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The Determination of the Nationality of Investors under Investment Protection Treaties

The International Law Association
German Branch
Sub-Committee on Investment Law

by

The Working Group

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PREFACE

Introductory Preface to the Two Working Group Papers Published by the Subcommittee on Investment Law of the German Branch of the International Law Association

Prof. Dr. Dr. Rainer Hofmann, Prof. Dr. Richard Kreindler

The two working group papers, published under the titles "General Public International Law and International Investment Law – A Research Sketch on Selected Issues" and "The Determination of the Nationality of Investors under Investment Treaties – A Preliminary Report", present the fruits, common positions and recommendations of the members of the Subcommittee on Investment Law of the German Branch of the International Law Association, after intensive research and discussions during the past 18 months. The two papers aim to contribute to the development of international investment law in general and to the formulation of German positions and interests in particular.

The Subcommittee on Investment Law of the German Branch of the International Law Association was established in 2008 by Prof. Dr. Dr. Rainer Hofmann and Prof. Dr. Richard Kreindler. The Subcommittee had its origins in a discussion within the Board of the German Branch of the International Law Association in Heidelberg in Summer 2007. As a result of that discussion, the Board favored the creation of a new Subcommittee on Investment Law, modeled after the Subcommittee on Air and Space Law, which had been established by Prof. Dr. Karl-Heinz Böckstiegel and is currently headed by Prof. Dr. Stephan Hobe.

The Subcommittee on International Investment Law was founded against the background of the increasing significance of international investment law both globally and as relates to Germany. It was concluded that this development called for a focus on issues and interests from a German perspective in the form of a standing committee. The aim of the Subcommittee on Investment Law is to bring together German interests in the field of investment law and to identify and elaborate common positions, notably from the viewpoint of German investors, the German Government and German academia respectively, including in the context of the interest in a well-conceived and properly functioning system of dispute resolution through investment-related arbitration. With its establishment within the framework of the German Branch of the International Law Association, the Subcommittee also seeks to serve as a source of continuing education and expertise for the German Branch's members in the field of investment law and investment arbitration.

The working group initially consisted of some 20 practitioners, professors, in-house counsels and other representatives of government, academia and industry in

Germany whose activities and expertise materially touch on issues of international investment law and arbitration. The Subcommittee meets twice a year in Frankfurt Main and has as its goal discussion, research and writing on one or two comprehensive topics each year. The present publication is the result of the Subcommittee's initial work. The working group on "General Public International Law and International Investment Law" was headed by Prof. Dr. Christian Tietje and the working group on "The Determination of the Nationality of Investors under Investment Treaties" by Robert Hunter. The papers prepared by each working group were intensively discussed during the plenary sessions of the Subcommittee and reflect both the commonality and diversity of opinions and positions within the Subcommittee.

The papers were first published in draft form on the occasion of the "50 Years BITs" conference in Frankfurt Main in December 2009. Both papers were part of the handout distributed to all participants. The Subcommittee sought thereby to elicit comments from a wide range of colleagues in the field, to be reflected in the final version of the working group papers.

In its session of April 2010, the Subcommittee on Investment Law decided to enlarge its current basis of members. It now consists of some 30 experts in the field of investment law who in the upcoming year will address two closely interrelated topics: "Legality of the Investment" and "Investment Law and Corruption." The working group on "Legality of the Investment" will be headed by Dr. Sabine Konrad, while the working group on "Investment Law and Corruption" will be headed by Prof. Hilmar Raeschke-Kessler and Dr. Marie Louise Seelig.

We hope that this current publication contributes to the further development of international investment law in Germany and elsewhere, and we welcome comments on the Subcommittee's work. Finally, we express our gratitude to Prof. Dr. Christian Tietje and Robert Hunter, who have worked tirelessly towards achieving this comprehensive work-product in the form of the working group papers. We also thank each of the Subcommittee members for their contributions to the working papers, the related discussions, and the overall work product represented in the pages that follow.

Frankfurt am Main, Germany, December 2010.

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A. Introduction

Much has changed since the time when the State alone as a subject of international law could raise a claim for injuries suffered by individuals and those individuals, as objects of international law, were not themselves entitled to do so. In the field of diplomatic protection – the ancestor of modern treaty-based investment protection law – the fact of nationality was necessarily the key to remedies and redemption: the link of nationality provided the legitimacy of a State's intervention on behalf of its citizen against another sovereign State.

The system of bilateral investment treaties was conceived to overcome the unwieldy institution of diplomatic protection. Bilateral investment treaties have both established specific standards of treatment and invested investors themselves with the extraordinary opportunity of asserting their own rights under international law. The exhaustion of local remedies – necessary in diplomatic protection – has been waived in the modern investment protection system for the benefit of the speed and ease of investors achieving a remedy in cases of alleged infringements of those rights.

Nonetheless, nationality has remained a threshold criterion for protection due to the fact that the system of foreign investment protection rests largely on a network of bilateral treaties. The result is that the definition of the term 'investor' in investment treaties is still derived from the concept of nationality.

The question might be asked whether this is an anachronism. Until even recently nationality indicated the attachment of a person to a nation in the sense of a group consisting of people with a matching culture, heritage or philosophy. In today's world of globalisation, nationality might be seen rather – at least in the field of international commerce and investment – as a fact of coincidence or convenience. Moreover, as considered below, the very term 'nationality' is imperfect and even problematic in its application to describing the attribution of a corporation to a particular State. Particularly with regard to multinational enterprises, the concept of nationality offers at least a prima facie flexibility that may be utilised and also exploited when structuring foreign investments. It is hardly surprising that questions of nationality have been the object of jurisdictional arguments by respondent states as well as the focus of more elaborate provisions in investment treaties themselves.

This paper explores the issues arising from the use of the concept of nationality in the context of international investment protection law. The paper focuses for the most part on the nationality of corporate investors since the vast majority of foreign direct investments are made by legal entities rather than natural persons.

First we analyse the status of investors' nationality in current BIT practice, reviewing provisions in different investment treaties with a focus on the German BIT programme.

Secondly, we take a look at the German municipal legal system and examine the tendency away from the traditional way of defining corporate nationality by seat towards a formal approach. While offering more flexibility and increasing the competitiveness of German corporate law by simplifying cross-border transfer of registered companies, we question whether these advantages may emerge at the expense of legal certainty in the field of investment protection law.

This naturally leads, thirdly, to the question whether such a formalistic approach when adapted to the BIT programme is consistent with principles of public international law or conversely whether it is allowable to set aside a definition in a treaty by reference to extraneous considerations of general international law (which may be called the "Jurisprudential approach").

Fourthly, we show that there are, increasingly, legislative approaches to denying treaty protection to corporations under certain circumstances (which may be called the "Legislative approach").

Fifthly, we examine whether analogies may be drawn from the field of double-taxation treaties.

Sixthly, we consider questions of continuity of nationality.

Finally, the paper concludes by raising those policy issues that might emerge in the context of determining a corporate investor's nationality. In particular we address whether there are any particular issues that need to be addressed to provide more legal certainty for German companies investing abroad. The fact that, as a result of tectonic changes occurring during the preparation of this paper, we stand at the dawn of a brave new – and substantially uncharted – world of EU-level investment agreements lends a particular topicality, even urgency, to those issues.

B. The Determination of Nationality of Investors in International Investment Agreements (IIAs) – Taking Stock of the Criteria Used in Modern Investment Law

Markus Perkams

I. Introduction

IIAs form the basis of modern investment protection law. Therefore, any discussion regarding the determination of nationality of investors in this field of law as it stands today must be preceded by a survey of the different criteria used in the treaties in order to define such nationality.

This survey is divided into three parts: The first part provides an overview of the criteria most commonly found in IIAs. The second part then focuses on German IIAs and provides a summary of the criteria referred to in such treaties. Finally, the third section deals with customary practices of German IIAs, *i.e.* the rulings issued by arbitral tribunals with regard to the nationality of investors under German IIAs.

II. Overview of the Criteria Most Commonly Used

Virtually all IIAs provide that both juridical persons and natural persons are deemed to constitute "investors".[1] The following criteria are predominantly used in IIAs with regard to the determination of their respective nationality.

1. Juridical Persons

IIAs tend to use three criteria to define the link of nationality between a juridical person and a country: the location of its seat, the place of incorporation and exercise of control. A fourth approach entails forgoing the inclusion of a precise definition and to instead refer to the conditions prescribed by the law of the home state for the incorporation of a juridical person.

At a general level, two observations warrant closer scrutiny:

First, the three listed criteria specified above can be used alone, in combination, or as alternatives. While at least one of the first two of these criteria can be found in almost every treaty, the control criterion is referred to only in a limited number of IIAs and even then more often than not only in combination with one of the other

[1] The following summary is based on a review of publicly available IIAs concluded by a considerable number of Western European countries as well as by the U.S. and Canada. Although it admittedly thus excludes the growing number of IIAs concluded nowadays with non-industrialised nations, it should nevertheless be representative, since it incorporates the criteria used by other countries as part of the reviewed treaties.

two criteria.[2] Some IIAs limit the scope of the treaty by requiring that a juridical person must have its "*effective economic activities*" in the home state.[3]

Second, it is worth noting that countries do not necessarily use the same definition in every treaty. Some German IIAs, for example, merely refer to the seat as a criterion for determining the German nationality of the investor,[4] while other German IIAs also require the investor to be "*lawfully existing consistent with legal provisions*".[5] The same holds true for Italian IIAs, some of which either merely use the seat criterion[6] or the place of incorporation[7] whereas others use a combination of these criteria.[8] In light of these differences, every IIA obviously needs to be interpreted on a case-by-case basis according to its own terms.

Turning our attention to the relevant criteria, examples of their employment in IIAs are set out below:

a) The seat criterion

The seat criterion plays a prominent role inter alia in German IIAs, most of which use it as the decisive criterion for the definition of a German investor abroad. An example is Art. 1 of the German-Indian IIA:

> (…)
> (a) Companies means
> (ii) in respect of the Federal Republic of Germany:
> juridical persons as well as commercial or other companies or associations with or without legal personality having its seat in the territory of the Federal Republic of Germany, irrespective of whether or not its activities are directed at profit;[9]

Other countries that refer to the seat criterion principally in combination with one of the other criteria, include Italy, France and Spain.[10] With regard to the exact

2 Other somewhat unusual criteria limit the scope of application: For example, a Belarusian investor in Germany is only protected if he possesses a licence to invest abroad, see Art. 1 3. b) of the German-Belarus IIA with Belarus.

3 See *e.g.* Art. 1 2. a) (ii) and b) (ii), Greece-Bosnia Herzegovina IIA and Art. 1 3. b) of the Greece-Algeria IIA. (See section 5 below regarding denial of benefits clauses).

4 See *e.g.* Art. 1 4. a) of the Germany-Albania IIA; see Art. 1 4. a) of the Germany-Bolivia IIA; or Art. 1 3. a) of the Germany-Bosnia Herzegovina IIA.

5 See Art. 8 (4) a) of the Germany-Bangladesh IIA; see also Art. 1 3. 2. of the Germany-Bulgaria IIA; see also Art. 1 (1) 4. of the Germany-Algeria IIA; or Art. 8 (4) a) of the Germany-Cameroon IIA.

6 See *e.g.* Art. 1 4. of the Italy-Jordan IIA.

7 See *e.g.* Art. 1 4. of the Italy-Bangladesh IIA; Art. 1 4. of the Italy-Croatia IIA; Art. 1 (2) (b) of the Italy-Hong Kong IIA; or Art. 1 4. of the Italy-Pakistan IIA.

8 See *e.g.* Art. 1 4. of the Italy-Algeria IIA; or Art. 1 4. of the Italy-Estonia IIA.

9 See also Art. 1 3. a) of the Germany-Afghanistan IIA; see also Art. 1 4 b) of the Germany-Bahrain IIA; see also Art. 1 4. a) of the Germany-Chile IIA; see also Art. 1 4. a) of the Germany-Cuba IIA; see also Art. 1 4. a) of the Germany-Ecuador IIA; see also, Art. 1 4. a) of the Germany-Ghana IIA; Art. 1 4. a) of the Germany-Hong Kong IIA; Art. 8 4. a) of the Germany-Jordan IIA; Art. 1 4. a) of the Germany-Mongolia IIA.

10 See for example with regard to Spain: Art. 1 b) of the Spain-Albania IIA; Art. 1 b) of the Spain-Pakistan IIA; with regard to France: Art. 1 2. b) of the France-Czechoslovakia IIA; Art. 1 3. a) of

wording of the IIAs, it is worth noting that the treaties do not always use the term "*seat*" as such, but instead refer to "*main office*"[11], "*residence*"[12], or the "*siège social*"[13]. These terms could be interpreted as referring to either the administrative seat or to the statutory seat of a company – a differentiation that could become particularly problematic if a treaty only uses the term "*seat*" without clarifying which seat is decisive.[14]

b) The place of incorporation

The place of incorporation is the sole criterion provided for in some Italian IIAs, such as in Art. 1.4 of the IIA between Italy and Bangladesh:

> The term "legal person", in reference to either Contracting Party, shall be construed to mean any entity established in the territory of one of the Contract in accordance with the respective national legislation such as public establishments, joint-stock corporations or partnerships, foundations or associations regardless of whether their liability is limited or otherwise.

In addition, IIAs entered into by the Netherlands, Portugal, Spain or the United Kingdom use the place of incorporation as the decisive (or joint) criterion for the determination of the nationality of their investors.[15]

c) The control criterion

The control criterion finally is less widely used than the seat or the place of incorporation. A good example of its combination with other criteria is Art. 1 2. of the French-Saudi-Arabian IIA:

> Le terme «d'investisseur» désigne:
> (…)
> toute personne morale constituée sur le territoire de l'une des Parties contractantes, conformément à la législation de celle-ci, y possédant son siège social, ou contrôlée directement ou indirectement par des nationaux

the France-Singapore IIA; see with regard to Italy: Art. II. 3. of the Italy-Philippines IIA; Art. 1 2. b) of the Italy-Venezuela IIA.

11 See Art. 1 3. b) of the Portugal-Mexico IIA or Art. 1 3. b) of the Portugal-Turkey IIA to name but a few.

12 See Art. 1 4. (b) of the Germany-Kenya.

13 See Art. 1 2. of the France-Croatia IIA; Art. 1 2. b) of the France-Malaysia IIA or Art. 1 3. of the France-Ukraine IIA.

14 With regard to the situation under German law, see the following chapter as regards the impact of the new German law on the interpretation of German IIAs.

15 With regard to the Netherlands, see Art. 1 b) ii) of the Netherlands-Georgia IIA; Art. 1 b) ii) of the Netherlands-Romania IIA; Art. 1 b) ii) of the Netherlands-Vietnam IIA. With regard to Portugal, see: Art. I. 1 I) b) of the Portugal-Brazil IIA; Art.1 3. b) of the Portugal-Turkey IIA. With regard to Spain, see: Art. I 1. b) of the Spain-Columbia IIA; Art. 1 2. b) of the Spain-Syria IIA. With regard to the United Kingdom, see: Art. 1 (1) (d) (i) of the UK-China IIA; Art. 1 (d) (ii) of the UK-Russia IIA; Art. 1 (d) (i) of the UK-United Arab Emirates IIA.

> de l'une des Parties contractantes, ou par des personnes morales possédant leur siège social sur le territoire de l'une des Parties contractantes et constituées conformément à la législation de celle-ci, telles que des sociétés par actions, des entreprises, des coopératives, des sociétés de capitaux, des sociétés de personnes, des offices, des établissements, des fonds, des organisations, des associations commerciales et autres entités similaires, qu'elles soient à responsabilité limitée ou non[16];

Other countries that selectively use this criterion include Finland[17], the Netherlands[18], and Sweden[19]. In so doing, these countries frequently use the control criterion to broaden the definition of the term "investor" to include juridical persons that are established in the host state or in a third country, but controlled by an investor from the home state.[20]

d) *Reference to the law of the home state*

Finally, a fourth approach that simply refers to the laws of the home state can be found in the most recent IIAs entered into by the U.S. The key term necessary for a determination of the nationality of a juridical person, namely, "*enterprise of a party"* is defined in Art. 1 of the U.S.-Uruguayan IIA:

> "enterprise of a Party" means an enterprise constituted or organized under the law of a Party, and a branch located in the territory of a Party and carrying out business activities there.

This approach leaves it to the discretion of the home state to define which judicial persons should or should not enjoy protection. This approach has also been adopted in the multilateral Energy Charter Treaty, which might be due to the fact that it would have become too complicated and impracticable to list a separate definition for each member state.

2. *Natural Persons*

The definition of the very term varies from one IIA to the other with terms such as *natural persons,*[21] *nationals,*[22] *physical persons*[23] *or citizens*[24] being most frequently used. Art. I 2. (a) of the Swedish-Philippine IIA for instance reads:

16 France-Saudia Arabia IIA.

17 Finnish IIAs tend to cite an *(predominating) interest*; see Art. 1 3. a) of the Finland-Egypt IIA or Art. 1 (1) c) (ii) of the Finland-Lithuania IIA with Lithuania.

18 The criterion in Dutch IIAs is worded as *controlled directly or indirectly by natural or legal persons*; see Art. 1 (b) (iii) of the Netherlands-Brazil IIA or Art. 1 (b) (iii) of the Netherlands-Ethiopia IIA.

19 Stipulations in Swedish IIAs randomly paraphrase the control criterion as either *predominant Swedish interest* as for instance in Art. 1 (3) (c) of the Sweden-Argentina IIA and Art. 1 (3) (a) of the Sweden-Egypt IIA with Egypt; *effectively controlled by natural or legal persons* as can be found in Art. 1 (2) (c) of the Sweden-South Africa IIA or – more precisely – if a company of a contracting party holds *at least 51% of the equity interest or voting rights in respect of shares owned by* any third-party country as set forth in Art.1 (d) of the Sweden-India IIA.

20 See Art. 1 (2) c) of the Austria-South Africa IIA.

21 See Art. 1 2. a) of the Ireland-Czech Republic IIA.

(...)
2. The term "investor" shall mean:
(a) natural persons, who with respect to the Republic of the Philippines, are citizens of the Philippines within the meaning of its Constitution, and with respect to the Kingdom of Sweden, natural persons who are citizens of Sweden within the meaning of its laws;

The mechanism most commonly used in IIAs to define the term "natural persons" is citizenship according to the national law of each contracting party or somewhat less frequently, the residence of the investor in question. Both criteria are used either alone or in combination.

Under the Energy Charter Treaty, the terms "citizenship", "nationality" or a "permanent residence" in the territory of the contracting party are all deemed to fall within the scope of the definition of a natural person as investor.[25]

III. The Definition of Investors under German IIAs

The IIAs entered into by Germany do not use the same criteria for determining German investors abroad and foreign investors in Germany. One therefore needs to differentiate between both groups of investors and to further differentiate between juridical persons and national persons within these groups.

1. The definition of German investors abroad under German IIAs

a) Juridical Persons

As recently as 28 October 2008, legislative changes in Germany have caused the seat theory to be supplanted by the incorporation theory with regard to the legal existence of juridical persons under German law.[26] These reforms resulted in the German Model IIA 2009 being modified to accommodate this change. Therefore, future German IIAs will most probably define the term investor with regard to German companies differently to that in existing IIAs.

22 See Art. 1 1. (b) (i) of the USA-Egypt IIA.

23 See Art. 1 (3) of the Japan-China IIA.

24 See Art. 1 of the New Zealand-Chile IIA.

25 See Art. 1 (7) of the Concluding Document of the Hague Conference on the European Energy Charter (Energy Charter Treaty) of 17 December 1994, available at: <http://www.encharter.org/fileadmin/user_upload/document/EN.pdf#page=211> (accessed on 25 March 2011).

26 The legislative changes and their possible consequences for the interpretation of German IIAs are addressed in greater detail in the following section.

(1) The definition of German investors in existing IIAs

(a) The three criteria in German IIAs

All existing German IIAs predominantly use the place of seat for determining the nationality of German juridical persons. An example is Art. 1 2. of the German-Chinese IIA of 2003:

> (…) the term "investor" means
> (a) in respect of the Federal Republic of Germany:
> (…)
> any juridical person as well as any commercial or other company or association with or without legal personality having its seat in the territory of the Federal Republic of Germany, irrespective of whether or not its activities are directed at profit; (…).

What is striking in this respect, however, is that a number of German IIAs[27] do not limit the determination of nationality to the seat, but also require compliance with other criteria, including, in particular, the place of incorporation. In contrast to the above excerpt taken from the German-Chinese IIA, Art. 1 4. of the German-Mexican IIA reads as follows:

> The term "companies" refers to any juridical person, as well as any other commercial companies or other companies or associations, constituted or organised under the applicable law of a Contracting State whether or not for profit, whose territorial seat is located in the territory of any of the Contracting States.

In addition, the German-Egyptian IIA, features a unique prerequisite requiring a *"substantial interest in the company"* by nationals of either contracting party. This is the only German IIA which contains elements of a effective control mechanism, albeit using inexplicit language.

(b) Further elements for the definition of German investors

The extracts taken from the German-Chinese and the German-Mexican IIAs reveal that various German IIAs contain further criteria as regards the definition of German investors.

Firstly, a multitude of German IIAs clarify the fact that the aforementioned criteria constitute an investor regardless of whether or not the investor possesses legal personality, is profit orientated or has limited liability.[28] Hence, these criteria neither narrow nor broaden the definition of the term investor but merely serve to clarify its interpretation.

[27] Art. 1 4. of the Germany-Algeria IIA, Art 1 3. b) of the Germany-Brazil IIA, Art 1 1. b) of the Germany-Lebanon IIA, Art. 1 4. of the Germany-Mexico IIA, Art. 1 3. b) of the Germany-Thailand IIA, Art. 1 3. b) II. of the Germany-Saudi Arabia IIA.

[28] Profit motivation and legal personality are set forth in 118 and 117 German IIAs respectively (see Art. 1 3. a) of the Germany-Afghanistan IIA or Art. 1 4. a) of the Germany-Lithuania IIA, containing both criteria), whereas limited liability and lawful existence account for 41 and 38 each (see Art 1 4. a) of the Germany-Mauritania IIA or Art. 1 4. b) of the Germany-Portugal IIA.

Secondly, several IIAs require the lawful existence of the respective company. While it is debatable whether this narrows the scope of the treaty or merely serves to clarify the meaning of terms such as seat and place of incorporation, it nevertheless explicitly links the protection of the IIA to compliance with the local laws of the home state.

Those further criteria usually follow a predictable pattern. Profit orientation and legal personality are almost without exception combined criteria and stand alone with the core seat criterion[29], while legal liability and lawful existence again are invariably interlinked and constitute the fourth and fifth criteria whenever they are stipulated in IIAs[30].

A further notable requirement is set down in the IIAs between Germany and both the former Soviet Union (1989) and former Czechoslovakia (1990) respectively. A clause in these treaties requires that German companies are authorised to generally make investments in those countries. It is doubtful, however, whether this criterion has any continuing significance today.

(2) The definition of German investors in the new Model IIA

To date, there is not a single German IIA that defines the investor's nationality solely on the basis of its place of incorporation (*Gründungstheorie*). This is poised to change, however, with the conclusion of future treaties based on the new Model IIA 2009 which adopts the place of incorporation as the key criterion in line with the recently enacted Act Modernising the Law Concerning the GmbH and Combating Abuses (*Gesetz zur Modernisierung des GmbH-Rechts und zur Bekämpfung von Missbräuchen*, MoMiG) in which the seat theory is supplanted by the incorporation theory in German company law. Art. 1 3. b) of the German Model IIA 2009 provides:

> The term "investor" means
> (a) in respect of the Federal Republic of Germany:
> (....)
> any juridical person and any commercial or other company or association with or without legal personality which is founded pursuant to the law of the Federal Republic of Germany or the law of a Member State of the European Union or the European Economic Area and is organized pursuant to the law of the Federal Republic of Germany, registered in a public register in the Federal Republic of Germany or enjoys freedom of establishment as an agency or permanent establishment in Germany pursuant to Articles 43 and 48 of the EC Treaty;

As regards the seat theory being supplanted by the incorporation theory, it is also worth noting that the German Model IIA 2009 covers not only German investors but

29 See Art. 1 1. a) of the Germany-Angola IIA, Art. 1 3 b) of the Germany-Macedonia IIA, Art. 1 4. of the Germany-Paraguay IIA or Art. 1 (3) a) 2 of the Germany-Serbia IIA.

30 See Art. 8 (4) of the Germany-Greece IIA, Art. 1 3. c) of the Germany-Hungary IIA or Art. 1 (4) (a) of the Germany-Malaysia IIA.

also investors incorporated under the laws of other Member States of the EU or the European Economic Area (EEA) that fulfil one of the aforementioned criteria.

b) Natural Persons

For the purpose of determining natural persons as investors, almost all German IIAs refer to the definition provided for in Art. 116 of the German Basic Law. The German IIAs with Bulgaria, Hungary, Romania, and the former Socialist Federal Republic of Yugoslavia nonetheless contain notable exceptions, namely, the sole requirement that German citizens have a permanent place of residence in the area covered by the IIA. The German IIAs with the former Czechoslovakia, the former Soviet Union and Poland in contrast define a German investor as "*an individual having a permanent place of residence in the respective area covered by this agreement*", again without making reference to Art. 116 of the German Basic Law.

The German Model IIA 2009 further amends this passage by including nationals of a Member State of the European Union or of the European Economic Area who are established in Germany pursuant to Art. 43 ECT.

2. The definition of foreign investors in Germany under German IIAs

a) Juridical Persons

(1) The three criteria with regard to foreign investors in Germany

It is worth noting that the application of the key defining criteria – seat and place of incorporation – is much more diversified as regards the determination of foreign investors in German IIAs.

This is hardly surprising having regard to the dualism between the seat theory – which is prevalent in large parts of Continental Europe, above all in France and Germany and the successor states of their former colonies – and incorporation theory which is prevalent in the United Kingdom and the successor states of its former colonies. The incorporation theory was adopted and espoused by the United Kingdom in the 18th century as overseas trading companies rose to prominence with the Her Majesty's Treasury seeking to keep them under the control of the British Empire.[31] The colonial activities, particularly in relation to overseas trade, of France and Germany, did not however necessitate similar measures. Consequently, the seat theory remained the decisive criterion in those countries and their former colonies over the centuries.

As a result, the use of these two core criteria either alone or in combination is significantly more balanced compared to the definition of German investors abroad (see *supra* B.III.1) as the isolated application of the place of seat and place of

[31] *Grossfeld*, in: Hefermehl/Gmür/Brox (eds.), Festschrift für Harry Westermann, 199 (202 *et seqq.*).

incorporation in each case is stipulated in 51 IIAs[32] and 42 IIAs[33] respectively, while the combination of these criteria is stated in 33 IIAs[34].

The control criterion one again plays a less significant role. The nationality of the shareholders or companies who control an entity investing in Germany is used in 9 IIAs[35]. In addition, an effective economic activity in the country of origin is stipulated in 3 IIAs[36].

(2) Further criteria used in the definition of the term foreign investors in Germany

Definitions of foreign investors in Germany depend less on clarifications regarding the necessity of legal personality, profit motivation and limitation of liability than in the case of the designation of German investors abroad. Profit motivation on behalf of the foreign investor is cited in 50 IIAs compared to 118 citations in definitions of German investors abroad. Citations of legal personality amount to 40 to 117 respectively, while notations of limitation of liability account for 23 and 41 citations respectively. In contrast to the German definitions, however, some definitions of the foreign investor require legal personality[37] or profit motivation[38] as a definitive prerequisite and not purely for clarification purposes. Accordingly, these definitions, to some extent, narrow the scope of the treaty.

32 IIAs between Germany and Afghanistan, Albania, Argentina, Azerbaijan, Belarus, Benin, Botswana, Brazil, Bulgaria, Burundi, Cap Verde, Croatia, the former Czechoslovakia, Egypt, Estonia, Ethiopia, the former Soviet Union, Georgia, Greece, Guinea, Hungary, Iran, Israel, Kazakhstan, Kenya, Latvia, Libya, Lithuania, Macedonia, Malta, Mauretania, Mozambique, Niger, Oman, the Palestinian National Authority, Panama, Papua New Guinea, Peru, Poland, Portugal, Rwanda, Slovakia, Slovenia, South Africa, Syria, Tunisia, Turkey, Uganda, Ukraine, Uruguay and Venezuela.

33 IIAs between Germany and Angola, Antigua & Barbuda, Bolivia, Brunei, Burkina Faso, Cambodia, Central African Republic, Chad, China, Cuba, Democratic Republic of the Congo, Dominica, Ecuador, the former Socialist Federal Republic of Yugoslavia, Gabon, Ghana, Guyana, Honduras, Hong Kong, India, Indonesia, Jamaica, Jordan, Korea, Kyrgyzstan, Madagascar, Malaysia, Mali, Mauritius, Nepal, Pakistan, Qatar, St. Lucia, St. Vincent and the Grenadines, Serbia, Singapore, Sri Lanka, Tanzania, Timor-Leste, Togo, Trinidad & Tobago, Uzbekistan and Germany.

34 IIAs between Algeria, Armenia, Bahrain, Bangladesh, Barbados, Bosnia Herzegovina, Chile, Costa Rica, Cote d'Ivoire, El Salvador, Guatemala, Haiti, Kuwait, Laos, Lebanon, Mexico, Moldova, Mongolia, Morocco, Namibia, Nicaragua, Nigeria, Paraguay, Philippines, Sierra Leone, Sudan, Swaziland, Thailand, Turkmenistan, United Arab Emirates, Vietnam, Zambia and Zimbabwe.

35 See, for example, Art. 1 3. b) ii) of the Germany-Antigua and Barbuda IIA, Art. 1 5. a) of the Germany-Brunei IIA as well as the respective provisions in the IIAs between Germany and Egypt, Israel, Namibia, Niger, Qatar, Zambia and Chad.

36 See Art. 1 3. b) ii) of the Germany-El Salvador IIA, Art. 8 (4) (b) of the Germany-Malta IIA and, in addition, Art. 1 3. (a) of the Germany-Philippines IIA.

37 See Art. 1 4. b) of the Germany-Armenia IIA, Art. 1 4. a) of the Germany-Mali IIA and finally Art. 1 4. b) of the Germany-Turkmenistan IIA.

38 See Art. 8 (4) b) of the Germany-Niger IIA, Art. 8 4) b) of the Germany-Senegal IIA and, in addition, Art. 8 (4) b) of the Germany-Togo IIA.

Lawful existence or incorporation is stipulated in a large number of IIAs (55)[39] with a couple of states[40] among them designating this criterion as their only mechanism to define the term investor.

b) *Natural persons*

Similar to the qualification of natural persons as German investors (see *supra* B.III.1.b)), the vast majority of provisions on the determination of natural persons as foreign investors refer to constitutional law or the applicable nationality law of the respective contracting state.[41] Art. 1 of the IIA between Guyana and Germany reads:

> (…)
> 3. the term nationals means
> (…)
> (b) In respect of the Co-operative Republic of Guyana: citizens of Guyana who are properly accorded that status under the provisions of the Constitution of the Co-operative Republic of Guyana and the Guyana Citizenship Act, Chapter 14:01 of the Laws of Guyana;

Anomalies are apparent in the relevant paragraphs of the Bosnia and Herzegovinian, Hungarian, and Israeli-German IIAs with all stipulating residence[42] or main place of business[43] as an additional prerequisite to the mere nationality criterion.

IIAs concluded by Poland[44], the former Czechoslovakia[45] and the former Soviet Union[46], in contrast, exhibit a very broad approach to the definition of the term natural person as an investor by allowing every resident of the respective contracting state to initiate legal action under their IIA.

Further the Germany-Hong Kong IIA treats natural persons as investors who have the right of abode in the territory of Hong Kong[47] while the IIA between the Palestinian National Authority and Germany contains an unusual clause stipulating the right of abode and the right to vote as joint criteria[48]. Furthermore, nationals of Belarus must additionally hold an authorization to make an investment.[49]

39 See, for example, Art. 1 2. (b) of the Germany-China IIA, Art. 8 (4) a) of the Germany-Democratic Republic of the Congo IIA or Art. 1 4. of the Germany-Mexico IIA.

40 See Art. 1 4. (b) of the Germany-Lesotho IIA, Art. 8 (4) b) of the Germany-Liberia IIA, Art. 1 3. b) of the Germany-Tajikistan IIA and, in addition, Art. 8 (4) b) of the Germany-Yemen IIA.

41 See only Art. 1 (3) (b) of the Germany-Singapore IIA or Art. 8 (3) b) of the Germany-Turkey IIA. A highly unusual stipulation can be found in Art. 8 3. (b) of the Germany-Tanzania IIA with Germany requiring natural persons to be "*certified as Nationals by the Minister for the time being responsible for citizenship*".

42 See Art. 1 3. b) of the Germany-Hungary IIA and Art. 1 (3) (b) of the Germany-Israel IIA.

43 Art. 1 3. b) of the Germany-Bosnia Herzegovina IIA.

44 See Art. 1 (1) c) of the Germany-Poland IIA.

45 See Art. 1 3. of the Germany-former Czechoslovakian Republic IIA.

46 See Art. 1 (1) c) of the Germany-former USSR IIA.

47 See Art. 1 4. b) of the Germany-Hong Kong IIA.

48 See Art. 1 3. a) of the Germany-Palestinian National Authority IIA.

49 See Art. 1 3. b) of the Germany-Belarus IIA.

3. *The interpretation of the term investor in German IIAs by arbitral tribunals*

The question whether a natural or juridical person qualifies as an investor under the relevant German IIA has been dealt with in two published arbitral proceedings. Both decisions involve the issue of the standing of shareholders who control an entity incorporated either in a state other than the home state (*Sedelmayer v. Russian Federation*) or in the host state (*Siemens v. Argentina*).

a) *Sedelmayer v. Russian Federation (Germany-Union of the Soviet Socialist Republics IIA)*

In *Sedelmayer v. Russian Federation*[50] the claimant, a German citizen, was the sole shareholder of *SGC*, a company incorporated in Missouri, USA for tax reasons. Through bespoke company Mr. *Sedelmayer* invested in the common stock of a joint stock company which was founded with a Russian company to trade in police equipment for local law enforcement authorities and establish its business in the private security industry.

The arbitral tribunal ruled against the Russian Federation's argument denying Mr *Sedelmayer's ius standi* on the grounds that *SGC* had to be deemed an American company devoid of any right to lodge a claim under the German-Soviet IIA which refers to the seat criterion as far as juridical persons are concerned.[51] In line with a series of arbitral awards[52] since the ICJ case concerning *Elettronica Sicula S.p.A.*[53] the tribunal pierced the corporate veil by examining which entity has de facto control of the vehicle through which the investment is made.[54] In the light of the key objective of the IIA – promoting investment in the two countries – the arbitral tribunal deemed the application of the control theory as reasonable. While Art. 1 (1) c) of the German-Soviet IIA lacks any reference to the control theory, with both two contracting states rarely stipulating this criterion in their respective IIAs, the tribunal held that a statement in the Protocol attached to the main body of the treaty provides for compensation to an investor if the other contracting party interferes with the economic activities of an enterprise in which he is participating. Therefore, Mr. *Sedelmayer*, as a German resident, was held to be a de facto investor entitled to seek protection of his investments under the German-Soviet IIA.

[50] *Franz Sedelmayer v. Russian Federation*, Arbitration in Stockholm, Arbitration Award of 7 July 1998.

[51] See Art. 1 (1) c) of the Germany-USSR IIA.

[52] See only *Amco Asia Corp. v. Republic of Indonesia*, ICSID Case No. ARB/81/1, Decision on Jurisdiction of 25 September 1983; *Tokios Tokelės v. Ukraine*, ICSID Case NO. ARB/02/18, Decision on Jurisdiction of 29 April 2004; *Waste Management, Inc. v. United Mexican States*, ICSID Case No. ARB (AF)/00/3, Final Award of 30 April 2004. In all three cases the chain of entities consisted of even further links with each arbitral tribunal stopping the examination and granting jurisdiction as soon as one entity fulfilled the requisite nationality criteria under the relevant IIA.

[53] ICJ, *Elettronica Sicula S.p.A.* (also known as *ELSI*) (USA v. Italy), ICJ Report 1989, 15.

[54] *Franz Sedelmayer v. Russian Federation*, Arbitration in Stockholm, Arbitration Award of 7 July 1998, 27.

b) Siemens v. Argentina (Germany-Argentina IIA)

In *Siemens v. Argentina*[55], the respondent objected to the arbitral tribunal having jurisdiction to hear the case arguing that investments were carried out by a local corporation, *Siemens IT Services S.A.* ("*SITS*") and therefore lacking a direct relationship between the investor and the investment under application of the seat criterion. The tender regulations, however, required that a local company had to be established for the purpose of the bid and subsequent investments. *SITS* itself was incorporated by the claimant's wholly-owned affiliate *Siemens Nixdorf Informationssysteme AG* ("*SNI*"). After the contract to establish a system for migration control and personal identification had been won by *SITS*, a new government came to power and suspended the contract which in turn enticed the claimant to resort to investment protection under the German-Argentine IIA.

Similar to the *Sedelmayer* case, the tribunal held that indirect claims through another corporation possessing a nationality that would not entitle the claimant to advance proceedings are not limited by the effective seat criterion as set forth in Art. 1 4. of the German-Argentine IIA.[56] Consequently, the arbitral tribunal pierced the corporate façade of to attribute *ius standi* to *Siemens* as the sole shareholder of *SIN* and hence in effective control of *SITS*. The tribunal also construed the IIA in question in such manner that the stipulated seat criterion could not exclude the additional recourse to the control criterion, in particular in the light of the protocol to Art. 4 which enables claims of investors who own shares of a local corporation which suffer damage as a result of state measures.[57]

Both decisions upheld the approach (*i.e.* to pierce the corporate veil when an investment is made through a chain of entities) that is regularly applied by arbitral tribunals also with regard to non-German IIAs.

[55] *Siemens A.G. v. The Argentine Republic*, ICSID Case No. ARB/02/8, Decision on Jurisdiction of 3 August 2004.

[56] *Ibid.*, para. 137 *et seqq.*

[57] *Ibid.*, para. 140.

C. Impact of MoMiG on "Sitztheorie" / "Gründungstheorie" – Consequences for German BITs

Marie Louise Seelig
Anke Sessler
Hartmut Paulsen

I. Introduction

The following paper addresses the potential impact of recent legislative changes to German corporation law resulting from the entry into force of the Act to Modernise the Law Governing Private Limited Companies and to Combat Abuses (*Gesetz zur Modernisierung des GmbH Rechts und zur Bekämpfung des Missbrauchs* or "MoMiG") on German investor protection under German bilateral investment treaties ("BITs"). In particular, the authors analyze the way that the shift from Seat Theory (*Sitztheorie*) to Incorporation Theory (*Gründungstheorie*) as effectuated by MoMiG might impact German investor protection under German BITs, which until now extended protection only to corporate investors having their "seat" in Germany. Thus, the relevant criterion to determine a corporate investor's nationality under a German BIT has been the prerequisite "German seat".

To introduce the topic, the authors briefly explain the background of MoMiG and the transition from Seat Theory to Incorporation Theory (C.II). Next, in order to determine whether MoMiG impacts investor protection, the authors first analyze the pre-MoMiG protection of corporate investors under German BITs (C.III). Then, the authors make an initial assessment whether and in what way MoMiG might impact corporate investor protection if the corporate investor, in accordance with MoMiG, decides to move its administrative seat abroad (C.IV). Finally, the authors address specific transition issues, which might have an impact on corporate investor protection under German BITs.

In brief conclusion, the authors argue that the current German BITs, which still define investor nationality by the criterion "German seat", should be interpreted in accordance with the new developments effectuated by MoMiG. The criterion "German seat" should be interpreted as also meaning "statutory seat", thereby extending BIT protection to corporate investors who have moved their administrative seat abroad. However, until this proposed interpretation has been confirmed by international arbitral decisions, there exists some legal uncertainty as to whether a German corporate investor who moves its administrative seat abroad still enjoys protection under a German BIT. Thus, the authors recommend that a corporate investor, before making such a decision, should carefully assess the risks of such a move, including by evaluating the standard of protection it possibly might enjoy under the BITs of the country to which it plans to move its administrative seat.

II. Brief Introduction to MoMiG and the Transition from Seat Theory (*Sitztheorie*) to Incorporation Theory (*Gründungstheorie*)

When enacting MoMiG, the German federal legislature sought, among other goals, to allow a German corporation to move its administrative seat (*Verwaltungssitz*) abroad. The legislative purpose was to allow for more flexibility and increase competition between different jurisdictions. The German federal legislature thus responded to several European Court of Justice ("ECJ") decisions calling for European Union Members, including Germany, to show greater flexibility in the recognition of European corporations.[58] This would ensure compliance with the EU principle of freedom of establishment.

Before November 1, 2008, the date on which MoMiG entered into force, German corporation law was comparatively strict. It required that a German limited liability company (*Gesellschaft mit beschränkter Haftung* or "GmbH") or a stock corporation have its administrative seat (*Verwaltungssitz*) in Germany pursuant to § 4 a para. 2 old German Limited Liability Company Law (*Gesetz betreffend die Gesellschaften mit beschränker Haftung* or "GmbHG") and § 5 para. 2 old Stock Corporation Act (*Aktiengesetz* or "AktG") if it were to be recognized as a juridical person under the German Corporation law.[59] When enacting MoMiG, the German federal legislature struck out § 4 a para. 2 old Limited Liability Company Act and § 5 para. 2 Stock Corporation Act. Both of these provisions required that a corporation's seat generally should be at the place where the corporation had its main place of business or where the managing board of the administration was located.[60] Under MoMiG, the German federal legislature today allows a German corporation to choose an administrative seat which differs from the seat of incorporation (*Satzungssitz*). However, MoMiG now provides that the *Satzungssitz*, not the *Verwaltungssitz*, must be located within Germany, as set forth in the newly revised § 4 a GmbHG and § 5 AktG.

This legislative development has been characterized as a transition from the so-called *Sitztheorie* ("Seat Theory") to the *Gründungstheorie* ("Incorporation Theory").[61] Pursuant to the Seat Theory, the relevant criterion to determine a corporation's nationality is the administrative seat of its principle place of business. According to the Incorporation Theory, the relevant criterion for determining a corporation's nationality and thus the applicable law is the seat of incorporation, which can differ from the administrative seat.

[58] For a detailed analysis of the European Court of Justice's decisions *Centros*, *Überseering*, *Inspire Art*, *Cartesio*, etc., see *Franz/Laeger*, BB 2008, 678 *et seqq.*

[59] For purposes of this paper, the term "Corporation Law" shall mean AktG and GmbHG jointly. For further details, see *Preuß*, GmbHR 98 (2007), 57 (59).

[60] Translation of convenience. § 4 para. 2 old GmbHG provides: "*Als Sitz der Gesellschaft hat der Gesellschaftsvertrag in der Regel den Ort, an dem die Gesellschaft einen Betrieb hat, oder den Ort zu bestimmen, an dem sich die Geschäftsleitung befindet oder die Verwaltung geführt wird*".

[61] As a matter of dogma, one should differentiate first between the conflicts of law that determines the applicable substantive law either by reference to the Seat Theory or Incorporation Theory and, second, once the substantive law has been determined, the principles governing the substantive Corporation Law. The Corporation Law itself then reflects either the Seat Theory or the Incorporation Theory. With respect to this differentiation, see *Franz/Laeger*, BB 2008, 678 (682).

Historically, under German Corporation Law, which followed the Seat Theory, if a GmbH moved its administrative seat outside of Germany, it would be deemed liquidated and thus no longer in existence. The reason was that the main prerequisite for determining the company's existence under German law, a German administrative seat or principle place of business, was no longer met.

By allowing German corporations to move their administrative seat or principal place of business abroad without losing their existence as a German corporation, the German federal legislature made it clear that the relevant criterion in order to determine the corporation's nationality is no longer the administrative seat or principle place of business, but its "statutory seat" (*Satzungssitz*).

However, this legislative transition from Seat Theory to Incorporation Theory relates only to German corporations such as the GmbH and the AG. MoMiG does not apply to other forms of companies, such as partnerships (*Personengesellschaften*), *e.g.*, general partnerships (*offene Handelsgesellschaften* or "OHG") or private limited partnerships (*Kommanditgesellschaften* or "KG").[62] Consequently, for the moment it remains unclear whether the shift from Seat Theory to Incorporation Theory as effectuated by MoMiG will have a particularly far-reaching effect. Hopefully this question will be clarified once the German Federal Ministry of Justice's draft providing for an amendment to the Introductory Code to the German Civil Code ("Einführungsgesetz zum Bürgerlichen Gesetzbuch" or "EGBGB") is enacted. Art. 10 of the draft amendment to the EGBGB would codify Incorporation Theory by providing that companies, associations and juridical persons will be governed by the law under which they are registered or organized.[63]

Consequently, this paper will mainly address the impact of MoMiG on the protection of German corporate investors under German BITs in light of the new possibility to move the administrative seat or the principal place of business of a corporation (*Kapitalgesellschaft*) abroad. In doing so, the authors will first turn to the question of how investor nationality under German BITs was determined under the "old" law, *i.e.* pre-MoMiG. Secondly, the authors will then analyze how investor nationality under German BITs will be determined according to the "new" law, *i.e.* post-MoMiG. This analysis will prepare the ground for the following part of the paper, in which the authors will address the transition issues which the legislative change might cause with respect to investor protection under German BITs.

III. Previous Legal Situation: Determination of the Nationality of the Investor Under German BITs According to the "Old" Corporation Law

In order to enjoy protection under a German BIT a corporate investor must fall under the scope of protection of the BIT. Generally, the applicable law governing the scope of investor protection under German BITs is the BIT itself and public international law.

[62] *Fingerhut/Rumpf*, IPRax 2008, 90 (92).

[63] For further details, see *Rotheimer*, NZG 5 (2008), 181 *et seqq.*

The old 2005 German Model BIT and most other German BITs[64] provide that corporate investors which have their seat in Germany enjoy protection under the German BIT. Art. 1 No. 3 (a) 2005 German Model BIT expressly states:

> "The term 'investor' means in respect of the Federal Republic of Germany […] any juridical person as well as any commercial or other company or association with or without the legal personality having its seat in the territory of the Federal Republic of Germany, irrespective of whether or not its activities are directed at profit."[65]

Thus, it appears that pursuant to the 2005 German Model BIT, which reflects the wording of most other German BITs, the relevant criterion to determine the investor's nationality is whether the investor has its seat in Germany. Yet what is meant by the criterion "seat"? Art. 1 No. 3 (a) and the other provisions of the 2005 German Model BIT do not further define this criterion. The reference to the prerequisite of a German "seat" is unclear in itself inasmuch as the term "seat" within the context of corporations could mean "administrative seat" or "principal place of business" or "statutory seat" etc.

Thus, in order to determine under which circumstances a corporate investor having its "seat" in Germany enjoys protection under German BITs, we must turn to the applicable public international law. Public international law, however, does not generally determine the nationality of investors, but it refers us to the relevant national law, which either follows Seat Theory or Incorporation Theory.[66] The reason is that it is within the realm of each State's sovereignty to determine the nationality of its own investors. Besides, many German BITs provide more or less explicitly that German law should be applied in order to determine a corporate investor's nationality. *E.g.* the Germany-Costa Rica BIT provides that 'any juridical person [...] which has its seat within the territory of the Federal Republic of Germany and which exists according to the German laws' enjoys protection under the BIT.[67]

For this reason, we must turn to German Corporation Law to determine what is meant by "seat" and hence to determine the investor's nationality. The determination of the investor's nationality itself depends on whether the corporate investor is

[64] See *e.g.* the Germany-China IIA (2005), Germany-India IIA (1995), and the Germany-Greece IIA (1961).

[65] *Böckstiegel/Kröll/Nacimiento* (eds.), Arbitration in Germany, The Model Law in Practice 1173-1184, Annex V: German Model Treaty on the Encouragement and Reciprocal Protection of Investments (2005).

[66] Here, we are not addressing the issue of conflicts of law, *i.e.* situations where an investor could enjoy IIA protection under the laws of several jurisdictions. Furthermore, we are not addressing the issue whether elements other than domestic law requirements must be met when determining an investor's nationality, *e.g.*, the issue of piercing the corporate veil, control issues etc. We understand that those issues are also addressed in other papers in this group. For further details regarding the applicable law governing determination of nationality and these issues see *Acconci*, JWIT 5 (2004), 139 *et seqq.*

[67] English translation of convenience. The original German text provides: „jede juristische Person [...], die ihren Sitz im Hoheitsgebiet der Bundesrepublik Deutschland hat und gemäß den deutschen Rechtsvorschriften besteht," See *e.g.* Art. 1 4. a of the Germany-Costa Rica IIA similarly see also *e.g.* Art. 8 4 a of the Germany-Yemen IIA, see *e.g.* Art. 8 4 a of the Germany-Bangladesh IIA.

recognized as a legal entity within the meaning of the BIT. This is related to the question of whether the corporation has its "seat" in Germany.

As explained above, pursuant to the old German Corporation law a corporation enjoyed the rights and obligations as a juridical person in Germany only if it was incorporated in Germany and had its administrative seat or principle place of business in Germany. Thus, in order to determine the corporate investor's nationality under old German Corporation Law, it has been argued that two criteria had to be met: first, the corporate investor had to be incorporated in Germany with its statutory seat in Germany and, second, it had to have its administrative seat or principal place of business in Germany.[68]

Alternatively, pursuant to German case law it is also possible that a foreign corporation which is incorporated neither in Germany nor in the EU, but which has its administrative seat in Germany, is recognized as a partnership (*Personengesellschaft*) under German law and is thus deemed to have the capacity to sue and be sued.[69] Thus, it is conceivable that under German corporate law, a corporation whose statutory seat is not in Germany but which has its administrative seat there still enjoys protection under the German BIT as a mere partnership (*Personengesellschaft*), *i.e.* solely on the grounds of having its administrative seat in Germany.[70] In summary, pursuant to the old German Corporation Law the term "seat" in the sense of the German BITs appeared to refer at least to the administrative seat or the principal place of business. Thus, in order to enjoy protection under the 2005 German Model BIT and older BITs, a corporate investor must have at least its administrative seat or principal place of business in Germany. Consequently, if a corporate investor moves its administrative seat or its principal place of business to a different country it no longer enjoys protection under the BIT in accordance with the old Corporation Law.

IV. Novel Legal Situation: Determination of the Nationality of the Investor Under German BITs According to the "New" Corporation Law

As already explained above, under the new Corporation Law, which reflects the MoMiG changes, a German corporation no longer needs to have both its statutory seat and its administrative seat or principal place of business within Germany. Pursuant to the new Corporation Law, a German corporation may now move its administrative seat abroad without any impact on its legal status as a German corporation under German Corporation Law.

68 *Karl*, ICSID Review – FILJ 11 (1996), 1 (8).

69 See German case law regarding the *eingeschränkte Sitztheorie* (limited seat theory) in *Behme*, BB 2008, 70 (70).

70 See here the recent BGH decision "*Trabrennbahn*". Here, the BGH qualified a *Swiss AG*, which had its administrative seat in Germany, as a German partnership (*Personengesellschaft*) with unlimited liability. It remains to be seen whether this is a stand-alone decision or whether the BGH will also recognize other foreign companies from non-EU countries, which are not incorporated in Germany but which have their administrative seat in Germany, as German partnerships (*Personengesellschaften*). BGH, NJW 2009, 289 *et seqq.*

The question arises whether this new flexibility has any impact on the BIT protection of German corporations. As stated above, the 2005 Model BIT and most of the other German BITs define the investor's nationality by relying on the criterion "German seat." The question is whether the German investor would lose protection under the BIT if it moved its "administrative seat" abroad.

1. *Two alternative answers to this question are conceivable:*

a) *First Alternative: A corporation which moves its administrative seat outside of Germany no longer enjoys protection under the German BIT*

On the one hand, one could argue that a corporate investor which moves its administrative seat outside of Germany no longer enjoys protection under the German BIT. It no longer meets the BIT requirement of having an "administrative seat" within Germany. In support of this conclusion, one could argue that at the time of the conclusion of the relevant German BIT, the investor's nationality was determined pursuant to the applicable German Corporation Law which was effective at that time. As explained above, under the old German Corporation Law an investor needed to have at least its administrative seat in Germany in order to enjoy BIT protection. Consequently, if the investor now moved its administrative seat abroad, it would no longer meet the prerequisite "German seat" and would thus no longer enjoy protection under the German BIT.

b) *Second Alternative: A corporation which moves its administrative seat outside of Germany still enjoys protection under the German BIT*

On the other hand, one could argue that a corporate investor which moves its administrative seat outside of Germany still enjoys protection under the German BIT for it still has its "statutory" seat within Germany, which suffices for general corporate law protection according to the new German Corporation Law.

The question is whether the term "seat" can also be interpreted as meaning the "statutory seat" as specified by the new Corporation Law. The issue would be whether we would have to turn to the old law which was effective at the time of the drafting of the law in order to specify the term "seat" or whether we can turn to the current Corporation Law which governs at the time the investor seeks protection under the BIT. Here, one could argue that the relevant time for determining the investor's nationality is the time when protection under the German BIT is invoked. The reason is that at the time the investor seeks protection under the German BIT, it must be within the scope of protection under the German BIT. It is an accepted principle in international law that the jurisdictional requirements, including the prerequisite that the corporate investor must fall within the scope of the BIT protection, must be met at the date when protection under the BIT is invoked, *i.e.* generally the date of commencement of the Arbitral Proceedings.[71] Consequently, the investor must be

[71] *Dolzer/Schreuer*, Principles, 41 *et seqq.*

recognized and protected as a German corporation at the time of the institution of the Arbitral Proceedings. This however can be determined only by referring to the law applicable at the time of the commencement of the arbitral proceedings, which would be the current Corporation Law if the proceedings were commenced today.

Hence, the applicable law determining the investor's nationality pursuant to the German BIT would be the new GmbHG and AktG as revised by MoMiG. Pursuant to the new Corporation Law, the requirement that the investor have its "seat" within Germany refers only to the statutory seat and not to the administrative seat. Consequently, a corporate investor that has its statutory seat within Germany but moves its administrative seat abroad would still have its "seat" in Germany. The term "seat" under the German BIT would need to be interpreted according to the new German Corporation Law meaning that the "seat" of a corporation could also mean the "statutory" seat rather than the "administrative" seat. Consequently, if one followed this interpretation a corporate investor would still enjoy protection under the German BIT if it only had its statutory seat in Germany.

2. Discussion and Conclusion

First, one could argue in favour of the first alternative, which denies protection to a corporate investor that moves its administrative seat outside of Germany, by referring to the historic understanding of the German nationality criterion "seat." Historically, as can be derived from most of the BITs currently effective, only the investor which had its administrative seat or principal place of business fell within the scope of protection under the German BIT. The term "seat" used in the 2005 German Model BIT reflects that Germany followed the Seat Theory in contrast to the Incorporation Theory, which requires that the German investor has its administrative seat in Germany.[72]

Second, one could argue that if the nationality of an investor should have been determined by referring to the investor's "statutory seat" or "seat of incorporation," the relevant BIT would have expressly provided so. This however, is not the case, since the most of the German BITs including the 2005 German model BIT refer only to the "seat" meaning the administrative or management seat.[73]

In contrast, the 2008 German Model BIT expressly defines the investor's nationality by referring to the Incorporation Theory: Art. 1.3. b) of the revised 2008 German Model BIT defines the term "investor" as any juridical person, commercial or other company or association […] which is organized or registered under German law:

> The term "investor" means
> "(a) in respect of the Federal Republic of Germany:
> (....)
> any juridical person and any commercial or other company or association with or without legal personality which is founded pursuant to the law of

[72] *McLachlan/Shoare/Weiniger*, International Investment Arbitration, para. 5.34.
[73] *Ibid.,* para 5.34.

> the Federal Republic of Germany or the law of a Member State of the European Union or the European Economic Area and is organized pursuant to the law of the Federal Republic of Germany, registered in a public register in the Federal Republic of Germany or enjoys freedom of establishment as an agency or permanent establishment in Germany pursuant to Articles 43 and 48 of the EC Treaty".

Consequently, since the 2008 German Model BIT effectuated a shift from Seat Theory to Incorporation Theory it can be argued by way of an *argumentum e contrario* that the term "seat" used in the 2005 German Model BIT cannot be interpreted in accordance with Incorporation Theory as referring to the "statutory seat". Otherwise the changes made in the 2008 German Model BIT would have been unnecessary.

Third, such a dynamic interpretation of the term "seat" pursuant to the Home State's currently applicable law could also lead to potential abuses: such interpretation would leave it in the Home State's discretion unilaterally to extend or broaden investor protection under the relevant BIT by merely changing its national legislation.

Fourth, another policy argument in favour of this strict interpretation of the term "seat" could be that it is the investor's choice whether to move its administrative seat abroad. If the investor decides to move its administrative seat abroad, it must also accept the negative consequences of a possible waiver of German BIT protection.

Thus, in view of these arguments, there exist certain viable and persuasive arguments which support the answer that corporate investors that move their administrative seat abroad no longer enjoy BIT protection under those German BITs which expressly provide that the investor must have its seat in Germany.

Nevertheless, we think that the more convincing arguments speak in favour of BIT protection, even if the investor moves its administrative seat abroad but keeps its statutory seat in Germany in accordance with MoMiG:

First, the term "seat" used in the 2005 German Model BIT and the older German BITs is unclear by itself and needs to be further defined by referring to the applicable domestic Corporation Law which is in force at the time of the request for arbitration. Thus, in order to determine whether an investor currently enjoys protection, we must turn to the new German Corporation Law, which expressly provides that a corporation need only have its statutory seat in Germany in order to enjoy corporate rights and obligations in Germany. This follows from the general principle in international law, as explained above, that the relevant time to determine the investor's nationality is the time when BIT protection is invoked and the applicable law, which must be turned to, must be the law which is in effect at the time the BIT protection is invoked. Consequently, one could argue that as of today it is irrelevant whether at the time of the conclusion of the BIT the term "seat" referred to the administrative seat, for this law is no longer applicable in Germany. The law which now governs the interpretation of the term defines "seat" as "statutory seat." Consequently, a corporation having its "statutory seat" in Germany should enjoy protection under the German BIT.

Second, public international law and domestic law is by nature transitory as evidenced for example by the enactment of MoMiG or the revision of the 2005 Model BIT through the 2008 Model BIT. Thus, treaties such as BITs need to be flexible and allow for new interpretations reflecting the currently applicable law. In particular, terms used in treaties such as the term "seat" can be interpreted only by turning to the applicable Corporation Law which further specifies the meaning of such criteria. Consequently, following this approach, the definition of the term "seat" as used in the 2005 German Model BIT and other German BITs is subject to a flexible interpretation in accordance with the current applicable law meaning that post MoMiG, the term "seat" used in old BITs also refers to the "statutory seat" of a corporation.

Third, while it is conceivable that such a flexible interpretation of the term "seat" would allow states unilaterally to broaden investor protection, Host States that disagree with such an interpretation might, as a last resort, terminate the BIT.

Fourth, also in light of the principle of unity of the legal order (*einheitliche Rechtsordnung*) the term "seat" must be interpreted in accordance with the new German Corporation Law, which requires that the corporation have its statutory seat in Germany in order to be recognized as a corporation. It would be inconsistent and contradictory and thus not in accordance with the principle of unity of the legal order if German Law on the one hand allowed corporations to transfer the administrative seat abroad, but on the other hand would deny those investors BIT treaty protection if they took advantage of such an option. Consequently, the shift from the Seat Theory to the Incorporation Theory should also be accounted for by interpreting German BITs with the goal to reconcile conflicting positions in light of the principle of unity of the legal order which calls for such a reconciliation.

In summary, as of today there exists no confirmation that corporate investors who move their administrative seat or principle place of business abroad would continue to enjoy protection under the old German BITs, which rely on the criterion "German seat" as the prerequisite for BIT protection. However, as stated above, the more convincing arguments speak in favour of investor protection under the old BITs, even if the investor only has its statutory seat within Germany. Consequently, if one follows this line of the argument, MoMiG allows German investors greater flexibility to move their administrative seat abroad, but at the same time the old BITs should be interpreted so that in addition an investor who still has its statutory seat in Germany should nevertheless enjoy BIT protection.

V. Several Issues Arising in Connection with the Transition as Effectuated by MoMiG:

In the following section, the authors address specific questions relating to investor protection under German BITs that might arise in connection with the transition from Seat Theory to Incorporation Theory as effectuated by MoMiG.

1. *Do Already Transacted Investments Lose Protection if the Corporate Investor Moves Its Administrative Seat Abroad?*

The first issue that might arise is whether a previously transacted investment would lose protection if the German corporate investor moved its administrative seat abroad in accordance with MoMiG. As explained above, unfortunately there currently exists no clear-cut answer to this question. The wording of the 2005 Model BIT and of the old BITs, under which an investor presumably would seek protection, suggests that only investors who have their "administrative seat" in Germany enjoy BIT protection. However, as has been pointed out above, it can be argued persuasively that the term "seat," which is used in the old BITs, should be interpreted in light of the revised German Corporation Law. Thus, German corporations may move their administrative seats abroad without losing their rights as a juridical person under German law and German BIT protection. In particular, this interpretation would be in line with the current applicable law and would contribute to the unity of the legal order. Furthermore, it would implement the purposes pursued by MoMiG: to increase flexibility of a German corporation by allowing it to move its administrative seat abroad without losing protection under German law.

However, until international law and international arbitral tribunal decisions provide guidance on whether this approach should be followed an investor should be aware that it is taking the risk of losing German BIT protection if it moves its administrative seat abroad. Thus, before making such a decision, an investor should carefully assess whether it would enjoy a similar protection in the country to which it plans to move its administrative seat.

Some of the criteria which the investor should take into account when making that decision should be: has the country to which it plans to move its administrative seat concluded BITs with the countries in which the investor has made investments and that might be the subject matter of an investment arbitration proceeding? Does the country to which it plans to move its administrative seat follow Incorporation Theory or Seat Theory when determining investor nationality? If the country follows Seat Theory, the investor should generally enjoy BIT protection under the BITs concluded by that particular country. The reason is that the investor generally should meet the criterion for determining investor nationality under BITs by having its administrative seat within the country whose BIT protection is invoked. However, should the relevant country follow Incorporation Theory the investor might not be able to invoke protection under that country's BITs. If, for example, that country provides that only investors which are duly incorporated or organized pursuant to the laws of that jurisdiction enjoy protection under the BIT, an investor who has only its administrative seat in that country will probably not enjoy BIT protection unless its organizational form is recognised under the laws of that country.

Moreover, in light of the legal uncertainty as to the scope of the term "seat," the investor must take into account that the Host State might disagree with such a broad interpretation of the term "seat" and thus object to the investor's standing. Thus, before deciding to move its administrative seat abroad or even commencing a costly arbitration based on this broad interpretation, the investor is well advised first to seek diplomatic support from the Federal Republic of Germany. The Federal Republic of Germany could, for example, exchange diplomatic notes with the relevant Host State and thereby clarify and confirm that investors who have their administrative seat abroad and their statutory seat only within Germany also are protected under the relevant BIT.

In summary, currently there is no legal clarity as to whether a German corporate investor who moves its administrative seat abroad still enjoys protection under the

German BITs. Thus, before making such a decision, an investor should carefully consider the consequences, including whether it would enjoy protection under the BITs concluded by the country to which it moved its seat.

2. *Do Investors Who Did Not Enjoy Protection Under German BITs Under Previous Law Gain Protection Under the New Law?*

Another issue that might arise in this context is whether investors who did not meet the previous "administrative seat" criterion might now enjoy protection under the German BITs by virtue of having their statutory seat in Germany. If one were to follow this proposition, protection under German BITs could also be invoked by so-called "letterbox" companies. Companies which have only their statutory seat in Germany but which do not conduct any other business within Germany or which have no effective link to Germany other than their incorporation, would now enjoy BIT protection. In this context it has been discussed whether additional criteria such as a "control or ownership" test should be applied in order to determine investor nationality and prevent abuse.[74] This issue is considered elsewhere in this paper and is not addressed further in this chapter.

3. *Structuring Prospective Foreign Investments: Increase in Flexibility and Legal Certainty?*

MoMiG, by allowing corporate investors to move their administrative seat abroad, significantly increases investor flexibility. Furthermore, under the new German Corporation Law, investors are able to conduct their business abroad through foreign subsidiaries which are incorporated under German law, *e.g.* GmbHs. Whether this is advisable needs to be determined by taking into account whether the law of the Host State would recognize the subsidiaries organised under German law and whether particular restrictions would apply. Most importantly though, the investor must be aware that given the legal uncertainty explained above, it is currently unclear whether the foreign subsidiaries that have their principal place abroad but are organized under German law enjoy protection under the German BITs.

VI. Concluding Remarks

MoMiG might impact corporate investor protection under the German BITs if the investor decides to move its administrative seat abroad. Whether the investor still enjoys protection under the BITs currently in effect depends on how the determinative nationality criterion "seat" included in the BITs is interpreted. Here, the authors argue that the criterion "seat" should be interpreted in light of the change from Seat Theory to Incorporation Theory. Consequently, corporate investors who

[74] For further detail see *Schlemmer*, in: Muchlinski/Ortino/Schreuer (eds.), The Oxford Handbook of International Investment Law, 49 (79 *et seqq.*).

move their administrative seat abroad but who would still have their statutory seat within Germany would nevertheless enjoy protection under the German BITs. However, until this interpretation has been confirmed, German corporations should be aware that the transfer of their administrative seat to another country might lead to a forfeiture of their protection under the German BITs. In light of this, before making such a decision a corporate investor should carefully assess whether it risks being without any BIT protection when transferring its administrative seat or whether it might be eligible for adequate BIT protection under its new Host State's BITs.

In light of this legal uncertainty, the authors recommend that the Federal Republic of Germany enter into a dialogue with the states with whom Germany has concluded BITs, in order to clarify and confirm that German investors that move their administrative seat abroad, but still have their statutory seat in Germany, also enjoy protection under the relevant BIT.

D. The Nationality of Corporations

The question of how to determine the nationality of a corporation was debated amongst the members of the group. Some asked the question whether a corporation's entitlement to protection was one of form or also one of substance. Others argued that the debate was about whether it was allowable to set aside a definition in a treaty by reference to extraneous considerations of general international law – a question they answered in the negative.

For the benefit of the reader and to reflect the broad spectrum of opinions, the group decided to include two articles (sections D.I and D.II)

I. Is a Corporation's Entitlement to the Protection of an Investment Treaty a Question Solely of Form or is it also a Question of Substance?

Robert Hunter[75]

1. Introduction

As we have seen in section B above, BITs contain a wide range of definitions qualifying the status of corporations as investors of a contracting state. At one end of this range is a short formal requirement of either a place of incorporation or a seat in the home state; at the other are additional criteria such as substantial business activities or an "effective seat" in the home state.

Where the contracting parties have stipulated additional requirements, the precise expression of their intention is likely to preclude any need for an international tribunal to consider more rigorous requirements than those that already appear on the face of the BIT.

Where a BIT contains only a short formal requirement of incorporation (or to a lesser extent seat), however, exceptional circumstances of a particular case may confront a tribunal with the question whether it is appropriate and necessary to apply additional extraneous criteria or rules of general international law over and above satisfaction of these purely formally expressed requirements.

In this latter situation, there are two approaches a tribunal might take. One is to infer that the contracting parties to the BIT intended that no additional criteria be applied over the formally expressed criterion in the BIT. The other is to infer an intention that the bare wording of the BIT may be interpreted by reference to the application of rules of general international law. (We use "general international law" in this context to refer in a broad sense to "the body of rules which are legally binding on states in their intercourse with each other."[76]).

[75] Grateful acknowledgement is made to *Florian Franke* of Frankfurt University for his substantial contribution to this section of the paper.

[76] *Jennings/Watts*, Oppenheim's International Law, Vol. 1: Peace, § 1.

There is support for each of these approaches in decisions of investment tribunals interpreting BIT provisions in a more general context. Some tribunals have taken the formalistic approach, adhering to the explicit wording of the BIT and demonstrating a marked reluctance to read the 'investor' provisions in the light of rules of general international law. An example of this approach is given in the decision of the Tribunal in *Waste Management*:

> "Where a treaty spells out in detail and with precision the requirements for maintaining a claim, there is no room for implying into the treaty additional requirements, whether based on alleged requirements of general international law in the field of diplomatic protection or otherwise."[77]

An example of the opposite approach can be found in the decision in *Enron v. Argentina*:

> "The fact that a treaty may have provided expressly for certain rights of shareholders does not mean that a treaty not so providing has meant to exclude such rights if this can be reasonably inferred from the provisions of such treaty. Each instrument must be interpreted autonomously in the light of its own context and in the light of its interconnections with international law."[78]

Specifically in the context of the "nationality" of corporations, tribunals to date have tended towards the formalistic approach (if not always unanimously).[79]

In this section we consider whether under certain circumstances it is appropriate for or even open to a tribunal to go outside the formal stipulations of a BIT and thereby possibly to deny a claim by a corporation that, although fulfilling the formal requirements of a BIT, may be contrary to general international law because it lacks a substantial connection to the home State.

Since the provisions of a BIT express the will of the contracting states, recourse to general international law must be approached cautiously. As expressed by *McLachlan*:

> "General international law in investment treaty cases does not become the juridical equivalent of a bag of liquorice allsorts, in which the Tribunal may pick and choose at will those doctrines which suit its decision. Rather, its primary role is the progressive illumination of the parties' intentions as expressed in their treaty text: or its application to issues not expressly addressed in the treaty a different way."[80]

77 *Waste Management Inc. v. United Mexican States*, ICSID Case No. ARB(AF)/00/3, Final Award of 30 April 2004, para. 85. Note that the phrase "in detail and with precision" in this passage is used in the sense that Chapter 11 of NAFTA spells out in detail and with evident care the conditions for commencing arbitration under its provisions; the Chapter does not contain any "detailed" or "precise" stipulation regarding the criteria to be applied by the tribunal to the issue in hand in that part of the tribunal's reasoning, which concerned the state parties' intentions as regards the protection – or exclusion from protection – of 'indirect' investments.

78 *Enron Creditors Recovery Corporation (formerly Enron Corporation) and Ponderosa Assets, L.P. v. Argentine Republic*, ICSID Case No. ARB/01/3, Decision on Jurisdiction of 14 January 2004, 19.

79 *Tokios Tokelės v. Ukraine*, ICSID Case No. ARB/02/18, Decision on Jurisdiction of 29 April 2004; *Tokios Tokelės v. Ukraine,* ICSID Case No. ARB/02/18, Dissenting Opinion, Prosper Weil of 29 April 2004; Permanent Court of Arbitration; *Saluka Investments BV v. The Czech Republic*, UNCITRAL, Partial Award of 17 March 2006.

80 *McLachlan*, ICLQ 57 (2008), 361 (391).

2. *Range of Possible Results Should BIT Protection be Afforded Solely on the Basis of Formal Criteria*

Investment tribunals have yet to give an unequivocal answer to the question whether a strictly formal approach should invariably be applied to the consideration of the structuring of foreign investment, thus permitting the possibility of exploitation of legal loopholes.[81]

It is helpful in this context to distinguish between two types of situation.

The first is where a corporation lacks substantial links to the state of incorporation but maintains a close connection to the host state of the investment itself: in other words, where nationals of State A have created a corporation in State B and claim through this corporate vehicle against their own government. From the point of view of substance such a claim could be seen as domestic although formally it may be said to fulfil the requirements of the BIT.

As regards this first situation, ICSID Tribunals to date have tended to allow claims of host state nationals brought through the vehicle of foreign corporations.[82] Nonetheless, doubts as to the legitimacy of such claims have been expressed having regard to the fact that the "object and purpose" of BITs are typically to "intensify economic co-operation between both states" and to "creat[e] favourable conditions for investments by investors of either State in the territory of the other State".[83] The questioning of legitimacy may be said to be greater where it can be shown on the facts that the incorporation has been made with the specific intention of exploiting BIT protection in the situation of an otherwise domestic investment.[84]

The second situation concerns corporations which, as in the first example, have no substantial connection to their state of incorporation but, contrary to the first example, have no connection to the host state either.

Just as in the case of the first example, ICSID tribunals have tended to confirm their jurisdiction in these circumstances too upon enquiry restricted to the formally expressed criteria.[85]

Objections to the legitimacy of the formal approach are different in this situation to those in the case of same nationality. In particular, it has been argued that since the – or at least a principal – "object and purpose" of a BIT is typically to increase foreign investment, the origin of the capital should be irrelevant so long as it is foreign.[86]

It is not within the scope of this paper to consider matters of policy or economics. From a teleological aspect, however, it may be observed that the preambles of most

[81] *ADC Affiliate Limited and ADC & ADMC Management Limited v. Republic of Hungary*, ICSID Case No. ARB/03/16, Award of 2 October 2006; *TSA Spectrum de Argentina S.A. v. Argentine Republic*, ICSID Case No. ARB/05/5, Award of 19 December 2008.

[82] See *e.g. Tokios Tokelės*; *The Rompetrol Group N.V. v. Romania*, ICSID Case No. Arb/06/03, Decision on Jurisdiction of 18 April 2008.

[83] *Inter alia* according to the German model BIT of 2009.

[84] *Burgstaller*, JWIT 7 (No. 6, 2006), 857 (877).

[85] *ADC v. Hungary*, see *supra* footnote 81.

[86] *Wisner/Gallus*, JWIT 5 (No. 6, 2004), 927 (944).

BITs promote foreign investment between two particular states[87] and not FDI in general. It may therefore be questioned whether it can properly be asserted as a matter of general principle that the origin of capital is invariably immaterial.

Such a teleological approach is echoed in the ICJ's judgment in the *Barcelona Traction* case, where it is reasoned that "since ... investments [by a State's nationals abroad] are part of a State's national economic resources, any prejudice to them directly involves the economic interest of the State";[88] by deduction, it may be said that, conversely, where such investments are in substance not part of the home state's economic resources, there is no such economic interest and therefore no substantial infringement of the state's right. It is arguably immaterial to a teleological interpretation that a right might be said to be an investor's independent of the exercise of any right of the home state.

The application of this range of results may have practical consequences. Most obviously, an "unconnected" corporation that is successful in an arbitral proceeding may face the situation of the defeated host state refusing to honour the award. In a situation of such non-fulfilment, the claimant corporation would normally expect to be able to invoke the diplomatic protection of its home state, but in this situation it is questionable whether the home state would want to incur such efforts or risk its bilateral relations with the host state in supporting the claim of a corporation that lacked any effective connection to it; for instance, the USA has adopted this position,[89] just as it also recognises the right in principle of a host state "to reject representation by the state of incorporation where that state has been chosen solely for legal convenience, for example as a tax haven, and the corporation has no substantial links with that state"[90].[91]

We consider in the rest of this section whether general international law provides a tribunal with any opportunity to look beyond the purely formal and, if so, what rules it should apply.

3. *Are BITs Permeable to Rules of General International Law?*

Before looking at particular rules, it is helpful first to address the question whether external rules of general international law may be applied at all. Such an enquiry is

[87] Preamble of the German Model BIT: "Desiring to intensify economic co-operation between *both States*, intending to create favourable conditions for investments by investors of *either State* in the territory or the *other State*, recognizing that the encouragement and contractual protection of such investments are apt to stimulate private business initiative and to increase thee prosperity of *both nations*." (Emphasis added.).

[88] ICJ, *Case concerning the Barcelona Traction, Light & Power Company, Limited, Second Phase* (Belgium v Spain), ICJ Reports 1970, 3 para. 86.

[89] *Muchlinski*, in: Binder/Kriebaum/Reinisch/Wittich (eds.), International Investment Law for the 21st Century – Essays in Honour of Christoph Schreuer, 341 (348).

[90] Third Restatement of the Law, Foreign Relations Law of the United States, § 213, Comment c.

[91] Precisely this empirical risk is also contemplated by article 9 of the ILC Draft Articles: "It is wrong to place the sole and exclusive right to exercise diplomatic protection in a State with which the Corporation has the most tenuous connection as in practice such State will seldom be prepared to protect such a corporation." *ILC*, 58th session, Draft Articles on Diplomatic Protection with Commentaries YILC 2 (2006), commentary on article 9.

necessary as it could be argued that BIT-based investment protection law has established a system of rules that is closed to the addition of external general principles in the same way as has been argued concerning WTO law. [92]

Generally speaking, general international law is widely subject to the disposition of the parties.[93] As the International Court of Justice has said:

> "it is well understood that, in practice, rules of international law can, by agreement, be derogated from in particular cases or as between particular parties."[94]

Limitations to contracting out are only set by the peremptory norms of international law, such as *jus cogens*.[95]

By the same token, states may contract out of certain requirements of general international law. For example, BITs with investor-state arbitration consents allow private foreign investors to sue a state, often without the exhaustion of the local remedies rule which is a mandatory requirement in the law of diplomatic protection.[96] Thus, by agreeing on the specific language of the BIT, the signatory states have shown in this respect an intention to exclude any other rule of general international law, including the rules of diplomatic protection.

The differences between the law of diplomatic protection and the law of investment protection are well recognised in international jurisprudence. The ICJ, for example, has differentiated clearly between both regimes:

> "in contemporary international law, the protection of the rights of companies and the rights of their shareholders, and the settlement of the associated disputes, are essentially governed by bilateral or multilateral agreements for the protection of foreign investments […]. In that context, the role of diplomatic protection somewhat faded, as in practice recourse is only made to it in rare cases where treaty régimes do not exist or have proved inoperative."[97]

The interplay between BITs and general international law is governed by the *lex specialis rule*. This rule suggests that if a matter is regulated by a general standard as

92 *Pauwelyn*, AJIL 95 (2001), 535 *et seqq*.

93 *ILC*, 58th session, Fragmentation of International Law, Report finalized by *Koskenniemi*, 13 April 2006, 79.

94 ICJ, *North Sea Continental Shelf* (Germany v. Denmark), ICJ Report 1969, 3 (42) para. 72.

95 *ILC*, 58th session, Fragmentation of International Law, Report finalized by *Koskenniemi*, 13 April 2006, 83 (para. 154).

96 See Art. 14, *ILC*, 58th session, Draft Articles on Diplomatic Protection with Commentaries YILC 2 (2006).

97 ICJ, *Ahmadou Sadio Diallo* (Republic of Guinea v. Democratic Republic of the Congo), Preliminary Objections, Judgment of 24 May 2007, para. 88; see also ICJ, *Case concerning the Barcelona Traction, Light & Power Company, Limited, Second Phase* (Belgium v Spain), ICJ Reports 1970, 3, para. 36, where the Court held that rules of diplomatic protection were applicable "*in the absence of a special agreement on the subject between the parties*" and *Azurix Corp. v. The Argentine Republic*, ICSID Case No. ARB01/12, Decision on the Application for Annulment of the Argentine Republic of 1 September 2009, para. 87, where *"the Committee notes that the Barcelona Traction case concerned customary international law rules of diplomatic protection rather than investment treaty arbitration"*.

well as by a more specific rule, the latter should take precedence over the former.[98] Although generality and speciality are relational concepts that have to be assed with regard to subject matter and parties[99], there are good reasons to assume that treaties, and thus also BITs, generally enjoy priority over general international law insofar as the respective rule is not a peremptory norm.[100]

The *lex specialis* rule as a conflict-resolution technique does not exclude the residual application of general international law. This even holds true for entire sets of special rules, which are sometimes referred to as "self-contained regimes" [101]. Thus, the ILC concluded in its Report on the Fragmentation of International Law:

> "No legal regime is isolated from general international law. It is doubtful whether such isolation is even possible: a regime can receive (or fail to receive) legally binding force ("validity") only by reference to (valid and binding) rules or principles *outside it*. In previous debates within the Commission over "self-contained regimes", "regimes" and "subsystems", there was never any assumption that they would be hermetically isolated from the general law."[102]

There has been much debate over the question under what circumstances, if any, there may be a fall-back to the general rules.[103] There is however authority that even such strong sub-systems are permeable to general rules of international law.[104] Even EC law, with its complex system of primary and secondary rules, is deemed not to be insulated from general rules of general international law.[105] It would be foolish to assume that BITs alone are hermetically sealed against the application of general rules.

Assuming that investment law is permeable to general international law in principle, the question falls to identify whether there are any particular window or windows through which general international law may be applied to the *lex specialis* regime of a BIT.

It may first be asked whether this is a question of the application of extraneous rules at all rather than simply a question of treaty interpretation. The distinction between "using rules of international law as part of the apparatus of treaty

98 *ILC*, 58th session, Fragmentation of International Law, Report finalized by *Koskenniemi*, 13 April 2006, 34 para. 56, 39 para. 66.

99 *Ibid.*, 60 para. 111 *et seq.*

100 *Ibid.*, 47 para. 85.

101 For further reference on this concept see *Simma*, Netherlands Yb of Int'l Law 16 (1985), 111 (117). The ICJ made reference to the concept of self-contained regimes in the Tehran Hostages Case. This case arose out of the seizure and detention as hostages of US diplomatic and consular staff in its embassy in Tehran. Dealing with the question whether alleged criminal activities of the United States in Iran could be regarded as a defence of Iran's conduct, the Court held hat the rules of diplomatic law constitute a self-contained regime which already foresees remedies for abuses by members of a mission. According to the Court, this precluded the applicability of secondary rules. See ICJ, *United States Diplomatic and Consular Staff in Tehran* (USA v. Iran), ICJ Reports 1980, 3 (40) para. 86.

102 *ILC*, 58th session, Fragmentation of International Law, Report finalized by *Koskenniemi*, 13 April 2006, 100. See also *Simma*, Netherlands Yb of Intl Law 16 (1985), 111 (129).

103 *ILC*, 53rd session, Wrongful Acts, with commentaries YILC 2 (2001), 140, Art. 55.

104 *Simma*, Netherlands Yb of Int'l Law 16 (1985), 111 (129).

105 The issue was discussed concerning termination of EC membership, see *Marschik*, Subsysteme im Völkerrecht, 125.

interpretation and applying the rules of international law directly to the facts in the context of which the treaty is being considered"[106] may indeed be difficult to establish.[107] In practice, it is necessary to consider the application of extraneous rules in any event: as has been said, application and interpretation "might lap into each other" since "it would be difficult to apply something without at the same time interpreting it, and to interpret a term without a context in which to apply it."[108]

Norms that allow a direct application of general international law may be found in procedural law as well as any particular BIT. For example, Art. 42 (1) ICSID allows Tribunals to apply international law if the parties have not agreed on a different choice of law. Art. 103 of the UN Charter states that obligations under the UN Charter prevail over other treaty obligations of the Member States.

The indirect application of general international law may be found in the use of Art. 31 (3) (c) VCLT[109], itself a rule of international law that has been widely applied by investment tribunals.[110] Article 31 (3) (c) VCLT stresses a general principle of treaty interpretation that puts the treaty in the context of the international legal system. Treaties being themselves creatures of international law,

> "however wide their subject matter, they are all nevertheless limited in scope and are predicated for their existence and operation on being part of the international law system."[111]

Authority for this can be found too in the following passage of the decision of the US-Iran Tribunal in the *Amoco International Finance* case:

> "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"[112]

It may reasonably be concluded that general international law extraneous to a BIT is relevant to its interpretation and application, even in the presence of a treaty that establishes a *lex specialis* regime, and that tribunals may fill gaps in BITs by reference to general international law.[113]

4. Possible Additional Rules of General International Law

One possible source of international law principles to deal with situations such as those explained above concerning "same state" status or the lack of substantial connection between the exporting State and a corporation seeking to establish treaty protection is the principles that have been developed under the rubric of a "genuine"

106 *Gardiner*, Treaty Interpretation, 278.

107 *Van Aaken*, Finnish Yb of Int'l Law 17 (2008), 91 *et seqq.*

108 *Klabbers*, in: Craven/Fitzmaurice/Vogiatzi (eds.), Time, History and International Law, 141 (144).

109 "There shall be taken into account, together with the context any relevant rules of international law applicable in the relations between the parties.".

110 *Schreuer*, TDM 3 (2006), 3.

111 *McLachlan*, ICLQ 54 (2005), 279 (280).

112 *Amoco International Finance Corporation v. Iran* (1989), 15 Iran-USCTR 189 para. 112.

113 *Gardiner*, Treaty Interpretation, 284.

or "effective" link in the field of diplomatic protection. A second possible source is a more general form of estoppel that prohibits the exercise of an existing right under abusive circumstances. In fact, both sources are intimately connected to the extent that the first might even properly be seen as an aspect of the second, as discussed in the following paragraphs.

a) *'Effective Link' Principle*

At the level of international law, states may exercise protection on behalf of those of their nationals who suffer injuries within the territory and due to the misconduct of a foreign state. This presents an incongruity: the right is defined by nationality[114] but nationality is a municipal law concept: states are free to decide on whom they confer nationality.[115]

In the *Nottebohm Case*, the International Court of Justice determined that nationality, "in order to be capable of being invoked against another State" (or "opposed") at an international level, "must correspond with a factual situation" and specifically requires a "genuine and effective connection".[116]

This judgment has prompted much controversy in jurisprudence and among scholars.[117] In particular, views diverge as to whether the "genuine and effective connection" postulated in *Nottebohm* is a preliminary necessity for the nationality of a natural person. Many have argued that the impact of *Nottebohm* is limited to the very specific pattern of facts in that case, *Nottebohm* himself having had tenuous links to Liechtenstein and in particular having acquired that nationality by naturalisation in an exceptional way.

It has also been recognised that the mandatory application of a general "genuine and effective connection" requirement would be problematic. As explained in the commentary to Article 4 of the International Law Commission's (ILC) Draft Articles on Diplomatic Protection, echoing Judge *Read* in his dissenting judgment at the time:

> "...it is necessary to be mindful of the fact that if the genuine link requirement proposed by Nottebohm was strictly applied it would exclude millions of persons from the benefit of diplomatic protection as in today's world of economic globalization and migration there are millions of persons who have moved away from their State of nationality and made their lives in States whose nationality they never acquire or have acquired nationality by birth or descent from States with which they have a tenuous connection."

[114] *Panevezys-Saldutiskis Railway Case* (Estonia v. Lithuania), P.C.I.J. 1930, P.C.I.J. Series A/B, No. 75, 16: "it is the bond of nationality between the State and the individual which alone confers upon the State the right of diplomatic protection".

[115] *Nationality Decrees issued in Tunis and Morocco (French Zone)*, P.C.I.J. 1923, P.C.I.J. Series B, No. 4, 24: "*in the present State of international law, questions of nationality are ... in principle within the reserved domain*".

[116] ICJ, *Nottebohm Case* (Liechtenstein v. Guatemala), Second Phase, ICJ Report 1955, 4 (22).

[117] *Jones*, ICLQ 5 (1956), 230 *et seqq.*; *Kunz*, AJIL 54 (1960), 536 *et seqq.*

Even as applied to natural persons, such results demonstrate the impracticability of a generally stated principle and imply that the *Nottebohm* judgment does not in fact stand and fall on the viability of an "effective and genuine link" test but rather that such a test might only have been the symptom of the application of a broader concept of an abuse of right.[118]

Investment Tribunals have had to deal with the *Nottebohm* principle in a couple of cases with individual claimants.[119] Respondent states have raised the jurisdictional objection *ratione personae* that claimants' nationality is not effective or that claimant has another more effective nationality. Up to now, tribunals have not yet denied their jurisdiction because claimants' nationality was not effective.

A "genuine link" requirement per *Nottebohm* is even more problematic when applied to corporations.

Corporations lack the inherent natural effects of a natural person's nationality,[120] both formally (for instance, the possession of a passport) and substantially (for instance, the affiliation to a group of people sharing similar values through heritage or acceptance). Corporations are also inherently, indeed essentially, different to natural persons 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 (subject to any particular questions of incapacity or trusteeship or the like) is always and only him- or herself. One consequence of this is that "corporate nationality ... is peculiarly subject to manipulation".[121]

For these reasons, the application of a concept of 'nationality' – at least as it is understood in relation to a natural person – to a legal entity is problematic and is probably best avoided. For convenience, we use it in this section as a shorthand for the attribution of certain factors connecting a juristic person to a particular state.

It is significant that early investment protection instruments did not ascribe protection to corporations on the basis of nationality at all. According to *Vandevelde*,[122] provisions in U.S. treaties granting protection specifically to companies date from a 1911 FCN with Japan[123] and they became a regular component of U.S. treaty practice in the interwar FCNs. Those agreements contained a standard provision that applied to "limited liability and other corporations and associations ..." that both "were organised in accordance with and under the laws" of one party and

118 *Sloane*, Harv. Int'l Law Journal 50 (2009), 1 (14).

119 *Mr. Saba Fakes v. Republic of Turkey,* ICSID Case No. ARB/07/20, Award of 14 July 2010; *Micula et al. v. Romania,* ICSID Case No. ARB/05/20, Decision on Jurisdiction and Admissibility of 24 September 2008; *Waguih Elie George Siag and Clorinda Vecchi v. Egypt,* ICSID Case No. ARB/05/15, Decision on Jurisdiction of 11 April 2007; *Champion Trading Company et al. v. Egypt,* ICSID Case No. ARB/02/9, Decision on Jurisdiction of 21 October 2003.

120 Understood as "a people having a common origin, tradition, and language and capable of forming or actually constituting a nation-state" (Merriam-Webster online, available at: <http://www.merriam-webster.com/dictionary/nationality> (last accessed on 25 March 2011).

121 Third Restatement of the Law, Foreign Relations Law of the United States, § 213, Reporters Notes 1.

122 *Vandevelde*, U.S. International Investment Agreements, 147.

123 US-Japan FCN (21 February 1911); the acronym "FCN" is used to refer to the family of all such instruments of Friendship, Commerce and Navigation.

maintained a central office within the territory of that party. Prior to this, FCNs "had extended protection to "citizens" or "nationals", terms that did not necessarily include corporations".[124] The requirement that the location of the central office or principal place of business be in the home state was dropped in post-War FCNs for ease of administration but was accompanied by a denial of benefits provision where a company was directly or indirectly controlled by nationals of a third country or countries.[125]

The early German BITs contained a similar distinction between natural and juristic persons. For instance, the Germany-Pakistan BIT of 1959 (the very first BIT of all) consistently uses the terms "*nationals* and *companies* of either state" to define respectively the classes of natural and legal protected persons. The term "nationals" was defined as "Germans within the meaning of the Basic Law for the Federal Republic of Germany" or "a person who is a citizen of Pakistan according to its laws" and the term "companies" comprised, in the case of Germany, juridical persons whether or not with legal personality having their seat in Germany and, in the case of Pakistan, juridical persons incorporated in Pakistan.[126] This dual definition began to be replaced by a single concept of "investor" in the mid-1980's and since 2001 nearly all German BITs have used this phrase, which is defined within each BIT as comprising both natural and juristic persons.

It is internationally well accepted that place of incorporation is the starting point for the evaluation of 'nationality' for the logical reason that a juristic person is a fiction of a particular municipal legal system. (The new 'Societas Europaea' transcends this traditional concept.) Hence, the state that created the juristic person must bequeath its nationality to the juristic person. The second theory of determination, that of seat, although widely accepted in continental European civil law systems, is of less practical importance since the majority of states required – at least until very recently[127] – that the seat of the company's administration must be located in the state in question in order for it to be incorporated there; thus in most instances applying the incorporation theory also implements the seat theory.[128] The third theory, the so-called 'control theory', determines the nationality of a corporation by reference to the nationality of its majority shareholders. This theory, however, does not enjoy wide acceptance at an international level.[129]

The analogous application of the *Nottebohm* "effective link" requirement to the 'nationality' of corporations was explicitly denied by the ICJ in the *Barcelona Traction* case:

124 *Vandevelde*, U.S. International Investment Agreements, 24.

125 *Ibid.*, 148.

126 Germany-Pakistan IIA (1959), Art. 8.

127 See *supra* Section C.

128 See *ILC*, 58th session, Draft Articles on Diplomatic Protection with Commentaries YILC 2 (2006), commentary on article 9, 53.

129 ICJ, *Case concerning the Barcelona Traction, Light & Power Company, Limited* (Belgium v. Spain), ICJ Reports 1970, 3 para 96: such an approach might "create an atmosphere of confusion and insecurity in international economic relations".

"However, in the particular field of the diplomatic protection of corporate entities, no absolute test of the "genuine connection" has found general acceptance. ... The court is of the opinion that there can be no analogy with the issues raised or the decision given in that case".[130]

The scope of this dictum has been called into question.[131] Scholars have argued that, since the ICJ had to decide about a claim of Belgium on behalf of *Barcelona Traction's* shareholders (Belgium nationals) and not about a claim of Canada on behalf of *Barcelona Traction* itself (Canadian incorporated), the ICJ did not intend to create a general principle.[132] It has also been observed that elsewhere in its judgment the ICJ accepted that certain "permanent and close connections" must exist in order to give a State the right to exercise diplomatic protection.[133]

Article 9 of the ILC 2006 Draft Articles on Diplomatic Protection mirrors such an approach, indicating a presumption in favour of incorporation for determining nationality that may be rebutted by evidence of substantially closer connections to another state. This shows that the ILC considered it desirable to exercise some form of control over a merely formal test of incorporation by reference to the question of substantial connection between a corporation and a particular state even though the requirements of the particular exception it formulated are very strict: both the seat of management and financial control must be located in a second state in order for it to apply.

Both the *Barcelona Traction* judgment and Article 9 illustrate the difficulty of applying to corporations concepts of nationality developed in relation to natural persons. Given both these difficulties as well as the well-recognised difficulties that would result from the general application of a "genuine and effective connection" requirement per *Nottebohm* even to natural persons, there are convincing grounds for rejecting the prescription of any rigid principles of adequate connection in relation to the nationality of a corporation beyond the specific provisions of a particular BIT.

b) *Abuse of rights*

The rejection of a rigid prescription of adequate connection is not necessarily the end of the matter since it remains to consider whether there is still scope for the application of a doctrine of abuse of rights in this area.

An abuse of rights occurs

130 *Ibid.,* para. 70.

131 See *Mann*, AJIL 67 (1973), 259 (273).

132 *Tietje/Bering*, in: ILA German Branch Sub-Committee on Investment Law, General Public International Law and International Investment Law – A Research Sketch on Selected Issues, 26 (30), available at: <http://www.50yearsofbits.com/docs/0912211342_ILA_Working_Group_IIL_PIL.pdf> (accessed on 25 March 2011).

133 ICJ, *Case concerning the Barcelona Traction, Light & Power Company, Limited* (Belgium v. Spain) Second Phase, ICJ Reports 1970, 3 para 71.

> "when a State avails itself of its rights in an arbitrary manner in such a way as to inflict upon another State an injury which cannot be justified by a legitimate consideration of its own advantage."[134]

The concept of the prohibition of the abuse of rights has its origins in the Roman law principle *sic utere iure tuo ut alienum non laedas*, which circumscribed the exercise of individual rights in such a way that others would suffer no injury.[135] The principle has both entered municipal legal systems[136] and become part of international law. Its most explicit expression may be found in Art. 300 of the Convention on the Law of the Sea:[137]

> "State Parties shall fulfil in good faith the obligations assumed under this convention and shall exercise the rights, jurisdictions and freedoms recognized in this Convention in a manner which would not constitute an abuse of right."

The principle of abuse of rights will prohibit the use of an existing right in circumstances where the exercise of that right (in this case, a state's right to confer its nationality and to exercise diplomatic protection) may result in situations which are not intended at the time of the right's creation.[138]

Any specific application of an abuse of rights doctrine must be approached with caution. According to *Oppenheimer*

> "the delimitation of its function is a matter of delicacy. ... It may be said that it is a useful agent in the progressive development of the law, but that, as a general principle, it does not exist in positive law. Indeed, it is doubtful if it could safely be recognised as an ambulatory doctrine, since it would encourage doctrines as to the relativity of rights and result, outside the judicial forum, in instability".[139]

Even allowing that others might hold a less restrictive view as regards the breadth of establishment of the doctrine, the concerns as to its relativity are central to its nature and are likely to be taken into account by investment tribunals.

In this context, it is interesting to note that it was recognised by the ICJ in the *Barcelona Traction* that even at the time of that decision (40 years ago) international law had insufficiently evolved within the context of the expansion of both foreign investment and the international activities of corporations to provide accepted rules to regulate the question of whether an "investment effectively belongs to a particular economy" and is thus properly the object of its protection.[140] Since it might be said that international law has yet to evolve in this respect, this is an area in which a "useful

[134] *Jennings/Watts*, Oppenheim's International Law, Vol. 1: Peace, § 124.
[135] *Kiss*, in: Bernhardt (ed.), Encyclopaedia of Public International Law, Vol.1, 4 *et seqq.*
[136] See German BGB, para. 226.
[137] Adopted in 1982 by the Third United Nations Conference, UN Doc. A/CONF. 62/122 published in BGBl. 1995 II, 612.
[138] *Kiss*, in: Bernhardt (ed.), Encyclopaedia of Public International Law, Vol.1, 4.
[139] *Jennings/Watts*, Oppenheim's International Law, Vol. 1: Peace, § 124.
[140] ICJ, *Case concerning the Barcelona Traction, Light & Power Company, Limited* (Belgium v. Spain) Second Phase, ICJ Reports 1970, 3 paras. 85-89.

agent in progressive development" might justifiably be employed even within the constraints of *Oppenheimer's* view.

Interestingly, it appears from Judge *Read's* dissenting judgment in *Nottebohm* that counsel for Guatemala raised the issue of abuse of rights in that case but that it was not relied on in the judgment of the court. This may well be because, as Judge *Read* himself observes, the court considered that Liechtenstein caused no damage to Guatemala on the facts of that case and it would therefore have been necessary to reject this plea in any event.[141] It may be questioned today both whether damage is a necessary constituent of an abuse of rights and also, if it is, whether it could properly be said that on the facts Guatemala would indeed have suffered no loss from the exercise of a right of protection by Liechtenstein.[142]

Leaving aside the question of damage, the result of *Nottebohm* might well have been reached on the ground of abuse of right. On the facts of that case, *Nottebohm* had changed his nationality briefly before the outbreak of World War II. As a German citizen with a domicile in an enemy State[143], he would most likely have experienced the consequences of the law of war (*e.g.* discriminatory measures such as the confiscation or condemnation of his property).[144] As a national of a neutral State[145], however, he could not be prosecuted by Guatemala. Thus, it has reasonably been suggested that, by acquiring the nationality of Liechtenstein, *Nottebohm* may have had the intention of evading the rule of law of war and that this would be a "paradigmatic case" of an abuse of right "situation where 'a right is exercised intentionally for an end that is different from that for which the right has been created, with the result that injury is caused'".[146]

It can be seen that the lack of an "effective" or "genuine" link may convincingly – and less problematically – be seen in terms of a symptom or indicia of abusive conduct rather than as being itself a mandatory prerequisite for the international recognition of a single nationality.[147]

That leaves the question of the need for proof of damage to be considered. As stated above, damage has traditionally been considered to be an essential element of the abuse of right principle and in the *Nottebohm* case itself Judge *Read* would have rejected the plea on the basis no proof of damage could be sustained.

Leaving aside the question whether proof of damage is necessarily required in principle as an element of the defence of abuse of right in international law (which is beyond the scope of this paper), it has been plausibly argued that the loss of a defence in international law is in itself sufficient to amount to such an "injury", even if a legal rather than a substantial one.[148] This might be the more so in the context of a BIT

[141] ICJ, *Nottebohm Case* (Liechtenstein v. Guatemala), ICJ Reports 1955, 22, Dissenting Opinion of Judge Read, 37 *et seq.*
[142] As to the latter, see *Sloane*, Harv. Int'l Law Journal 50 (2009), 1 (23).
[143] Guatemala had formally declared war against the German Empire in 1941.
[144] See *Kunz*, AJIL 54 (1960), 536 (543).
[145] Liechtenstein remained neutral during World War II.
[146] *Sloane*, Harv. Int'l Law Journal 50 (2009), 1 (20).
[147] *Ibid.*, 1 (19).
[148] *Ibid.*, 1 (23).

claim, where the loss of such a right might result in the host state's susceptibility to the direct fiscal loss of the cost of reparation.

Investment tribunals have had to deal with the abuse of rights doctrine in several cases.[149] The question has been brought to them in different guises, for instance as "an abuse of the convention purposes",[150] "an abuse of legal personality",[151] an "abuse of corporate form"[152] or an "abuse of the system of international investment protection".[153]

In *Phoenix v. Czech Republic* the tribunal detected an abuse of rights and denied its jurisdiction. The claimant *Phoenix*, an Israeli company, was controlled by a Czech national. Two months before the notification of the dispute, *Phoenix* had acquired interests in two Czech companies. The companies formerly belonged to the family of *Phoenix's* Czech shareholder and they were already involved in disputes with Czech authorities. The tribunal evaluated the timing of the investment, the timing of the claim, the substance of the transaction and the true nature of the operation. It observed that violations and damages occurred before the investment was made and that after the investment was made there was no further activity. It stated that all those elements lead to the conclusion of an abuse of rights.

In *Mobil Corporation and Others v. Venezuela* the tribunal also considered the application of the abuse of rights doctrine. In this case, the investment – two oil concessions – was initially made by *Exxon Mobil* via two Bahamas companies. The concession contracts had to be renegotiated after Venezuela introduced a new carbon law. During the time of the renegotiations *Exxon Mobil* restructured its investment via a Dutch company. After the renegotiations failed and the concessions were nationalised, the Dutch company commenced arbitration under the Netherlands-Venezuela BIT of 1993. Venezuela raised the objection that the sole purpose of the restructuring was to gain protection of the Netherlands-Venezuela BIT; it argued that the tribunal lacked jurisdiction on the basis of application of the abuse of rights doctrine. The Claimants argued that there was no legal basis for imposing nationality requirements extraneous to the treaty or for disregarding the nationality of the holdings. The tribunal considered it necessary to consider whether or not there had been an abuse of right in order to determine its jurisdiction, differentiating between "legitimate corporate planning" and "abuse of right". It answered the question of abuse in the negative on the facts because Venezuela had been notified about the restructuring and because there had been activity after the transfer, save that it found

149 The most recent one is *Mobil Corporation et al v. Bolivarian Republic of Venezuela*, ICSID Case No. ARB/07/27, Decision on Jurisdiction of 10 June 2010.

150 *Autopista Concesionada de Venezuela C.A v. Bolivarian Republic of Venezuela*, ICSID Case ARB/00/5, Decision on Jurisdiction of 27 September 2001, ICSID Review – FILJ 16 (No. 2, 2001), 469 para. 122.

151 *Tokos Tokelés v. Ukraine*, ICSID Case No. ARB/02/18, Decision on Jurisdiction of 29 April 2009, ICSID Review – FILJ 20 (No. 1, 2005), 205 para. 56.

152 *Aguas del Tunari S.A. v. Republic of Bolivia,* ICSID Case No. ARB/02/3, Decision on Respondent's Objections to Jurisdiction of 21 October 2005, ICSID Review – FILJ 20 (No. 2, 2005), 450.

153 *Phoenix Action Ltd v. The Czech Republic*, ICSID Case No. ARB/06/5, Award of 15 April 2009, para. 113.

that it had no jurisdiction to rule on disputes that had started before the restructuring.[154]

These examples indicate that investment tribunals have been ready to apply the abuse of rights doctrine to questions of nationality in the field of investor-state arbitrations.

5. Conclusion

Where a BIT contains only a short formal stipulation defining the "nationality" of a corporate investor a tribunal may be faced with the question whether it is necessary and appropriate to apply general principles outside the BIT with the possibility of denying treaty protection to a claimant corporation.

Tribunals faced with this question to date have tended to determine jurisdiction by applying just the formal criteria.

The doctrine of abuse of rights is a possible tool to resolve such situations. It can be said to provide a necessary corrective to ensure the sustainability of a healthy investment environment. The imposition of a rigorous requirement, however, that a corporate investor be required to have an "effective" or "genuine" link to the home state is problematic and should be rejected.

Application of such a general principle of abuse of rights should not be seen as a satisfactory universal solution since it may only be applied in exceptional cases. Since tribunals will have to consider it on a case by case basis legal certainty can never be reached by such an approach. It follows that the surest means to achieve predictability, let alone certainty, in this area is in the explicit formulation of "nationality" requirements in individual BITs.

[154] *Mobil Corporation et al v. Bolivarian Republic of Venezuela*, ICSID Case No. ARB/07/27, Decision on Jurisdiction of 10 June 2010, para. 205.

II. The Nationality of Corporations in International Investment Law

Dr. Sabine Konrad
Dr. Friedrich Rosenfeld

1. *Introduction*

The large majority of substantive and procedural guarantees of international investment law is contained in International Investment Agreements ("IIAs").[155] Investors who want to rely on these guarantees must set out that they "belong" to one of these Contracting States. This legal bond is expressed by the concept of nationality.

There is a lot of confusion about the concept of nationality. In particular, there is no consensus among scholars as to how the nationality of corporations has to be determined. According to a treaty-based approach, tribunals merely have to apply the criteria that have been agreed upon by the Contracting States in the pertinent IIA.[156] Thus, if an IIA defines a corporation as a legal person which has its place of incorporation[157] or its seat[158] in a foreign country, it should be sufficient if these conditions are met.

Proponents of an external standards approach see this differently.[159] In their view, the nationality of corporations cannot be determined solely by having recourse to the criteria set out in the IIA. Rather, additional criteria beyond the text of the treaty have to be used in order to ensure that there is factually an effective connection between the corporation and the home State. Most commonly, it is suggested to apply the genuine link criterion. This criterion has its origin in the *Nottebohm* case, in which the International Court of Justice ruled that for the purposes of diplomatic protection nationality requires a "genuine and effective connection."[160]

The implications of the two approaches shall be set out in the present article. This will be done in three steps. First, the policy considerations behind the two approaches will be explained. In the ensuing part, it will be set out that international tribunals have strictly abided by a treaty-based approach. Finally, it will be shown that from a dogmatic perspective, there is no basis for applying an external standards approach.

155 Some of the guarantees have obtained the status of customary international law.
156 See *e.g. McLachlan/Shore/Weiniger*, International Investment Arbitration, 131. See also *Bernardini*, in: Ortino/Liberti/Sheppard/Warner (eds.), Investment Treaty Law – Current Issues II, 17 (23).
157 See *e.g.* Art. 1.4 Italy-Bangladesh IIA.
158 See *e.g.* Art. 1 lit. a (ii) Germany-India IIA.
159 See *e.g. Hunter*, in: ILA German Branch/Working Group, The Determination of the Nationality of Investors under Investment Protection Treaties – A Preliminary Report, 32 *et seqq.*, available at: <http://www.50yearsofbits.com/docs/0912211341_ILA_Working_Group_Nationality.pdf> (accessed on 25 March 2011).
160 ICJ, *Nottebohm Case* (Liechtenstein v. Guatemala), Second Phase, ICJ Reports 1955, 4 (22).

2. *Policy Considerations*

Two prominent considerations are advanced by proponents of an external standards approach to justify their position. On the one hand, they argue that corporations of Non-Contracting States, which fulfill the formal criteria of an IIA but have no further connection with the Contracting States, should not be entitled to protection.[161] This argument is based on the premise that IIAs aim to promote foreign investment solely between the Contracting States and not foreign investment in general.

On the other hand, they emphasize the need to prevent claims of domestic corporations against their own State.[162] Thus it is argued that in the absence of an effective link, corporations might acquire the nationality of a foreign Contracting State solely to seek investment protection in the situation of an otherwise domestic investment. Such "nationality shopping" would run counter to basic ideas of investment protection.[163]

Both considerations rest on the underlying assumption that the origin of investment matters for purposes of international investment law. There is hardly support for this proposition.[164] States that have wanted to exclude investments of a particular origin from the scope of protection of an IIA have stipulated this in the pertinent treaty.[165] As an example, one might adduce the denial of benefits clause in the Energy Charter Treaty (ECT). Art. 17 (1) of the ECT reserves for each Contracting Party the right to deny the advantages of the ECT to entities that are controlled by citizens or nationals of a Non-Contracting State and that have no substantial business activities in the territory of the Contracting Parties. One also finds origin of capital clauses that concern "domestic" investments. In the Germany-Costa Rica BIT, for example, it is stipulated that the treaty does not apply to investments in Costa Rica if the relevant investor had for more than ten years its place of domicile in Costa Rica, unless the investment was contributed from abroad.[166] There would be no need for such clauses if the nationality of corporations had to be determined according to an external treaty standard.[167]

As regards the fear that investors might embark on a waive of "nationality shopping", there is no empirical evidence to support this claim.[168] In sum, there are hardly any reasons to apply an external standards approach. From a policy perspective, it seems more convincing to strictly abide by what the Contracting Parties have stipulated in the relevant IIA.

161 See *Schlemmer*, in: Muchlinski/Ortino/Schreuer (eds.), The Oxford Handbook of International Investment Law, 51 (79).

162 *Burgstaller*, JWIT 7 (No. 6, 2006), 857 (877).

163 See also *Lee*, Stanford Journal of Int'l Law 42 (2006), 237 (238 *et seq.*).

164 *Wisner/Gallus*, JWIT 5 (No. 6, 2004), 927 (944).

165 See also *Dolzer/Schreuer,* Principles of International Investment Law, 55.

166 Germany-Costa Rica IIA.

167 See also *Happ*, in: Hofmann/Tams (eds.), The International Convention on the Settlement of Investment Disputes (ICSID) – Taking Stock after 40 Years, 103 (113). See, however, also p. 106.

168 Arguably, the costs which are involved with establishing a company in another country provide a safeguard against "nationality shopping".

3. *Jurisprudence*

A treaty-based approach has also been endorsed in jurisprudence. International tribunals have strictly abided by the wording of IIAs, showing a marked reluctance to apply external standards.[169] Importantly, they have done so in the two situations, which – according to the proponents of the external treaty approach – show the insufficiency of the treaty-based approach.

As has been shown above, the first situation concerns claims of a corporation that has no effective bonds with the Contracting States of an IIA. Such a situation was dealt with in *Saluka v. Czech Republic*.[170] The proceedings in this case were initiated under the Netherlands-Czech Republic BIT. The claimant, *Saluka*, was a legal person incorporated under the laws of the Netherlands but controlled by its Japanese owners. The respondent objected to the jurisdiction of the tribunal arguing that *Saluka* was merely a shell company.[171] The tribunal did not exclude that from a political perspective there might be reasons to restrict claims of shell companies which do not have a real connection with the Contracting Parties of an IIA.[172] In its legal analysis, however, the tribunal came to a different conclusion. Thus, it found that the claimant fulfilled the criteria of the BIT and was to be considered as a Dutch company.[173] In the view of the tribunal, there was no legal basis for applying criteria beyond those stipulated in the BIT.[174]

The second situation concerns claims of a corporation that has close ties with the host State and could thus be regarded as a domestic enterprise. Such a situation was dealt with in the *Tokios Tokelės v. Ukraine* arbitration.[175] The claimant, *Tokios Tokelės*, was a corporation established under the laws of Lithuania. 99% of its shares were held by Ukrainian nationals. *Tokios Tokelės* initiated proceedings under the auspices of ICSID arguing that Ukraine had violated the Lithuania-Ukraine BIT. Ukraine objected to the jurisdiction of the Centre under the BIT and the ICSID Convention. It submitted, inter alia, that the claimant was not a "genuine investor of Lithuania" because it was owned and controlled by Ukrainian nationals.[176] In the view of the respondent, to find jurisdiction in this case would be tantamount to allowing Ukrainian nationals to pursue international arbitration against their own government. This, the respondent argued, would be inconsistent with the object and purpose of the ICSID Convention. The tribunal rejected Ukraine's claim by a majority decision. In doing so, it relied on the treaty text which defined "investor" as "any entity" established in Lithuania or Ukraine as well as "any entity" established in third countries that is controlled by nationals of or by entities having their seat in Lithuania

169 *Cf. McLachlan/Shore/Weiniger*, International Investment Arbitration, 132.
170 *Saluka Investments BV v. The Czech Republic*, UNCITRAL, Partial Award of 17 March 2006.
171 *Ibid.*, para. 183.
172 *Ibid.*, para. 240.
173 *Ibid.*, para. 241.
174 *Ibid.*
175 *Tokios Tokelės v. Ukraine*, ICSID Case No. ARB/02/18, Decision on Jurisdiction of 29 April 2004.
176 *Ibid.*, paras. 21 *et seqq.*

or Ukraine. According to the tribunal, this wording reflected an intention to provide broad protection of investors and their investments – irrespective of the origin of capital.[177] It thus held:

> This Tribunal, by respecting the definition of corporate nationality in the Ukraine-Lithuania BIT, fulfils the parties' expectations, increases the predictability of dispute settlement procedures, and enables investors to structure their investments to enjoy the legal protections afforded under the Treaty. We decline to look beyond (or through) the Claimant to its shareholders or other juridical entities that may have an interest in the claim.[178]

Only the president of the tribunal, *Prosper Weil*, dissented to this conclusion. He argued that, albeit there is no express ICSID requirement in relation to the origin of the capital, the object and purpose of the Convention made it a highly relevant criterion.[179] *Weil* thus asserted that the tribunal should have pierced the corporate veil and deemed *Tokios Tokelės* a Ukrainian national. His position has been rejected by other tribunals.[180]

4. Dogmatic Considerations

From a dogmatic point of view, this strong preference for the treaty-based approach seems entirely sound and convincing. There are two reasons. The first concerns the interplay of IIAs with general international law. If an IIA contains detailed provisions on a certain issue, there is no basis for applying external standards at all. The second reason concerns the fact that there are simply no standards which might be applicable. In particular, the concept of nationality as it has emerged in the field of diplomatic protection cannot be applied to international investment law.

a) No basis for applying external standards

The interplay of IIAs and general international law is governed by the *lex specialis* rule. This rule suggests that if a matter is regulated by a general standard as well as by a more specific rule, then the latter should take precedence over the former.[181] Although generality and speciality are relational concepts that have to be assessed with

[177] *Ibid.,* paras. 32, 82.

[178] *Ibid.,* para. 40.

[179] *Tokios Tokelės v. Ukraine,* ICSID Case No. ARB/02/18, Dissenting Opinion, Prosper Weil, 29 April 2004, paras. 20, 30.

[180] See *e.g. Ioan Micula, Viorel Micula, S.C. European Food S.A., S.C. Starmill S.R.L. and S.C. Multipack S.R.L. v. Romania*, ICSID Case No. ARB/05/20, Decision on Jurisdiction and Admissibility of 24 September 2008, para. 100; *The Rompetrol Group N.V. v. Romania*, ICSID Case No. ARB/06/3, Decision on Respondent's Preliminary Objections on Jurisdiction and Admissibility of 18 April 2008, paras. 79 *et seqq.*

[181] *ILC*, 58th session, Fragmentation of International Law, Report finalized by *Koskenniemi*, 13 April 2006, 34 para. 56. See also p. 39 para. 66.

regard to subject matter and parties[182], there are good reasons to assume that treaties, and thus also IIAs, generally enjoy priority over custom in as much as the respective rule of customary law does not have the status of *ius cogens.*[183]

The *lex specialis* rule is a conflict-resolution technique which does not exclude the residual application of general international law. This even holds true for entire sets of special rules, which are sometimes referred to as "self-contained regimes" [184]. Thus, the ILC concluded in its Report on the Fragmentation of International Law:

> No legal regime is isolated from general international law. It is doubtful whether such isolation is even possible: a regime can receive (or fail to receive) legally binding force ("validity") only by reference to (valid and binding) rules or principles *outside* it. In previous debates within the Commission over "self-contained regimes," "regimes" and "subsystems," there was never any assumption that they would be hermetically isolated from the general law.[185]

There are two ways general international law might have an impact upon international investment law: On the one hand, rules of international law might be directly applicable. Such a direct application of international law is self-explaining if there is a norm which explicitly stipulates to do so. As an example, one might adduce Art. 42 (1) of the ICSID Convention, which allows tribunals to apply international law if the parties have not agreed on a different choice of law, for example in an IIA. In the absence of such a provision, rules of international law might still be applicable to fill gaps, provided that this corresponds to the common will of the parties. On the other hand, rules of international law might be indirectly applicable. Thus, the principle of systemic integration as enshrined in Article 31 (3) (c) of the Vienna Convention on the Law of Treaties (VCLT) – itself a rule of international law that has been widely applied by investment tribunals[186] – foresees that there shall be taken into account, together with the context, any relevant rules of international law applicable in the relations between the parties.

However, even to the extent international law extraneous to IIAs is relevant to their interpretation and application, there is an important limit. A reference to general international law is only permissible inasmuch as it corresponds to the common will of the parties. The common will is expressed normally in the IIA, the text of which

182 *Ibid.*, 60 paras. 111 *et seqq.*

183 *Ibid.*, 47 para. 85.

184 For further reference on this concept see *Simma*, Netherlands Yb of Int'l Law 16 (1985), 111 (117). The ICJ made reference to the concept of self-contained regimes in the *Tehran Hostages* case. This case arose out of the seizure and detention as hostages of US diplomatic and consular staff in its embassy in Tehran. Dealing with the question whether alleged criminal activities of the United States in Iran could be regarded as a defence of Iran's conduct, the Court held that the rules of diplomatic law constitute a self-contained regime which already foresees remedies for abuses by members of a mission. According to the Court, this precluded the applicability of secondary rules. See ICJ, *United States Diplomatic and Consular Staff in Tehran* (United States of America v. Iran), ICJ Reports 1980, 3 (40) para. 86.

185 *ILC*, 58th session, Fragmentation of International Law, Report finalized by *Koskenniemi*, 13 April 2006, 100. See also *Simma*, Netherlands Yb of Int'l Law 16 (1985), 111 (129).

186 *Malaysian Historical Salvors SDN BHD v. The Government of Malaysia*, ICSID Case No. ARB/05/10, Decision on the Application for Annulment of 16 April 2009, para. 56.

has been approved by the sovereign, which means in most cases the State's parliament. Hence, every interpretation of an IIA has to take the text of the IIA as its starting point.[187] The approach of the New Haven School[188] to attribute more weight to broader policy goals than to the text of the treaty, has found no recognition in international law.[189]

As the tribunal in *Waste Management Inc. v. United Mexican States* held:

> Where a treaty spells out in detail and with precision the requirements for maintaining a claim, there is no room for implying into the treaty additional requirements, whether based on alleged requirements of general international law in the field of diplomatic protection or otherwise.[190]

Basically all IIAs contain such detailed provisions on the nationality of investors. They are prefaced by virtually identical wording. In every case, the wording is cast in the form of an exhaustive definition, often containing a *renvoi* to national law. This definition in the treaty is an expression of sovereign will and must be respected. Nationality is closely linked to sovereignty and to the question of statehood as such.[191] Naturally, States therefore consider it a function of their statehood to define the nationality of their own citizens and corporations comprehensively and not to leave room for arbitral discretion or the application of external standards.[192]

Hence, there is no basis for applying external standards.

b) No external standards

Apart from this, there are no external standards according to which the nationality of corporations could be determined. Notably, the genuine link criterion of the *Nottebohm* case is not applicable to international investment law. This has the following reasons:

First, it has to be underlined that the *Nottebohm* judgement concerned the diplomatic protection of natural persons. Even in so far, it has prompted much

[187] *Azurix Corp. v. The Argentine Republic*, ICSID Case No. ARB01/12, Decision on the Application for Annulment of the Argentine Republic of 1 September 2009, para. 90: "[T]he starting point in determining the effect of [a] treaty is the terms of the treaty itself, rather than the principles of customary international law that may or may not be displaced by the treaty provisions."

[188] *McDougal/Reisman*, Yale Studies in World Public Order 6 (1979 – 1980), 249 (270 *et seq.*).

[189] *Briggs*, AJIL 65 (1971), 705 (711).

[190] *Waste Management Inc. v. United Mexican States*, ICSID Case No. ARB(AF)/00/3, Final Award of 30 April 2004, 30 para. 85.

[191] "Generally speaking, it is true that a sovereign State has the right to decide what persons shall be regarded as its nationals." Question Concerning the Acquisition of Polish Nationality, Advisory Opinion, PCIJ, Ser. B., No. 7, 1923, 16. "The Court considers that, in so far as Yugoslavia is now bound by the 1919 Treaty as successor to the Kingdom of the Serbs, Croats and Slovenes, its obligations under that Treaty would be limited to its present territory." ICJ, *Application of the Convention on the Prevention and Punishment of the Crime of Genocide* (Bosnia and Herzegovina v. Serbia and Montenegro), Preliminary Objections, 1996 ICJ Reports, 595 (619 *et seq.*).

[192] Significantly, States choose a different method for the definition of investment. The investment is in most cases defined as "any kind of asset", which is followed by a non-exhaustive catalogue of examples. The difference is explained when one considers the nature of nationality – as opposed to the economic nature of "asset" – a notion which also evolves over time as new kinds of assets come into existence.

criticism.[193] For example, it has been argued that the test of a "genuine connection" proves impracticable for imposing a limit on the granting of nationality. This concern is also expressed in the commentary to Article 4 of the International Law Commission's (ILC) Draft Articles on Diplomatic Protection, which states:

> [I]t is necessary to be mindful of the fact that if the genuine link requirement proposed by *Nottebohm* was strictly applied it would exclude millions of persons from the benefit of diplomatic protection as in today's world of economic globalization and migration there are millions of persons who have moved away from their State of nationality and made their lives in States whose nationality they never acquire or have acquired nationality by birth or descent from States with which they have a tenuous connection.[194]

Second, the ICJ explicitly rejected the analogous application of an "effective link" criterion for determining the nationality of corporations in the *Barcelona Traction* case. It held:

> However, in the particular field of the diplomatic protection of corporate entities, no absolute test of the "genuine connection" has found general acceptance. […] The court is of the opinion that there can be no analogy with the issues raised or the decision given in [the *Nottebohm*] case.[195]

The fact that the Court still found that there were "permanent and close connections" between *Barcelona Traction* and Canada is hardly a reason to call this dictum into question.[196] This is so because the Court did not explicitly consider such connections to be a precondition for the exercise of diplomatic protection.

Finally, and most importantly, it should be borne in mind that there are essential differences between the law of diplomatic protection and the law of investment protection.[197] Diplomatic protection is a right which is available to all States irrespective of any treaty relations. It is the bond of nationality which confers this right. Since States are completely free to choose which system of granting nationality they employ, the desire for some limits on the opposability of nationality may be understandable to avoid being confronted by a "national" who acquired nationality under dubious circumstances (as was the case in *Nottebohm*). This is reflected in the following statement of the International Law Commission:

> In *Barcelona Traction* the International Court of Justice warned that the granting of the right of diplomatic protection to the States of nationality of shareholders might result in a multiplicity of actions which "could

193 *Sloane*, Harv. Int'l Law Journal 50 (2009), 1 (11 *et seqq.*); *Jones*, ICLQ 5 (1956), 230 *et seqq.*; *Kunz*, AJIL 54 (1960), 536 *et seqq.*

194 *ILC*, Draft Articles on Diplomatic Protection with commentaries, YILC 2 (2006), Article 4.

195 ICJ, *Case concerning the Barcelona Traction, Light & Power Company, Limited,* (Belgium v Spain), Second Phase, ICJ Reports 1970, 3 (42) para. 70.

196 *Ibid.*, para. 71. The interpretation of the International Law Commission in its commentary on Article 9 of the Draft Articles on Diplomatic Protection is therefore highly questionable. See *ILC* Draft Articles on Diplomatic Protection with commentaries, Article 9.

197 *Muchlinski*, in: Binder/Kriebaum/Reinisch/Wittich (eds.), International Investment Law for the 21st Century – Essays in Honour of Christoph Schreuer, 341 (362). See also *Amerasinghe*, British Yb of Int'l Law 47 (1974), 227 (244).

> create an atmosphere of confusion and insecurity in international economic relations". The same confusion might result from the granting of the right to exercise diplomatic protection to several States with which a corporation enjoys a link or connection.[198]

Investment protection is governed by a different regime. Here, it is essentially the text of the IIA which defines who enjoys protection.[199] States make a choice of the other contracting party or parties; they agree on the text of the treaty. Due to the treaty basis of investment protection, there is no comparable risk of a State being confronted by an unknown number of other States with whom no treaty relations exist. For this reason, it would be unconvincing to apply principles which have emerged in the field of diplomatic protection to investment treaties.

The differences between the law of diplomatic protection and the law of investment protection are well-recognized in international jurisprudence. The ICJ, for example, differentiated clearly between both regimes arguing that:

> in contemporary international law, the protection of the rights of companies and the rights of their shareholders, and the settlement of the associated disputes, are essentially governed by bilateral or multilateral agreements for the protection of foreign investments [...]. In that context, the role of diplomatic protection somewhat faded, as in practice recourse is only made to it in rare cases where treaty régimes do not exist or have proved inoperative.[200]

In sum, strong reasons militate to reject the prescription of any rigid principles of adequate connection in relation to the nationality of a corporation beyond the specific provisions of a particular IIA.

5. Conclusion

The concept of "nationality" in the context of investment treaties has created a lot of confusion among scholars. Some authors believe that standards which have purportedly emerged in the field of diplomatic protection can be applied to determine the nationality of corporations. Such an external standards approach is misplaced. In the context of investment protection, nationality expresses nothing more than the applicability of an IIA *ratione personae*. The determination of who enjoys protection

[198] *ILC*, Draft Articles on Diplomatic Protection with commentaries, YILC 2 (2006), Article 9.

[199] Notably, many BITs do not even mention the term "nationality" but simply define who shall be considered an "investor".

[200] ICJ, *Case Concerning Ahmadou Sadio Diallo* (Republic of Guinea v. Democratic Republic of the Congo), Preliminary Objections, ICJ Judgment of 24 May 2007, para. 88. See also ICJ, *Case concerning the Barcelona Traction, Light & Power Company, Limited, Second Phase* (Belgium v. Spain) Judgement, ICJ Reports 1970, 3 (42) para. 36, where the Court held that rules of diplomatic protection were applicable "in the absence of a special agreement on the subject between the parties" and *Azurix Corp. v. The Argentine Republic*, ICSID Case No. ARB01/12, Decision on the Application for Annulment of the Argentine Republic of 1 September 2009, para. 87, where the Committee notes that the *Barcelona Traction* case concerned customary international law rules of diplomatic protection rather than investment treaty arbitration.

requires, therefore, nothing more than an interpretation of the pertinent treaty provisions.

E. Denial of Benefit Clauses and any other Mechanisms that Limit the Scope of BITs for Investors

Richard Happ

I. Introduction

In today's globalised economy, many companies structure their outbound foreign investments through one or several subsidiaries in various countries, making use of double taxation treaties or beneficial tax provisions for holding companies. Some may even channel investments through holding companies in certain countries solely for the benefit of obtaining BIT protection.

Most bi- and multilateral investment protection treaties contain relatively straightforward clauses regarding the nationality of foreign investors. For natural persons, it is sufficient that they have the nationality of their home state. While passports or nationality certificates are prima facie evidence of nationality, tribunals consider that they have the right to review for themselves whether a claimant indeed has the nationality of the home state. For juridical persons, *i.e.* companies, most treaties merely require that the company has been established in accordance with the laws of the home state and/or has its seat in the home state.

Sections D.I and D.II discussed whether and under which circumstances it might be appropriate for a tribunal to go outside the formal stipulations of a BIT and thereby possibly to deny a claim by a corporation that, although fulfilling the formal requirements of a BIT, lacks substantial connection to the home state.

Some BITs, however, under certain circumstances allow states to "deny the benefits" of the BIT to companies incorporated in the other Contracting Party. This section discusses those "denial-of-benefit clauses": what are the circumstances which allow a state to invoke such a clause, how is it invoked and what are the effects of its invocation?

Finally, we consider whether any helpful analogies may be drawn from the field of double taxation treaties.

II. History, Development and Usage of such Clauses

Denial of benefit clauses first seem to have surfaced in US treaty practice after the Second World War, *e.g.* the US-Japan FCN treaty.[201] As one author explains, there had been extreme reluctance before the Second World War even to include corporations into the protection of such treaties, and the denial of benefits clauses might have been

[201] US-Japan FCN treaty (9 April 1953).

included due to the fear of preventing, via the incorporation of a company, "free riders" from third countries to gain protection.[202]

As far as we can see, such clauses subsequently have been included in nearly all FCN-treaties or BITs concluded by the United States. They can also be found in the BITs of other states as well as in Free Trade or Economic Cooperation Agreements.

An example of a denial of benefits clause in a multilateral agreement would be Article 17 of the Energy Charter Treaty (ECT):

> "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: (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."

Denial of benefit clauses exist, however, in different formulations. A survey shows that many treaties concluded by the United States have clauses similar to Article 17 ECT in that they have two "legs": the first one requires that the prospective investor does not have substantial business activities in his home state and is owned or controlled by persons of another state (the "nationality-leg"). The second leg requires that the prospective investor is owned or controlled by persons of a state with whom the denying state does not entertain normal economic relations or adopts measures which would be circumvented in applying the treaty (the "measure-leg").[203] A similar

[202] *Walker*, AJIL 50 (1956), 373 (388); see also *Mistelis/Baltag*, Penn State Law Review 113 (2009), 1301 *et seqq.*

[203] Article 10.12 US-Colombia FTA: *"1. A Party may deny the benefits of this Chapter to an investor of another Party that is an enterprise of such other Party and to investments of that investor if persons of a non-Party own or control the enterprise and the denying Party: (a) does not maintain diplomatic relations with the non-Party; or (b) adopts or maintains measures with respect to the non-Party or a person of the non-Party that prohibit transactions with the enterprise or that would be violated or circumvented if the benefits of this Chapter were accorded to the enterprise or to its investments. 2. A Party may deny the benefits of this Chapter to an investor of another Party that is an enterprise of such other Party and to investments of that investor if the enterprise has no substantial business activities in the territory of any Party, other than the denying Party, and persons of a non-Party, or of the denying Party, own or control the enterprise."* A clause with a similar wording has been inserted in Article 11.12 of the US-Australia FTA, Article 10.12 US-Peru FTA, Article 10.11 US-Morocco FTA, Article 10.12 US-Panama FTA.

See Article XII US Model BIT (1994): *"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."*

Article 17 US Model BIT (2004): *"1. A Party may deny the benefits of this Treaty to an investor of the other Party that is an enterprise of such other Party and to investments of that investor if persons of a non-Party own or control the enterprise and the denying Party: (a) does not maintain diplomatic relations with the non-Party; or (b) adopts or maintains measures with respect to the non-Party or a* clause is also contained in Article 1113 NAFTA.[204] It is interesting to note that clauses in some Canadian treaties, which like the United States is a party to NAFTA, also adopt a two-leg structure.[205] Many other investment treaties, however, only contain a denial of benefits clause with the first leg, *i.e.* requiring that the prospective investor has no substantial business activities in his home state and is owned or controlled by persons of another state.[206] Given the scope of this working paper, which is focused on issues of nationality, only the first leg will be analysed.

person of the non-Party that prohibit transactions with the enterprise or that would be violated or circumvented if the benefits of this Treaty were accorded to the enterprise or to its investments. 2. A Party may deny the benefits of this Treaty to an investor of the other Party that is an enterprise of such other Party and to investments of that investor if the enterprise has no substantial business activities in the territory of the other Party and persons of a non-Party, or of the denying Party, own or control the enterprise." This clause has for example been incorporated in Article 17 of the US-Uruguay IIA.

[204] Article 1113 NAFTA: "*1. A Party may deny the benefits of this Chapter to an investor of another Party that is an enterprise of such Party and to investments of such investor if investors of a non-Party own or control the enterprise and the denying Party: (a) does not maintain diplomatic relations with the non-Party; or (b) adopts or maintains measures with respect to the non-Party that prohibit transactions with the enterprise or that would be violated or circumvented if the benefits of this Chapter were accorded to the enterprise or to its investments.*

2. Subject to prior notification and consultation in accordance with Articles 1803 (Notification and Provision of Information) and 2006 (Consultations), a Party may deny the benefits of this Chapter to an investor of another Party that is an enterprise of such Party and to investments of such investors if investors of a non-Party own or control the enterprise and the enterprise has no substantial business activities in the territory of the Party under whose law it is constituted or organized."

[205] Article 18 Canada FIPA: *"1. A Party may deny the benefits of this Agreement to an investor of the other Party that is an enterprise of such Party and to investments of such investor if investors of a non-Party own or control the enterprise and the denying Party adopts or maintains measures with respect to the non-Party that prohibit transactions with the enterprise or that would be violated or circumvented if the benefits of this Agreement were accorded to the enterprises or to its investments. 2. Subject to prior notification and consultation in accordance with Article 19, a Party may deny the benefits of this Agreement to an investor of the other Party that is an enterprise of such Party and to investments of such investors if investors of a non-Party own or control the enterprise and the enterprise has no substantial business activities in the territory of the Party under whose law it is constituted or organized."*

Article G-13 Canada-Chile FTA: *"1. A Party may deny the benefits of this Chapter to an investor of the other Party that is an enterprise of such Party and to investments of such investor if investors of a non-Party own or control the enterprise and the denying Party: (a) does not maintain diplomatic relations with the non-Party; or (b) adopts or maintains measures with respect to the non-Party that prohibit transactions with the enterprise or that would be violated or circumvented if the benefits of this Chapter were accorded to the enterprise or to its investments. 2. Subject to prior notification and consultation in accordance with Articles L-03 (Notification and Provision of Information) and N-06 (Consultations), a Party may deny the benefits of this Chapter to an investor of the other Party that is an enterprise of such Party and to investments of such investors if investors of a non-Party own or control the enterprise and the enterprise has no substantial business activities in the territory of the Party under whose law it is constituted or organized.*

[206] Article 9 Austria-Libya IIA: *"A Contracting Party may deny the benefits of this Agreement to an investor of the other Contracting Party and to its investments, if investors of a Non-Contracting Party own or control the first mentioned investor and that investor has no substantial business activity in the territory of the Contracting Party under whose law it is constituted or organized."*

An almost identical clause is contained in Article 10 of the Austria-Lebanon IIA: *"A Contracting Party may deny the benefits of this Agreement to an investor of the other Contracting Party and to its investments, if investors of a Non-Contracting Party own or control the first mentioned investment and the first mentioned investor has no substantial business activity in the territory of the Contracting Party under whose law it is constituted or organized."*.

III. Analysis of these clauses

1. *Individual elements*

The nationality-leg has two different elements.

First it requires that the investor does not have "real economic activities" or "substantial business activities" in its state of incorporation. As far as we can see, no treaty further defines these requirements. An investment arbitration tribunal thus is faced with the difficulty of applying this clause. The plain meaning suggests that "real" economic activities require that the company has activities going beyond mere formal activities which may be statutorily required, *i.e.* paying taxes or having shareholders meetings.[207] Similarly, "substantial" business activities seems to imply that the activities are well above minimum business activities which might be required under law for a corporation to exist.

There exist, however, no clear criteria in academic literature or arbitral holdings to distinguish "substantial" or "real" activities from "insubstantial" or "unreal" activities. Holdings of arbitral tribunals are of no great assistance. In *BP et al. v. Argentina*, the arbitral tribunal affirmed that *BP* had substantial business activities in the host state without substantiating this assertion further.[208] According to its Annual Report and Accounts at the time, *BP* employed some 37,000 employees and maintained offices in 50 states so that a substantial economic activity was clearly given. In *Plama Consortium Limited v. Republic of Bulgaria,* the claimant itself acknowledged that it did not have any significant business activities in Cyprus where it was incorporated.[209] The tribunal subsequently noted in its award that it was "clear" that the claimant did not have any substantial business activities, but did not specify the reasons for that statement. Similarly, in *Petrobart v. Kyrgyzstan* the tribunal stated that the claimant had substantial business activities in the host state, but did not elaborate on the issue in depth.[210] In *Tokios Tokelės v. Ukraine,* the Lithuanian-Ukrainian BIT did not contain a denial of benefits clause. Ukraine nevertheless argued that the claimant lacked "substantial business activities" in Lithuania and therefore was not a real investor. The tribunal rejected this argument on the grounds that, unlike the ECT, the BIT did not contain such a provision. In addition, it noted that the claimant had provided it with "financial statements, employment information, and a catalogue of materials produced during the period 1991-1994", which appeared to constitute "substantial business activities" in Lithuania.[211] Further details, however, are not available. In *Amto v. Ukraine*, the tribunal considered that having an office, paying

207 *Cf. Amto (Latvia) v. Ukraine*, SCC Case No. 70 (2005), Award of 26 March 2005, para. 69.

208 *Pan American Energy LLC and BP Argentina Exploration Company v. Argentine Republic*, ICSID Case No. ARB/03/13, joined with *BP America Production Company, Pan American Sur SRL, Pan American Fueguina, SRL and Pan American Continental SRL v. The Argentine Republic*, ICSID Case No. ARB/04/8, Decision on Jurisdiction of 27 July 2006, paras. 203, 204, 221.

209 *Cf. Plama Consortium Limited v. Bulgaria*, ICSID Case No. ARB/03/24, Award of 27 August 2008, para. 81.

210 *Cf. Petrobart v. Kyrgyzstan,* SCC No. 126/2003, Award of 29 March 2005, 63.

211 *Tokios Tokelės v. Ukraine*, Case No. ARB/02/18, Decision on Jurisdiction of 29 April 2004, para. 37.

taxes and employing personnel would be sufficient to constitute "substantial activities".[212] In the three *Yukos* cases, the Claimants had conceded that they had not conducted substantial business activities, so the tribunal did not need to analyse that issue.[213] Thus, no generally applied criteria can be deduced from the awards rendered so far. It therefore seems likely that a determination whether a company has "substantial" or "real" economic activities can only be undertaken on a case-by-case basis.

The second requirement is that the company in question, which does not have substantial business activities in its state of incorporation, also needs to be owned or controlled by someone not having the nationality of the company. The wording of these clauses differs. Some treaties speak of "nationals" and some of "investors". The wording of many clauses does not explicitly require that the person owning or controlling the prospective investor is a natural person. Problems thus might arise in constellations with multiple levels of ownership by people/companies from various states. Where the chain of ownership includes companies from several states, it needs to be determined whether the denial of benefit-clause can be applied on each and every level, or only to the last and final owner[214]. That might also depend on the specific wording of each treaty.

Some clauses require that those persons are persons "of a third country", some refer to persons "of a Non-Party" and the recent 2004 US Model BIT even to "persons of a non-Party, or the denying Party". The 2004 US Model BIT thus explicitly covers *Tokios Tokelės* – like situations. As regards the ECT, certain tribunals have held that the "third state" must be a non-Contracting Party.[215]

However, whether the different clauses also have a different or the same meaning can only be determined on the basis of an interpretation of each clause within the context of the each specific treaty and in the light of its object and purpose. Whether the wording of the clause in one treaty has been influenced by the wording of another clause in an earlier treaty needs careful analysis.

2. *Function of denial of benefit clauses*

A problem which, as it seems, has first been discussed in the Decision on Jurisdiction in *Plama v. Bulgaria*[216] is the function of the denial of benefit clauses. The *Plama* tribunal had to deal with a situation where the Respondent had invoked Article 17 Energy Charter Treaty.

212 *Amto (Latvia) v. Ukraine*, SCC Case No. 70 (2005), Award of 26 March 2005, para. 68.

213 *Yukos Universal Ltd. v. Russian Federation*, Interim Award of 30 November 2008, para. 461; *Hully Enterprises Ltd. v. Russian Federation*, Interim Award of 30 November 2008, para. 461; *Veteran Petroleum Trust v. Russian Federation*, Interim Award of 30 November 2008, para. 517.

214 *Cf. TSA Spectrum de Argentine S.A. v. Argentine Republic*, ICSID Case ARB/05/5, Award of 19 December 2008.

215 See *Amto (Latvia) v. Ukraine*, SCC Case No. 70 (2005), Award of 26 March 2005, para. 61; *Veteran Petroleum Trust v. Russian Federation*, Interim Award of 30 November 2008, para. 555 (and the two other *Yukos* decisions, *supra* footnote 213).

216 *Plama Consortium Limited v. Bulgaria*, ICSID Case ARB/03/24, Decision on Jurisdiction of 8 February 2005.

The wording of these clauses clearly suggests that the state, if it wants to deny, must take positive action.[217] This already has been held by *Walker* in his seminal paper on comparable clauses in US FCN treaties:

> "It will be noted that this reservation does not specify an automatic condition precedent to the enjoyment of treaty rights by companies; rather, it is a latent protective clause which a party may utilize if it wishes to take the initiative of so doing"[218]

Treaties do not specify how the right is to be exercised. The *Plama* tribunal argued that

> "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."[219]

On the basis of that holding, *Essig* argued that states should exercise their right with a law containing an abstract and general denial of benefits provision.[220] That is not convincing. The clauses only allow a state to deny the benefits of a treaty to investors fulfilling specific criteria, *i.e.* having no "substantial business activities". That can only be determined on a case-by-case basis. Consequently, the right must be exercised vis-à-vis the investor relying on the respective treaty. A general provision in a law would not have any legal effect under the treaty as the exercise would not result in the denial of benefits to a specific investor.[221]

Most treaties simply provide that an investor can be denied "the benefits of this treaty". Where that is the case, it does not seem necessary to analyse further whether the exercise affects jurisdiction or only merits of a possible investment case.[222] The possibility of investor-state arbitration is part of the benefits an investor enjoys and is thus affected by the denial of benefits. This of course does not mean that an arbitration tribunal could not even review whether the state was entitled to exercise the denial of benefits provision, as some argue. Under the principle of *kompetenz-kompetenz*, a tribunal remains competent to decide about its own jurisdiction.

Other treaties such as the Energy Charter Treaty speak of the "advantages of this part" which can be denied, with the dispute settlement provision located in another part of the treaty. While on first sight it seems that the exercise of this right affects only the substantive rights and not the dispute settlement clause, the difference seems to be of an academic nature. Under the so-called "oil platforms"-test, investment treaty tribunals will find that they have no jurisdiction if the facts as submitted by the

217 *Ibid.*, para. 155; *Veteran Petroleum Trust v. Russian Federation*, Interim Award of 30 November 2008, para. 512.

218 *Walker,* AJIL 50 (1956), 373 (388).

219 *Plama Consortium Limited v. Bulgaria*, ICSID Case ARB/03/24, Decision on Jurisdiction of 8 February 2005, para. 157.

220 *Essig*, TDM 4 (No. 5, 2007), 1 (10).

221 *Cf. Mistelis/Baltag*, Penn State Law Review 113 (2009), 1319 *et seq.*; *Jagusch/Sinclair*, in: Ribeiro (ed.), Investment Arbitration and the Energy Charter Treaty, 73.

222 See, *inter alia*, *Empresa Eléctrica del Ecuador, Inc. v. Republic of Ecuador*, ICSID Case No. ARB/05/9, Award of 2 June 2009, para. 71.

claimant cannot give rise to a breach of the treaty. Even if the exercise of the denial of benefits-clause were to be considered to affect only the substantive rights and thus the merits of case, a tribunal would have to decline jurisdiction if the state legitimately exercised its rights under the denial of benefits clause.

A major point of controversy seems to be whether the effect of the exercise of a denial of benefits clause is prospectively, *i.e.* only from the moment of exercise onwards, or retrospectively. The *Plama* tribunal considered that a retrospective effect would contradict with legitimate expectations of an investor[223], while others noted that a denial of benefits – clause such as Article 17 ECT would put the investor on notice and prevent any legitimate expectations[224]. This paper, however, does not deal with Article 17 ECT but with denial of benefit-clauses in general. Whether a specific clause has prospective or retrospective effect depends on an interpretation of that specific clause in the context of the other provisions of that treaty and in the light of its object and purpose. It seems neither apposite nor possible, and the least in this paper, to give a general answer.

IV. Relevance for existing and future Investment Treaties

Current German bilateral investment treaties do not contain denial of benefit-clauses.

The inclusion of such clauses in future investment treaties protecting German investors (whether EU treaties or mixed treaties) would not disadvantage German companies investing abroad under the protection of a German bilateral investment treaty, unless they themselves would fall under a denial of benefit-clause (for the purposes of this paper, we assume the contrary). If they invest via a third country, *e.g.* in order to enjoy tax benefits, they might risk the denial of benefits of a BIT existing between that third country and their target country. However, several treaty tribunals now have held that in the absence of language to the contrary German BITs also protect indirectly held investments.[225]

As has been discussed at the beginning of this section, denial of benefit-clauses most likely were introduced into treaties to prevent "free riders" from obtaining treaty benefits. Investors however do not invest in Germany just because there are BITs in place. It is thus doubtful whether such clauses need to be introduced into treaties. Germany already now has means to prevent shell companies from investing in Germany, the most effective ones being so-called "treaty override clauses" in German law, denying under certain requirements foreign companies the benefits of double taxation agreements (*cf. e.g.* § 50d EStG).

However, if denial of benefit-clauses are to be included into future investment treaties, those clauses should contain more specific criteria than "substantial business

[223] *Plama Consortium Limited v. Bulgaria*, ICSID Case ARB/03/24, Decision on Jurisdiction of 8 February 2005, para. 162. This was affirmed by the three *Yukos* decisions, *cf. Veteran Petroleum Trust v. Russian Federation*, Interim Award of 30 November 2008, para. 514 (the other two decisions being similar as the tribunal was identical).

[224] *Cf. Shore*, IALR 2007, 58 (64).

[225] See the discussion below in Section G.III.

activities". The review of the existing awards and decisions dealing with this – or a similar worded – criterion shows that tribunals have little guidance to base their decisions on. With regard to double taxation treaties, such guidance exists. The economic rationale behind double taxation treaties and bilateral investment treaties might be different, making it unfeasible to 'copy' the requirements from one sort of treaty into another. The criteria used in double taxation treaties, and their suitability for bilateral investment treaties, is to be discussed in the next section.

F. Considerations and Theories from the Practice of Double-taxation Treaties

Ulrich Klemm

When projecting the starting point of this issue to the development of treaty practice concerning double-taxation treaties, one can discern certain parallels. Other than in a few early double-taxation treaties, nationality as a connecting factor has never played an important role in international tax law. Based on the OECD model tax treaty, rights and obligations under double taxation treaties rest on the term 'resident' (Art. 4 (1) of the OECD model tax treaty). Therefore, international tax law uses location-dependant factors of actual nature. The result that might be desired by applying the genuine link requirement in international investment law is achieved in the field of international tax law by Art. 4 (1) of the OECD model tax treaty. The extensive reasoning of tribunals, such as in the ICSID cases of *Siag v. Egypt* or *Champion Trading Company v. Egypt*, would not have been necessary had one used the instruments of international tax law as stated in the OECD model treaty.

Tax law also offers interesting dogmatic figures for the distinction concerning legal persons. In the case of relations to third states, one can think of qualifying the corporation as a conduit company. The benefits of tax treaties can be denied to these companies because of their mere conveyance function. It is obvious that with such provisions in BITs, Tribunals might be able to avoid controversial decisions like the one in *Tokios Tokelės* at the expense of investors engaging in abusive conduct. An additional dogmatic construct, which was introduced to the OECD model treaty 30 years ago, is the principle of the beneficial owner. It is interesting how a legal principle of the common law became so widely used in double taxation treaty practice. The term of the "beneficial owner", which is comparable with the concept of "wirtschaftliches Eigentum" in German tax law, finds its origins in Anglo-American trust law. By using the term "beneficial owner", the benefits of double taxation treaties can be denied to persons who are not within the ambit of such treaties and who may seek to enjoy the advantages of such treaties by utilising straw man (treaty shopping). Such devices might be relevant in the context of the reconsideration of indirect investments (in the sense of investments via corporate vehicles in intermediate third countries) in section G.III below.

In conclusion, one can state that more frequent use of the term 'residence' as a distinguishing factor as well as the application of principles developed for conduit companies and the theory of the beneficial owner may result in a higher precision in determining the legitimate 'investors' for the purposes of BITs.

G. Continuity of Nationality

Patricia Nacimiento

The previous sections of this paper have illustrated that nationality as requirement in BITs and MITs is not an isolated, formal concept but is rather influenced by various additional elements and is subject to interpretation. At the same time it remains the basic threshold criterion for determining whether an investor comes within the scope of protection of a certain BIT or MIT or not. Leaving aside further questions of substance, is interesting to note, however, that none of the current BITs or MITs provides for precise requirements for the time an investor is required to have maintained a favourable nationality (duration of nationality). The following section will discuss the meaning of duration of nationality in connection with international investment protection treaties (BITs and MITs) and will elaborate on explicit and implicit requirements.

I. Meaning of Duration

Problems in connection with duration of nationality may arise out of mergers, assignment, decease or cessation and may become evident in all stages of an investment dispute proceeding. The question whether an investor's nationality must remain unchanged from the date by which the dispute is brought before an investment tribunal through the date of the resolution of the claim is treated as a problem of "continuous nationality".[226] However, the question of duration of nationality is not limited to that specific point of time but needs to be considered in a broader sense both before and after that period.

Generally speaking, duration of nationality refers to the simple period of time a natural or legal person has been the national of a certain State. However, such an isolated view would misconceive the needs of the nationality requirement in the context of investment treaty practice. Rather, duration of nationality has to be read along with the definition of an investor protected under an IIA. Put this way, it is an element to consider when determining whether a natural or legal person comes within the personal scope of an investment treaty. Consequently, the question of duration may be subdivided into two parts: (i) how long will a person be required to have maintained its nationality before being considered as a "national" under an investment treaty? and (ii) for how long such nationality needs to be maintained once a request for an investment dispute settlement proceeding has been filed?

At first glance and in line with the conclusions drawn in section D of this paper, the duration requirement may be considered on a rather formal basis. Most IIAs provide for natural or legal persons to fall into their scope of application that they simply need to be nationals of a contracting State at the time the application for

[226] *Cf. McLachlan/Shore/Weiniger*, International Investment Arbitration, 151 *et seqq.*

proceedings is filed. This question may clearly be answered with "yes" or "no" and is only subject to evidence. However, requirements of duration are not only discussed in their capacity of being formal conditions, but also with regard to potential abuses. Such questions arise, for example, in cases where a company is established offshore without developing any business activities only for the purpose of coming under a specific BIT. Thus it becomes clear that the requirement of duration is closely connected to other requirements regarding 'nationality' such as the 'effective link' principle (*cf. supra* section D above).

II. Explicit Requirements

1. Bilateral Treaties

A first distinction has to be drawn between natural and legal persons since they are treated differently in international investment law.[227] While the former are subject to the nationality laws of the different States, the nationality of the latter will be determined by national company laws. This may also have implications on the question of duration for the nationality requirement.

a) Natural persons

The first point to note is that – as far as can be seen – there are no explicit requirements of duration of nationality in BITs. An exemplary study of all German BITs as of 1 June 2009[228] conducted by us has shown that the personal scope of applicability is not normally subject to a certain duration or continuity of nationality. Rather, natural persons are entitled to protection under German BITs simply in their capacity as being German citizens.

Article 1(3) of the 2005 Germany-Afghanistan BIT[229], which is geared to the 2005 German Model Treaty, may serve as an example of the common wording of recent German BITs:

> "the term "investor" means
> (a) in respect of the Federal Republic of Germany:
> – Germans within the meaning of the Basic Law of the Federal Republic of Germany,
> – any juridical person as well as any commercial or other company or association with or without legal personality having its seat in the territory of the Federal Republic of Germany, irrespective of whether or not its activities are directed at profit, […]"

Nevertheless, it is interesting to note that two BITs stand out for their additional requirements. The 1986 Germany-Hungary BITs scope of application is limited to

227 *Schlemmer*, in: Muchlinski/Ortino/Schreuer (eds.), International Investment Law, 49 (75).
228 Total number of Bilateral Investment Treaties concluded, 1 June 2009: available at: <http://www.unctad.org/sections/dite_pcbb/docs/bits_germany.pdf> (accessed 25 March 2011).
229 Germany-Afghanistan IIA.

Germans and Hungarians with their "place of residence" within the territorial scope of the BIT.[230] Similarly, but even more rigid, the 1990 Germany-Czechoslovakia BIT defines investor as "natural person with its permanent place of residence" within the territorial scope of the BIT.[231]

In connection with these special requirements, two remarks must be made. First, it is important to note that they do not directly apply to duration of 'nationality', but merely complement the nationality requirement with an additional condition. Therefore, it cannot be concluded that they stipulate 'nationality' of a certain duration. However, 'nationality' and 'residence' have to be read along with each other. Put another way, the sole fact of nationality does not allow for protection under the relevant BIT as long as the national is not resident in the State and is not a permanent resident respectively.

The second observation concerns the usage of the residence requirement and its consequence for the construction of BITs without such requirement. It may be said that if a State had the intention to protect only natural persons who have been nationals for a certain period of time when concluding a BIT, the State would most likely have introduced the 'residence' or 'permanent residence' requirement into the BIT.

Also, there is no reason to believe that States are legally not free to combine 'nationality' directly with a duration requirement (leaving aside political reasons). It could therefore be concluded that in the absence of such additional requirement, there is evidence that it is the intention of a contracting State of a BIT that 'nationality' should not be construed in a way that introduces an additional time element.

As far as can be seen, the same applies to most other BITs concluded by States other than Germany with regard to natural persons.[232]

b) *Legal persons*

As far as legal persons are concerned, there are also no explicit duration requirements. In the majority of cases, German BITs provide protection to any legal person with its seat in the territory of Germany. Again, the 2005 German-Afghanistan BIT[233] may serve as an example stating in Article (1)(3)(a) that:

> "any juridical person as well as any commercial or other company or association with or without legal personality having its seat in the territory of the Federal Republic of Germany, irrespective of whether or not its activities are directed at profit, […]".

[230] Article 1(3) a), Germany-Hungary IIA.

[231] Article 1(3), Germany-Czechoslovakia IIA. The same applies to the 1976 Germany-Israel IIA with regard to the nationals of Israel, Germany-Israel IIA. For other countries, see also *McLachlan/Shore/Weiniger*, International Investment Arbitration, 141.

[232] *Schlemmer*, in: Muchlinski/Ortino/Schreuer (eds.), International Investment Law, 49 (71 *et seq.*) with further evidence on p. 81; *McLachlan/Shore/Weiniger*, International Investment Arbitration, 140 *et seq.*

[233] Total number of Bilateral Investment Treaties concluded, 1 June 2009, available at: <http://www.unctad.org/sections/dite_pcbb/docs/bits_germany.pdf> (accessed 25 March 2011).

No further references to the duration of the seat are made. This seems to be consistent with international treaty practice. While the concept of determining nationality in international treaties may theoretically include consideration of the place of incorporation, the seat of its registered office, the effective business seat of the corporation or of the nationality of the natural persons in control of the corporation, the widest criteria used in BITs are administrative or effective seat.[234] Again, as neither criterion is conclusively defined by public international law but rather subject to municipal law, BITs themselves do not contribute anything to the question of duration.

2. *Multilateral Treaties*

A review of relevant MITs (*i.e.* NAFTA, ECT, ASEAN and ICSID Convention) shows that they also lack explicit requirements on duration of nationality.[235] As far as the question of how long nationality has to be maintained once a request for an investment dispute settlement proceeding has been filed is concerned, the ICSID Convention is an exception. Article 25(2) ICSID reads as follows:

> "National of another Contracting State" means:
> (a) any natural person who had the nationality of a Contracting State other than the State party to the dispute on the date on which the parties consented to submit such dispute to conciliation or arbitration as well as on the date on which the request was registered pursuant to paragraph (3) of Article 28 or paragraph (3) of Article 36, but does not include any person who on either date also had the nationality of the Contracting State party to the dispute; and
> (b) any juridical person which had the nationality of a Contracting State other than the State party to the dispute on the date on which the parties consented to submit such dispute to conciliation or arbitration and any juridical person which had the nationality of the Contracting State party to the dispute on that date 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."

Thus, it appears clear that, at least for a dispute filed under the ICSID dispute settlement provisions, a natural person as investor is required to have a certain nationality at the date the request for an ICSID proceeding has been filed (*dies a quo*) and on the date such request has been registered ("double test").[236] However, no statement is made with regard to the date of the decision (*dies ad quem*). It should also be thoroughly noted that the double test only applies to natural persons.

[234] *Schlemmer*, in: Muchlinski/Ortino/Schreuer (eds.), International Investment Law, 49 (76).
[235] Compare *McLachlan/Shore/Weiniger*, International Investment Arbitration, 143 *et seqq.*
[236] See *Schreuer*, The ICSID Convention: A Commentary, Article 25, paras. 448-455.

3. Interim Result

As a first result, it can be said that international treaty practice lacks explicit requirements about the duration or the continuation of nationality with some rare exceptions. Therefore, it appears *prima facie* that States did not intend to establish the requirement of a certain duration of nationality. If they had wanted to do so, they would have been free to include appropriate limitations in the treaties.

III. Implicit Requirements

Nevertheless, there may be implicit requirements concerning the duration of nationality out of municipal law or public international law rules.

1. Municipal Law

In principle, States are free to choose the criteria that will determine nationality under an international treaty.[237] They are not bound by their municipal legislation.[238] Leaving aside the different concepts and rules of municipal law of citizenship, it may be nevertheless worth noticing that it is unlikely and – as far as can be seen – untypical that States do assign citizenship without any effective link between an individual and the respective State.

Rather, it is likely that such effective link requirement may also include a time element, *e.g.* duration of residence etc. Implicitly, as protection under an IIA is primarily dependent on the nationality as ascertained by municipal law, this has an influence on the personal scope of application of the relevant IIA. Nevertheless, such municipal laws may vary widely and provide for very different requirements.

In contrast, nationality of a legal person is subject to the determination by municipal law only to a lesser extent. The concepts of incorporation and (effective) seat are widely known not only to all local company laws but also to (public) international law. Therefore, even though States are in principle free to determine the nationality of a corporation within their national boundaries according to their own criteria,[239] they are in practical terms more restricted, as the principles they use are also defined in international law. Similarly to the case of natural persons, this may lead to the extraction of an implicit duration requirement. If, for example, a State uses the effective seat criterion, the minimum duration would be the time to establish such effective seat by the corporation. This applies *mutatis mutandis* to all other concepts.

[237] *Dolzer/Stevens*, Bilateral Investment Treaties, 31.

[238] *Ibid.*

[239] For the ICSID Convention, see *Schlemmer*, in: Muchlinski/Ortino/Schreuer (eds.), International Investment Law, 49 (77).

2. *Public International Law*

In general, Public International Law does not provide for rules applicable to the determination of nationality of an individual.[240] This is reflected by the text of the 1930 Hague Convention on Certain Questions Relating to the Conflict of Nationality Laws, which never came into force but reflects the generally accepted position in international law.[241] Article 1 of the Convention reads as follows:

> "It is for each State to determine under its own law who are its nationals. This law shall be recognized 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."

However, as it has been shown in-depth in section D.I.3 of this paper, rules of (general) public international law may apply, or at least strongly influence, the concept of nationality in international investment treaties. Such application would also concern duration of nationality as one element of the general notion of "nationality".

Coming back to the *Nottebohm* case[242], the "bond" mentioned by the ICJ is likely to contain an element of duration as it sets forth substantive requirements for the conferral of a certain nationality (*i.e.* citizenship). This may therefore be an initial source for the concretion of the duration requirement by international tribunals.

As far as the nationality of legal persons is concerned, an ICSID tribunal in the *Loewen* case has decided in a NAFTA dispute that in

> "international law parlance, there must be continuous national identity from the date of the events giving rise to the claims, […], through the date of the resolution of the claim, […]".[243]

This statement is enlightening with regard to a certain period of time for legal persons, but it does not help for the question of duration in general and for natural persons. As far as the latter are concerned, it is most likely that the *Loewen* findings may not be applied to them as the underlying concepts of nationality for natural persons on the one hand and legal persons on the other hand differ to a large extent.

Although the *Loewen* award only deals with the period of time between the date of the events through the date of the resolution of the claim and expressly notes that

> "[t]here is no language in those articles, or anywhere else in the treaty, which deals with the question of whether nationality must continue to the time of resolution of the claim [.]"[244]

it may serve as a reference for further reflections in a broader sense. While other international tribunals concerned with investment arbitration have adopted a rather formal approach (*cf.* section D above), the *Loewen* tribunal does not limit its scope of jurisdiction to the text of the treaty but holds that:

[240] *Ibid.*, 71 *et seqq.*
[241] *Ibid.*
[242] ICJ, *Nottebohm Case*, (Liechtenstein v Guatemala*)*, ICJ Report 1955, 4.
[243] *The Loewen Group, Inc. and Raymond L. Loewen v. United States of America*, ICSID Case No. ARB(AF)/98/3, Award of 26 June 2003, 42 ILM 811 (2003).
[244] *Ibid.*

"[i]t is that silence in the Treaty that requires the application of customary international law to resolve the question of the need for continuous national identity."[245]

Applied *mutatis mutandis* to the duration of nationality requirement, such an approach would require to draw substantive provisions of duration from the general rules of public international law. Consequently, one would have to "extract" the duration element from the relevant judgments and awards of public international law.

However, as long as it is controversial if such "substantive" approach may be taken from a general point of view, it may rather be advisable to refrain from deriving substantive provisions from such general decisions.

IV. Conclusion

These reflections have shown that:

- there is no explicit requirement in the wording of most IIAs neither with regard to the question of how long will a person be required to have maintained its nationality before being considered as a 'national' under an investment treaty nor for how long such nationality needs to be maintained once a request for an investment dispute settlement proceeding has been filed. A rare exception is the ICSID Convention;
- neither national laws nor public international law provides for clear rules to determine the question of duration of nationality and

international arbitration courts may tend to apply a rather formalistic approach in case the question of nationality would rise under an IIA.

[245] *Ibid.*

H. Policy Issues: Is the Current Status of Law and Treaty Practice Satisfactory?

Patricia Nacimiento – Sections I. & II.
Patrick Fiedler, Robert Hunter, Ulrich Klemm – Section III.

This final section of the paper is concerned with identifying areas that might usefully be the subject of further attention by and discussion between states and multinationals to promote legal certainty and the continuing sustainability of a fair and useful investment protection programme, obviously within the scope of the issues addressed by this paper.

I. Is it sustainable in the eyes of contracting states?

Ultimately a definite answer to the question whether the current status of law and of treaty practice are sustainable may only be provided by contracting States themselves. However some observations may help to answer this empirical question.

First, one has to remember that States themselves have the power to design the BITs they conclude and to exercise influence on the drafting of multilateral treaties. As has been shown above in question 1, there has been to date an enduring consistency in the general design and the wording of IIAs. This is strong evidence for the fact that States consider such treaty practice to be sustainable. Nonetheless, there are signs that the situation may now be becoming more dynamic.

Secondly, the same conclusion applies as far as the construction of IIAs by international tribunals as part of the treaty practice is concerned. States are free to correct treaty practice as interpreted and applied by tribunals by redesigning the wording of their future IIAs.

II. Do current nationality provisions meet the needs of multinational corporations?

As it is stated in the first paragraph of this Section, the definition of nationality is of real practical importance to investors, both at the time of the structuring and making of an investment. This is particularly true for multinational corporations ("MNCs"), as they are the most important cross-border investors in terms of amounts invested. To determine whether the current status of law (*i.e.* nationality requirements under IIAs) and treaty practice meet the needs of MNCs, one needs to consider (i) the structure of MNCs themselves and (ii) the structure of their investments.

1. The structure of MNCs and IIAs

In terms of legal form, a MNC may be structured in very different ways. What is common to all MNCs is that they operate cross-border controlling one or more affiliates in a State other than their home State. Such control may be legal or *de* *facto*.[246] Therefore, their investments constitute Foreign Direct Investment (FDI) activities, which need to be distinguished from pure portfolio investments. Typically, they are in full control of a local subsidiary. As it has been shown above, the nationality of a legal person in IIAs is determined by place of its incorporation, the seat of its registered office, its effective business seat or by reference to the nationality of the natural persons in control of the corporation.[247] Also, the notion of a legal person tends to be broad in general IIA usage. For these reasons, it may be concluded that MNCs raise no general problems with regard to IIAs nor are there concerns about the applicability of IIAs with regard to the nationality requirement as they are free to establish a foreign subsidiary with full legal personality.

However, the structure of MNCs may lead to problems when determining the nationality of a corporation, for example with the effective seat test, in certain cases. The more MNCs become 'transnational', the more problems will occur when applying the standard nationality tests. In addition, the complex legal structures under which several MNCs are established makes it very difficult to apply such tests. However, MNCs seem to cope with this situation. As far as can be seen, there is no case with a substantial dispute over the nationality requirement involving a MNC. Rather, the wide approach of most IIAs allows for a large manoeuvring room for MNCs when designing their legal structure.

2. *The structure of MNC investments and their protection by IIAs*

In principle, the same applies to the structuring of an MNC's investments. To the extent that MNCs act through portfolio transactions, they will not be treated differently from purely national corporations. When they invest through FDI, which means they establish a subsidiary to conduct their business activities, the same questions on the test of nationality will apply for the subsidiary. It is again under the control of the MNC to structure the holding in such way as to come under the scope of a certain IIA. In this connection, problems may appear when it is not clearly distinguishable which entity (the "mother" MNC or the subsidiary) has acted with regard to a business transaction. Often, cross-border transactions are conducted out of more than one location of the MNC's internal network. This gives rise to the possibility of questions about who is the real investor in the sense of an IIA. As discussed in section H.III below, such difficulties may be partly resolved with a clear definition of 'investment' in an IIA, but the problem of nationality for the determination of the personal scope of application will remain unaffected. This problem may be solved on a multilateral level. When concluding BITs, States are only entitled to act with regard to their national territory for sovereignty reasons. Therefore, 'nationality' will always be at the core of the personal scope of application in such treaties. Only when acting multilaterally may States find consistent solutions for MNCs with different places of business.

246 *Muchlinski*, Multinational Enterprises and the Law, 51 *et seqq.*
247 *Ibid.*, 679.

3. Conclusion

The current status of law and treaty practice seems to meet the needs of MNCs in general with regard to the nationality requirement. Nevertheless, the complex structures of MNCs are likely to raise problems in connection with the personal scope of applicability of s. These questions are subject to further detailed studies.

III. Related issues concerning investments through Third Countries

At first glance, a consideration of issues concerning the definition and determination of the meaning of 'investments' is outside the scope of a paper concerned with the nationality – and therefore the definition – of 'investors'. On closer inspection, questions of nationality are inextricably linked to questions of indirect investment as a matter of policy in the context of the promotion and protection of cross-border flows of investment, particularly within the context of multinational corporations. Not least, the very notion of a 'control test' when applied to defining a corporate investor's nationality involves a blurring of the distinction between 'investor' and 'investment' to a substantial extent.

1. What is 'indirect investment'?

The phrase 'indirect investment' may be used to describe a variety of different situations. In the context of this paper we use it to describe situations where an investor makes its investment indirectly through a supervening legal entity so that the actual investment is directly made by that entity rather than the investor from whom the capital for the investment derives. The intermediate legal entity or entities may be incorporated either in the host state of the investment or in third states. The focus of this section is on the latter.

The situation where the intermediate legal entity is incorporated in the host state itself is typically regulated by express wording in investment treaties. This is necessary since it is very common in practice that a host State will admit certain types of investment only through the establishment of a local corporation and it would substantially defeat the purpose of promoting foreign investment if all such investments were to be excluded from the scope of protection. For this reason, BITs almost invariably contain express provisions allowing claims based upon foreign investment through locally incorporated companies. There are two ways that this is typically achieved.

The first is through including shareholdings in the host state within the definition of investments qualifying for protection. Such a technique has been used from the very first BIT[248] and has generally proved satisfactory in practice to deal with the

[248] Article 8(1)(b) of the Germany-Pakistan IIA (1959) includes "any partnerships, companies or assets of a similar kind, created by the utilisation" of "capital brought into the territory for investment" as "investment" for the purposes of this first bilateral investment treaty. By 1961 the Germany-Thailand BIT already contained the now familiar list of "every kind of asset" including "shares or other kinds of interest in companies".

situation of locally incorporated investment vehicles. (The inclusion of shareholdings in the definition of protected "investments" resolves the question of qualification for protection but leaves other related issues open, above all as regards the valuation of the investor's loss since the loss of the local affiliate company may typically not be reflected directly in the loss of value of its shares in the intermediate corporate vehicle. Such complexities of valuation go beyond the scope of this paper, which is concerned solely with the question of the scope of protection.)

An alternative way of solving the problem of protecting locally incorporated SPVs is exemplified by Article 25 (2) (b) (ii) of the Washington Convention, which provides instead that a corporation that has the nationality of the host State of the investment may still be entitled to bring a claim if it is controlled by nationals of another contracting State.

The situation is much less frequently regulated by express provisions in BITs when it comes to investments owned through intermediaries in third states. Irrespective of whether an investor may be required to incorporate a local investment vehicle in the host state itself, that investor may wish or even need to structure its investment through a third country subsidiary that has been interposed between the investor itself and the investment.

It is very common in practice for investors to structure their foreign investments in this way. One ready illustration of this is to compare the amount of primary foreign direct investment[249] made by German investors in developing economies with the amount of direct investment they made in states which are widely used for the seating of intermediate holding companies. According to a German Federal Bank study, German FDI in China amounted to 14 billion Euros in 2007 and in Brazil 9.2 billion Euros and in India 3.8 billion Euros, whereas in the same year German investors invested in the Cayman Islands, Hong Kong and Bermuda 9.7 billion, 4.7 billion and 1.3 billion Euros respectively.[250] Similarly, a study by China's Ministry of Commerce (MofCOM) has shown that only 5% of the cumulated FDI between 1990 and 2005 in China stemmed directly from the UK, France and Germany together whereas 6% was made by legal entities incorporated in the British Virgin Islands alone and[251] 45% came from Hong Kong and Macao. These data suggest that a large amount of investment both going into and coming out of China is channelled through third States.

Where – as frequently – there is no express provision in the applicable BIT to deal with the question, tribunals have typically allowed claims concerning such 'indirect' investments, reasoning that indirect claims are not prohibited by the treaties. A recent example is the jurisdictional decision in the ICSID case of *Tza Yap Shum v. Peru.* Here the (Chinese) investor set up a local corporation in Peru which then was

[249] Primary direct investment constitutes the direct capital links arising from residents' participating interests in enterprises abroad.

[250] German Federal Bank, Bestandserhebung über Direktinvestitionen, April 2009, available at: <http://www.bundesbank.de/download/statistik/stat_sonder/statso10.pdf> (accessed on 25 March 2011).

[251] Network Center of MOFCOM, available at: <http://english.mofcom.gov.cn/statistic/statistic.html> (accessed on 25 March 2011).

transferred to a subsidiary incorporated by the investor offshore in the British Virgin Islands.[252] As a result the actual investment in Peru was held only indirectly by the Chinese investor through his offshore company in the BVI. The tribunal upheld the claim against a jurisdictional challenge based on the fact of such indirect investment.

The starting point for the reasoning of such decisions is the definition of the term "investment". In *Siemens A. G. c. República Argentina*[253], the Tribunal noted that (as also in the *Tza Yap Shum v. Peru* case) there was "no explicit reference to direct or indirect investment" in the relevant BIT (Germany-Argentina) and that the definition of 'investment' was very broad. The drafters of the Germany-Argentina BIT had included a non-exhaustive list of "particularly" included investments. The Tribunal concerned itself with one of these categories: "shares, rights of participation in companies and other types of participation in companies" and held that its plain meaning was that shares held by a German shareholder were protected under the Treaty and the BIT did not require that there be no interposed companies between the investment and its ultimate owner. Therefore, a literal reading of the Treaty could not support the claim that the definition of investment excluded indirect investments.

In a number of other cases concerning, for example, NAFTA[254], the US-Kazakhstan BIT[255] and the France-Dominican Republic BIT[256], tribunals have been primarily concerned with determining the investors' nationalities rather than the nationalities of corporate schemes through which the investment had been channelled. These cases suggest a consensus that in the absence of the explicit exclusion from an investment treaty's protection indirect investment is included within the definition of investment.

It should be noted however that this support is sometimes qualified. For instance, the tribunal in its award in *Tza Yap Shum v Peru* noted in the context of a consideration of the risk of multiple claims that in the instant case the investor was by far the majority shareholder in the only intermediate company separating him from the investment. This implies that, in similar cases involving indirect investment where no explicit provision is made in the applicable investment treaty, tribunals may differentiate between cases such as *Tza Yap Shum* involving short chains of majority holdings and other situations involving minority holdings held through multiple layers of intermediate companies. Similar concerns were expressed, for instance, in *Enron Corporation et. al. v. República Argentina,* where the Claimant had indirectly owned approximately one-third of the shares in an Argentinean company and made a claim under the US-Argentina BIT, which explicitly protected indirect investment.

252 *Tza Yap Shum v. Peru*, ICSID Case No. ARB/07/6, IIC 382, Decision on Jurisdiction and Competence, 19 June 2009.

253 *Siemens A. G. v. República Argentina*, ICSID Case No. ARB/02/8, Decision on Jurisdiction of 03 August 2004, para 139.

254 *Waste Management v. United Mexican States,* ICSID Case No. ARB(AF)/98/2, Award of 2 June 2000, para. 85.

255 *AIG Capital Partners, Inc. and CJSC Tema Real Estate Company v. Republic of Kazakhstan*, ICSID Case No. ARB/01/6, Award of 7 October 2003.

256 *Sociéte Générale v. The Dominican Republic*, LCIA Case No. UN7927, Award on Preliminary Objections to Jurisdiction of 19 September 2008, para. 52 and Annex 1.

2. Recent State Practice

Recently, an increasing number of BITs have included specific wording addressing the question of investments held through third states. On the whole, these have tended to be favourable to extending the scope of protection to include such forms of investment, at least to some extent. In such cases, provisions define a foreign incorporated company as belonging to a capital exporting state using the control theory in determining the nationality of the corporate 'investor'. Examples of this explicit approach can be seen in the Sweden-Indonesia and Finland-Estonia BITs. In both cases the treaty's definition of investor includes a company incorporated in a third state but with a "*predominant interest*" held by an investor of a contracting state. Another example is in the new Germany-China BIT of 2003. While this contains on the one hand the decades-old definition of "investment" as meaning "ev*ery kind of asset invested directly or indirectly by investors of one Contracting Party in the territory of the other Contracting Party",* it adds a new qualification of "invested directly" as meaning

> "… invested by an investor of one Contracting Party through a company which is fully or partially owned by the investor and having its seat in the territory of the other Contracting Party".

The Netherlands-China BIT of 2002 contains a more restrictive definition, presumably aimed at avoiding the possibility of multiple claims:

> "The term 'investments' ... includes investments of legal persons of third States which are owned or controlled by investors of one Contracting Party and which have been made in the territory of the other Contracting Party in accordance with the laws and regulations of the latter. The relevant provisions of this Agreement shall apply to such investments only when such third state has no right or abandons the right to claim for compensation after the investments have been expropriated by the Contracting Party."

In contrast, other modern treaties suggest a trend in the direction of specifically <u>ex</u>cluding the protection of investments made through third state holdings. For instance, the current German Model BIT contains the following new qualification:

> "In the case of indirect investments, in principle only those indirect investments shall be covered which the investor realises via a company situated in the other Contracting State."

While framed only in terms of a "principle", the intention of this addition may be presumed to be to exclude (rather than include) holdings of shares of German investors through third state companies from the scope of protection. Certainly it gives little comfort to an MNE planning an investment through an intermediate holding in a third state.

The fact that a number of treaties and proposed model treaties now specifically address this issue merits an examination of the policy issues that might motivate the development of a state practice on the one hand and the legitimate needs of corporations in structuring their investments on the other. This is particularly relevant at a time when the European system of BITs is fundamentally subject to review in the light of the ratification of the Treaty of Lisbon and its transfer of competence for foreign direct investment to the European Union's Common Commercial Policy with effect from December 2009.

3. *Policy Issues from the Perspective of States*

From the point of view of a net capital-exporting state, one reason to wish to restrict protection of investments held through third states might be pursuance of the OECD's declared policy to crack down against tax havens. OECD states have been engaged in heightened efforts to increase pressure and impose sanctions on tax haven states since the beginning of the financial crisis in 2007. The more restrictive drafting of BITs so as to exclude investment treaty protection for investments made through third states might be intended to act as a disincentive to the structuring of investments in this manner consistent with such a general fiscal policy of discouraging the use of tax havens. Such a policy would be primarily a concern of capital exporting states.

From the perspective of a net capital-importing state, a different concern is that the protection of investments through third states opens up the possibility of facing multiple claims before diverse tribunals and differing investment treaties in situations where the host state of the investment has treaties with both the state of the parent company and the state of the intermediate holding company. Under the trend of broad interpretation of "indirect" investments, investors who funnel their investments through offshore vehicles in such jurisdictions may benefit from the protection afforded to their intermediary investor as well as continuing to benefit from protection under the BITs of their home state. Although any such duplication should properly be taken into account in the assessment of loss under any particular award, the prospect alone of having to defend multiple claims is sufficient motivation to a state to seek to avoid such a situation in the first place even leaving aside the additional disadvantage of the risk of the legal uncertainty created by the possibility of inconsistent decisions. Further, even where claims might otherwise be coordinated within the umbrella of a group concern, separate proceedings will typically be necessary where the MNE wishes to ensure that it has the best chances of recovering all of its loss and where there is no available practicable regime of consolidation or joinder of investor-state proceedings.

Finally, it might be said that the exclusion of indirect investment creates a more certain and straightforward framework since it will generally avoid the need for a tribunal to look beyond the formalities of the particular investment or to become involved in complex issues of valuation of loss in more remote relationships.

4. *Policy Issues from the Perspective of Corporations*

From the investor's point of view, and particularly in the case of a multinational enterprise ("MNE"), there are a number of reasons why an investment in a foreign country might desirably if not even necessarily be channelled via a third state.

First, a very common motive is tax optimisation. In contrast to tax avoidance and evasion which are not tolerated in the German and other legal systems, tax optimisation is commonly regarded as legitimate. Indeed the German Constitutional

Court has long held it to be a fundamentally protected human right,[257] reasoning that taxpayers are allowed to choose the least tax intensive out of multiple legitimate options.

Secondly, there may be operational reasons for structuring a foreign investment through a third country vehicle. For example:

a) An MNE might organise its global business in different operating divisions, each structured as a separate company. Investments in each of the specific divisions will likely then be held not directly by the MNE's group holding company but through the intermediate 'parent' company of the particular division. Such company may well be incorporated in a state other than that of either the global parent or the particular investment.
b) Cultural and language reasons might play a role in the use of regional interim holdings. For instance, it might be convenient to hold and administer Asian investments through an intermediate parent in, *e.g.*, Singapore, where it is convenient to concentrate employees with the required language and cultural skills to deal with a multitude of subsidiaries in countries like India, China, Malaysia and Indonesia.

Thirdly, the holding of foreign investments through entities in a third state may be required or desirable to simplify anticipated future M&A activity. For instance, different jurisdictions require different formalities for the transfer of shares. In some states the transfer of the shares of a limited company is not subject to notarisation whereas it is in others. In other states such as China formalities of transfer may take a very long time to the extent that they act as a deterrent or other hindrance to M&A activity. In such cases the MNE will want to structure its foreign investments from the outset in a way that will enable efficient disposal of an investment as and when later required.

Finally, there may of course be cases where the choice of intermediate holding is dictated specifically by "treaty shopping": that is, where the ultimate investor would have no or inadequate protection for its investment due to the lack of an appropriate BIT between his own state and that of the target of the investment and the investment is therefore structured through a third state that does have such a treaty (*e.g.* as in the ICSID case of *Aguas del Tunari S.A. v. Republic of Bolivia*, where the investor appears to have been motivated by the search for a more advantageous BIT.[258])

5. Finding a Balance

How then to balance these reasons against the interests of exporting and importing states outlined above?

As a general point, it may be said that from the point of view of an MNE based in, say, Germany, an investment in a foreign country is part of its property and operation irrespective of whether it is held directly or indirectly. This is evident even from the existence of the consolidated balance sheet: it makes no significant difference

[257] German Constitutional Court, BVerfG, NJW 1959, 979.

[258] The case is not typical for indirect investments since it was based on a Netherlands-Bolivia IIA.

to such a balance sheet whether a plant that has been expropriated in a particular host country was held directly or indirectly by the group parent. It is therefore consistent with the intention of an investment treaty – that is, to promote investments of investors of the one state in the other contracting state – to treat all such investments alike.

A capital exporting state may indeed have fiscal motives to encourage direct investment over indirect (third state) investment. It may for instance be concerned to avoid the use of two-tier layers of single purpose vehicles designed only to avoid capital gains tax in the home state upon the sale of the investment. However, it might be asked whether investment treaties are the correct forum for the implementation of a tax policy. Even if it were, German tax avoidance legislation has generally been aimed at prohibiting schemes directed at income that was originally generated in Germany being structured via other states to avoid the payment of taxes in Germany rather than at encouraging income earned abroad to be structured so as to maximise fiscal revenues in Germany from German-controlled or initiated operations abroad. Moreover, applying a fiscally-motivated exclusion of indirect investments indiscriminately risks excluding from the scope of protection many investments that have been motivated wholly or partly by other non-fiscal reasons such as those mentioned above.

From the perspective of a net capital importing country, the risk of multiple claims may perhaps be mitigated in other ways.

The risk of outright treaty shopping is not one that is effectively addressed by the exclusion of indirect investment: the "mischief" here is not the "indirectness" of the investment but rather the lack of substantial connection between the SPV and the state in which it is incorporated and is therefore one that can be addressed where necessary in other ways through denial of benefit clauses or through the application of the doctrine of abuse of rights.

The risk is rather that the inclusion of indirect investments in the treaty of the state of a group parent country with a particular host state might provide two or more tiers of protection for the same investment of capital: one from the state of the group parent and another from the third state in which the group parent's intermediate vehicle is situated. One way to address this risk is that adopted in the Netherlands-China BIT cited above aimed at giving priority to the claim of the most "direct" investor to the exclusion of more remote indirect ones. However, this solution is problematic from the perspective of an MNE for several reasons:

a) First, as mentioned already above, from a group concern point of view it is irrelevant whether an investment is owned directly by the group parent or an intermediate company within the group. The protection of the interests of an MNE should not depend on whether a third state has signed a BIT with the home state of the investment; rather, the MNE's home state's protection should extend to all that MNE's investments within the material scope of protection of any particular BIT. The Netherlands-China solution is not a complete answer to this question: while it does provide protection of the investor's home state in the situation where there is no BIT at all between the intermediate state and the host state (or the rights under it have been abandoned), in the situation whether there is such a BIT it abrogates responsibility for both the standard and the enforceability of the protection under that BIT to the intermediate state.

b) Secondly, there are political factors why the MNE might prefer the protection of its home state to that of a third state. For instance in the post-award phase the MNE is likely to receive more support in obtaining fulfilment of an award from its own government than from that of a third state with a weaker association.

c) Thirdly, the provision of protection for indirect investments might also affect the availability of investment guaranties and other aspects of export financing.

d) Fourthly, it risks the loss of protection should the MNE relocate or otherwise restructure its intermediate companies while retaining its own nationality.

6. Recommendations

The wholesale exclusion of indirect investments from the scope of the protection of investment treaties as a matter of state practice may not be in the interests of German investors, in particular MNE's. On the other hand, the interests of German investors do not require that all indirect investments, however remote, be included within the scope of protection of German BITs.

The more moderate restriction as it has been formulated in the Netherlands-China BIT is not an ideal solution for the reasons iterated above. If restrictions on the scope of protection need to be found to provide a sustainable alternative to the current practice of indiscriminate inclusion of all indirect investment, industry and government should seek to find an alternative formulation that addresses the legitimate concerns of both states and investors, such as defining criteria for the inclusion of indirect investments appropriate in particular to the needs and practices of MNEs. The solutions attempted in the Sweden-Indonesia and Finland-Estonia BITs mentioned above may provide a possible model.

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NEW ZEALAND

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SPAIN

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