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Enabling Retrospective Application of the Denial of Benefits Clause: an Analysis of Decisions of Tribunals Under the Energy Charter Treaty

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ENABLING RETROSPECTIVE APPLICATION OF THE
DENIAL OF BENEFITS CLAUSE: AN ANALYSIS OF
DECISIONS OF TRIBUNALS UNDER THE ENERGY
CHARTER TREATY

Ramya Ramachanderan

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I. INTRODUCTION

Denial of Benefits (hereinafter “DOB”) clauses are not a novelty in BITs. The NAFTA,¹ CAFTA,² and the ECT³ (hereinafter “ECT”) all contain similar provisions. DOB’s were favored by States who wished to limit the benefits of the investment treaty to *bona fide* investors, in an effort to prevent treaty shopping. DOBs are “often seen as a safeguard against free riders,”⁴ or as a method “to preserve in the relationship between two states.”⁵ Because the existence of an international investment treaty regime is founded upon the principle of *pacta sunt servanda*,⁶ tribunals are dissuaded from reading a DOB clause in an investment treaty that does not

¹ North American Free Trade Agreement, art. 1113.

² Central America-United States Free Trade Agreement, art. 10.21.

³ Energy Charter Treaty, art. 17.

⁴ Loukas A. Mistelis & Crina Mihaela Baltag, *Denial of Benefits and Article 17 of the Energy Charter Treaty*, 113(4) PENN STATE L. R. 1321 (2009).

⁵ CRINA BALTAG, *THE ENERGY CHARTER TREATY: THE NOTION OF INVESTOR*, Wolters Kluwer (2012); *See also* RUDOLF DOLZER & CHRISTOPH SCHREUER, *PRINCIPLES OF INTERNATIONAL INVESTMENT LAW*, 55 (Oxford University Press 2008) (“Under such a clause the states reserve the right 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. The economic connection would consist in control by nationals of the state of nationality or in substantial business activities in that state”).

⁶ *See generally* Thomas Waelde, *The “Umbrella” (or Sanctity of Contract/Pacta Sunt Servanda) Clause in Investment Arbitration*, British Institute of International and Comparative Law, available at https://www.biicl.org/files/946_thomas_walde_presentation.pdf (last visited on Nov. 13, 2017).

expressly include it.⁷ Analytical approaches to the DOB clause as under Art. 17 of the Energy Charter Treaty has contributed to substantial jurisprudence in the development of the clause, its purpose, and use.

Art. 17 of the ECT reads:

Each Contracting Party reserves the right to deny the advantages of this Part to:

- 1. a legal entity if citizens or nationals of a third state own or control such entity and if that entity has no substantial business activities in the Area of the Contracting Party in which it is organized; or*
- 2. an Investment, if the denying Contracting Party establishes that such Investment is an Investment of an Investor of a third state with or as to which the denying Contracting Party:*
 - a. does not maintain a diplomatic relationship; or*
 - b. adopts or maintains measures that:*

⁷ See *id*; see also *Tokios Tokeles v. Ukraine* ICSID Case No ARB/02/18, Decision on Jurisdiction ¶ 36 (Apr. 29, 2004) (“We regard the absence of [a denial-of-benefits] provision as a deliberate choice of the Contracting Parties. In our view, it is not for tribunals to impose limits on the scope of BITs not found in the text, much less limits nowhere evident from the negotiating history.”).

- i. *prohibit transactions with Investors of that state; or*
- ii. *would be violated or circumvented if the benefits of this Part were accorded to Investors of that state or to their Investments.*

There are two key features to the wording of this text that guide a reasonable interpretation should the clause be invoked by a State. On the one hand, the clause specifies that denying benefits of the treaty, is a *right* that is *reserved* to each contracting State. On the other hand, the clause provides that the denial of benefits may be to an investor or an investment. With regard to the former, interpretation of the exercise of the reserved right has been an issue of much contention under the ECT and under other treaties.⁸

Other treaties, use similar wording in their DOB Clauses. The US-Ecuador BIT,⁹ CAFTA, and NAFTA “*reserve*” the right. This textual proposition poses many vexing question of procedure—what is the meaning of a “reserved” right? How should a State exercise a right that is reserved? Does it mean that the right does not exist until it is exercised? Tribunals have explored the extent and meaning

⁸ The most prominent and debated decision is of the ECT tribunal in *Plama Consortium Limited v. Republic of Bulgaria*, ICSID Case No. ARB/03/24, Decision on Jurisdiction (Feb. 8, 2005).

⁹ Treaty between the United States of America and the Republic of Ecuador concerning the Encouragement and Reciprocal Protection of Investment, 1993 [US-Ecuador BIT].

of the right itself, holding that a DOB clause must only be applied prospectively.¹⁰ This paper explores the question of whether the DOB clause should be applied retrospectively.¹¹ It consists of four parts including this introduction. Part II will appraise the reasoning used by tribunals so far, in determining the effects of the DOB clause. Part III will describe the three main arguments used by tribunals that categorically reject a retrospective application of a DOB clause. Part IV identify the flaws in the reasoning of the proposition by analyzing the right under the DOB clause. Part V will offer a conclusion by suggesting changes in the drafting of DOB clauses for an effective invocation and denial of benefits by a host state.

II. TRIBUNALS IN FAVOR OF PROSPECTIVE APPLICATION

It is interesting to note that no tribunal, under any investment treaty, has made a pronouncement of a “correct” time to

¹⁰ *Supra* note 8; *see generally* Limited Liability Company Amto v. Ukraine, SCC Case No. 080/2005, Final Award (Mar. 26, 2008) [ECT]; Empresa Electrica del Ecuador v. Republic of Ecuador, ICSID Case No. ARB/05/9, Award (June 2, 2009) [US-Ecuador BIT]; Ulysseas, Inc. v. Republic of Ecuador, UNCITRAL Interim Award (Sept. 28, 2011) [US-Ecuador BIT]; Liman Caspian Oil BV and NCL Dutch Investment BV v. Republic of Kazakhstan, ICSID Case No. ARB/07/14 [ECT]; Petrobart Limited v. The Kyrgyz Republic, SCC Case No. 126/2003 [ECT]; Khan Resources Inc., Khan Resources B.V. and Cauc Holding Company Ltd. v. The Government of Mongolia and Monaton Co., Ltd. PCA Case No. 2011-09 [ECT].

¹¹ By questioning “retrospectivity” I mean, upon the “exercise” of the clause, does the denial of benefits occur from the time of the investment or from the time the clause is invoked?

invoke the DOB clause.¹² The most prominent tribunal holding that a denial of benefits clause is to be applied prospectively, is the oft-criticized decision in *Plama v. Bulgaria*.¹³ The tribunal in *Plama* held that a DOB clause could not have a retrospective effect because it is an issue related to the merits of the parties dispute;¹⁴ that only matters relating to procedure could have a prospective application, if any.

Aside from the question of jurisdiction and admissibility of the question of denial of benefits,¹⁵ perhaps a less subjective ground is that of the concept of “half-notice.” For example, the tribunal in *Amto v. Ukraine*¹⁶ following the *Plama* decision held that the presence of a DOB clause in the

¹² See generally Lindsay Gastrell & Paul-Jean Le Cannu, *Procedural Requirements of ‘Denial-of-Benefits’ Clauses in Investment Treaties: A Review of Arbitral Decisions*, 30(1) ICSID R. – FOREIGN INVESTMENT LAW JOURNAL, 7897 (2015) available at <https://doi.org/10.1093/icsidreview/siu030> (last visited on Nov. 13, 2017).

¹³ *Supra* note 8; see generally *id.*

¹⁴ See generally the reasoning of the tribunal in *Empresa Electrica del Ecuador v. Republic of Ecuador*, ICSID Case No. ARB/05/9, Award (June 2, 2009).

¹⁵ See e.g. Jan Paulsson, *Jurisdiction and Admissibility*, Global Reflections on International Law, Commerce and Dispute Resolution, ICC PUB. 601 (2005). See also Michael Waibel, *Investment Arbitration: Jurisdiction and Admissibility*, University of Cambridge Faculty of Law Research Paper No. 9/2014 (2014); Andrew Newcombe, *The Question of Admissibility in Investment Treaty Arbitration*, KLUWER ARB. BLOG, (Feb. 3, 2010), <http://arbitrationblog.kluwerarbitration.com/2010/02/03/the-question-of-admissibility-of-claims-in-investmenttreaty-arbitration>.

¹⁶ *Limited Liability Company Amto v. Ukraine*, SCC Case No. 080/2005, Final Award (Mar. 26, 2008).

BIT is only a “half notice” and that “without further reasonable notice of its exercise by the host state, its terms tell the investor little; and for all practical purposes, something more is needed.”¹⁷

Treating the presence of the DOB clause in a BIT as a “half notice” is furthered more by what the *Plama* tribunal called an “active exercise.” In *Khan Resources v. Mongolia*,¹⁸ the tribunal first held that a question of denial of benefits does not deny a litigant the benefit of arbitration under the treaty. The Tribunal also held that the question of denial of benefits does not go to the jurisdiction of the tribunal, but goes to the admissibility instead.

At the outset, it must be stated that in the Tribunal’s view, the Respondent’s argument cannot affect the Tribunal’s jurisdiction over Khan Netherlands’ claims under the ECT. The introductory section of Article 17 of the ECT specifies that it concerns the denial of advantages of “this Part,” that is, Part III of the Treaty, which is titled “Investment Promotion and Protection” and sets forth the

¹⁷ *Plama Consortium Limited v. Republic of Bulgaria*, ICSID Case No. ARB/03/24, Decision on Jurisdiction (Feb. 8, 2005) ¶ 157; *See generally* *Yukos Universal Limited (Isle of Man) v. The Russian Federation* (PCA Case No. AA 227), Interim Award on Jurisdiction and Admissibility (Nov. 30, 2009).

¹⁸ *Khan Resources Inc., Khan Resources B.V., and Cauc Holding Company Ltd. v. The Government of Mongolia, MonAtom LLC*, UNCITRAL PCA Case No. 2011-09, Decision on Jurisdiction (Nov. 30, 2011).

substantive protections that each Contracting Party shall accord to investors of other contracting parties. Article 26 of the ECT, on which the Claimants rely to establish the Tribunal's jurisdiction, is found in Part V, which is dedicated to "Dispute Settlement." Thus, on a reading of the ordinary meaning of the terms of Article 17, this provision can operate to deny Khan Netherlands the benefit of the substantive protections it would otherwise be entitled to under the Treaty, but not to deny it the advantage of arbitrating its dispute with the Respondents before this Tribunal. The question of the application of Article 17 is therefore one for the merits, not jurisdiction.¹⁹

Therefore, the *Khan Resources* tribunal holds that an invocation of Art. 17(1) does not automatically deny benefits of the BIT to the party against whom the invocation is sought. Instead, the tribunal interpreted the DOB clause with the rules of interpretation from the Vienna Convention.²⁰ By applying Arts. 31 and 32 of the Vienna Convention, the tribunal found that the ordinary meaning of the word "reserved" in the context of the DOB necessarily means that it is only a "half notice" through the following reasoning.

¹⁹ *Id.* at 88, ¶ 411.

²⁰ Vienna Convention on the Law of Treaties, 1969.

Article 17(1) of the ECT provides that the Contracting Party “reserves the right” to deny the benefits of Part III of the ECT. The ordinary meaning of the verb “to reserve” suggests that the right to deny the benefits of the Treaty is being kept by the Contracting Party, to be exercised in the future.⁵¹⁰ Had Article 17 been intended to deny benefits automatically, it could easily have been phrased to do so. A formulation such as: “The advantages of Part III of the ECT shall be denied to” would have made such meaning plain. This leads the Tribunal to conclude that the Contracting Party’s right to deny the benefits of Part III of the ECT *must be exercised actively*.²¹

The reasoning from *Khan Resources* is in line with the jurisprudence on the ECT by past tribunals like *Plama*.²² And so the idea of half-notice directly influences the conclusion that the reserved right should be actively exercised.²³ The tribunal in *Liman Caspian Oil*²⁴ fully delineated the concept of an “active exercise” by holding:

the Tribunal notes that there is no disagreement between the Parties on the point that Article 17 contains a

²¹ *Supra* note 18, at 90, ¶ 419.

²² *Plama Consortium Limited v. Republic of Bulgaria*, ICSID Case No. ARB/03/24, Decision on Jurisdiction (Feb. 8, 2005), ¶¶ 146-151.

²³ See generally Carmen Nunez-Lagos, *The Invocation of “denial of benefits clauses”: when and how?*, KLUWER ARBITRATION BLOG (Feb. 17, 2014), <http://arbitrationblog.kluwerarbitration.com/2014/02/17/theinvocation-of-denial-of-benefits-clauses-when-and-how-2/> (last visited on Nov. 12, 2017); see also *supra* note 12.

²⁴ *Liman Caspian Oil BV and NCL Dutch Investment BV v. Republic of Kazakhstan* (ICSID Case No. ARB/07/14), Final Award.

notification requirement to the effect that a state must expressly invoke Article 17(1) of the ECT to rely on the rights under that provision. The Tribunal agrees that this is the only interpretation that can be drawn from the wording that the host state “reserves the right to deny the advantages of this Part”. To reserve a right, it has to be exercised in an explicit way.²⁵

This necessarily means that an active exercise is crucial for a contracting state to expect its interests to be protected under the BIT. The *Liman Caspian* tribunal further emphasizes that this active exercise requirement is a notification whose effects are only prospective.

With regard to the question of whether the right under Article 17(1) of the ECT can only be exercised prospectively, the Tribunal considers that the above mentioned notification requirement – on which the Parties agree – can only lead to the conclusion that the notification has prospective but no retroactive effect.²⁶

²⁵ *Id.* ¶ 254.

²⁶ *Id.* ¶ 225.

The tribunal reasons that a prospective effect is was the intention of the parties to the BIT because the preamble to the BIT wishes to *promote long term co-operation* between the States; that such a long term cooperation is only possible if a clause that denies benefits can be exercised prospectively.

Accepting the option of a retroactive notification would not be compatible with the object and purpose of the ECT, which the Tribunal has to take into account according to Article 31(1) of the VCLT, and which the ECT, in its Article 2, expressly identifies as “to promote long-term co-operation in the energy field”. Such long-term co-operation requires, and it also follows from the principle of legal certainty, that an investor must be able to rely on the advantages under the ECT, as long as the host state has not explicitly invoked the right to deny such advantages. Therefore, the Tribunal finds that Article 17(1) of the ECT does not have retroactive effect.²⁷

²⁷ *Id.*

III. THE BASIS OF THE PROPOSITION'S ARGUMENTS

The tribunals so far have arrived at conclusion that an invocation of the DOB clause can only be prospective.²⁸ First, since the presence of the clause in the BIT is only a “half-notice”, it necessarily requires an active exercise in order for a State to prevent an investor from acquiring benefits under the BIT. This proposition has been delineated in the previous section of this paper.

Second, that the interpretation of the clause in the context of the scheme of the ECT and its preamble necessarily renders the clause applicable only prospectively. This idea was explored by the *Liman* tribunal which ultimately led the tribunal to hold that the clause should only apply prospectively.²⁹ The reason for this determination is two-fold. Primarily, there is a difference in the balance of powers between an investor and a State.³⁰ Secondarily, the tribunals

²⁸ See generally Aldo A. Badini, *Practical Lessons for States and Investors From the Pac Rim Arbitration*, in YEARBOOK ON INTERNATIONAL ARBITRATION (Marianne Roth & Michael Geistlinger eds.) (2013).

²⁹ See *supra* note 24 at ¶¶ 224-25; See also Debora Pinto, *Is the retrospective exercise of the ‘denial of benefits’ clause contrary to the investor’s legitimate expectations under the Energy Charter Treaty?*, Maastricht University Working Paper (March 2016) DOI: 10.13140/RG.2.1.1164.2481 (last visited on Nov. 13, 2017).

³⁰ See Arseni Matveev, *Investor-State Dispute Settlement: The Evolving Balance Between Investor Protection and State Sovereignty*, 348-86 40 UNIV. W. AUS. L. R. (2015). See also Henry Farrell, *People are freaking out about the Trans Pacific Partnership’s investor dispute settlement system. Why should you care?*, THE WASHINGTON POST (Mar. 26, 2015), <https://www.washingtonpost.com/news/monkey-cage/wp/2015/03/26/people-arefreaking-out-about-the-trans-pacific->

so far have stressed that since the right under the DOB clause is reserved, it is necessary for its invocation to be “clear” and “public.”³¹ For instance, the *Plama* tribunal gives a list of instances as to how a DOB clause can be exercised in a manner that could possibly allow a retrospective application.

The Tribunal has also considered whether the requirement for the right’s exercise is inconsistent with the ECT’s object and purpose. The exercise would necessarily be associated with publicity or other notice so as to become reasonably available to investors and their advisers. To this end, a general declaration in a Contracting State’s official gazette could suffice; or a statutory provision in a Contracting State’s investment or other laws; or even an exchange of letters with a particular investor or class of investors. Given that in practice an investor must distinguish between Contracting States with different state practices, it is not unreasonable or impractical to interpret Article 17(1) as requiring that a Contracting State must exercise its right before applying it to an investor

partnerships-investor-dispute-settlement-system-why-should-youcare/?utm_term=.39429452566b.

³¹ *Plama Consortium Limited v. Republic of Bulgaria*, ICSID Case no. ARB/03/24, Decision on Jurisdiction (Feb. 8, 2005) at 50, ¶ 157

and be seen to have done so. By itself, Article 17(1) ECT is at best only half a notice; without further reasonable notice of its exercise by the host state, its terms tell the investor little; and for all practical purposes, something more is needed.³²

Third, an investor's legitimate expectations under the investment treaty may be violated if the denial of benefits clause is allowed to be exercised retrospectively. This is because, it is argued, that an investor will enjoy the benefits of the BIT until it has been put to an official notice by a clear expression by the host state. Otherwise, the investor could become entrenched into the host state without any return on its investment. This argument also goes back to the issue of balance of power.

The covered investor enjoys the advantages of Part III unless the host state exercises its right under Article 17(1) ECT; and a putative covered investor has legitimate expectations of such advantages until that right's exercise. A putative investor therefore requires reasonable notice before making any investment in the host state whether or not that host state has exercised its right under Article 17(1) ECT. At that stage, the putative

³² *Id.*

investor can so plan its business affairs to come within or without the criteria there specified, as it chooses. It can also plan not to make any investment at all or to make it elsewhere. After an investment is made in the host state, the "hostage factor" is introduced; the covered investor's choices are accordingly more limited; and the investor is correspondingly more vulnerable to the host state's exercise of its right under Article 17(1) ECT. At this time, therefore, the covered investor needs at least the same protection as it enjoyed as a putative investor able to plan its investment. The ECT's express "purpose" under Article 2 ECT is the establishment of "... a legal framework in order to promote long-term co-operation in the energy field ... in accordance with the objectives and principles of the Charter" (emphasis supplied). It is not easy to see how any retrospective effect is consistent with this "long-term" purpose.³³

³³ *Id.* at 51, ¶ 161.

This decision by the *Plama* tribunal has been cited by other tribunals as well, strengthening the overall influence of the argument over time.³⁴

IV. FLAWS WITH PROSPECTIVE APPLICATION

The purpose of a DOB clause is to deter shell companies from obtaining the benefit of an investment treaty. It is a conscious decision that is made by contracting states to an investment treaty.³⁵ The ability to enter into any clause of choice by contracting parties to an investment treaty is enshrined in the principle of *pacta sunt servanda*,³⁶ and is a right that flows from the sovereignty of the state.³⁷ The principles of *pacta sunt servanda* and state sovereignty necessarily coexist in the sphere of international investment law. This is precisely why a regular denial of benefits of an

³⁴ See also Limited Liability Company Amto v. Ukraine, SCC Case No. 080/2005, Final Award (Mar. 26, 2008) [ECT]; Empresa Electrica del Ecuador v. Republic of Ecuador, ICSID Case No. ARB/05/9, Award (June 2, 2009) [USEcuador BIT]; Ulysseas, Inc. v. Republic of Ecuador, UNCITRAL Interim Award (Sept. 28, 2010) [US-Ecuador BIT]; Liman Caspian Oil BV and NCL Dutch Investment BV v. Republic of Kazakhstan, ICSID Case No. ARB/07/14 [ECT]; Petrobart Limited v. The Kyrgyz Republic, SCC Case No. 126/2003 [ECT]; Khan Resources Inc., Khan Resources B.V. and Cauc Holding Company Ltd. v. The Government of Mongolia and Monaton Co., Ltd. PCA Case No. 2011-09 [ECT].

³⁵ See generally M Sornarajah, *Good Faith, Corporate Nationality, and Denial of Benefits*, in GOOD FAITH AND INTERNATIONAL ECONOMIC LAW (Andrew D Mitchell, M. Sornarajah, Tania Voon eds. 2015).

³⁶ Jason Webb Yackee, *Pacta Sunt Servanda and State Promises to Foreign Investors Before Bilateral Investment Treaties: Myth and Reality*, 32 FORDHAM INT'L L. J. 1550 (2008).

³⁷ M. Sornarajah, THE INTERNATIONAL LAW ON FOREIGN INVESTMENT, at 88-143, 3d. (Cambridge University Press 2012).

investment treaty to an investor and its investment that is otherwise covered by the treaty, would violate the treaty.³⁸

However, when a treaty is drafted with the goal that it shall not entertain an investor or an investment that does not conform to the requirements of the investment treaty through a DOB clause, a tribunal must be conscious of the intent of the contracting parties. First, the DOB clause was included in treaties historically to safeguard contracting states against “free riders.”³⁹ These “free riders” were nationals of a third state who could reorganize their corporate structure in a manner that would allow them to gain rights or interests in a contracting state contrary to the intention of the contracting states to the treaty.⁴⁰ Historically, the DOB clause was featured in the early treaties on Friendship, Commerce and Navigation (“FCN”) where the clause was referred to as a “reservation. . . directed primarily at the exercise by a company of its ‘functional’ rather than its ‘civil’ capacity.”⁴¹ This would mean that a contracting state could deny the benefits of a treaty without automatically denying nationality or existence of the entity, or the ability of such entities to redressal in courts.⁴² But the ability of contracting states to determine the basis upon which it shall protect investors and

³⁸ *Id.*

³⁹ *Supra* note 4, at 1302.

⁴⁰ Herman Walker Jr., *Provisions on Companies in United States Commercial Treaties*, 50 AM. J. INT’L L. 373, 388 (1956).

⁴¹ *Id.*

⁴² *Supra* note 4, at 1303

investments goes to the central idea of state sovereignty itself.⁴³

For instance, academics note that a state can choose a “latent protective clause which [it] may utilize if it wishes to take the initiative of so doing”⁴⁴ because it is the ‘basic task’ of a BIT to determine whether an investor has sufficient links to a treaty country.⁴⁵ The reason for this expedition is that granting benefits of investment treaties to third countries or to entities who “are primarily associated with those countries and with which the denying country has no relationship, would be ‘to abandon . . . [the] right to negotiate corresponding privileges and obligations from those countries.’⁴⁶”⁴⁷ Academics also note that a DOB clause and its presence in an international treaty is a “method to counteract nationality planning” that entities undertake when they attempt to invest in a country, purely to seek protection under an investment treaty.⁴⁸ Therefore, the BIT will require that there exist a “bond” between the investor

⁴³ See e.g. Ileana M. Porras, *The Puzzling Relationship Between Trade and Environment: NAFTA, Competitiveness and the Pursuit of Environmental Welfare Objectives*, 3 INDIANA J. GLOBAL LEG. STUD. 65 (1995).

⁴⁴ *Supra* note 40.

⁴⁵ *Supra* note 4, at 1303; See also J.W. Salacuse, *BIT by BIT: The Growth of Bilateral Investment Treaties and Their Impact of Foreign Investment in Developing Countries*, 24 INT’L L. 655, 665 (1990) (stating that the determination of which investors are covered by the treaty reveals the asymmetry in the relationship between the two countries.)

⁴⁶ *Id.*

⁴⁷ *Supra* note 4, at 1303.

⁴⁸ RUDOLPH DOLZER & CHRISTOPH SCHREUER, *PRINCIPLES OF INTERNATIONAL INVESTMENT LAW* 55 (Oxford Univ. Press 2008).

and the state whose nationality it claims to have, creating a DOB clause.

Under such a clause the states reserve the right 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. The economic connection would consist in control by nationals of the state of nationality or in substantial business activities in that state.⁴⁹

This goal is even evidenced in the early FCN's⁵⁰ which was modified to be introduced into modern day BITs. For example, the following is the text from an FCN between the U.S. and China:

each High Contracting Party reserves the right to deny any of the rights and

⁴⁹ *Id.*

⁵⁰ *The Treaty of Friendship, Commerce and Navigation, with Final Protocol between the United States of America and Siam*, signed on 13 November 1937, provides in Article 1(8) that "neither High Contracting Party shall be required by anything in this paragraph to grant any application for any such right or privilege [exploration and exploitation of mineral resources] if at any time such application is presented the granting of all similar applications shall have been suspended or discontinued."; See also *Thailand—U.S. Treaty of Amity and Economic Relations*, signed on 29 May 1966, in 5 INT'L LEG. MATERIALS 876, 884 art. XII(1)(f) (1966), *Treaty of Amity and Economic Relations between the United States of America and the Togolese Republic*, signed on 8 February 1966.

privileges accorded by this Treaty to any corporation or association created or organized under the laws and regulations of the other High Contracting Party which is directly or indirectly owned or controlled, through majority stock ownership or otherwise, by nationals, corporations or associations of any third country or countries.⁵¹

This stresses the purpose of DOB's clause is a determination by each contracting state to decide whether treaty benefits should be granted to a national suspected of indulging in 'treaty shopping.'⁵² Soon after their presence in FCNs, the DOB clause trickled down into model BIT's as well.⁵³ Therefore, the object and purpose of a DOB clause is

⁵¹ *Treaty of Friendship, Commerce and Navigation between the United States of America and the Republic of China*, signed on 4 November 1946 and entered into force on 30 November 1948, in 43 AM. J. INT'L L. SUPP. 27, 48 art. XXVI (5) (1949).

⁵² P.B. Gann, *The U.S. Bilateral Investment Treaty Program*, 21 STAN. J. INT'L L. 373, 379-80 (1985); For treaty shopping, see generally M. Sornarajah, *Portfolio Investments and the Definition of Investment* 24 ICSID REV. 516 (2009); M. Sornarajah, *Evolution or revolution in international investment arbitration? The descent into normlessness*, in *Evolution in International Investment Treaty Law and Arbitration* (Brown Chester and Miles Kate eds. 2011); See also JORUN BAUMGARTNER, *TREATY SHOPPING IN INTERNATIONAL INVESTMENT LAW* (Oxford University Press, 2016).

⁵³ See e.g. 1994 U.S. Model BIT, in CAMPBELL MCLACHLAN, LAURENCE SHORE, & MATTHEW WEINIGER, *INTERNATIONAL*

to prevent a treaty shopping investor from acquiring benefits of the BIT because the contracting parties to the treaty specifically intended such an effect.

Another important factor that tribunals have overlooked in their logic to favor a prospective application is the concept of the notice. Tribunals derive the conclusion that the presence of the DOB clause in the BIT is a half notice, from the text of the clause itself. For instance, the ECT states: “Each Party *reserves* the right to deny benefits . . .” Supposedly, the word *reserves* is a latent right.⁵⁴ But such an interpretation is still contrary to the object and purpose of the DOB clause itself. In its justification, the *Plama* tribunal distinguished between the existence of a right and the actual exercise of the right.

a Contracting Party has a right under
Article 17(1) ECT to deny a covered
investor the advantages under Part III;

INVESTMENT ARBITRATION: SUBSTANTIVE PRINCIPLES 386-92
app. 5 (Oxford Univ. Press 2007). (The text read:

*Each Party reserves the right to deny to a company of the
other Party the benefits of this*

*Treaty if nationals of a third country own or control the
company and*

*a) the denying Party does not maintain normal
economic relations with the third country; or*

*b) the company has no substantial business activities
in the territory of the Party under whose laws it is
constituted or organized.)*

⁵⁴ See *supra* note 34, where all the decisions specifically state that a reserved right is so dormant that it requires an active exercise in a manner that is clear to the investor against whom it is invoked.

but it is not required to exercise that right; and it may never do so.⁵⁵

Therefore, academics and tribunals alike, are in agreement that the DOB clause under the ECT, is silent on the method of invoking the right under the clause.⁵⁶ But this is not necessarily true. If in actuality, there is ambiguity in the construction of the clause as to its exercise, the interpretation can still be achieved through the application of the Vienna Convention.⁵⁷ However, tribunals have incorrectly applied the Vienna Convention by making the central focus of the clause the investor.

For the Investor, the practical difference between prospective and retrospective effect is sharp. The former accords with the good faith interpretation of the relevant wording of Article 17(1) in the light of the ECT's object and purpose, but the latter does not.⁵⁸

The tribunal concluded that a prospective application was appropriate also because a retrospective application

⁵⁵ *Supra* note 8, ¶ 155.

⁵⁶ *Supra* note 4, at 1319; see also *id* at ¶¶ 157-58. Cf. H. Essig, *Balancing Investors' Interests and State Sovereignty: The ICSID Decision on Jurisdiction Plama Consortium Ltd. v. Republic of Bulgaria*, 5 OIL, GAS & ENERGY L. INTELLIGENCE, (April 2007) (recommending that States should enact a law that is clear as to the exercise of the DOB clause)

⁵⁷ *Supra* note 20.

⁵⁸ *Supra* note 8, ¶ 164.

would contradict the objects and purpose of the ECT by discouraging investments since it violates the “legitimate expectations” of an investor.⁵⁹ However, legitimate expectations are determined by the information the investor knew at the time of investment planning.⁶⁰ Other tribunals have held time and time again that legitimate expectations of an investor are “based on the conditions offered by the host state at the time of the investment.”⁶¹ Therefore, it is necessary for the basic expectations to exist at the time of the investment in order for an investor to claim that protection itself is part of the legitimate expectations by itself.⁶¹

⁵⁹ See also Michele Potesta, *Legitimate Expectations in Investment Treaty Law: Understanding the Roots and the Limits of a controversial concept*, 28 ICSID REV. (2013).

⁶⁰ See Christoph Schreuer & Ursula Kriebaum, *At What Time Must Legitimate Expectations Exist?* TRANSNAT’L DISPUTE MGMT. in A LIBER AMICORUM: THOMAS WALDE – A LAW BEYOND CONVENTIONAL THOUGHT (2012) ⁶¹ See *Tecnicas Medioambientales Tecmed S.A. v. The United Mexican States*, Award, 29 May 2003, 43 I.L.M. 133, ¶ 130 (2004).

⁶¹ See *Enron Corporation and Ponderosa Assets. L.P. v. Argentine Republic*, Award 22 May 2007 (concerning Enron’s indirect investment of 35.5% in Transporatadora Gas del Sur, one of the major Argentine networks for the transportation and distribution of gas, Argentina had offered by means of the Argentine Gas Law, the Gas Decree and the Basic Rules of the License key tariff-related guarantees); See also *B.G. Group Plc v. Republic of Argentina*, Final Award, 24 December 2007 (where B.G. Group had a direct and indirect investment in MetroGas, a natural gas distribution company incorporated in Argentina); See also *LG&E Energy Corp., LG&E Capital Corp. and LG&E International Inc. v. Argentine Republic*, Decision on Liability, 21 ICSID REV. 2013 (2006); See also *National Grid v. Republic of Argentina*, Award, 3 November 2008; See *supra*, note 60, at 3.

Surely, the concept of legitimate expectations is subject to the kind of investment that is made as well. Tribunals have stressed on the totality of an investment in determining the kind of expectations an investor might have had while making its investment plan and structure in the host state.⁶² But the focal point to determine legitimate expectation is the exact point in time when the decision to invest was taken.⁶³ Several items may be classified as the information available to an investor at the time it makes the investment, including any particular assurances made to an investor by the host state, specific contractual arrangements, particular promises exchanged between the host state and the investor, and the protections extended under the investment treaty.⁶⁴ The protections guaranteed under an investment treaty are a general expectation.⁶⁵ Therefore, when an investor reads the text of the investment treaty under which it seeks coverage and finds a DOB clause therein, the legitimate expectation of the investor cannot be said to exist without qualification. From an investment law perspective, an investor has already been put on notice of a clause that could potentially be invoked by the host state to protect its interests.⁶⁶ Since there the key factor in the determination of

⁶² See *Ceskoslovenska Obchodni Banka, a.s ("CSOB") v. The Slovak Republic* ICSID Case No. ARB/97/4).

⁶³ *Supra* note 60, at 8; See also *Sempra Energy International v. Argentine Republic*, Award, 28 September 2007; LG&E

⁶⁴ See generally *supra* note 60.

⁶⁵ *Id.*

⁶⁶ See *Duke Energy Electroquil Partners & Electroquil SA. V. Republic of Ecuador*, ICSID Case No. ARB/04/19, Award, 18 August 2008 (the tribunal took into consideration, the expectations that Duke Energy had

legitimate expectations, is the appreciation of cumulative facts and circumstances that surround the investor, a blanket statement as to the application of a DOB clause is therefore untenable.⁶⁷ James Chalker correctly described the tendency of the tribunal in *Plama*:

Plama constructed a legal standard overly deferential to the investor and interpreted the ECT's object and purpose with an overemphasis on investor protection to dismiss Bulgaria's jurisdictional objection. The tribunal equated the object and purpose of the ECT with a high degree of investor protection. This protection is not limited to basic issues of fairness or nondiscrimination, but includes predictability, namely the ability to rely on Article 26 of the ECT to litigate a claim. The tribunal cited two sources for its interpretation of the ECT's object and purpose: Article 2 of the Treaty and an essay by "distinguished commentators", but it also suggested

at the time of the investment, and at a later time, based on the facts that had occurred in the period prior to the investment made in Ecuador).

⁶⁷ See also James Chalker, Making the Energy Charter Treaty Too Investor Friendly: *Plama Consortium Limited v. The Republic of Bulgaria*, 5 TRANSNAT'L DISP. MGMT. (2005) available at www.transnational-disputemanagement.com/article.asp?key=874; See generally IMPROVING INTERNATIONAL INVESTMENT AGREEMENTS (Armand de Mestral & Celine Levesque eds., 2013).

that concern for investor protection permeates the ECT. While the ECT is certainly concerned with investment promotion, the Plama tribunal misinterpreted International Court of Justice and international arbitral tribunal decisions and overstated the amount of investor protection demanded by the Treaty's object and purpose, and in so doing, failed to engage in a meaningful inquiry into its basis for jurisdiction.⁶⁸

It is with these flaws in mind that one must evaluate the decision of the tribunal in *Plama* that has been faithfully reproduced in other decisions of tribunals under the ECT. But following a wrong consistently does not change the fact that the core principle and argument is wrong. A tribunal looking to make any sense of the DOB clause under the ECT must therefore pay close attention to several aspects of the investor, and of its investment before it attempts to interpret a portion of the ECT.

First, the tribunal must determine the point at which the investor can be said to have possessed legitimate expectations of protection under the ECT. This means, the tribunal must necessarily take into account whether the host state has made particular promises, or entered into specific covenants with that specific investor to induce an investment. Second, the tribunal must then explore whether the investor has indulged in legitimate treaty shopping. This

⁶⁸ *Id.*

does not mean to imply that treaty shopping is inherently bad or detrimental to the interests of the host state. Treaty shopping is good due diligence employed by an investor in order to make legitimate investments that can be beneficial to the host state.⁶⁹ Third, in inquiring whether the application of the DOB should be prospective or retrospective, the tribunal must necessarily rely upon the specific point in time where the investor assumed legitimate expectations of protection under the investment treaty. This point will guide the tribunal to align itself with the intent of the contracting parties to the BIT in the inclusion of the DOB clause.⁷⁰ Finally, a tribunal must also ask whether the investor or the investment that is being denied protection under the treaty is the kind that the contracting parties intended to be covered under the DOB clause. This means that the tribunal must necessarily perform an analysis of the requirements under a DOB before it determines whether the state can effectively deny benefits.

V. CONCLUSION

In light of the aforementioned fallacies in the logic consistently used by tribunals to delegitimize a host state's prerogative in denying benefits of a BIT to an investor or an

⁶⁹ See BAUMGARTNER, *supra* note 52.

⁷⁰ The intent of the contracting parties to an international treaty is also part of the *travaux préparatoires* of the treaty itself and must be given due consideration in the interpretation of a treaty. See RICHARD GARDINER, TREATY INTERPRETATION (Oxford, 2d. 2015); See also MARC J. BOSSUYT, GUIDE TO THE TRAVAUX PRÉPARATOIRES OF THE INTERNATIONAL COVENANT ON CIVIL AND POLITICAL RIGHTS (Martinus Nijhoff, 1987).

investment, it may be necessary to re-structure the clause itself. This is recommended especially in the light of the misinterpretation of tribunals that wish to cite to the decision in *Plama* to gain the ability to prevent a host state from denying benefits.

Before proposing a re-drafted DOB clause, it is also necessary to talk about the definition of an “investor” under a BIT. The definition clauses of a treaty are the most important tool used by a tribunal to decipher what contracting parties to the treaty intended by their use of common place words. These words include “asset,” “finance” etc. If contracting parties to an investment treaty wish to truly prevent treaty shopping in their jurisdictions and effectively reduce the chances that an investor can misuse the investment treaty, contracting parties must necessarily re-think their strategy with the definitions clause. Arguably, for the most part, the people who draft an investment treaty are seldom lawyers, but are diplomats and politicians who may not be fully aware of the legal consequences of difference in terminology. Furthermore, there is paucity of uniform legal language across the world. What may be a simple, un-complicated word in a civil law context, may be totally different from the legal context and the interpretation of the word in a common law context. Therefore, the lack of a uniform consensus on the usage of terms may pose to be quite a challenge.

Investment treaties have, in the past changed the way in which an investor is viewed. Some have a nationality test for the determination of who a recognized investor under the

treaty is, some others have a control test.⁷¹ These tests are also a means for states to determine which kind of investors it wishes to recognize.⁷² Therefore, the definition of an investor must be aligned with the requirements of a DOB clause for better execution by a host state. By aligning both definitions, two purposes are achieved. First, there is no ambiguity regarding which investor may be denied benefits because the test is in-tune with the rest of investment treaty. Second, an investor is put on notice of its ineligibility to acquire treaty protections altogether because the investor would not otherwise be covered under the treaty anyway.

Therefore, the following is the proposed revision of a DOB clause in manner that circumvents the issue of invocation giving notice to a putative investor and that of the defense of legitimate expectations.

Art. X: Each Contracting Party hereby denies benefits of the entirety of this investment treaty to:

- 1. a legal entity*
 - a. if citizens or nationals of a third state own or control such entity;*
 - and*
 - b. if that entity has no substantial business activities in the Area of*

⁷¹ For more on the types of tests and the influence of the ICSID Convention, see *Salini Costruttori S.p.A and Italstrade S.p.A v. Kingdom of Morocco*, ICSID Case No. ARB/00/4, Decision on Jurisdiction (French Original: 129 *Journal du droit international* 196 (2002)) (English translation: 42 *I.L.M.* 609 (2003), 6 *ICSID Rep.* 400 (2004)).

⁷² See also Alex Grabowski, *The Definition of Investment under the ICSID Convention: A Defense of Salini*, 15(1) *CHI. J. INT'L L.* (2014)

- the Contracting Party in which it is organized; or*
2. *an Investment, if the denying Contracting Party establishes that such Investment is an Investment of an Investor of a state that is not a Contracting Party to this treaty, or as to which the denying Contracting Party:*
 - a. *does not maintain a diplomatic relationship; or*
 - b. *adopts or maintains measures that:*
 - i. *prohibit transactions with Investors of that state; or*
 - ii. *would be violated or circumvented if the benefits of this Part were accorded to Investors of that state or to their Investments.*
 3. *For the purposes of clause 1 above, ownership shall mean [ownership by percentage of shares or stake owned in the entity or otherwise in sync with the definition of an "investor" under the investment treaty; and control shall mean [type of control exercised by the parent company over the subsidiary that is the investor, or by the board of directors who are nationals of a third state]*

This definition now clarifies that the right under a DOB clause is no longer “reserved” and is more automatic from the outset of the treaty, dismissing any insinuation that the benefits of the treaty could possibly extend to any “investor.” And finally, the third clause clarifies the threshold that tribunals must now follow to determine what kind of investors will not be protected under the treaty. The second part of the definition also takes inspiration from the many cases on piercing the corporate veil to enable tribunals to see that the intent of the contracting states was to dissuade treaty shopping and prevent shell companies from gaining coverage under the treaty.⁷³

⁷³ For piercing of the corporate veil in general, see generally Yaroslau Kryvoi, *Piercing the Corporate Veil in International Arbitration*, 1 GLOB. BUS. L. REV. 169-186 (2011); See also Yaroslau Kryvoi, *Piercing the Corporate Veil and Enforcement*, KLUWER ARBITRATION BLOG (May 3, 2010), <http://arbitrationblog.kluwerarbitration.com/2010/05/03/piercing-the-corporate-veil-and-enforcement/>.