Kiev Arbitration Days 2013

Denial of Benefits in Investment Arbitration: requirements and effects

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Denial of Benefits – Definition under the ECT

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ARTICLE 17
NON-APPLICATION OF PART III IN CERTAIN CIRCUMSTANCES

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

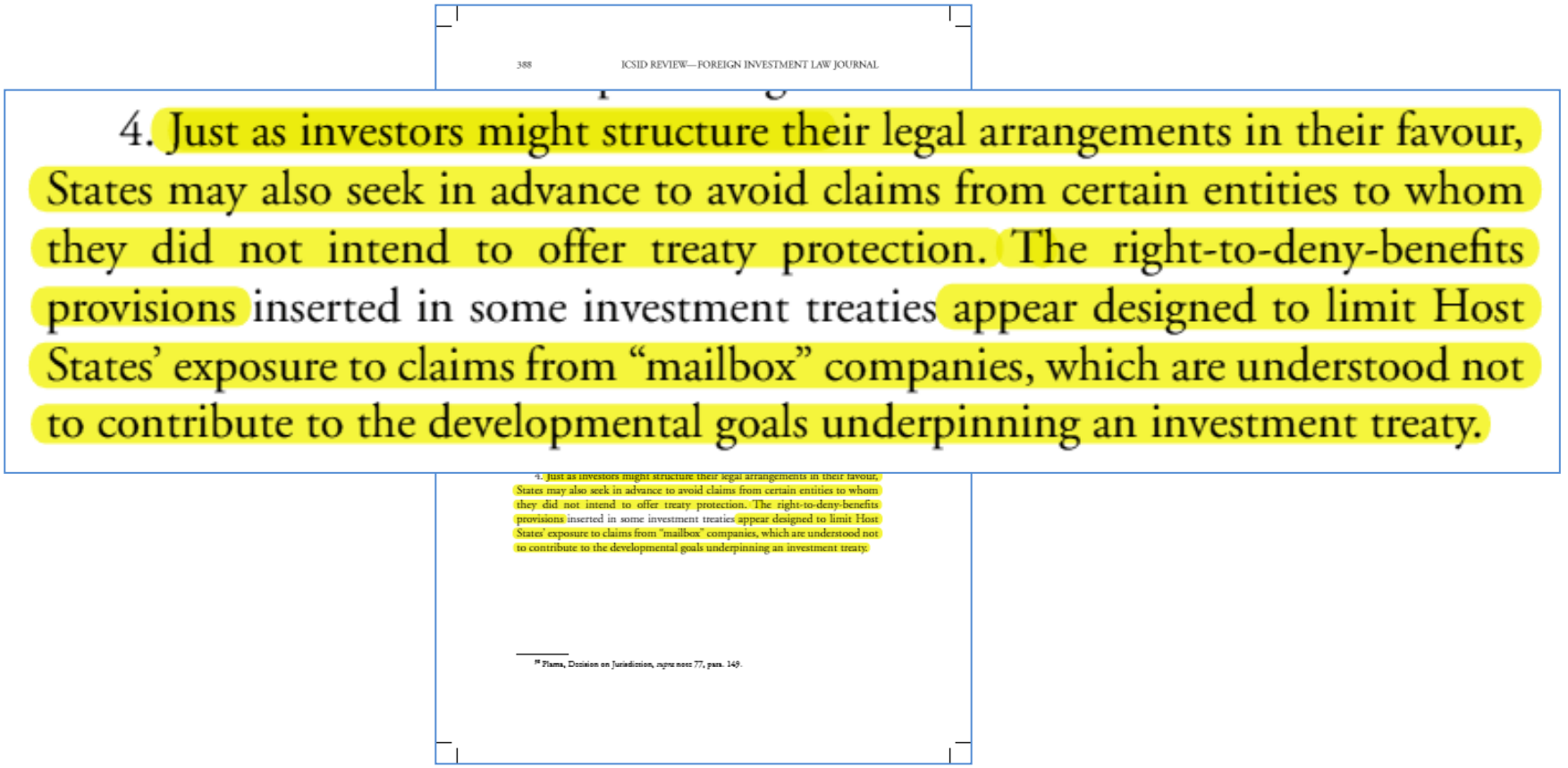
(b) adopts or maintains measures that:

(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.

Energy Charter Treaty, available at: http://www.encharter.org/fileadmin/user_upload/document/EN.pdf, Article 17

The *rationale* behind the rule



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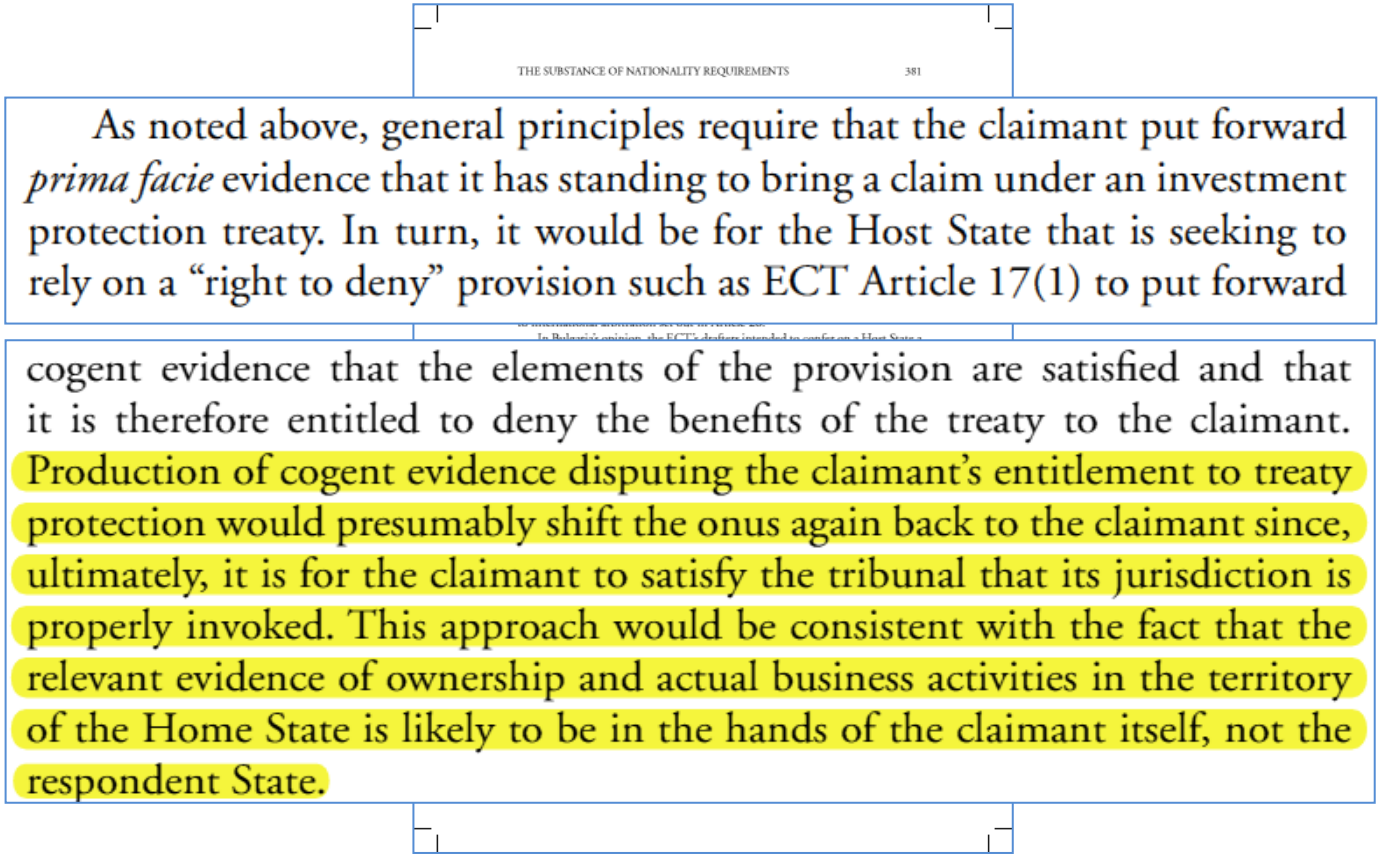
4. Just as investors might structure their legal arrangements in their favour, States may also seek in advance to avoid claims from certain entities to whom they did not intend to offer treaty protection. The right-to-deny-benefits provisions inserted in some investment treaties appear designed to limit Host States' exposure to claims from "mailbox" companies, which are understood not to contribute to the developmental goals underpinning an investment treaty.

4. Just as investors might structure their legal arrangements in their favour, States may also seek in advance to avoid claims from certain entities to whom they did not intend to offer treaty protection. The right-to-deny-benefits provisions inserted in some investment treaties appear designed to limit Host States' exposure to claims from "mailbox" companies, which are understood not to contribute to the developmental goals underpinning an investment treaty.

[59] Plama, Decision on Jurisdiction, *supra* note 77, para. 149.

Anthony C. Sinclair, The Substance of Nationality Requirements in Investment Treaty Arbitration, ICSID Review-FILJ No. 20, 2005, page 388

A practical issue: *onus probandi*



THE SUBSTANCE OF NATIONALITY REQUIREMENTS 381

As noted above, general principles require that the claimant put forward *prima facie* evidence that it has standing to bring a claim under an investment protection treaty. In turn, it would be for the Host State that is seeking to rely on a "right to deny" provision such as ECT Article 17(1) to put forward cogent evidence that the elements of the provision are satisfied and that it is therefore entitled to deny the benefits of the treaty to the claimant. Production of cogent evidence disputing the claimant's entitlement to treaty protection would presumably shift the onus again back to the claimant since, ultimately, it is for the claimant to satisfy the tribunal that its jurisdiction is properly invoked. This approach would be consistent with the fact that the relevant evidence of ownership and actual business activities in the territory of the Home State is likely to be in the hands of the claimant itself, not the respondent State.

Anthony C. Sinclair, The Substance of Nationality Requirements in Investment Treaty Arbitration, ICSID Review-FILJ No. 20, 2005, pages 380-381

What does "substantial" mean? The *AMTO v. Ukraine* case (ECT)

In support of its contention that AMTO conducts substantial business activity in

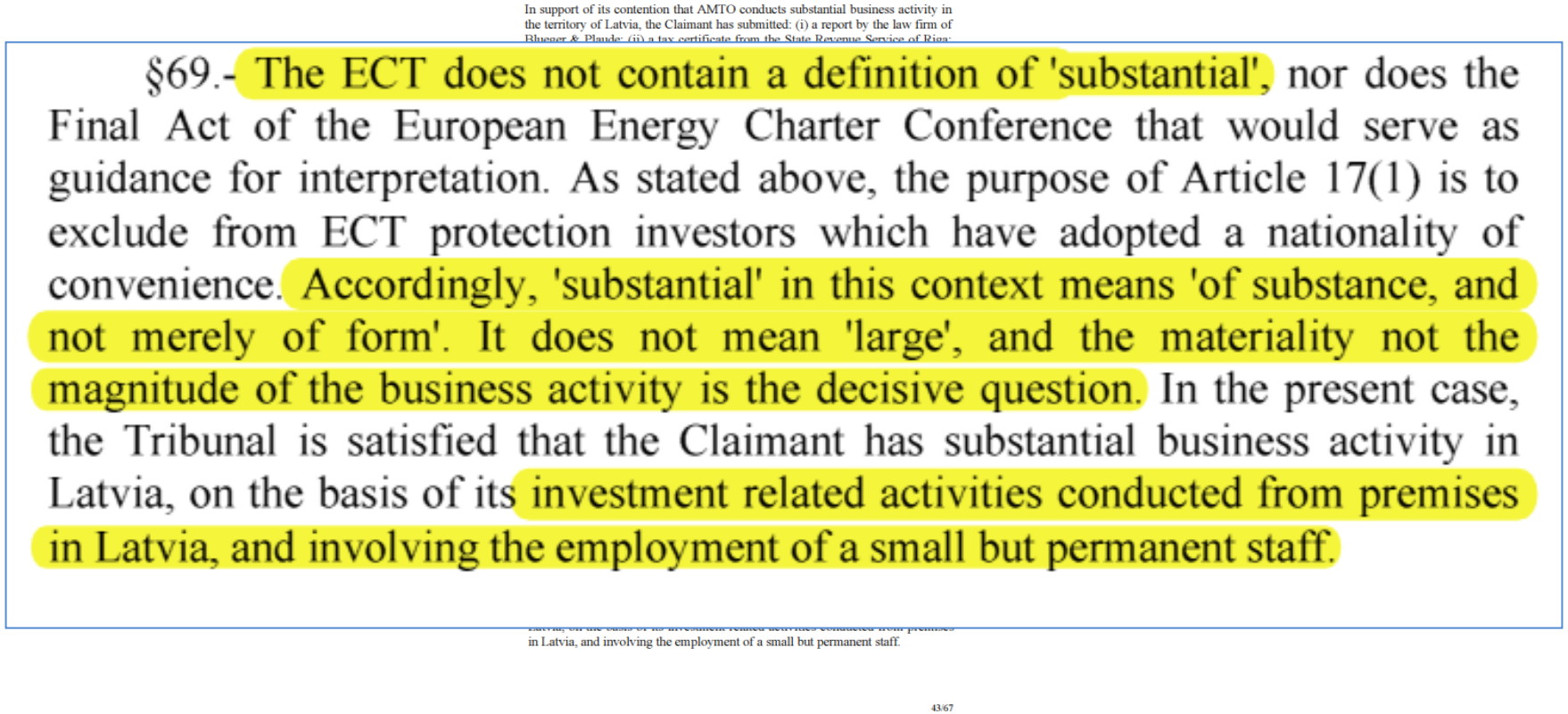
AMTO's tax certificate shows payment of taxes during the period from January 1, 2000 until March 31, 2007 of the following types: (i) residents income tax; (ii) social insurance obligatory payments; (iii) internal VAT; and (iv) entrepreneurial activity risk state fee. The Claimant states that it employs two staff full-time and the 'social insurance obligatory payments' relate to these staff. No VAT has been paid during the referred period.

AMTO also holds a multi-currency account in the Latvian bank Rietumu Banka. A brief statement of the activity of this account from March 6, 1998 to March 31, 2007 giving the total amount of transactions in each currency has been presented as evidence by the Claimant. However, this bank statement provides no evidence of payments in respect of day-to-day business activities, and the Tribunal has not been provided with evidence that any other bank account exists.

The Claimant also submitted a statement from AMTO's landlord, certifying that AMTO has been renting an office in Riga from September 1, 2000 to the date of the statement, March 30, 2007.

Limited Liability Company AMTO v. Ukraine, Final Award, para. 68 (**Under ECT**)

What does “substantial” mean? The *AMTO v. Ukraine* case (ECT)



In support of its contention that AMTO conducts substantial business activity in the territory of Latvia, the Claimant has submitted: (i) a report by the law firm of Bluegger & Plaude; (ii) a tax certificate from the State Revenue Service of Riga;

§69.- The ECT does not contain a definition of 'substantial', nor does the Final Act of the European Energy Charter Conference that would serve as guidance for interpretation. As stated above, the purpose of Article 17(1) is to exclude from ECT protection investors which have adopted a nationality of convenience. Accordingly, 'substantial' in this context means 'of substance, and not merely of form'. It does not mean 'large', and the materiality not the magnitude of the business activity is the decisive question. In the present case, the Tribunal is satisfied that the Claimant has substantial business activity in Latvia, on the basis of its investment related activities conducted from premises in Latvia, and involving the employment of a small but permanent staff.

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Limited Liability Company AMTO v. Ukraine, Final Award, para. 69 (**Under ECT**)

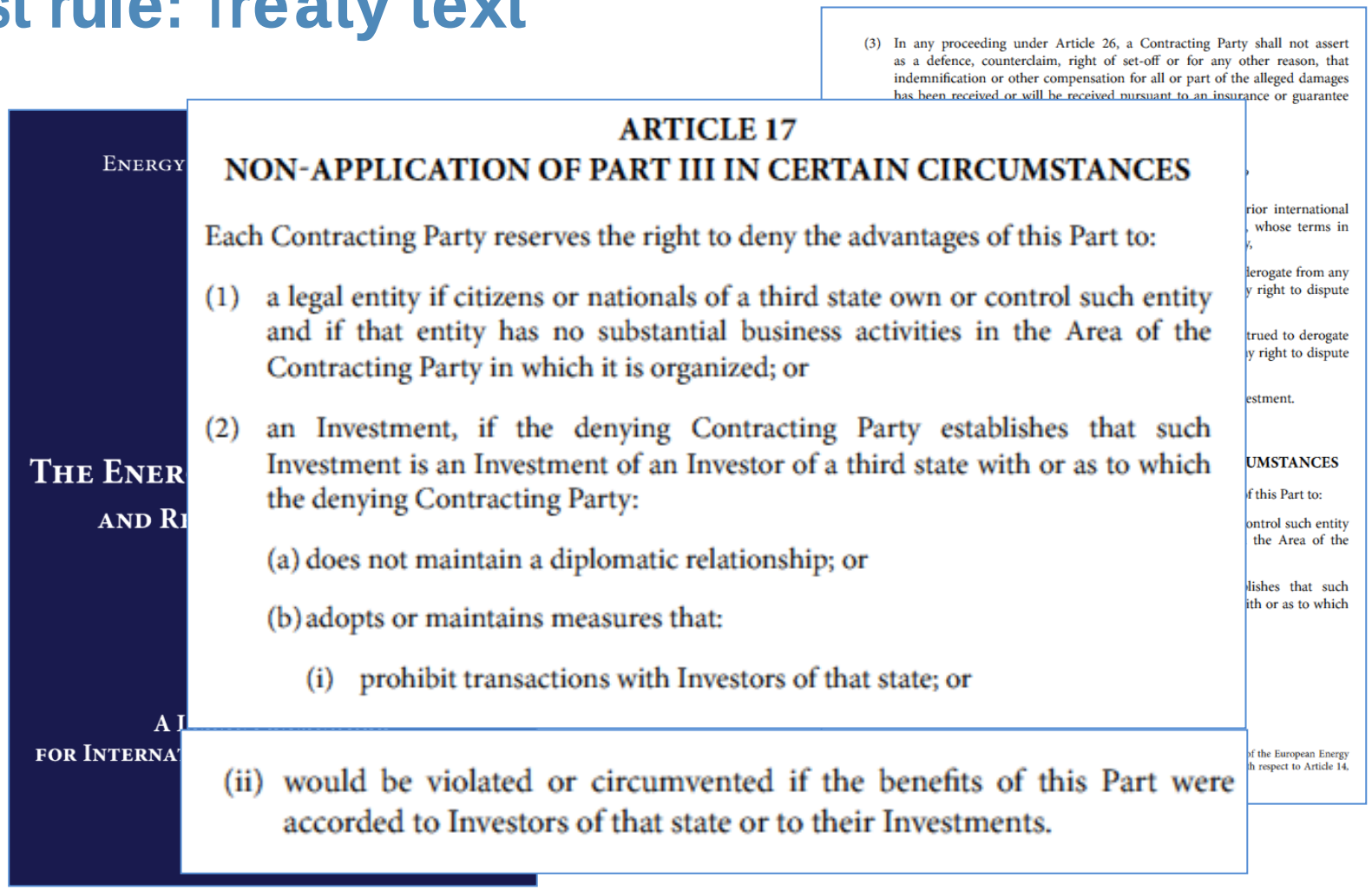
Investments held through shell companies

Islands. Moreover, the Claimant's activities, both in the Cayman Islands and the USA, were principally to hold the shares of its subsidiaries in El Salvador. The position might arguably be different if it was acting as a traditional holding company owning shares in subsidiaries doing business in the USA; but that is not this case. The Claimant's activities as a holding company were not directed at its subsidiaries' business activities in the USA, but in El Salvador.

In short, as regards business activities in the territory of the USA, the Tribunal concludes that the Claimant was and is not a traditional holding company actively holding shares in subsidiaries but more akin to a shell company with no geographical location for its nominal, passive, limited and insubstantial activities.

Pac Rim Cayman LLC c. El Salvador (ICSID Case No. ARB/09/12), Award on Jurisdiction, paras. 4.74-4.75

Is there a time-limit to deny benefits?
First rule: Treaty text



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(3) In any proceeding under Article 26, a Contracting Party shall not assert as a defence, counterclaim, right of set-off or for any other reason, that indemnification or other compensation for all or part of the alleged damages has been received or will be received pursuant to an insurance or guarantee

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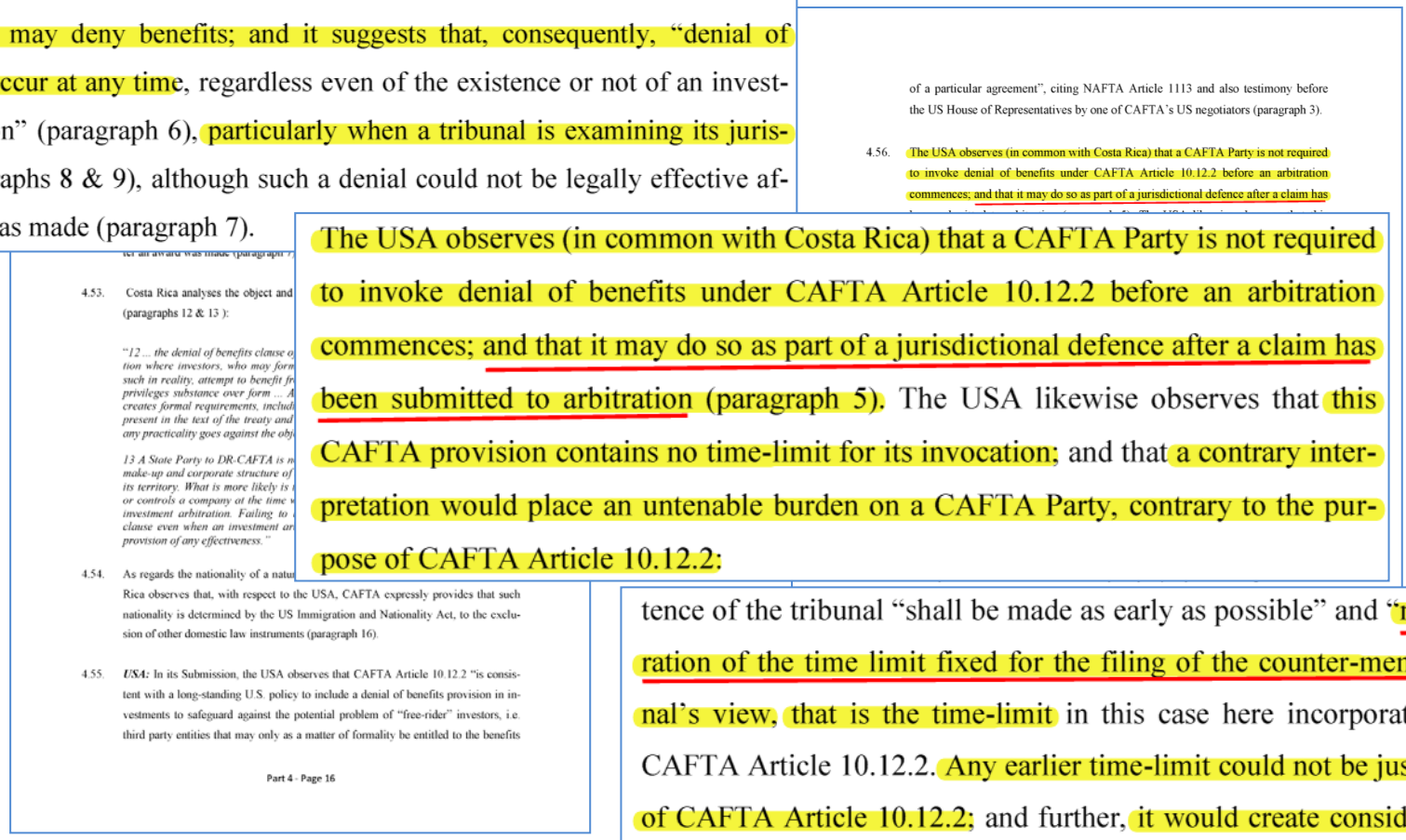
Energy Charter Treaty, available at: http://www.encharter.org/fileadmin/user_upload/document/EN.pdf, Article 17

Time-limit to deny benefits

As to timing, Costa Rica observes that CAFTA Article 10.12.2 is silent on when a CAFTA Party may deny benefits; and it suggests that, consequently, "denial of benefits may occur at any time, regardless even of the existence or not of an investment arbitration" (paragraph 6), particularly when a tribunal is examining its jurisdiction (paragraphs 8 & 9), although such a denial could not be legally effective after an award was made (paragraph 7).



of a particular agreement", citing NAFTA Article 1113 and also testimony before the US House of Representatives by one of CAFTA's US negotiators (paragraph 3).

4.56. The USA observes (in common with Costa Rica) that a CAFTA Party is not required to invoke denial of benefits under CAFTA Article 10.12.2 before an arbitration commences; and that it may do so as part of a jurisdictional defence after a claim has

4.53. Costa Rica analyses the object and
(paragraphs 12 & 13):

"12 ... the denial of benefits clause o
tion where investors, who may form
such in reality, attempt to benefit fr
privileges substance over form ... A
creates formal requirements, includ
present in the text of the treaty and
any practicality goes against the obj

13 A State Party to DR-CAFTA is n
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its territory. What is more likely is
or controls a company at the time
investment arbitration. Failing to
clause even when an investment ar
provision of any effectiveness."

4.54. As regards the nationality of a natu
Rica observes that, with respect to the USA, CAFTA expressly provides that such nationality is determined by the US Immigration and Nationality Act, to the exclusion of other domestic law instruments (paragraph 16).

4.55. ***USA:*** In its Submission, the USA observes that CAFTA Article 10.12.2 "is consistent with a long-standing U.S. policy to include a denial of benefits provision in investments to safeguard against the potential problem of "free-rider" investors, i.e. third party entities that may only as a matter of formality be entitled to the benefits

Part 4 - Page 16

The USA observes (in common with Costa Rica) that a CAFTA Party is not required to invoke denial of benefits under CAFTA Article 10.12.2 before an arbitration commences; and that it may do so as part of a jurisdictional defence after a claim has been submitted to arbitration (paragraph 5). The USA likewise observes that this CAFTA provision contains no time-limit for its invocation; and that a contrary interpretation would place an untenable burden on a CAFTA Party, contrary to the purpose of CAFTA Article 10.12.2:

tence of the tribunal "shall be made as early as possible" and "no later than the expiration of the time limit fixed for the filing of the counter-memorial". In the Tribunal's view, that is the time-limit in this case here incorporated by reference into CAFTA Article 10.12.2. Any earlier time-limit could not be justified on the wording of CAFTA Article 10.12.2; and further, it would create considerable practical difficulties for CAFTA Parties inconsistent with this provision's object and purpose, as observed by Costa Rica and the USA from their different perspectives as host and home States (as also by the Amicus Curiae more generally). In the Tribunal's view,

Pac Rim Cayman LLC c. El Salvador (ICSID Case No. ARB/09/12), Decision on Jurisdiction, paras. 4.52, 4.56 and 4.85

Time-limit to deny benefits

4.83. ***(iii) Timeliness:*** There is no express time-limit in CAFTA for the election by a CAFTA Party to deny benefits under CAFTA Article 10.12.2. In a different case un-

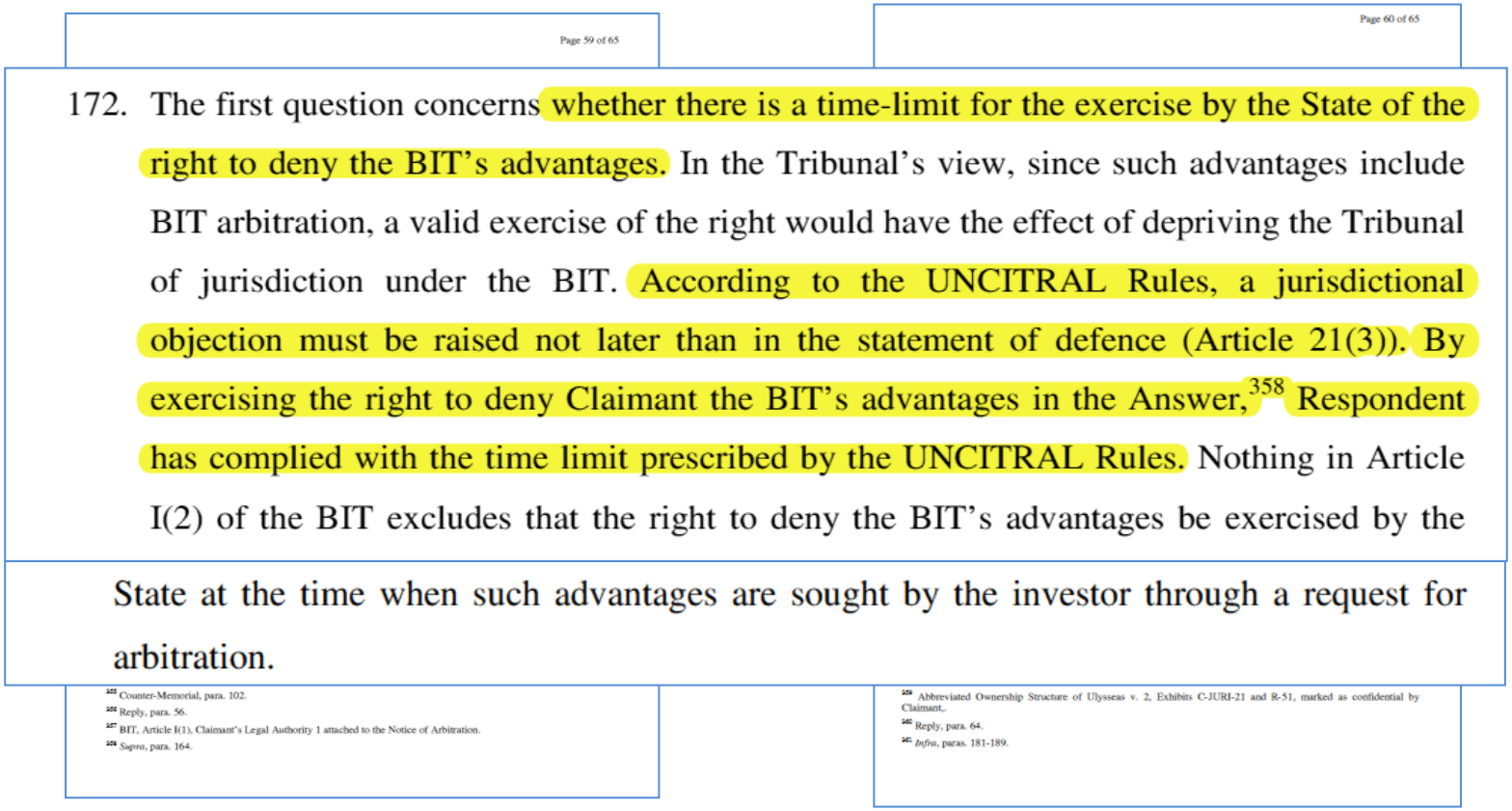
Pacific Rim, a person of a non-CAFTA Party for the purpose of CAFTA Article

CAFTA Party under CAFTA Article 10.12.2, denying benefits to the Claimant under

4.85. Second, this is an arbitration subject to the ICSID Convention and the ICSID Arbitration Rules, as chosen by the Claimant under CAFTA Article 10.16(3)(a). Under ICSID Arbitration Rule 41, any objection by a respondent that the dispute is not within the jurisdiction of the Centre, or, for other reasons, is not within the competence of the tribunal "shall be made as early as possible" and "no later than the expiration of the time limit fixed for the filing of the counter-memorial". In the Tribunal's view, that is the time-limit in this case here incorporated by reference into CAFTA Article 10.12.2. Any earlier time-limit could not be justified on the wording of CAFTA Article 10.12.2; and further, it would create considerable practical diffi-

Pac Rim Cayman LLC c. El Salvador (ICSID Case No. ARB/09/12), Decision on Jurisdiction, para. 4.92

Time-limit to deny benefits (reference to Arbitration Rules)



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172. The first question concerns whether there is a time-limit for the exercise by the State of the right to deny the BIT's advantages. In the Tribunal's view, since such advantages include BIT arbitration, a valid exercise of the right would have the effect of depriving the Tribunal of jurisdiction under the BIT. According to the UNCITRAL Rules, a jurisdictional objection must be raised not later than in the statement of defence (Article 21(3)). By exercising the right to deny Claimant the BIT's advantages in the Answer,[358] Respondent has complied with the time limit prescribed by the UNCITRAL Rules. Nothing in Article I(2) of the BIT excludes that the right to deny the BIT's advantages be exercised by the State at the time when such advantages are sought by the investor through a request for arbitration.

[355] Counter-Memorial, para. 102.
[356] Reply, para. 56.
[357] BIT, Article I(1), Claimant's Legal Authority 1 attached to the Notice of Arbitration.
[358] *Supra*, para. 164.

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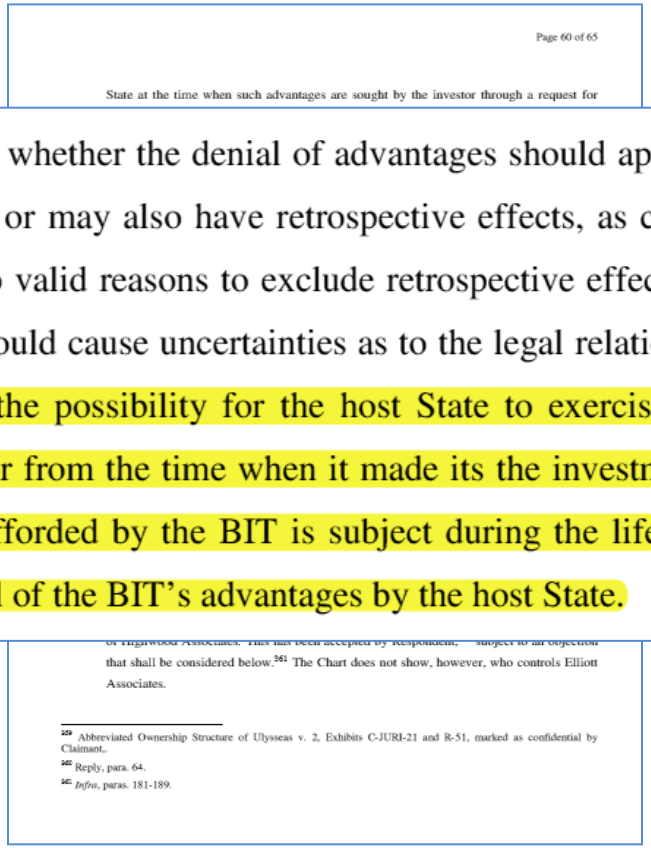
[359] Abbreviated Ownership Structure of Ulysseas v. 2, Exhibits C-JURI-21 and R-51, marked as confidential by Claimant,.
[360] Reply, para. 64.
[361] *Infra*, paras. 181-189.

Ulysseas Inc v Ecuador (UNCITRAL), Award, para. 172

Practical issue: retroactive effects?



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State at the time when such advantages are sought by the investor through a request for

173. A further question is whether the denial of advantages should apply only prospectively, as argued by Claimant, or may also have retrospective effects, as contended by Respondent. The Tribunal sees no valid reasons to exclude retrospective effects. In reply to Claimant's argument that this would cause uncertainties as to the legal relations under the BIT, it may be noted that since the possibility for the host State to exercise the right in question is known to the investor from the time when it made its the investment, it may be concluded that the protection afforded by the BIT is subject during the life of the investment to the possibility of a denial of the BIT's advantages by the host State.

that shall be considered below.[961] The Chart does not show, however, who controls Elliott Associates.

[959] Abbreviated Ownership Structure of Ulysseas v. 2, Exhibits C-JURI-21 and R-51, marked as confidential by Claimant,.

[960] Reply, para. 64.

[961] *Infra*, paras. 181-189.

Ulysseas Inc v. Ecuador (UNCITRAL), Award, para. 173
See also, *Empresa Eléctrica del Ecuador Inc. v. Ecuador*, Award, para. 71

Or prospective/ultractive effects? (I)

The covered investor enjoys the advantages of Part III unless the host state exercises its right under Article 17(1) ECT; and a putative covered investor has legitimate expectations of such advantages until that right's exercise. A putative investor therefore requires reasonable notice before making any investment in the host state whether or not that host state has exercised its right under Article 17(1) ECT. At that stage, the putative investor can so plan its business affairs to come within or without the criteria there specified, as it chooses. It can also plan not to make any investment at

In the Tribunal's view, therefore, the object and purpose of the ECT suggest that the right's exercise should not have retrospective effect. A putative investor, properly informed and advised of the potential effect of Article 17(1), could adjust its plans accordingly prior to making its investment. If, however, the right's exercise had retrospective effect, the consequences for the investor would be serious. The investor

Plama Consortium Limited v. Bulgaria, Decision on Jurisdiction, paras. 161 and 162 (**Under ECT**)
See also, *Yukos v. Russian Federation*, Decision on Jurisdiction, para. 458 (**Under ECT**)

Or prospective/ultractive effects? (II)

225. With regard to the question of whether the right under Article 17(1) of the ECT can only be exercised prospectively, the Tribunal considers that the above mentioned notification requirement – on which the Parties agree – can only lead to the conclusion that the notification has prospective but no retroactive effect. Accepting the option of a retroactive notification would not be compatible with the object and purpose of the ECT, which the Tribunal has to take into account according to Article 31(1) of the VCLT, and which the ECT, in its Article 2, expressly identifies as "*to promote long-term co-operation in the energy field*". Such long-term co-operation requires, and it also follows from the principle of legal certainty, that an investor must be able to rely on the advantages under the ECT, as long as the host state has not explicitly invoked the right to deny such advantages. Therefore, the Tribunal finds that Article 17(1) of the ECT does not have retroactive effect.

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Liman Caspian Oil BV and NCL Dutch Investment BV v. Kazakhstan, Award, para. 225 (**Under ECT**)

Effect of such denial

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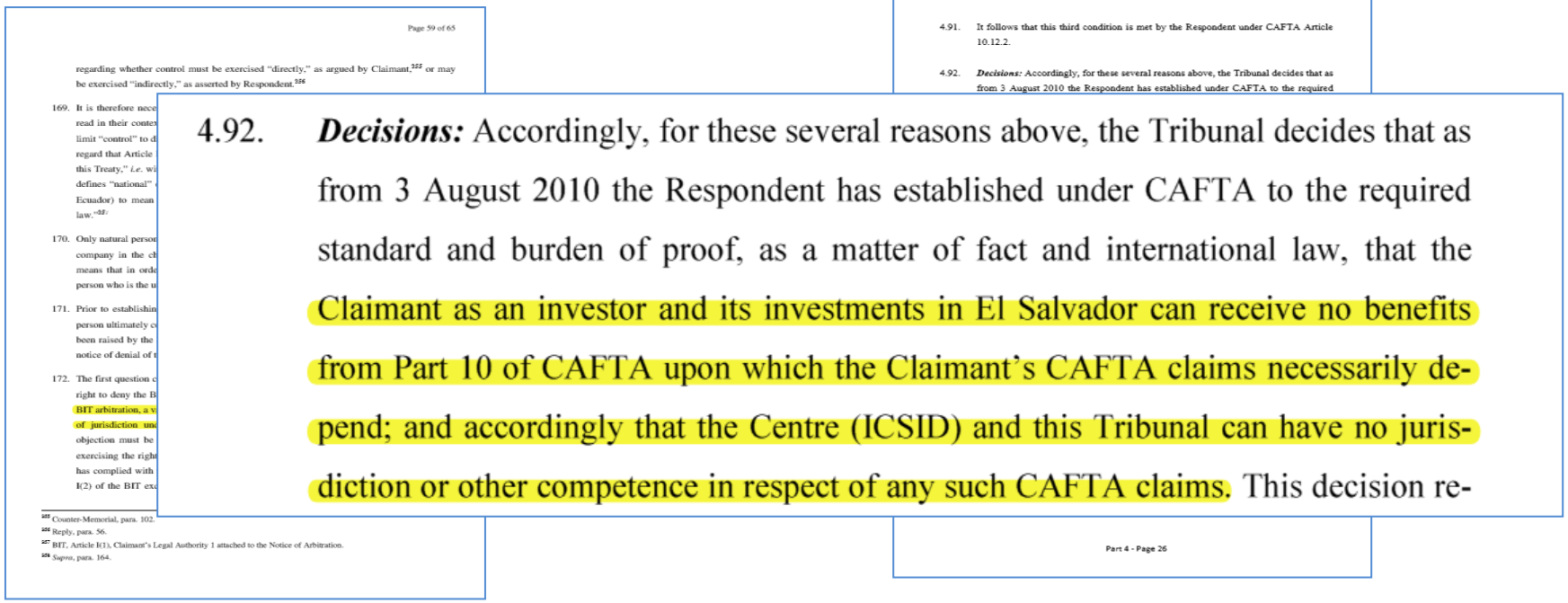

4.92. ***Decisions:*** Accordingly, for these several reasons above, the Tribunal decides that as from 3 August 2010 the Respondent has established under CAFTA to the required standard and burden of proof, as a matter of fact and international law, that the Claimant as an investor and its investments in El Salvador can receive no benefits from Part 10 of CAFTA upon which the Claimant's CAFTA claims necessarily depend; and accordingly that the Centre (ICSID) and this Tribunal can have no jurisdiction or other competence in respect of any such CAFTA claims. This decision re-

Ulysseas Inc v. Ecuador (UNCITRAL), Award, para. 172, **and** *Pac Rim Cayman LLC c. El Salvador* (ICSID Case No. ARB/09/12), Decision on Jurisdiction, para. 4.92