluded that art 25(1) of the ICSID Convention prevented unilateral withdrawal of consent to arbitration after filing of a request for arbitration because jurisdiction had crystallised at that point.¹⁰¹¹ Notice of denial of benefits could validly be given only in the window between notice of a dispute and filing and registration with ICSID of the request for arbitration.¹⁰¹² After that point, it was too late to deny the benefits of the treaty unilaterally: “there cannot be an embedded conditionality in the Treaty which could be triggered after the submission of the dispute to arbitration”.¹⁰¹³

AMPAL charts a median course between the ECT prospective-notice-only cases and the cases which permit notice of denial at any point up to the date for notice of objections to jurisdiction. However, the *AMPAL* and *Pac Rim* cases are at odds. The *Pac Rim* Tribunal held that the respondent state’s consent to ICSID arbitration was necessarily qualified by the denial of benefits clause in CAFTA and reliance on that denial clause did not amount to a unilateral withdrawal of consent to arbitration contrary to art 25(1) of the Convention.¹⁰¹⁴ *AMPAL* did not address

¹⁰⁰⁶ *Ulysseas*, above n 120, at [172]–[174].

¹⁰⁰⁷ At [172].

¹⁰⁰⁸ At [173].

¹⁰⁰⁹ *Ampal*, above n 951.

¹⁰¹⁰ United States-Egypt BIT at [1] of the Protocol.

¹⁰¹¹ *Ampal*, above n 951, at [168].

¹⁰¹² At [162]–[171].

¹⁰¹³ At [169]. The Tribunal also interpreted the Protocol to the Treaty (at [1]) to require prompt consultations between the state parties to the Treaty in circumstances where one party intended to deny the benefits of the Treaty to an investor: see [133]–[161] and [172].

¹⁰¹⁴ *Pac Rim*, above n 23, at [4.90].

that on its reasoning as to the import of art 25(1), *Pac Rim* was wrongly decided.¹⁰¹⁵ Further, the result in *AMPAL*, if followed in future cases, leaves states' ability to deny benefits subject to different timing constraints depending on whether the relevant treaty requires ICSID or ad hoc arbitration.

Denial clauses undoubtedly aim to address the concern of states about the use of shell or conduit companies to manipulate corporate nationality to access treaty protection.¹⁰¹⁶ But their existence in investment treaties or chapters is sporadic and the effectiveness of such clauses to achieve this aim has been mixed.

Where denial clauses do exist, they have the beneficial attribute of being an express recitation of the circumstances in which contracting states consider denial to be justified.¹⁰¹⁷ Denial of benefits provisions "result in greater predictability regarding the applicable limits ... on corporate nationality planning",¹⁰¹⁸ and thereby "bring greater certainty to the currently unsettled, yet critically important, issue of corporate nationality planning in investment treaty arbitration".¹⁰¹⁹ Accordingly, denial clauses are distinctly preferable to reliance on considerations not found in the text of a treaty—such as the principle of abuse of right—to attenuate treaty shopping.¹⁰²⁰

However, the variable jurisprudential approaches to the timing of notice of denial and burden of proof issues presently detract from the utility of denial of benefits provisions.¹⁰²¹ As observed above, the ECT line of cases produces an absurd situation, whereby contracting states must publish criteria for denial in advance of investment, even though pre-publication can only ever be in general terms which provide no more certainty or guidance to an investor than the denial provisions in the ECT. In non-ECT cases, the effective exercise of denial of benefits can be far from straightforward. *AMPAL* illustrates that the window of time for exercise of denial of benefits provisions may be much smaller in ICSID cases than in ad hoc arbitration.

¹⁰¹⁵ See *Ampal*, above n 951, at [162]–[173].

¹⁰¹⁶ See *Sinclair*, above n 7, at 385.

¹⁰¹⁷ *Feldman*, above n 16, at 302.

¹⁰¹⁸ At 301.

¹⁰¹⁹ At 302.

¹⁰²⁰ At 282–283 and 301.

¹⁰²¹ At 300.

Attention to treaty drafting about what is denied, to whom it is denied, when such rights may be denied, and who must prove the conditions for denial is desirable to increase the effectiveness of denial of benefits clauses. The timing of notice of denial could be better prescribed and the onus of proof expressly put on the claimant at the outset, or once the respondent state meets an initial evidentiary burden sufficient to put the claimant's substance or nationality in issue.¹⁰²²

Gastrell and Le Cannu report that they have “not seen a broad shift towards the inclusion of more specific guidelines in recent treaty practice”,¹⁰²³ although some examples exist such as the Canada-China BIT which provides that the denial of benefits clause may be invoked “at any time including after the institution of arbitration proceedings”.¹⁰²⁴

Similarly, use of the mandatory “shall” must indicate to tribunals that a denial of benefits clause is intended to operate automatically. The Tribunals in *Yukos* and *Plama* compared the permissive language of art 17(1) of the ECT with the mandatory “shall” terminology in art 6 of the ASEAN Agreement, which would operate automatically so far as notice is concerned.¹⁰²⁵ Self-invoking denial of benefits clauses were also recommended by UNCTAD in 2011.¹⁰²⁶ Gastrell and Le Cannu were not aware of any investment treaties which had incorporated such mandatory language as at 2015,¹⁰²⁷ however, the new denial of benefits clause in the Netherlands Model BIT 2019 adopts the mandatory language that a tribunal “shall decline jurisdiction” if the terms of the denial clause apply.¹⁰²⁸

Another approach is to question why denial clauses exist as a concept separate from treaty definitions which set out who may benefit from the protections of a treaty: the definitions of investor and/or national. It is difficult to conceive of circumstances where a state, having been sued by a corporate claimant that meets the exclusionary criteria of a denial of benefits clause, would elect to be sued rather than exercise its right to deny benefits to the claimant.

¹⁰²² This point is also made by Gastrell and Le Cannu, above n 946, at 96–97.

¹⁰²³ At 97.

¹⁰²⁴ Canada-China BIT (signed 9 September 2012), art 16(2) and (3).

¹⁰²⁵ *Plama*, above n 135, at 156; and *Yukos*, above n 24, at 454.

¹⁰²⁶ United Nations Conference on Trade and Development, above n 99, at 98–99.

¹⁰²⁷ Gastrell and Le Cannu, above n 946, at 97.

¹⁰²⁸ Netherlands Draft Model BIT 2018, art 16.

If express treaty language is the primary answer to avoid illegitimate treaty shopping, a more direct means to that end is to prescribe such limitations in the definition of “national” or “investor”. This approach avoids the drawbacks of denial of benefits clauses, which require a respondent state to make a timely decision on a case-by-case basis to take away benefits and to prove it has the right to do so; rather it would be a jurisdictional issue to be raised and assessed together with other jurisdictional issues, with the onus of proof on the investor.

As noted in Chapter 5, this is the approach taken by the ILC in the Draft Articles on Diplomatic Protection, which include its equivalent of a denial of benefits clause as part of the nationality provision.¹⁰²⁹

Denial of benefits provisions have the potential to address treaty shopping but are hampered in doing so effectively by their absence in the majority of investment treaties, the nature of the criteria they employ, and the practicalities of notice and burden of proof as interpreted by some tribunals. Accordingly, while denial provisions may yet play some part in the instigation and application of a purposive test, their utility remains limited until they are universal, the controversies about their application are better resolved, and the criteria contained in them evolve past the troublesome concepts of “control” and “substantial business activity”.

11.4 An inherent meaning of “national of a contracting state”

In circumstances where no denial of benefits clause exists, or where it is ineffective to contain illegitimate treaty shopping, extra-treaty restraints are relevant. Extra-treaty mechanisms to employ a substantive purposive test rely on tribunals rather than contracting states. The first potential mechanism is to imply an inherent substantive meaning into “national of a contracting state” in art 25(2)(b) of the ICSID Convention and/or treaty definitions of “national”, “investor” or “owner/owns” or “controller/control”.

On the basis of the literal approach decisions set out in Chapter 3.2, this is a fraught path for states who wish to constrain corporate nationality planning: “any

¹⁰²⁹ Draft Articles on Diplomatic Protection, art 9.

attempt to read additional requirements into a treaty's definition of 'investor' ... will very likely fail".¹⁰³⁰

Nevertheless, this thesis has illustrated examples of construction of treaty terms which imply a substantive approach, particularly the interpretation of the concept of "investment" in investment treaties (Chapter 7.4) and terms such as "derived by", "received by" and "beneficial ownership" in tax treaties (Chapter 6).

These cases demonstrate the concept that the object and purpose of investment treaties requires an inherent meaning of jurisdictional terms¹⁰³¹ and that such an approach is a proper application of the Vienna Convention principles of interpretation explained in Chapter 2.3: to interpret treaty terms holistically in *good faith*, in accordance with the *ordinary meaning*, in their *context*, and in the light of its *object and purpose*.¹⁰³²

The way in which treaty terms may be interpreted to elevate the substantive position over the legal position created by use of corporate structures is illustrated by the reasoning in *Re FG (Films) Ltd*,¹⁰³³ albeit that this case involved construction of a statute. FG Films was a mailbox company incorporated in the United Kingdom. It entered into a contract with an American company to produce a film. The President of the American company held 90 per cent of the shares in FG Films. The film was financed and produced by the American company.

FG Films applied to the United Kingdom Board of Trade to register the film as a "British film" under the meaning of the British Films Act. To qualify as a British film, the "maker" of the film was required to be a British person (natural or juridical). Vaisey J held that FG Films Ltd was not the "maker" of the film because, "this insignificant company" did not undertake the arrangements for the making of the film. On the contrary, they acted only as a nominee or agent of the American company.¹⁰³⁴

This is the same reasoning as applied in *Adams v Cape* to disregard the corporate personality of the Lichtenstein subsidiary described by the English Court

¹⁰³⁰ Feldman, above n 16, at 288.

¹⁰³¹ See Chapter 6, per *NAG*, above n 469, at 901.

¹⁰³² As sanctioned in *Venoklim*, above n 30, at [156].

¹⁰³³ *Re FG (Films) Ltd* [1953] 1 WLR 483 (Ch).

¹⁰³⁴ At 616.

of Appeal as “a creature of Cape” (see Chapter 4).¹⁰³⁵ It is also the reasoning applied to the substance (or lack thereof) of the participation of conduit companies in corporate structures set up solely for accessing tax treaties. In the investment treaty context, if a claimant company does not participate in an investment and exists for no commercial reason other than a claim of nationality to access an investment treaty, then treaty terms such as “investor” or “national”, or possibly “owner” or “controller”, should be interpreted in the same substantive way as the “maker” of the film in *FG Films*.

The concepts of “investor” or “national” in investment treaties are amenable to a substantive approach. They can be approached in a formalistic way as the literal approach cases do, but there is no reason in principle why these concepts cannot connote an entity that has an economic reason to exist and therefore connection with its state of nationality rather than existing as a merely ephemeral creation. As explained in Chapters 8 and 10, the rationale for interpreting these concepts in a substantive rather than a formal way is embedded in the need to interpret jurisdictional concepts in line with the object and purpose of jurisdictional provisions in investment treaties. And, as illustrated in the comparative Chapters, a substantive approach is consistent with analogous issues in other relevant areas of municipal and international law.

Alternatively, the terms “owner” or “controller” of an investment in investment treaties could be interpreted in a substantive sense (as per the terms “received by”, “derived from” and “beneficial ownership” in tax treaties) to require actual, rather than legal, evidence of control or ownership of an investment. Such evidence would likely show a reason to exist: i.e. to manage the investment. However, focus on sole factors of ownership or control can lead to error. They do not permit the timing of the investment to be taken into account, for example. And the existence of evidence of substantive ownership or control may not necessarily equate with an absence of treaty abuse as illustrated in Chapter 9.

The best prospect of an inherent meaning of “national of a contracting state” is to replicate the jurisprudential approach to jurisdiction *ratione materiae* as discussed in Chapter 7.4. The approach by literal cases to the meaning of “national

¹⁰³⁵ *Adams*, above n 283, at 543.

of a contracting state” in art 25(2)(b) of the ICSID Convention means that it has little utility as an objective outer limit to party consent; the parties’ definition of a “national” in the relevant treaty is accepted so long as it is a reasonable criterion, in the sense of well-recognised or common.

The better approach is to interpret the concept of “investor” or “national” in the teleological way the *Phoenix* Tribunal interpreted the investment at issue using a factual and contextual analysis as explained in Chapters 7.4 and 10.¹⁰³⁶ This approach looks to the results of the application of the parties’ agreed criterion to assess reasonableness of outcome. While an investment may meet the reasonable and common criteria expressed in the definition of investment in the instant treaty, tribunals nevertheless examine whether, on a case-by-case basis, the transaction meets an inherent definition of investment based on *Salini*-type factors.¹⁰³⁷ This is also the approach taken by art 25(2)(b) second clause cases such as *TSA Spectrum* and *Vacuum Salt* which take a substantive approach to the identification of the nationality of the foreign controller.

Chapter 8 demonstrated how jurisdictional provisions have their own object and purpose which has not been recognised by the literal approach cases. Appreciation of the specific role of jurisdictional provisions permits an interpretation which gives substance and utility to the concepts of “national” and/or “investor” to act as inherent arbiters of reasonable limits to jurisdiction *ratione personae* in the same way that the term “investment” fulfils that function for jurisdiction *ratione materiae*. This substantive approach to the terms “investor” and/or “national” fits better the rules of interpretation in art 31(1) of the Vienna Convention by giving equal weight to ordinary meaning, context, object and purpose and good faith.

The same approach can apply to non-ICSID cases in the same way as tribunals have dealt with the concept of investment in non-ICSID cases such as *Romak*; that is, to imply an inherent meaning of “national” or “investor” (or owner or controller) into the relevant treaty. The same purposive test as proposed in respect of art 25(2)(b) of the ICSID Convention can be applied within the confines of each treaty.

¹⁰³⁶ *Phoenix Action*, above n 136, at [79].

¹⁰³⁷ See *Salini*, above n 47.

If, however, the contracting states expressly acknowledge in a treaty that they accept the use of conduit companies and/or expressly exclude any substantive test, then so long as the parties were not subject to the ICSID Convention, jurisdiction *ratione personae* would be upheld. Neither would the principle of abuse of right apply because a state which had expressly agreed to standing for conduit companies could not complain of an abuse if that scenario arose.

11.5 Abuse of right

The better extra-treaty mechanism to respond to the mischief of nationality planning “lies in the principle specifically tailored to combat problems of this nature: the general principle of law prohibiting abuse of right”.¹⁰³⁸ Investment treaty tribunals have been too timid in their use of this principle. In particular, manipulation of corporate nationality by use of corporations of convenience must be recognised as a misuse of investment treaty rights.

The principle of abuse of right is a subset of the doctrine of good faith in international relations. Or, as Bin Cheng explains, abuse of right is merely the application of the principle of good faith to the exercise of rights.¹⁰³⁹

The principle of good faith, including abuse of right, exists to some extent in most national legal systems as illustrated in the municipal law discussion in Chapter 4. It has been recognised as a fundamental principle of international law in treaties (including the Vienna Convention),¹⁰⁴⁰ and established as an applicable principle of

¹⁰³⁸ Sloane, above n 16, at 42.

¹⁰³⁹ Cheng, above n 133, at 121.

¹⁰⁴⁰ See also, for example, the United Nations Convention on the Law of the Sea 1833 UNTS 3 (signed 10 December 1982, entered into force 16 November 1994), art 300; and the Statute of the Permanent Court of International Justice 6 LNTS 379 (opened for signature 16 December 1920, entered into force 20 August 1921), art 38(1).

customary international law binding on states and individuals in international law,¹⁰⁴¹ and in investment treaty arbitration,¹⁰⁴² since early last century.¹⁰⁴³

However, the principle, and the doctrine of good faith more generally, are elusive to define in anything but general and relative terms.¹⁰⁴⁴

The fundamentals of the concept of good faith at international law are relative concepts of honesty, fairness and reasonableness.¹⁰⁴⁵ The leading commentators on the principle of abuse of right, Cheng and Kiss, both emphasise that the exercise of a right must be reasonable taking into account, and striking a balance between, the respective interests of the relevant actors.¹⁰⁴⁶ Cheng concludes that good faith implies “a certain standard of fair dealing, sincerity, honesty, loyalty and, in short, of morality” in dealings between parties to an instrument.¹⁰⁴⁷ Lack of good faith (i.e. bad faith) need not be intentional.¹⁰⁴⁸

At its most straightforward, the principle of good faith requires that when a right is exercised, it is exercised reasonably.¹⁰⁴⁹ Good faith reasonableness “imposes

¹⁰⁴¹ See, for example, Byers, above n 312, at 398–399; *Certain German Interests in Polish Upper Silesia (Germany v Poland) (Merits)* (1926) PCIJ (series A) No 7 at 30; *Free Zones of Upper Savoy and the District of Gex (France v Switzerland)* (1952) PCIJ (series A/B) No 46 at 167; *Certain Norwegian Loans (France v Norway) (Merits)* [1957] ICJ Rep 9; *South West Africa Cases (Ethiopia v South Africa; Liberia v South Africa) (Second Phase)* [1966] ICJ Rep 6; *Barcelona Traction*, above n 3, at [56]–[57]; *Nuclear Tests (New Zealand v France) (Merits)* [1974] ICJ Rep 457 at 473; *Border and Transborder Armed Actions (Nicaragua v Honduras) (Jurisdiction)* [1988] ICJ Rep 69 at 94; and *United States – Import Prohibition of Certain Shrimp and Shrimp Products WT/DS58/AB/R*, 12 October 1998 (Report of the Appellate body).

¹⁰⁴² For example, *Phoenix Action*, above n 136, at [133]; *Abaclat*, above n 828, at [646]; *Gustav FW Hamster GmbH & Co KG v Ghana (Award)* ICSID ARB/07/24, 18 June 2010 at [123]–[124]; *Mobil*, above n 23, at [167]–[170]; *Europe Cement Investment & Trade SA v Turkey (Award)* ICSID ARB(AF)/07/2, 13 August 2009 at [171]; *Libananco Holdings Co Ltd v Turkey (Preliminary Issues)* ICSID ARB/06/8, 23 June 2008 at [78]; and *Millicom International Operations BV v Senegal (Jurisdiction)* ICSID ARB/08/20, 16 July 2010 at [84].

¹⁰⁴³ Cheng, above n 133, at 102 citing *Metzger & Co (United States v Haiti)* [1901] USFR 262 at 271; and *Venezuelan Preferential Claims Case (Award)* 1 HCR 55, 22 February 1904 at 60. See also Alexandre Kiss “Abuse of Rights” in Rüdiger Wolfrum (ed) *The Max Planck Encyclopedia of Public International Law* (online ed, Oxford University Press) at [5], [6] and [8]; and Baumgartner, above n 1, at [9.2].

¹⁰⁴⁴ Kiss, above n 1043, at [4], [5] and [8].

¹⁰⁴⁵ See, for example, John F O’Connor *Good Faith in International Law* (Dartmouth Publishing, Aldershot, 1991) at 118–119; and Markus Kotzur “Good Faith (Bona Fides)” in Rüdiger Wolfrum (ed) *The Max Planck Encyclopedia of Public International Law* (online ed, Oxford University Press) at [21].

¹⁰⁴⁶ Cheng, above n 133, at 121 and 131–132; and Kiss, above n 1043 at [1], and [5]–[8].

¹⁰⁴⁷ Cheng, above n 133, at 119.

¹⁰⁴⁸ Kiss, above n 1043, at [6]. In investment treaty cases see, for example, *Técnicas Medioambientales Tecmed SA v Mexico (Award)* ICSID ARB(AF)/00/2, 29 May 2003 at [71]; and *Philip Morris*, above n 122, at [539].

¹⁰⁴⁹ Cheng, above n 133, at 125 as cited by the Appellate Body in *Shrimp Products*, above n 1041, at [158].

such limitations upon the right as will render its exercise incompatible ... with the legitimate interests of the other contracting party”.¹⁰⁵⁰ Thus, Cheng explains, “a fair balance is kept between respective interests of the parties and a line is drawn delimiting their respective rights”.¹⁰⁵¹

Moreover, a reasonable exercise of a right:¹⁰⁵²

... implies an exercise which is genuinely in pursuit of those interests which the right is destined to protect and which is not calculated to cause any unfair prejudice to the legitimate interests of another State

The focus is on the exercise of a right in accordance with the end for which it exists to the injury of another.¹⁰⁵³

Prior to the birth of the ICSID Convention and growth of investment treaties, discussion of good faith and abuse of right at international law assumed the exercise of a right by a state against another state. Now, investment treaties effectively give non-contracting investors rights at international law. Yet it is clear that investment treaty tribunals accept that the principles of good faith and abuse of right apply to those private investors, just as they do to treaty contracting states.¹⁰⁵⁴

In *Hamester*, the Tribunal expressed the principles of good faith and abuse of right in context of an investment treaty in this way:¹⁰⁵⁵

[An] investment will not be protected if it has been created in violation of ... international principles of good faith; by way of corruption, fraud, or deceitful conduct; or if its creation itself constitutes a misuse of the system of international investment protection

¹⁰⁵⁰ Cheng, above n 133, at 129.

¹⁰⁵¹ At 129. See also Kiss, above n 1043, at [5]: “the existing rights and the legitimate interests of the States concerned have to be balanced”.

¹⁰⁵² Cheng, above n 133, at 131–132.

¹⁰⁵³ Kiss, above n 1043, at [1]. See also Cheng, above n 133, at 122; and Benedict and others, above n 4, at 48.

¹⁰⁵⁴ See the examples above n 1042. See also Martins Paparinskis “Inherent Powers of ICSID Tribunals: Broad and Rightly So” in Ian A Laird and Todd J Weiler (eds) *Investment Treaty Arbitration and International Law* (JurisNet, New York, 2012) vol 5 11; and Topcan, above n 577.

¹⁰⁵⁵ *Hamester*, above n 1042, at [123].

These principles must apply equally to prevent manipulation of corporate nationality for the purpose of gaining the protection of an investment treaty. Such situations may accurately be described as “a misuse of the system of international investment protection”,¹⁰⁵⁶ or an exercise of a right “for an end different from that for which the right was created, to the injury of [a] State”.¹⁰⁵⁷

The principles of good faith and abuse of right respond well to the problem of treaty shopping because they apply by way of general international law and the Vienna Convention “to the interpretation and application of obligations” under all international investment agreements (ICSID or otherwise)¹⁰⁵⁸ regardless of express inclusion.¹⁰⁵⁹ Good faith and abuse of right are superior to specific rules recognising individual rights.¹⁰⁶⁰ Hence, the principles of good faith and abuse of right are ubiquitous and overarching.

Accordingly, the principles of good faith and abuse of right answer the concern of the literal approach tribunals that it is not permissible to impose extra-treaty requirements on claimants, nor that plain language of treaties can be violated by reading in additional criteria. A claim to jurisdiction may be denied or a claim ruled inadmissible on grounds not expressed on the face of an investment treaty in a principled way.

This omnipresent application of the principle of abuse of right also meets the complication mentioned above that ad hoc investment claims might be treated differently to ICSID cases if jurisdiction *ratione personae* was restricted by reading in a purposive test to art 25(2)(b).

The challenge that good faith principles bring to the literal approach cases is that the “unproblematic application of a doctrine of abuse of rights ... is difficult to reconcile with the formalistic approach of Tribunals such as *Waste Management* and *RomPetrol*”.¹⁰⁶¹ Voon, Mitchell and Munro consider the conflict between the literal

¹⁰⁵⁶ At [123].

¹⁰⁵⁷ Kiss, above n 1043, at [1].

¹⁰⁵⁸ *Europe Cement*, above n 1042, at [171]. See also, *Libanco*, above n 1042, at [38]; and *Millicom*, above n 1042, at [84].

¹⁰⁵⁹ *Hamester*, above n 1042, at [124].

¹⁰⁶⁰ Kiss, above n 1043, at [32].

¹⁰⁶¹ Voon, Mitchell and Munro, above n 39, at 64.

approach cases and abuse of right cases has been avoided because the principle of abuse of right has only been applied by investment treaty tribunals to deny jurisdiction where there is “clear evidence of gratuitous and wanton dishonesty on the part of the investor”.¹⁰⁶² Accordingly, it is an “extraordinary remedy” invoked “only in very exceptional circumstances”.¹⁰⁶³ This high threshold has limited the application of the principle to address treaty shopping issues.

However, a requirement for “exceptional circumstances”, or a need for a finding of dishonesty, is setting the bar too high. As explained above, the assessment of bad faith amounting to an abuse of right is an objective, not subjective assessment. It does not require proof of dishonesty or gratuitous wanton behaviour on the part of the claimant, nor the divination of an intangible character of exceptionality. Consistent with Kiss,¹⁰⁶⁴ the *Philip Morris* Tribunal recognised that while the threshold for a finding an abuse of right is a high one, “it does not imply a showing of [subjective] bad faith”; it is an objective test.¹⁰⁶⁵ The Appellate Body of the WTO required simply that the exercise of rights impinging on a treaty obligation be reasonable in the circumstances.¹⁰⁶⁶

Accordingly, all that is required to manifest bad faith or abuse is the attempted use of a right (innocently or fraudulently) contrary to the purpose for which that right exists; the unreasonable use of a right. Other than *Philip Morris*, investment treaty tribunals have taken too conservative an approach to the purview and application of the principle of abuse of right.¹⁰⁶⁷ Perhaps the label “abuse” has connotations that has promoted an overly cautious approach. More accurate nomenclature would be “misuse” (as per *Hamester*¹⁰⁶⁸) or “illegitimate use” of rights.

However, the terminology of these various yardsticks for abuse are not particularly helpful. Saying that the threshold is a high one, is measured by reasonableness, or that exceptional circumstances are required before a finding of

¹⁰⁶² At 65 citing *Phoenix Action*, above n 136, at [32]; and *Cementownia*, above n 871, at [156] and [159].

¹⁰⁶³ Voon, Mitchell and Munro, above n 39, at 65 citing *Chevron Corp v Ecuador (Interim Award)* Karl-Heinz Böckstiegel, Charles N Brower and Albert Jan van den Berg 1 December 2008 at [143] and [146]. See also Schreuer, above n 170, at 525 to the same effect.

¹⁰⁶⁴ Kiss, above n 1043, at [4]. See also *Tecmed*, above n 1048, at [71].

¹⁰⁶⁵ *Philip Morris*, above n 122, at [539].

¹⁰⁶⁶ *Shrimp Products*, above n 1041, at 158.

¹⁰⁶⁷ See to this point Julian Arato “Corporations as Lawmakers” (2015) 56 Harv Int’l LJ 229.

¹⁰⁶⁸ *Hamester*, above n 1042, at [123].

abuse is made, does not take one very far in ascertaining whether treaty rights have been misused.

To paraphrase Kiss and Cheng, abuse of right must be determined objectively by comparing whether a claimant purports to use a right for a purpose different to that for which the right was created.¹⁰⁶⁹ The right approach is not to define treaty abuse by the seriousness of the claimant's (mis)conduct, but simply to ask whether in the circumstances the claimant's purported use of treaty rights obtained by a convenient nationality is consistent with or contrary to the purpose of those rights. This formulation brings us back to a familiar discussion: the purpose of investment treaties in general and their jurisdictional provisions in particular.

Chapter 8 proposes that the purpose of investment treaties is to encourage investment from nationals of the other contracting states or states and the purpose of jurisdictional provisions is to prescribe the circle of beneficiaries, that is, to limit access to treaty rights to genuine nationals, as opposed to the whole World.

The purported use of treaty rights by corporations of convenience allows the benefits of investment treaties to entities that do not have a genuine economic connection to the investment, opens treaties to an unlimited category of beneficiaries, and exposes states to a corresponding extension of their treaty obligations. This scenario amounts to treaty misuse because the purported use is inconsistent with the purpose of the existence of the right, to the injury of the host state. The manipulation of corporate personality to gain a convenient nationality by virtue of the formal application of treaty terms is an unreasonable use of the right to treaty coverage in the required sense.

Furthermore, Kiss explains that the principle of abuse of right prohibits the use of an existing right where the exercise of that right may result in situations that are not intended at the time of the right's creation.¹⁰⁷⁰ If it is accepted that states choose to contract with certain states, not the whole World, and wish to limit the extent of their obligations accordingly, access to treaty benefits by a "legal fiction

¹⁰⁶⁹ Kiss, above n 1043; and Cheng, above n 133. See also *Saipem SpA v Bangladesh (Award)* ICSID ARB/05/07, 30 June 2009 at [160]: "[i]t is generally acknowledged in international law that a State exercising a right for a purpose that is different from that for which that right is created commits an abuse of rights." See also Kiss, above n 1043, at [33]: "proof should also be brought that the right has been used in disregard of the purpose for which it was originally intended".

¹⁰⁷⁰ Kiss, above n 1043, at [1].

[created] in order to gain access to an international arbitration procedure to which it was not entitled”,¹⁰⁷¹ is an illegitimate use of that treaty. The purported use of rights by such means is inconsistent with the reason for existence of jurisdictional limits to access to investment treaties.

Sornarajah’s view about treaty shopping is in these same terms: “jurisdiction shopping goes well beyond the purposes of both the ICSID Convention and the investment treaties” and therefore.¹⁰⁷²

... such flagrant abuse of the objectives for which the treaties were made by the parties should not be given effect to ... [t]he Party against which arbitration proceedings are brought could not have consented to jurisdiction in the circumstances, even if the wording of the treaty is satisfied.

As illustrated in Chapters 6 and 10, this is the approach to treaty abuse in tax treaty law. It is an abuse of double tax treaties to claim tax treaty benefits using a corporation of convenience, i.e. one set up primarily for that purpose. Additionally, as discussed in Chapter 5, the ILC, and recent commentators,¹⁰⁷³ have come to the conclusion that the limits placed on Liechtenstein to utilise rights of diplomatic protection by virtue of its conferment of nationality on Nottebohm (which was absent unlawful intent and in advance of any specific dispute arising) “may be consolidated into a requirement of good faith”.¹⁰⁷⁴

Increasingly, commentators consider that this is the correct position at investment treaty law. For example, Sloane promotes the principle of abuse of right as an appropriate and effective means to regulate nationality in the context of investor-state arbitrations.¹⁰⁷⁵ Otherwise:¹⁰⁷⁶

¹⁰⁷¹ *Phoenix Action*, above n 136, at [143].

¹⁰⁷² Sornarajah, above n 668, at 327–329.

¹⁰⁷³ Sloane, above n 16, at 11–12, 14 and 18–22; and Benedict and others, above n 4, at 43–45 and 49.

¹⁰⁷⁴ Dugard, above n 373, at [108].

¹⁰⁷⁵ Sloane, above n 16, at 37–55. See also Borman, above n 39, at 368; Lee, above n 14, at 377; Watson and Brebner, above n 39, at 317–320; and Baumgartner, above n 1, at [9.4.4].

¹⁰⁷⁶ Sloane, above n 16, at 41.

... the worry is ... that foreign investors will establish “mailbox” companies as mere investment vehicles to take advantage of corporate nationalities of convenience, which bring their investments within the scope of a BIT or other international instrument that authorise resort to ICSID arbitration.

Sloane’s answer is to take a functional approach to nationality which retains the state’s discretion to shape investment agreements, but imposes the abuse of right principle as part of general international law as “an appropriate legal mechanism that may be capable of remedying abusive manipulation” of nationality requirements.¹⁰⁷⁷

In other words, the agreement of states as to nationality criteria in a particular treaty gives rise to a presumption of coverage if those criteria are met, but is subject to a substantive check using the principle of abuse of right as a portal for the purposive approach described in Chapter 10. This is the same fundamental approach to analogous jurisdictional concepts illustrated in the tax treaty field in Chapter 6 and investment treaty field in Chapter 7.

Arato also criticises “the assumption that treaties between states for the reciprocal protection of one another’s nationals create infinite offers to arbitrate claims by any multinational creative enough in its planning”.¹⁰⁷⁸ He implores tribunals not to stand in the way of states’ attempts to achieve a more balanced investor-state regime,¹⁰⁷⁹ and calls for the principle of abuse of right to be extended to cover such situations, which means “going further than the current doctrinal limit, which calls for scrutiny only where restructuring occurred after the dispute arose”.¹⁰⁸⁰

Skinner, Miles and Luttrell observe that “the idea that Treaty Shopping is ‘bad faith’ may be gaining traction among international arbitrators”, although they conclude “it is unlikely that it will ever become an absolute inviolable rule.”¹⁰⁸¹ But they warn, “some macro-economic indications [are] that the high water mark of the BIT system may have already passed”.¹⁰⁸² The renunciation of ICSID by Venezuela

¹⁰⁷⁷ At 55.

¹⁰⁷⁸ Arato, above n 1067, at 288.

¹⁰⁷⁹ At 293.

¹⁰⁸⁰ At 289.

¹⁰⁸¹ Skinner, Miles and Luttrell, above n 40, at 261.

¹⁰⁸² At 282.

and Ecuador, and Australia's brief withdrawal from investor-state dispute mechanisms, are evidence of withdrawal from the system. A better balance is required. The authors put faith in "an emerging principle of abuse of process" and express the hope that "this principle will crystallise in future arbitral awards as a rule against Treaty Shopping".¹⁰⁸³

Zhang also champions a more equitable approach to interpretation of the concept of investor in investment treaties. While she accepts that it is not the role of tribunals to rewrite definitions in investment treaties, she promotes the concept of abuse of process as a reasonable response to treaty shopping,¹⁰⁸⁴ and that international law should be used to fill gaps in treaties provided that it is consistent with the intention of the parties.¹⁰⁸⁵ Baumgartner agrees that abuse of right has all the "(quasi-)constitutional qualities needed to build a bridge between international investment law and public international law and instil a more 'principled approach' into arbitral decision making".¹⁰⁸⁶

In the same way, the ILA's review of corporate nationality issues concluded that the doctrine of abuse of right is "a necessary corrective to ensure the sustainability of a healthy investment environment",¹⁰⁸⁷ and "a useful agent in the progressive development of the law" where, as recognised by the ICJ in *Barcelona Traction*, there are yet to be developed accepted rules of international law to decide the issue of whether an "investment effectively belongs to a particular economy".¹⁰⁸⁸

The view that "in principle, there is no reason why a prudent investor should not organise its investment in a way that affords maximum protection under existing treaties", is too permissive.¹⁰⁸⁹ The better approach is that:¹⁰⁹⁰

¹⁰⁸³ At 283.

¹⁰⁸⁴ Zhang, above n 39, at 62–65.

¹⁰⁸⁵ At 62 citing *Amoco International Finance Corp v Iran (Partial Award)* Iran-US CTR 310-56-3, 14 July 1987 at [112]: "The rules of customary law may be useful in order to fill in possible lacunae of the Treaty, to ascertain the meaning of undefined terms in its text or, more generally, to aid interpretation and implementation of its provisions."

¹⁰⁸⁶ Baumgartner, above n 1, at [9.4.4], [9.5] and [9.6].

¹⁰⁸⁷ Benedict and others, above n 4, at 5.

¹⁰⁸⁸ *Barcelona Traction*, above n 3, at [85]–[89] as cited in Benedict and others, above n 4, at 48.

¹⁰⁸⁹ Schreuer, above n 170, at 524 citing *Aguas del Tunari*, above n 22, at [321].

¹⁰⁹⁰ Zhang, above n 39, at 65.

... [if] the textual interpretation of the nationality rule in a BIT [gives] rise to conflict within the entire legal framework, the abuse of right principle should be applied to ensure that the investment protection granted according to the BIT to those real investors is based on all the relevant facts at the time of interpretation on a case-by-case basis.

That is, the use of formal textual interpretations by corporations to access a convenient nationality is subject to a substantive check by means of the principle of abuse of right to prevent misuse of treaty rights.

Accordingly, the principle of abuse of right can operate as a portal for a substantive check or constraint on treaty shopping. If a purposive approach is taken as outlined in Chapter 10, treaty abuse may be identified whenever the principal reason for a claimant to exist in the ownership chain of the investment is to access treaty rights, whether or not the specific dispute has arisen at the time of the inclusion of the claimant in the ownership structure of the investment.

The abuse of right principle is already part of investment treaty law; it requires no action to amend or terminate treaties and it applies to all treaties equally. It can and should be utilised by investment treaty tribunals in a progressive way to address treaty shopping by corporations of convenience.

12 Conclusion

The literal approach to corporate nationality in the context of investment treaty jurisdiction *ratione personae* is an outlier. Access to treaty rights by nationals of a respondent state or states that are not party to an investment treaty by manipulation of corporate nationality is an abuse of the investment treaty system and threatens its legitimacy.

The solution to the Nationality Controversy in investment treaty law is apparent from analogous jurisdictional issues in investment treaty law, general international law and tax treaty law: express nationality criteria are subject to an inherent substance over form check to test the bona fides of a claimant investor. That check turns on an inquiry into the commercial purpose of the putative investor with respect to the investment.

At its core, this thesis grapples with balancing the objectives of investment treaties: to encourage investment; but not every investment from everyone. The long-term promotion of investment depends on a balanced regime built on a “balanced interpretation that takes into account both State sovereignty and the State’s responsibility to create an adapted and evolutionary framework for the development of economic activities”.¹⁰⁹¹

As explained in Chapter 8, the concept of nationality is crucial to “balancing the interests of host States on the one hand and investors on the other”,¹⁰⁹² by setting the boundaries of investment treaty arbitration within the realm of international law and providing confidence of coverage to investors when investing in foreign countries but avoiding abuse of jurisdiction by persons not intended by contracting states to be protected by it.¹⁰⁹³

To achieve these interdependent but often conflicting objectives, this thesis concludes that jurisdictional provisions, and in particular corporate nationality in the context of jurisdiction *ratione personae*, must be interpreted in a substantive, not literal, way.

¹⁰⁹¹ *El Paso*, above n 694, at [70]. See also the caution against over-emphasis of investor rights enunciated in *Renta 4 SVSA v Russia (Award)* SCC 24/2007, 20 July 2012 at [55].

¹⁰⁹² *Broches*, above n 124, at 203.

¹⁰⁹³ At 199. See also *Lavista*, above n 16, at 11.

However, the present state of investment treaty jurisprudence in respect of corporate jurisdiction *ratione personae* has been described as “incoherent”.¹⁰⁹⁴ Respondent states are “increasingly questioning the bona fides of investors”,¹⁰⁹⁵ particularly where the putative investor is “a mere instrument used by a third person or entity that would not otherwise qualify as a protected investor”.¹⁰⁹⁶ However, absent extreme abuse, investment treaty tribunals have proved reluctant to attenuate treaty shopping by examination of corporate structures to assess nationality in a substantive sense.¹⁰⁹⁷

The strict constructionist approach to corporate nationality analysed in Chapter 3 focuses on the “ordinary meaning” tenet of interpretation in art 31(1) of the Vienna Convention. It eschews the implication of any substantive criteria to jurisdiction *ratione personae* and rejects the relevance and application of general international law as a check on treaty definitions of nationality. It does so based on a unicameral view of the object and purpose of the Convention and/or investment treaties, which identifies the import of capital as the primary or only object of the investment treaty regime. The literal approach assumes that contracting states consider the more capital the better regardless of the additional scope of state obligations, and warns that uncertainty of application of a substantive approach will undermine that purpose.

This thesis demonstrates that the literal approach is misguided in a number of aspects. First, it places too much emphasis on ordinary meaning over the other tenets of art 31(1) of the Vienna Convention: good faith, context and object and purpose. These other aspects of the general rule of interpretation enable a principled means to take a substantive approach to jurisdiction *ratione personae*.

Secondly, it promotes the benefits of investment treaties for states and gives too little consideration to concomitant obligations. The literal cases thereby allow corporate treaty shopping to skew unacceptably the balance of treaty obligations for states and distort the principle of reciprocity between state parties to a treaty.

¹⁰⁹⁴ Voon, Mitchell and Munro, above n 39, at 41. See 41–68.

¹⁰⁹⁵ At 42.

¹⁰⁹⁶ At 42.

¹⁰⁹⁷ Arato, above n 1067, at 275–276.

Thirdly, it is contrary to art 31(3)(c) of the Vienna Convention and the desirability of hegemony of international law to disregard the relevance and application of general international law and the law of diplomatic protection. Customary international law can limit the use of the concept of corporate nationality and corporate legal personality to avoid abuse of investment treaty jurisdiction.

Fourthly, the literal approach fails to appreciate that treaty shopping through corporate nationality planning for the sole purpose of achieving treaty coverage is an abuse of the system of investment treaty protection, regardless of when it occurs in the life of an investment.

Finally, it is wrong to conclude that a substantive approach is necessarily so uncertain that it undermines the purpose of investment treaties to encourage investment. A substantive approach based on a claimant's economic reason to exist in the ownership chain of an investment is practical and sufficiently certain to apply.

The purpose and nature of the investment treaty system is critical to these conclusions. It is correct, as the literal cases emphasise, that a fundamental objective of investment treaties is to foster an investment friendly environment between signatory states so as to attract foreign capital to stimulate commerce. Without enforceable legal protections, a prospective investor has a lower expectation of security in the investment and is therefore less inclined to conduct business abroad.¹⁰⁹⁸ However, that goal is not a omnipotent one because to attract foreign capital states give away a degree of sovereignty in the form of guarantees of treatment and rights.¹⁰⁹⁹

The argument that treaty shopping ought to be welcomed because it increases investment—i.e. the benefit of a treaty to a state—ignores the specific purpose of jurisdictional provisions to limit state obligations by identifying bona fide investors. In doing so, it allows abuse of investment treaties by permitting corporates owned by nationals of the respondent state or by nationals of third non-party states to procure rights under a treaty when they are in reality strangers to it. The literal

¹⁰⁹⁸ From a global perspective, international trade tends to foster prosperity and peaceful relations between nations: see UN Charter, art 55.

¹⁰⁹⁹ Sinclair, above n 7, at 363; and *Yukos*, above n 24, at [451].

approach thereby emasculates the limiting purpose of nationality in the ICSID Convention and in investment treaties.¹¹⁰⁰

Claims by corporate vehicles owned by nationals of the respondent state undermine the requisite international character of investments protected by the investment treaty system and claims by domestic investors and corporates owned by nationals of third states create an expansion of coverage to the benefit of investors at the expense of contracting states. As the significance of the requirement of nationality has “diminished to a mere formality”,¹¹⁰¹ investment treaties have lost their bilateral character; they have become quasi-multilateral.¹¹⁰² Such an approach affects the balance of state obligations and the principle of reciprocity encompassed by each treaty in an objectionable way. As Alberro-Semerena explained in *AdT*:¹¹⁰³

... the notion that the universe of beneficiaries of a bilateral investment treaty is infinite has no precedent in scholarly commentary or tribunal awards

A more balanced approach to jurisdiction *ratione personae* and corporate nationality is required that does not over-emphasise the object of facilitating capital flow and retains the proper function and role of the investment treaty system in the pantheon of international law as a mechanism for resolution of disputes between states and foreign investors that are genuine nationals of other contracting states.

The solution is a holistic good faith interpretation of jurisdiction *ratione personae*¹¹⁰⁴ which excludes from treaty coverage corporate entities which have procurement of treaty rights as the main purpose for their existence in the ownership structure of the investment. This purposive approach gives effect to the ordinary meaning of jurisdictional terms so far as that meaning is consistent with good faith,

¹¹⁰⁰ See, for example, Zhang, above n 39, at 50.

¹¹⁰¹ Anthony Sinclair “ICSID’s Nationality Requirements” in TJ Grierson Weiler (ed) *Investment Treaty Arbitration and International Law* (JurisNet, Huntington, 2008) 85 at 86–87 as cited in *Fakes*, above n 536, at [69].

¹¹⁰² Schill, above n 7, at 239 and 198–201. See also Legum, above n 11 at 524–525.

¹¹⁰³ *Aguas del Tunari*, above n 22, per the Declaration of José Luis Alberro-Semerena at [9].

¹¹⁰⁴ See Chapter 2.3, “Good faith interpretation” in particular. See in the tax treaty field *Yanko-Weiss*, above n 447, at 544–545.

the international context and bilateral character of a treaty, and the object and purpose of jurisdictional provisions.

This is not to dismiss the importance of the ordinary meaning of jurisdictional definitions, but to treat them as presumptively applicable. But the criteria of nationality agreed by the parties should be checked by international law if the result of the formal application of stated criteria is unreasonable in the sense that it circumvents the object and purpose of the relevant instrument or the ICSID Convention.

Chapters 4, 5, 6 and 7 demonstrate how a substantive approach of this nature has been adopted implicitly or explicitly in analogous fields of domestic and international law.

Chapter 4 analysed how common and civil systems of municipal law attenuate the use of corporate personality by disregarding the “corporate veil”. At common law this is largely achieved by principles of agency and trust law developed by judicial decisions over centuries, supplemented by a rarely used catch-all type discretion. In either regard, a substantive analysis of the commercial rationale for a corporate structure and the role of entities within it is critical to whether separate corporate personality is appropriately deployed. Mere functionaries or agents cannot utilise separate corporate personality to avoid legal obligations or gain advantage. In civil law systems, the right to separate corporate personality is limited by a broad application of the principle of abuse of right, which is less specific than common law rules, but achieves the same end.

Chapter 5 explained how the debate about substantive nationality of natural persons and corporate entities at international law began in the law of diplomatic protection. Despite an apparent substantive approach to nationality of natural persons in *Nottebohm*, the ICJ rejected the “genuine connection” test for corporates in *Barcelona Traction*. However, re-interpretation and criticism of that decision has resulted in a substantive test or check on the use of corporate nationality as articulated in art 9 of the ILC Draft Articles on Diplomatic Protection.

Article 9 relies on the criteria of control and substantial business activities, which are criticised in Chapter 9 of this thesis. Nevertheless, it is evidence of acceptance at international law that “there must be limitations on the powers of

individual states to treat persons as their nationals”¹¹⁰⁵ and that “international law has a reserve power to guard against giving effect to ephemeral, abusive and simulated creations”.¹¹⁰⁶

The literal cases on corporate nationality in investment treaty law reject reference to principles of general international law in preference to the more specific provisions of investment treaties. Yet given that nationality performs the same role in diplomatic protection law as it does in investment treaty law, and remains the residual remedy for foreign investors in the absence of an applicable investment treaty, diplomatic protection law remains a relevant touchstone comparison for determining the limits of the concept of nationality and preventing abuse of the system of investment treaty arbitration.¹¹⁰⁷

The approach of tax treaty jurisprudence to the use of conduit companies to access double tax treaties as reviewed in Chapter 6 is also the correct analysis for the Nationality Controversy at investment treaty law. An entity in the revenue stream of a corporate group without a substantive commercial reason to exist other than to access tax treaty benefits will not be entitled to them; tax courts and commentators consider such arrangements to be illegitimate treaty shopping because they are an abuse of the tax treaty system.

Both tax treaties and investment treaties exist to facilitate the flow of international capital. It is incongruous that two investment-focused international treaty systems approach corporate jurisdiction *ratione personae* in fundamentally different ways. Investment treaty law assesses corporate nationality literally, while tax treaty law imports a substantive approach by virtue of the requirement for good faith interpretation in art 31(1) of the Vienna Convention and a recognition of an inherent anti-abuse principle at international law. The tax treaty approach exposes the limitations and fallacies of the literal approach in investment treaty law and provides a model for investment treaty jurisprudence to identify and address illegitimate treaty shopping.

In the same way as tax treaty jurisprudence approaches jurisdiction *ratione personae* substantively, investment treaty law interprets treaty definitions as to

¹¹⁰⁵ Zhang, above n 39, at 518. To the same effect, see Amerasinghe, above n 125, at 248–249.

¹¹⁰⁶ Crawford, above n 372, at 706.

¹¹⁰⁷ See Lavista, above n 16, at 13.

jurisdiction *ratione materiae* in a substantive way. As articulated in *Phoenix*, the starting point is to deploy art 31(1) of the Vienna Convention in the holistic way emphasised in Chapter 2 by taking into account the purpose of jurisdictional clauses by means of a factual and contextual assessment of the investment.¹¹⁰⁸

Investment treaty tribunals conclude that the term “investment” has an inherent meaning and submit the substance of a transaction that meets the treaty parties’ definition of “investment” in a literal sense to a reasonableness test measured against the purpose of the investment treaty regime. If the substance of the transaction does not meet inherent objective elements of an investment (i.e. the *Salini* criteria: risk, contribution, and duration) then it does not qualify for protection. There is nothing inherently more substantive about the concept of “investment” as compared with the concept of “investor” or “national”. There is no logical reason to interpret jurisdiction *ratione personae* provisions in investment treaties in a fundamentally different way.

Further, as the Vienna Convention applies equally to investment treaties as it does to the ICSID Convention, an inherent meaning for “nationality” or “investor” can be implied whether the requirement for a certain nationality arises from the Convention or from the terms of a particular investment treaty.¹¹⁰⁹ The same principles can apply to ICSID and non-ICSID cases alike.

Chapter 7 also explains that the nationality of natural persons is approached substantively, to the extent that compliance with municipal law formalities for nationality is subject to a substantive check to consider whether technical formalities of municipal law are consistent with substantive reality for the purposes of international law. Sinclair has exposed these disparate philosophies, but investment treaty tribunals have not queried the logicity or desirability of endorsing different approaches to the nationality of natural and juridical persons. It is curious that a substantive approach presently plays a greater role in the circumstance of natural persons—where it is more difficult to obtain and relinquish nationality in practical terms—than of juridical persons where nationality can be manipulated more readily.

¹¹⁰⁸ *Phoenix Action*, above n 136, at [79].

¹¹⁰⁹ As illustrated for jurisdiction *ratione materiae* in *Romak*, above n 144.

A substantive approach is also taken to the nationality of a foreign controller by art 25 second clause cases such as *TSA Spectrum*, *Vacuum Salt*, and *Autopista*. There is no principled reason for nationality in first clause cases to be approached differently. No case has grappled with the merits of this distinction other than to utilise it as a means to distinguish one set of cases from the other and thereby perpetuate the contrary approaches.¹¹¹⁰

The comparative analysis in these Chapters demonstrates that it is an anomaly that corporate nationality in investment treaty law sits in a realm of formalism. These comparatives illustrate that a substantive approach to jurisdictional concepts is not foreign to investment treaty, general international law, or tax treaty law. A substantive approach to jurisdictional constructs is the norm and the literal approach to jurisdiction *ratione personae* for juridical persons in investment treaty law is the exception.

The comparatives also illustrate that there is no imperative which prevents a substantive approach to corporate nationality at investment treaty law. The argument of the literal cases that limits to jurisdictional provisions cannot be implied into investment treaties in a principled way, and that application of treaties will be too uncertain if such limits were applied, have not proved to be insurmountable obstacles in these comparative areas. Finally, they also show the way to adopt a workable substantive approach: to address the commercial reason to exist of the claimant investor in relation to the investment.

The essence of the argument against the practicality of a substantive approach to the nationality of an investor is a perceived lack of certainty, said to undermine the object to promote foreign investment. The literal approach to nationality does provide a high degree of certainty, but permits the use of “pseudo-foreign corporations” to gain access to investment treaties.¹¹¹¹ A substantive approach can give rise to relative uncertainty as to treaty coverage. Investors and states alike must be able to ascertain the scope of treaty coverage to plan their investment and laws respectively.¹¹¹²

¹¹¹⁰ See *TSA Spectrum*, above n 30, dismissing the first clause cases at [146]; *KT Asia*, above n 24; and *Rompetrol*, above n 24, dismissing the relevance of *TSA Spectrum* to first clause cases at [133].

¹¹¹¹ Pannier, above n 76, at 12.

¹¹¹² See Sloane, above n 16, at 42.

The predominant substantive criteria employed to date in some treaty definitions and denial of benefits clauses have been the concepts of “control” and “substantial business activity”. Chapter 9 illustrates that these concepts are useful to an extent but also suffer from excessive uncertainty in application and are not always of logical utility to determine the existence of a genuine connection to a home state.

The core of a practical substantive inquiry must be a purposive one: that is, an inquiry as to the purpose, or reason, for which an apparent right to nationality was obtained and is sought to be utilised.

This is the solution found in the field of double tax treaties: to ascertain the purpose for the existence of the purported corporate claimant in the corporate structure. If a corporate claimant exists only, or primarily, to access treaty benefits then it should not be permitted to sue the host state under the treaty as it is revealed as an entity of convenience for treaty purposes and as such constitutes an abuse of right.

Conversely, if there is a genuine ulterior commercial reason for the claimant to exist in the ownership structure of the investment, it follows that the corporate vehicle is not a mere convenience for treaty purposes and there is no reason to doubt its bona fides for claiming the requisite nationality for treaty coverage.

In addition to tax treaty cases, analysis of cases concerning lifting or circumventing the corporate veil at municipal law in Chapter 4, the nationality of natural persons in Chapter 7, and abuse of right in investment treaty law explored in Chapter 10, all reveal that the purpose or reason for existence of the corporate vehicle is the key question to gauge bona fides. As discussed in Chapter 5, the purpose for the acquisition of nationality is also the proper rationale for the finding that Mr Nottebohm abused his Lichtenstein nationality to gain rights at diplomatic protection law. Even some literal investment treaty cases employ a degree of substantive analysis regarding the reality of a corporate claim to nationality by an enquiry into the commercial purpose for the existence of the claimant in the ownership structure.

Moreover, a purposive test which seeks to ascertain the reason for a claimant company to exist as part of the ownership structure of the investment is practical and reasonably certain. The analogous cases reviewed in Chapters 4, 6, 7 and 10 reveal

substantive factors that look to the reason for the claimant's role in the ownership of the investment including: the timing of the investment compared with the introduction of the claimant into the corporate chain of ownership; the structure of the transaction; when it was planned and undertaken; the commercial effect on other companies in the group; the role of the claimant in controlling and managing the investment; the knowledge of the host state; and the business activities of the claimant in its home state.¹¹¹³

Rather than the uncalibrated yardstick of substantial business activity, or the potentially complicated and ever-shifting search for the nationality of the ultimate controller of a company, the purpose test focuses on the putative claimant. It must know and should be able to demonstrate the commercial reason for its existence in the corporate structure of the ownership of the relevant investment; thereby it can reasonably ascertain the likelihood of its right to protection under an investment treaty.

If the corporate claimant is a mere mask held up to garner rights under an investment treaty which would not otherwise be available to the investment, then it cannot be a bona fide investor in the sense that it does not accord with the purpose of jurisdictional provisions in investment treaties to limit the circle of investors to those that are substantively a national of a contracting state to a treaty. Nor does the use of a mere instrumentality to access treaty protections reflect a genuine exchange of reciprocal obligations by contracting states to investors domiciled in a contracting state.

It remains to consider, as this thesis does in Chapter 11, how a purposive approach as described above can be implemented in investment treaty law.

The most certain and clear approach is to incorporate language into treaties expressly to require a purposive inquiry. There is recent progress in this area for exactly the reasons articulated in this thesis: The Netherlands Model BIT 2019 includes substantive criteria in its definition of “investor”¹¹¹⁴ and a denial of benefits clause,¹¹¹⁵ “for a better balance between rights and obligations of governments and investors ... and to exclude mailbox companies from investment treaty

¹¹¹³ See Borman, above n 39, at 389.

¹¹¹⁴ Article 1(b).

¹¹¹⁵ Article 16(2).

protection”.¹¹¹⁶ The India Model BIT 2015 imposes a substantial business activity test as part of the definition of investor and permits denial where an investor has been established or restructured with the “primary purpose” of accessing treaty benefits.¹¹¹⁷

The exclusion of mail box companies is also the object of the growing incidence of denial of benefit clauses, but such clauses rely on the problematic substantive markers of “control” and “substantial business activity” and their like. Moreover, the restrictive interpretation of notice requirements, onus of proof and retrospectivity of denial clauses suggests that amendments to the definition of “investor” or “national” in treaties to implement a purposive approach may be more straightforward and effective.

In any event, transformation of treaty language by re-negotiation or amendment is an exercise progressed at glacial pace. While in the long term states must reform and amend their investment treaties to place express treaty limits on corporate nationality planning, in the short term, “a more concerted and purposive approach by arbitral tribunals would assist to curb treaty shopping”.¹¹¹⁸

This can be achieved by recognition that a substantive check is inherent in investment treaties: primarily by means of an interpretative methodology that places due weight on context, object and purpose, and good faith as required by the Vienna Convention and/or by application of the principle of abuse of right.

As tax treaty jurisprudence has done, and as investment treaty jurisprudence has done with respect to jurisdiction *ratione materiae*, investment treaty tribunals must embrace an inherent substantive meaning to jurisdiction *ratione personae* concepts of “investor” and “national”, or use the principle of abuse of right to fill the lacuna.

The principle of abuse of right at international law exists as it does in civil law systems to mediate between the rights of legal actors. To date, investment treaty tribunals have set the bar too high for an “abuse” to be found and/or have sought to identify abuse on too narrow a basis. The principle does not necessarily connote

¹¹¹⁶ Duggal and van de Ven, above n 660, at 354 citing *Investeren in Perspectief*, above n 939, at 71.

¹¹¹⁷ Articles 1.5 and 35.

¹¹¹⁸ Lee, above n 14, at 361. See also Arato, above n 1067, at 293: “[a]rbitral tribunals simply have to do better” in respect of this issue by taking a more flexible approach.

intentional bad faith or require an extreme or patent case of abuse, it is an abuse simply to use rights in a way contrary to their purpose; a misuse or unreasonable use of rights.

Investment treaty law utilises incorporation and consequent corporate personality for the purpose of identifying genuine corporate nationals of contracting states, not for its municipal purpose of limiting liability for shareholders. Accordingly, manipulation of these concepts to fulfil treaty criteria for nationality in a formal sense fails to meet the purpose of the use of the concept at international law; it is an unreasonable use of the notion of corporate nationality on the international plane, a misuse of treaty process. Investment treaty jurisprudence has yet to appreciate that the application of formal treaty criteria must give rise to reasonable results in the context of the investment treaty system, otherwise they produce an abuse of that system.

International law is not the product of a legislature. There is no formal system of *stare decisis*. It consists of treaty provisions and general statements of principle common to municipal legal systems. In these circumstances, a broad and omnipresent role is necessary and appropriate for the principle of abuse of right to fill gaps and correct absurdities. General legal rights require a general limitation principle to check abuse.

The use of corporate nationality to shop for access to investment treaties is an appropriate candidate for the “evolutive role” of abuse of right,¹¹¹⁹ at least until States develop specific express rules designed to solve the problem for the future.

¹¹¹⁹ Kiss, above n 1043, at [8].

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