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TITLE

RESOLVING THE CONCERNS OF TREATY SHOPPING IN INTERNATIONAL INVESTMENT LAW:
IS TREATY SHOPPING IN INTERNATIONAL INVESTMENT LAW A "LEGITIMATE NATIONALITY PLANNING" OR "TREATY ABUSE"

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TABLE OF CONTENTS

LIST OF ABBREVIATIONS 2

INTRODUCTION 3

CHAPTER 1. THE PHENOMENON OF TREATY SHOPPING 7

1.1 Defining Treaty Shopping 7

1.2 The Treaty shopping Methods 8

1.3 The Role of Nationality 9

CHAPTER 2. OBSERVING THE PHENOMENON OF TREATY SHOPPING FROM THE VIEWPOINT OF THE NATURE OF IIL 12

2.1 Reciprocity 12

2.2 State Consent 14

CHAPTER 3. OBSERVING THE PHENOMENON OF TREATY SHOPPING THROUGH THE CASE STUDY 18

3.1 Treaty Interpretation- Why is it important? 18

3.2 The permissive Approach: Textual/formal interpretation 19

3.2.1 Round Tripping 19

3.2.2 The Mailbox companies 22

3.3 Conclusions concerning non- prohibitive approach 24

3.4 The Prohibitive approach: looking behind the treaty text 25

3.4.1 Conclusions concerning prohibitive approach 31

CONCLUSION 32

LITERATURE 34

LIST OF ABBREVIATIONS

BIT	Bilateral Investment Treaty
ECJ	European Court of Justice
FDI	Foreign Direct Investment
FET	Fair and Equitable Treatment
FTA	Free Trade Agreement
ICC	International Chamber of Commerce
ICJ	The International Court of Justice
ICSID	International center of settlement of Investment disputes
IIA	International Investment Agreement
ISDS	Investor-State dispute Settlement
MFN	Most Favored Nation
NAFTA	North American Free Trade Agreement
NYC	The Convention on the Recognition and Enforcement of Foreign Arbitral Awards ("The New York Convention")
OECD	The organization for Economic Co-operation and Development
UNCITRAL	United Nations Commission on International Trade law
WTO	World Trade Organization

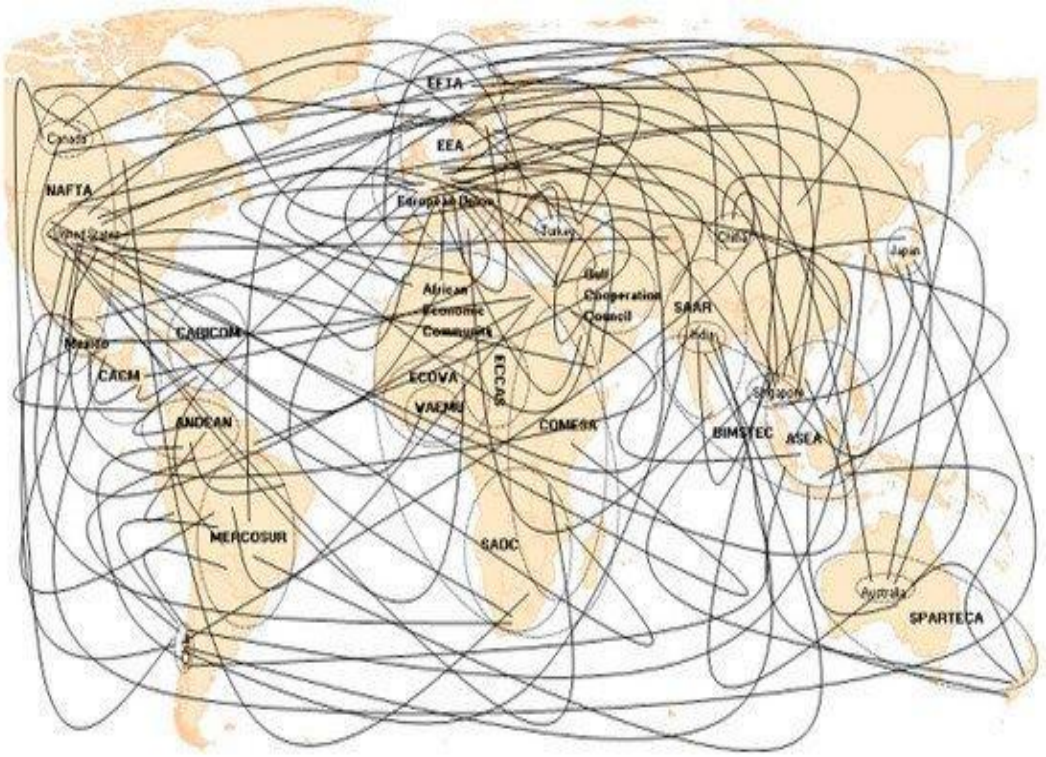
INTRODUCTION

International society is on the path of Globalization. From the perspective of International Investment and Trade, the world of today is more interconnected than ever before. The tremendous growth in the levels of foreign investment is a phenomenon of the recent decades. Capital no longer flows exclusively from the developed countries to the developing world, but also vice versa. This explains the worldwide growing significance of International Law and Policy of foreign investment.

IIL is a separate field of Public Law. Essentially, Investment Law deals with the principles and rules, which govern commercial activities undertaken by multinational enterprises in a territory of foreign State[1]. The IIL regime is comprised of numerous legal sources. Trying to identify it, Julie A. Maupin once figuratively stated:

> "*Textually, the regime is a 'spaghetti bowl' of around 3000 overlapping bilateral and regional treaties, tens of thousands of transnational contracts, and an unknown number of domestic statutes whose purported aim is to stimulate economic development by attracting and protecting foreign investments within the sovereign territory of host states*[2]*."*

[1] *Collins David, "An Introduction to International Investment Law", Cambridge University Press, (2017) p.133*
[2] *Dunlop, Andrea Bianchi and Anna Peters (eds.), "Transparency in International Law", Cambridge University Press, (2013) p.115*



(Figure 1 above (the 'spaghetti-bowl' metaphor) represents the multi-layered nature of the global IIA regime and the intertwined network of bilateral and multilateral treaties[3]).

IIL is a dynamic and challenging area of law. Therefore, Modern IIL system described by *Maupin* is a result of enormous evolution. The Modern international law relating to the treatment of alien property has its roots in the State practice of the late 18th and 19th centuries.

It was during this period that industrialization (primarily in Great Britain, but also other Western European countries and the US) began to generate large capital surpluses that would fuel foreign investment on a scale not previously seen in world history[4].

Inter- government treaties, which provide safeguards for the protection of aliens and their property abroad,have a long history. However, in the framework of IIAs, it was only in the second half of 20th century when their numbers exponentially[5] grew. Nowadays, the global IIA regime has reached 3200 IIAs, the majority of them being BITs. In most cases, their provisions are the ***centerpiece*** of law applied by investment tribunals[6].

Nowadays, nearly every country in the world has concluded IIAs, thereby committing themselves to observe particular principles on the treatment of foreign investments within

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[3] Karl J.Sleight, "The "Spaghetti bowl" of IIAs; The end of history?" Columbia FDI Perspectives, (2014), p. 13
[4] Johnson, Gimblett, "From Gunboats to BITs: The Evolution of Modern International Investment Law" Yearbook of International Investment Law, (2012), p 2
[5] Vandevelde Kenneth, "A Brief History of International investment Agreements", (2005)
[6] Pauwelyn Joost, Viñuales Jorge E. (eds), "The Foundations of International Investment Law: Bringing Theory in Practice" Oxford University Press, (2014), p 217-219

their territory. Foreign investment is often deemed as a stimulator of the local economy, a source of foreign currency income, new skills, information, and know-how. In other words, for most States, it is an engine of financial growth[7]. Through the BIT tool, States offer expanded security to foreign investors by ensuring an additional layer of protection beyond that provided by domestic laws. Thus, from a policy perspective, the host State deliberately renounces a component of its sovereignty in return for a certain new opportunity: a greater chance to attract an investor. Unlike host country laws on foreign investment – which can also offer adequate protection and incentives to foreign investors, but are liable to change – no state can unilaterally change international law or the provisions of IIAs. IIAs (or 'investment treaties') which are agreements between two or more states in which each Contracting State agrees to promote and protect investments made in its territory by investors of the other contracting State or States[8].

Although, there are several thousand concluded IIAs, the basic characteristics of such treaties, especially BITs, are more or less the same[9]. Typically, Investment agreements consist of three main elements:

- Definitions -particularly who can be qualified as an "***investor",***[10] and what constitutes an "***investor".*** This is a vital part of agreement, as it determines the scope and the reach of the treaty;
- Substantive obligations for the host state -particularly FET[11], MFN[12], prohibition of expropriation etc.;
- Provisions on investment-state dispute resolution, which provide possibility of international arbitration[13].

It is a very common characteristic of investment protection treaties to allow foreign investors to bring a claim before an international tribunal against the host state ***(directly/not through their home state).*** Basically, the opportunity to initiate arbitration against the State gives

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[7] *Subedi, S.P, "International investment law: Reconciling Policy and Principles" Hart Publishing (2008), 84*
[8] *Skinner, Miles and Luttrel "Access and Advantage in investor-state arbitration" JWELB (2010) 262 [online]*
[9] *IBID at p 84*
[10] *Foreign Investor is a person or organization that puts money into financial schemes, property, etc. in foreign country with the expectation of achieving a profit*
[11] *Under customary law, foreign investors are entitled to a certain level of treatment, and any. treatment which falls short of this level gives rise to the responsibility on the part of the State*
[12] *MFN clause provides that one country will treat the other in the same manner as it treats any other nation that is given preferential treatment.*
[13] *Dolzer. R, Schreuer C., "Principles of International Investment Law" Oxford University Press (2012) 11*

some kind of power or figurately saying “teeth" to the substantive obligations of an IA. Often, there is also no need to exhaust local remedies before arbitration is initiated[14].

States do not have obligation to grant an equal treatment to all Investors . So, Investors’ legal stance relative to State can vary. Consequently, IIL witnesses a growing number of treaty shopping[15] situations, where the Investors try to comply with the rules on **nationality of claims**[16] by incorporating in countries of convenience. This “legal maneuver” allows gain the access to favorable IIA provisions and dispute settlement mechanisms, to which they would otherwise have no access.

Treaty shopping raises several concerns. The attitude towards the issue vary widely[17]. Many States argue, *inter alia*, that “*it violates the principle of reciprocity, abuses their consent and negatively impacts their sustainable development*[18].” But does it also conflict with the primary goals and the rationale of the investment law system?

So why is this concept being so debated? The main reason here is the absence of a universally accepted definition of what constitutes Treaty shopping. It should be noted that despite the bad publicity and increasingly expressed dissatisfaction among States, treaty shopping is not per se prohibited (illegal) or even inadmissible under IIL. The ambivalence about the limits of Treaty Shopping is unsatisfactory for both States and investors – not to mention the functionality of the investment system in general. However, the legal practice demonstrates that there are some limits to treaty shopping.

Arbitral tribunals have had a few occasions to pronounce upon Treaty Shopping. Although expressing concern about it, in many cases, tribunals found themselves bound by broad definitions of “Investor” in BITs – i.e. tribunals declined to lift the corporate veil and look beyond the incorporation at the real ownership of purported investors. The fact that the investors did not have real economic connections with their new home state was not enough to render Treaty Shopping unlawful, as long as the requirement of incorporation was fulfilled.

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[14] Van Os & Knottnerus, Dutch Bilateral Investment Treaties: A gateway to ‘treaty shopping’ for investment protection by multinational companies, SOMO Report, (2011) p. 11

*[15] There is no globally recognized definition of the phenomenon of **treaty shopping**. Most authors seem to agree that treaty shopping presupposes a corporate structuring or restructuring decision of some sort with the aim to access a favorable (or more favorable) IIA provisions with the host State*

*[16] Investor–State arbitration allows foreign investors to directly claim against the State in which they invested. A fundamental requirement of all such arbitration is that the investor, whether an individual or a corporation, be a **national of a specific foreign country**. Yet the issue of investors’ nationality can be surprisingly complex. See, Robert Wisner, Nick Gallus; “Nationality Requirements in Investor-State Arbitration [online] page 1*

[17] Christopher Schreuer, “Nationality of Investors: Legitimate Restrictions vs Business Interests”, ICSID (2009) p.521,524

[18] Roos van Os, Roeline Knottnerus,supra 14, p 11

In determining the appropriate limits of this phenomenon, it must be noted that there are many forms of Treaty shopping. Some of them are more objectionable than others. For example, the distinction may be made between Treaty shopping at the "back end" and "front end" of the Investment[19]. Back end Treaty shopping is where a corporation restructures Investment after the dispute has arisen or became foreseeable, to gain access to desirable investment-state arbitration for particular dispute. Front end Treaty Shopping, in contrast, takes place, when Investment structure is planned in advance, in order to benefit from the favorable regulatory environment.

The complexity of the issue demands a highly nuanced approach. There are various arguments against Treaty shopping. These arguments may be broadly divided into three main categories: lack of Reciprocity, lack of State's informed consent and, policy reasons.

Is treaty shopping in International investment law "legitimate nationality planning" or "treaty abuse"? This is the question investment arbitral tribunals have been increasingly facing in investment treaty arbitration.

The need for an explicit dividing line between permissible nationality planning and abusive Treaty shopping became apparent a while ago, yet there is still no common consensus as to where to draw such line[20].

The study approaches the phenomenon of treaty shopping through three separate viewpoints. The first chapter discovers the core nature of the treaty shopping; in particular,

- What is treaty shopping? (definition)
- What are the main methods to carry it out?
- the main reasons behind its' occurrence.

Further, the most arguable notion the "Investor's nationality" is discussed from the perspective of the core nature of the IIL system. (pure rational analysis).

The Second chapter addresses a systematic approach. The issues regarding the nature of the treaty shopping are discussed through the lens of rational of Investment Law system (the fundamental analysis).

In the third Chapter the issues are discussed in the framework of arbitral decisions. The main approaches towards the phenomenon have been underlined (practical analysis).

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[19] *Skinner,et al,supra 8, p.260-263*

[20] *Baumgartner Jorum, "Treaty Shopping in International Investment Law" Oxford University Press (2017) p. 300*

In order to make more detailed and comprehensive examination of the issue the phenomenon of treaty shopping has been discussed only from the aspect of corporate restructuring.

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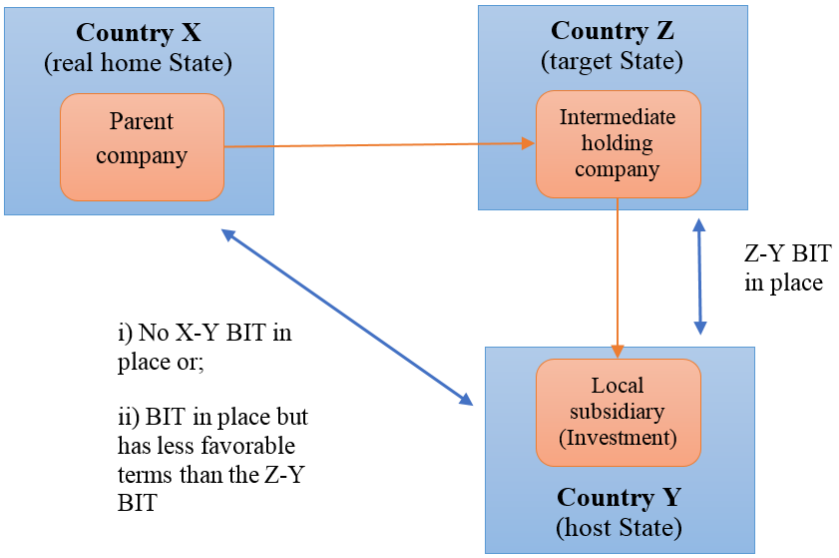
CHAPTER 1. THE PHENOMENON OF TREATY SHOPPING

1.1 Defining Treaty Shopping

It should be noted, that even the term "treaty shopping" does not enjoy universal consensus[21]. The first controversary surrounding ***Treaty shopping*** is the usage of differing terms to indicate the one and the same phenomenon Overall it may be described as "corporate restructuring", "nationality planning", "treaty abuse", "treaty planning". In this case the wording used to describe the event, somehow may become an indicator of user's judging of its "legitimacy"[22].

So, what is Treaty shopping? Most authors seem to agree that treaty shopping presupposes a corporate structuring or restructuring decision of some sort with the aim to access a favorable (or more favorable) IIA provisions with the host State[23]

There are two main possible scenarios of Treaty shopping. First, the investor's nationality/home state might not have a BIT with the state he wants to invest in. Second, the investor's nationality/home state might have a BIT with the state he wants to invest in, but its provisions may not be as favorable for him as the provisions of BIT between the third state and host state. By some corporate structuring maneuver, the investor will make a proper ground for being qualified as investor from his preferred state. Accordingly, his investment will be protected by the BIT concluded between the third (his preferred) state and the host state.



[21] *Ibid, p.7-9*
[22] *Zachary Douglas "The International Law of Investment Claims" Cambridge University Press (2009) 551*
[23] *Baugmarter supra 17, page 55*

(Figure 2, the scheme of treaty shopping)[24]

It is important to mention, that the treaty shopper, generally, has no real economic connection with the state due which he has routed his investment. The intentional structuring of investments through states with which the investment has no business connection in any form overall describes the core nature of Treaty shopping phenomenon.

1.2 The Treaty shopping Methods

In fact, there are two main methods for treaty shopping: direct and indirect. The first scenario is: an investor which is incorporated and has its corporate seat (actual governance) in State X, wishes to invest in state Y. States X and Y don't have a BIT, however, state Y has a very desirable BIT with state Z. The investor can either:

- incorporate a legal entity in state Z. (depending on the BIT provisions, this could be only a letterbox company).and then channel his investment through this shell company (this is the **direct metho**d); or
- channel his investment through a legal entity which is in turn owned by a legal entity from state C (indirect method).

In addition to this, we would like to distinguish two different methods of treaty shopping with regard to the time period in which the nationality of the target state is obtained, i.e. 'back end' and 'front end' treaty shopping[25].

The 'back end' treaty shopping: as the name suggests, means that the investor performs one of the above-mentioned arrangements after a dispute between the host state and the legal entity has already ***arisen,*** or is ***imminent***. For example, the investor sells the disputed assets to a company which has the nationality of the state with which the host state has a favorable BIT. Such was the attempt of the Claimant in **Phoenix Action Ltd. v Czech Republic[26],** where, in the face of an ongoing dispute before Czech courts, the assets representing the investment were sold to an Israeli company which, subsequently to the sale, immediately filed an arbitration claim pursuant to the Israel-Czech Republic BIT. The tribunal deemed this to be an unlawful abuse of the investment protection system

[24] *Roos van Os, Roeline Knottnerus, supra14, .p10*

[25] *Azaino, E. U., "Nationality/Treaty Shopping: Can Host Countries Sift the Wheat from the Chaff", CEPMLP Annual Review (2013)*

[26] *ICSID, 15.04.2009, Case No. ARB/06/5 (Phoenix Action, Ltd. v. The Czech Republic), Award [online]*

The "front end" treaty shopping means that the investor structures his investment pursuant to the nationality of convenience before the dispute arises, or even before the investment in the host state is made. A good example is **Mobil Corporation v. Venezuela**[27] arbitration. The investor restructured its investment in Venezuela through a Netherlands holding company a few years before the dispute arose. The tribunal held these actions to be perfectly legitimate.

1.3 The Role of Nationality

The concept of "nationality" lays in the heart of treaty shopping phenomenon. Simply put, the treaty shopping means having the right nationality at the right time. An investor's nationality is a considerable precondition for treaty shopping and, in fact**,** the main source of controversy

Thus, in order to have a complete understanding about examined issue, it is vital to first understand the concept of nationality. From the viewpoint of protecting foreign investors, nationality has multiple functions. The majority of Investment law's substantive and procedural guarantees are granted by IIA. So, by virtue of limited scope of application, the states are only obliged to observe special treatment to certain group of persons and legal entities. Also, jurisdiction of arbitral tribunals is determined by the claimant's nationality[28]. Hence, the investor, who seeks protection under treaty, must first demonstrate being a national of contracting state[29]. An important question arises what kind of connection to home state must investor have/show in order to obtain the benefits of the desirable IIA.

IIAs generally contain a specific provision in which the term ***investor*** is defined. The definition is usually derived from the concept of nationality. By mutually agreeing on "investor" definition, states limit the scope of the investment protection: only those who fall under agreed definition will be eligible for the benefits and protections of the treaty[30]. In other words, the definition of the term investor is crucial to determine the scope of an investment treaty[31].

From the first sight, determination of existence of legal bonds between home state and investor might not seem complicated. However, in nowadays economic reality multinational

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[27] *ICSID, 10.06.2010, Case No. ARB/07/27 (Mobil Corporation, Venezuela Holdings BV, Mobil Cerro Negro Holding Ltd, Mobil Venezolana de Petroleos Holdings, Inc, Mobil Cerro Negro, Ltd, and Mobil Venezolana de Petroleos, Inc v. Bolivarian Republic of Venezuela), Decision on Jurisdiction [online]*

[28] *This describes the nature of Jurisdiction Ratione Personae*

[29] *Schreuer, supra 17, p.200*

[30]

[31] *Professor Schreuer has highlighted an interesting ambiguity regarding investor's nationalit: "With respect to access to protection under IIAs, nationality is of the utmost importance but when an investment case reaches the substantive phase distinctions of nationality are a taboo". See Schreuer Christopher, supra17 p.261*

companies are not a rare phenomenon. Even small legal entities may have a complex organizational structure, which will make challenging determination of true legal bonds. Investments can be channeled through multiple entities in different jurisdictions and owned by nationals of different countries[32].

What are the ways of determination of corporate Investor's nationality?

For nationality determination IIAs tend to use three main tests:

- ***the incorporation test,***
- ***siège social (also known as the seat test) or***
- ***the control test.***[33]

a) Place of Incorporation

The most frequently used method of determination of an investor's nationality is ***incorporation test***. It sets lowest possible threshold to qualify as an investor. In the framework of this approach, "companies, which are incorporated or constituted in accordance with the laws of a particular State are considered to be nationals of that State[34]." Consequently, the incorporation test covers investors that are incorporated and organized according to the relevant national legislation. In this case there are no additional requirements: the corporation can be owned or factually controlled by nationals of a third State or even nationals of the host State itself and still be qualified as an Investor under BIT provisions. Furthermore, the test does not explicitly pun an obligation on the corporation to exercise any real economic/ business activity in the contracting state. Thus, even "mailbox" or "shell" companies can be qualified as Investors, if formal prerequisites are met.

Basing nationality analysis solely on incorporation criteria has its deficiencies. It is not guaranteed that the investor actually has an engagement in economic activity or has any other genuine link to the incorporation-state. That is the reason that States generally object deciding upon the nationality strictly on incorporation, even if the formal requirements set by the IIA and the national legislation are satisfied. Additionally, many arbitral tribunals have concluded that the incorporation test provided by the IIA does not allow them to examine the true nature of the investor's nationality nor require them to do so.

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[32] *Wisner Robert and Gallus Nick, "Nationality requirements in Investor-State Arbitration" (2004) p.5*
[33] *Van Os and Roelin Knottnerus, supra 11, p. 23*
[34] *Thorn Rachel and Doucleff Jennifer, "Disregarding the Corporate Veil and Denial of Benefits Clauses: Testing Treaty Language and the Concept of "Investor"", Kluwer Law International, (2010), p. 6-7*

However, it must be noted, that this test is applicable if a State is willing to grant treaty benefits and protection to investor-corporations irrespective of the nationality of individuals who own/control or manage them.

b) Siège Social (the seat test)

The ***siège social*** test has bigger potential to prevent treaty shopping (in general) because it potentially requires greater engagement from the investor. The theory provides that the nationality should be determined by the place of effective management. The "effective management" is defined as center of administration. In other words, it is the place where "the principal decisions of the company's management are actually executed into valid and externally focused management acts". Within the framework of this test "statutory seat would not suffice to meet this criterion, nor would a mere head office even though the latter is usually referred to as a "seat"[35]". Accordingly, the siège social theory demands more certain economic as well as legal connections between the legal entity and the country of nationality.

Accordingly, this criterion provides more tools for preventing the practice of treaty shopping. However, there can be some practical difficulties in determination of the seat of a multinational company.

c) Control Theory

The control test is also usually named an ownership test. This criterion provides that juridical person must considered to be an investor(national) of that State whose nationals own or control/manage it. In other words, the nationality of person(s) standing behind the company plays a definitive role. The control theory doesn't have a wide range of usage. Actually, in most cases, it is used as supplement with other nationality indicators.

It is worth mentioning, that the control test, whether alone or consolidated with other factors, has a big potential in preventing treaty shopping. It has the benefit of looking into "substance over form" by examining genuine economic links[36].

The control-focused approach also some drawbacks:

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[35] *Baumgartner, supra 20, p. 75*

[36] *Ester Guillermina. "Returning to the Issue of Nationality Case Comments" Journal of World Investment and Trade (2015) p.7, Issue 5*

- First, legal entities making international investments have multiple layers of ownership, which makes it difficult to identify the nationality of the real controlling person.
- There are some issues concerning the nature of the "control". How should the control be defined? Whether actual exercise of control (factual control) or legal ability to control (legal control) should be considered.
- There is some risk that the nationality could change over the lifetime of the investment[37].

Above mentioned concerns are the main reasons why the control theory is often bundled with other nationality criteria.

As a conclusion, it is obvious that the concept of nationality, which from the first glance seems to be a simple one, in fact, has a complicated nature.

CHAPTER 2. OBSERVING THE PHENOMENON OF TREATY SHOPPING FROM THE VIEWPOINT OF THE NATURE OF IIL

2.1 Reciprocity

The fundamental criticism against the phenomenon of Treaty shopping is that it contravenes the principle of reciprocity[38]. Investment treaties purport to "*establish reciprocal rights and obligations among the contracting states"*[39]. The phenomenon of Treaty shopping conflicts with this principle, by entitling corporations with no actual ties with the contracting State an opportunity to gain the benefits of an investment protection treaty although "*its home state does not accept any of the converse obligations against the host state*"[40].

The critics of Treaty shopping qualify corporations with no ties to the contracting state as *"free riders*" or "*corporations of convenience"* [41]. Basing on absence of actual ties and reciprocity, the host States generally wish to deny treaty shoppers' access to Investment Arbitration[42].

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[37] *Baumgartner, supra 20, p. 77.*
[38] *Oss and Knottnerus page11*
[39] *Mchlachlan Campell, Shore Laurance "International Investment Arbitration" oxford University press (2007) p.55*
[40]
[41] *Schreuer, supra 17, p. 523*
[42] *Ibid, p. 524*

The principle of reciprocity is also considered to be violated in the case of an internationalization of a dispute, which, by its essence, is domestic. The main argument is that the core purpose laying in the concept of investor protection is attraction of foreign capital. While the use of international arbitration for settling domestic disputes does not in any way serve for obtaining this goal. The principle of reciprocity establishes that the *"host state ought to receive some converse benefit for submitting themselves to arbitration"*[43]. This seems to be improbable in the case where the dispute is *de facto* a wholly domestic matter[44].

The above-mentioned argumentation is based on the assumption that all types of treaties are consistently "founded on the pattern of real reciprocity, which should be reflected in the treaty itself"[45]. The belief of exact *quid pro quo* governing all investment treaties may not always appear to be accurate. *Is there any guarantee that the balancing safeguards underlying investment treaties are, by their essence, equal/fair ones*? An IIA may be "constructed" in manner of "giving more benefits to the State, which has better bargaining power".[46] Hence, the

pure breach of the principle of reciprocity does not shatter the fair contractual balance. Professor Baumgartner also underlined that:

> *"(...) even when the treaty provisions are formally equivalent (...) the benefits arising from them might not be. For example, the US- Bangladesh BIT establishes similar provisions for both parties but still is more beneficial for US Investors, who invest in Bangladesh due to unequally higher probability that the US Investors will be able to invest in Bangladesh"*[47]

Therefore, many scholars think that in case of the breach of the principle of reciprocity "it is negotiated balance that is being distorted, no matter what the actual fairness credentials of this balance are"[48]

It is worth mentioning, that the true nature of the law of aliens, (which is the origin of foreign investment law), illustrates that the *raison d'être* of this field of law does not reflect the classic concept of reciprocity and mutuality, rather it sets confirmed standards for the unilateral conduct of the host state. In this regard, we can draw some parallels with concept

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[43] *Ibid p. 533*
[44] *Lee, J.," Resolving Concerns of Treaty Shopping in International Investment Arbitration", Journal of International Dispute Settlement, (2015), p.359*
[45] *Michael Lang, Pasquale Pistone et al "Building Bridges between Law and economy" IBDF (2007) p 27*
[46] *Baugmarter, supra 17, p 42*
[47] *Baugmarter,supra 17 p. 43*
[48] *Ibid p.42*

of protection of human rights. Similar to investor protection system the human right system protects individual's human rights: Human right treaties are the main tool which provide protection. in In the **Effect of Reservations case**[49] IACHR has revealed the nature of human right treaties**:**

> *"(...) modern human rights treaties in general, and the American Convention in particular, are not multilateral treaties of the traditional type concluded to accomplish the reciprocal exchange of rights for the mutual benefit of the contracting States. Their object and purpose is the protection of the basic rights of individual human beings irrespective of their nationality, both against the State of their nationality and all other contracting States. In concluding these human rights treaties, the States can be deemed to submit themselves to a legal order within which they, for the common good, assume various obligations, not in relation to other States, but towards all individuals within their jurisdiction* (...)" [50](emphasis added)

By the same token the IIL system constructs a structural setting the nature of which is not identical to agreements in which the general purpose is exchanging privileges on mutual basis by two parties. In fact, the concepts of mutuality and reciprocity are present in regime of an investment treaty, *"they just do not work in the same manner as in classical reciprocal agreement*"[51]. Instead of targeting the mutual exchange of benefits between parties, the IIA system "accepted standards for one-sided conduct of the host state."[52] It is expected than in this construction the interests of the both parties are mutually compatible, even reinforcing.[53]

In conclusion, the aim of IIA is not putting the benefits/interests of the host state opposite to those of the investor. Instead, as the parties share a "joint purpose" the main function of the Investment treaties is creating a balancing system of the host state's and of foreign investor's interest. As depicted above, the main desire of Investment protection system it is creating a favorable investment climate, which will attract foreign capital. Thus, observance of the issue from this viewpoint, can gave rise to conclusion, that the lack of strict reciprocity is not damaging to the fundamental purpose and objective of the investment law system.

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[49] *The Effect of Reservations on the Entry Into Force of the American Convention on Human Rights (Arts. 74 and 75),Advisory Opinion OC-2/82, September 24, 1982, Inter-Am. Ct. H.R. (Ser. A) No. 2 (1982)*
[50] *Ibid paragraph 29*
[51] *Roos van Os, Roeline Knottnerus, supra14, p. 12*
[52] *Lee supra 44, p.357*
[53] *Ibid, p.358*

2.2 State Consent

Another argument against the phenomenon of the Treaty Shopping is the absence of State consent:

> *"States have a sovereign nature and can only be bound by a treaty if they gave their consent to be bound"*[54].

States are not only free to choose whether to conclude a treaty, but they are also granted with rights to negotiate its terms.[55]In fact, the protection system of IIL obtains its legitimacy from the consent of State parties as expressed in the BIT/IIAs[56], therefore it is vital to evaluate the phenomenon of Treaty shopping from this aspect.

At the period of proliferation of BIT (started in the 1990s), when states first entered into investment protection agreements and gave their consent to solve Investor-State disputes before international arbitrations, the phenomenon of Treaty Shopping was not as widespread as it is nowadays. In fact, at the moment of conclusion of the first BITs States were not fully aware about future consequences, particularly that this agreement can be used to bring a claim against them by the third parties or their own citizens. So, *can we derive State consent to the nowadays situation from their primary consent to investment protection agreements, when the circumstances have changed so dramatically?*

Some States argue that their consent to present situation (consent to the phenomenon of Treaty shopping) cannot be simply derived from their "signature" at the time of conclusion of agreement. This notion was supported by the recent critical reactions to treaty shopping from developing countries in particular from Latin America and Southern Africa. These States have begun to adopt leery attitude towards IIAs[57] In a recent report of South Africa's BIT policy, the South African government voiced that:

> "(…) prior to 1994, the Republic of South Africa had no history of negotiating BITs and the risks posed by such treaties were not fully appreciated at that time,(…) the impact of BITs on future policies were not critically evaluated(…)As a result, the Executive entered into agreements that were heavily stacked in favour of investors

[54] *Sornarajah, M., "The Settlement Of Foreign Investment Disputes", Kluwer Law International (2000), p. 231*
[55] *Baugmarter,supra 17,p.34*
[56] *Lee; supra 44, p. 2*
[57] *Wells Louis, "The Emerging Global Regime for Investment: A Response",Harvard International Law Journal (2010) p. 42-45.*

without the necessary safeguards to preserve flexibility in a number of critical policy areas"[58](emphasis added)

Based on this argumentation many scholars suggest making amendments in the modern IIA system as *"these treaties were developed in other economic, political and social conditions*[59] *"*. In this respect, it should be noted that instead of restricting corporate nationality planning better solution may be *"renegotiation of the balance of the rights and obligations in the substantive parts of IIAs"*[60]. However, in this regards some relevant factors must also be taken into account: the process of investing by its nature presents a long-term engagement of capital by Investor. For the purpose of saving a continues nature of the investing process the validity and other relevant provisions of BIT (and other agreements, which aim to protect Investors) cannot be amended, whenever the States will want to do so.

On the other hand, interestingly enough the State consent may also be used as a basis for allowing Treaty Shopping: the wide scope of many BITs suggests that *"states have given their consent to the possibility of this course of actions"*[61] .After all, states were free and had the power to design and consent to investment treaties in manner they are in need of. An analogous opinion was expressed by the Tribunal in **Aguas del Tunari v. Bolivia case**,[62]

"(...) the language of the definition of national in many BITs evidences that such national routing of investments is entirely in keeping with the fundamental purpose of the instruments and the motivations of the state parties"[63]

From the viewpoint of this argumentation, broadening the State consent to wider scope of Investors is in harmony with the primary goal of the IIA system of attracting foreign Investors.

CHAPTER 3. OBSERVING THE PHENOMENON OF TREATY SHOPPING THROUGH THE CASE STUDY

[58] *Republic of South Africa, Department of Trade and Industry, Bilateral Investment Treaty Policy Framework Review "Government Position Paper" (2009) page 5*
[59] *Elkins Zachary, Guzman Andrew and Simmons Beth, "Competing for Capital: The Diffusion of Bilateral Investment Treaties 1960 – 2000" (2006) p. 811*
[60] *Lee supra 44, p 360*
[61]
[62] *Aguas del Tunari v. Bolivia (n 173) para 241; Standard Chartered Bank v. The United Republic of Tanzania, ICSID Case No. ARB/10/12, Award (2 November 2012) paragraph 270.*
[63] *Ibid paragraph 268*

3.1 Treaty Interpretation- Why is it important?

In the interest of fully figuring out arbitral awards concerning treaty shopping, it is necessary to shortly review the general approaches to investment treaty interpretation. Since IIL is a part of public international law, the foundation of interpreting IIAs is that of interpretation of international treaties in general.[64] Such general rules are contained in the VCLT[65]. Investment tribunals habitually begin their interpretation by invoking Article 31 of VCLT, according to which:

> "A *treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to terms of treaty in their context and in the light of its object and purpose* [66]"

Two general approaches have arisen from this phrasing: the textual and teleological interpretation[67]. Some tribunals have limited themselves strictly to the wording of the applicable IIA, others overrun the treaty text in search of interpretation, which reflects the objective and the main purpose of the treaty.

The textual approach provides, that treaty interpretation should be principally based on the actual terms, that are used in treaty text. Accordingly, the text of IIAs is the only fundamental origin for determining Contracting State's intention, and the tribunal cannot deviate from what the parties have agreed[68]. Hence, when interpreting treaty text, the tribunal tries to give the words, as they are used in treaty text, their *"ordinary meaning*[69]*."*

Textual approach leaves no space for applications, which are beyond the wording of the IIA, even if the outcome is, in fact, conflicting with the spirit of the treaty.

In contradiction, the teleological interpretation tries to highlight the underlying objective and purpose of the treaty. Thus, this approach may better reflect the Contracting States intentions, but it is also risking and fragmentations and conflict among tribunals, as such interpretation is inevitably value-bases and gives the arbitration great leeway[70]. In the cases, where the phenomenon of treaty shopping is discussed, usually there are pairings with the phenomenon

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[64] *Weeramantry Romesh, "Treaty interpretation in International Investment Arbitration;Oxford University Press 2012; Chapter I*
[65] *Vienna convention on the Law of Treaties, 23 May 1969*
[66] *Malgosia Fitzmaurice, Olufemi Elias, Panos Merkouris (eds) "Traety Interpretation and the Vienna Convention on Law of Treaties" Brill Nijhoff (2020), p129*
[67] *Koskenniemi Martti, "From Apology to Utopia: The structure of International Legal Agreement"; Cambridge University Press (2005), p. 333*
[68] *De Figueredo Roberto, "Interpretation of Investment Treaties" Kluwer arbitration Blog; (21October 2014)*
[69] *Pauwelyn and Elsig; supra 6, p. 205*
[70] *Pauwelyn and Elsig supra 6 p 453*

of good faith. This consolidation has played a considerable role in decisions, which criticize the treaty shopping.

In fact, the tribunal's actual choice of interpretation plays vital role in deciding the permissibility of treaty shopping. The cases are framed in accordance with the textual versus teleological approach separation. Still, it is not likely to determine which approach will prevail. While most of the recent cases have increasingly base on good faith considerations, backing for the formal/textual interpretation of the treaty text still remains strong.

3.2 The permissive Approach: Textual/formal interpretation

The permissive approach concerns to those cases in which arbitral tribunals have accepted treaty shopping through restructuring as lawful action falling under the limits of IIA text. In each instance, the tribunal took a consent-orientated stand and noted that "the explicit terms of applicable treaty provided the necessary and adequate criteria for determining corporate nationality, namely the place of incorporation"[71]. The core nature of this approach is pointing out the freedom of states to establish limits, if they so choose, on treaty shopping, when they are in the phase of negotiation of the IIA in question.

3.2.1 Round Tripping

The first type of cases, that we will discuss are those which involve so called "round-tripping [72]." This phrasing is used to describe those cases, where the investor, who is a national of a host state, owns/controls a legal entity, which is, incorporated in another state that has signed an IIAs with the host State. In this scenario the investor brings domestic investment claims by using ***only formally*** international entity.

Tokios Tokelès v Ukraine[73] was one of the substantive considerations of treaty shopping[74]. This case is one of the most typical examples of the formalistic interpretation of the investor's nationality. The factual circumstances of the case were the following: the claimant (Tokisos Tokelès), which was a publishing company incorporated in Lithuania, accused the Ukrainian government in engaging in series of actions that amounted to mistreatment of its

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[71] Feldman Mark, "Setting Limits on Corporate Nationality Planning in Investment Treaty Arbitration" (2012) p. 285

[72] This term is having a wide usage. For example, see Baumgartner, supra 20

[73] ICSID, 29.04.2004, Case No. ARB/02/18 (Tokios Tokelès v. Ukraine), Decision on Jurisdiction

[74] Ascensio Hervey, "Abuse of process in International Investment Arbitration", Chinese Journal of International Law, (2014), p. 20

investment in Ukraine, a wholly owned subsidiary called Taki Spravy[75]. The claimant brought action against the host state under the BIT concluded between Ukraine and Lithuania [76]. A dispute appeared over jurisdiction when the respondent (government of Ukraine) claimed, that Tokios Tokelès was nor a "genuine entity" of Lithuania, because it was owned and controlled predominantly by Ukrainian nationals (99 per cent of the capital of the company and two thirds of the management were of Ukrainian origin)[77] Respondent argued, that allowing the claimant to pursue the claim would be identical to allowing Ukrainian nationals to peruse international arbitration against their own government[78]. But, in fact the Ukrainian government did not challenge that the Tokios Tokelès was *de jure* Lithuanian under the BIT concluded between states, because the latter only required incorporation. Still, the respondent requested the tribunal to "pierce the corporate veil" and find that it had no jurisdiction *ratione personae* in this case[79].

On the other side the claimant claimed that it had met the applicable criteria and the incorporation test was absolutely straightforward.

The tribunal's decision was divided two-to one[80] (in favor of the Claimant)[81]. The arbitrators highlighted that: "*Contracting parties are free to define their consent to jurisdiction in terms that are broad or narrow; they may employ a control-test or reserve the right to deny treaty protection to claimants who otherwise would have recourse under the BIT. Once that consent is defined, however, tribunals should give effect to it, unless doing so would allow the Convention to be used for the purposes which it clearly was not intended*"[82](emphasis added).

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[75] *Martin Antoine, "International Investment Disputes, Nationality and Corporate Veil: Some Insight from Tokios Tokle's and TSA spectrum and Argentina", (2014) p.105*

[76] *Agreement between the Government of the Republic of Lithuania and the Government of the Ukraine for the promotion and reciprocal protection of investment (Ukraine- Lithuania BIT) 8 February 1994 (entered into force 6 March 1995); Article 2(1)*

[77] *Tokios Tokelès v. Ukraine, Decision paragraph 21*

[78] *"The Convention is designed to facilitate the settlement of investment disputes between States and nationals of other States. It is not meant for disputes between States and their own nationals." Schreuer Christoph, "The ICSID Comvention- A Commentary", Cambridge University Press (2001)*

[79] *Tokios Tokelès v Ukraine, Decision, supra 73, paragraph 23*

[80] *The majority noted that; "*Contracting Parties are free to define their consent to jurisdiction in terms that are broad or narrow; they may employ a control-test or reserve the right to deny treaty protection to claimants who otherwise would have recourse under the BIT. Once that consent is defined, however, tribunals should give effect to it, unless doing so would allow the Convention to be used for purposes for which it clearly was not intended" *Baugmarter supra 20, p.103-104*

[81] *Professor Prosper Weil (one of the presiding arbitrators) strongly dissented and eventually even resigned his position in protest of the decision to accept jurisdiction*

[82] *Tokios decision v. Ukraine decision, Supra 73 paragraph 40*

As, the claimant in fact had fullfed the written requirement of nationality, the majority of tribunal refused to limit the application of the BIT provision in the absence of direct treaty requirement for doing so.

In response to respondent's requirement to "pierce the corporate veil" the majority adopted a view that:

"(…) *none of the claimant's conduct with respect to its status as an entity of Lithuania constitutes an abuse of legal personality*[83]*."*

Even though the tribunal only relied on IIA's wording and declined to deeper evaluate the pure nature of claimant's corporate structure, one may draw a conclusion, *a contrairo,* that it will be possible to disregard the formal corporate structure should any fraud allegation be confirmed, and in this case it was the absence of such abuse that justified complete reliance on incorporate test[84].

The main aftermath of the *Tokios Tokelès* case is that states are granted with discretion in defining investors' nationality. Thus, as long as the host state has stipulated the incorporation test as the decisive factor, this will be respected absent an abuse of legal personality by the investor.[85] Under the framework of this logic it seems that the origin of the capital, even if it stems from the host state itself, is not important.

Rompetrol Group N.V v. Romania

Another case which represents a situation of an investor bringing claim against its own state of nationality through formally foreign company is ***Rompetrol Group N.V v. Romania***[86]**.** In this case a Rompetrol Group N.V(Netherland incorporated company), brought acclaim against Romania under the BIT concluded between Romania and Netherlands[87]. In fact, the company was a wholly owned subsidiary of a Swiss company, which was owned and controlled by Romanian national, who held 80 per cent of the shares[88]. Then the company

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[83] *The tribunal highlighted that the claimant "made no attempt whatever to conceal its national identity from the access to ICSID arbitration against Ukraine, as the enterprise was founded six years before the BIT between the Ukraine and Lithuania entered into force" paragraph 56*

[84] *Ascensio page 771-772*

[85] *Kjos Hege Elisabeth, "Case comments and Awards; Tokios Tokelès v Ukraine,Decision of Jurisdiction of April 29", Transnational Dispute management (2004)*

[86] *The Rompetrol Group N.V. v. Romania, Decision on Respondent's Preliminary Objections on Jurisdiction and Admissibility, ICSID Case No. ARB/06/3, De Decision on Respondent's Preliminary Objections on Jurisdiction and Admissibility (18 April 2008)*

[87] *Agreement on Encouragement and Reciprocal Protection of investments between the Government of the Kingdom of the Netherlands and the Government of Romania (Netherlands-Romania BIT) 19 April 1994 (entered into force 1 February 1995).*

[88] *The Rompetrol Group N.V v Romania supra 81, paragraph 41*

also set up an affiliate in Romania (holding 51 per cent of shares in this company, *in other words controlling interest*) which then owned the largest oil refinery of the Romania. Later in 2004 The National Anti-Corruption office of Romania inaugurated investigation concerning the refinery. The claimant has qualified State's actions as oppressive[89].

Romania challenged the tribunal's jurisdiction, by asserting that:

> *"(...) Despite the fact that the formal nationality requirements are indisputable met, the claimant could not bring a claim under the treaty, because its real and effective nationality is, in fact, that of respondent State. (...) The claimant company should not be allowed to initiate international proceedings in what is really domestic dispute: Rompetrol is owned and controlled by Romanian citizen, has its real seat in Romania, and the origin of funding is also Romanian[90]."*

The tribunal denied above-mentioned argumentation, thereby once again confirming the opinion, which was held in the case of ***Tokios Tokelès v Ukrain.*** The Tribunal thus declared that: ***"Hence the question becomes simply, what did these two states themselves agree to with their own free will in concluding the BIT? The Tribunal therefore holds that the definition of national status given in the Netherlands -Romania BIT is decisive for the purpose of establishing its jurisdiction[91]."***

Accordingly, by only looking to the definition of investor provided in BIT, the Claimant was qualified as such, and this decision further confirmed a literal reading of treaty provisions and correspondingly a permissive approach to treaty shopping.

3.2.2 The Mailbox companies

The other group of cases concerns the situations, where the investor is treaty shopping through "mailbox"[92] company. Typically, in this scenario the investor, which actually owns/controls the investment, is a national of another third state. Despite the fact that this cases are, in fact, international by their nature, many states protested against it stating that the investor, who does not have real economic connections with host state, should not be able to gain benefits from treaty protection.

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[89] *Kribaum Ursula "The Rompetrol Group N.V. v. Romania" The Journal of World Investment and Trade (2014) p. 5*
[90] *The Rompetrol Group N.V v Romania,supra 81, paragraphs 55, 83*
[91] *Ibid. paragraph 63*
[92] *The term "mailbox company" does not have a universally recognized definition*

Saluka Investment B.V V. Czech Republic[93]

In this case the cause of the dispute was the reorganization and privatization of the Czech Banking system. The Nomura Investment (which was an English subsidiary of a Japanese investment bank) obtained 46 per cent of the shares in Investiční a Poštovní Banka (commercial bank in Czech Republic) right after it was privatized. Then Noruma Europe transferred the relevant shares to its wholly owned subsidiary Saluka Investment B.V. This company was, in fact, established under the Netherlands law for the sole purpose of holding Noruma Europe's investments in the Czech Republic[94].

The Czech government extended a state grant to all major banks of the country except Investiční a Poštovní Banka. Saluka claimed that the state violated Article 3 (FET) and Article 5 (deprivation of investment) of the BIT concluded between Czech Republic and the Netherlands[95].

The Czech Republic challenged the jurisdiction of the Tribunal, on the grounds that the real investor was not Saluka but Noruma (which was not an eligible claimant under the BIT)[96]. Furthermore, the respondent stated that: *"(…) The Claimant is nothing more than a shall of Noruma and thus a bona fide investor because it has no real and continuous links to the Netherlands (…)*[97]*"*

The tribunal followed the same logic that it held in the cases of ***Tokios Tokelès and Rompetrol****:* it ultimately rejected the submissions of the Czech Republic. In this case the Tribunal highlighted:

> *"Contracting states had complete freedom to define investor. It is beyond the Tribunal's powers to import additional requirements which contracting States could themselves have added but which they omitted to add*[98]*"*
>
> It is worth mentioning that in this case the tribunal in some manner supported the statement of the Czech Republic, that the state party, which does not have a real economic connections with the host state, should not be entitled to the benefits of protection under the treaty stating that:

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[93] *Saluka Investment B.V v. Czech Republic, Uncitral/PCA, Partial Award (17 March 2006)*
[94] *Dugan Cgristopher et al., "Investor -State Arbitration" Oxford University press 2012 page 336*
[95] *Agreement on encouragement and reciprocal protection of investments between the Kingdom of the Netherlands and the Czech and Slovak Federal Republic (Netherlands-Czech BIT), 24 April 1991 (entered into force 1 October 1992).*
[96] *Saluka Investment B.V v. The Czech Republic paragraph 199*
[97] *Ibid. paragraph 138*
[98] *Ibid. paragraph 229*

"(*...) Accepting this possibility enables abuses of arbitral procedure and practices of trety shopping, which can entail many disadvantages (...)*[99]*"*

However later the tribunal also stated that: *"(...) The companies concerned have simply acted in a manner which is commonplace in the world of commerce (...). Ultimately the predominant fact that must guide the tribunal's exercise of its functions is the terms in which the contracting parties have agreed to establish the tribunal's jurisdiction*[100]*."*

Thus, in fact the tribunal has qualified this case of treaty shopping as a normal phenomenon without looking behind the treaty text.

ADC Affiliate Limited and ADC and ADMC Management Limited v. Hungary[101]

As in the case of **Saluka Investment B.V** two companies which had no financial connections with the host State brought a claim against it. The claimant companies were incorporated in Cyprus but were directly controlled by Canadian entities[102]. The claim was brought under the BIT concluded between the Cyprus and Hungary[103].

Hungary (respondent) claimed that: *"(...) Claimant are nothing but two shell companies established by Canadian investors with the ulterior motive to gain access to ISCID jurisdiction for nationals whose home state is not a contracting party of the ICSID convention*[104]*(...)the genuine link between the corporation and the state of its claimed nationality, which is the fundamental requirement of the rules of the international law, is missing.(...). The object and the purpose of the ICSID Convention require consideration of the origin of the investment capital when deciding on the investor's nationality. Thus, the tribunal should pierce the corporate veil*[105]*."*

Similarly, the tribunal denied the arguments of the respondent stating that: *"(...) The question of the claimant's nationality was settled unambiguously by the wording of BIT, and therefore there is no room for the consideration of customary law principles of nationality. (...) The*

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[99] *Ibid. paragraph 240*
[100] *Ibid. paragraph 228 and 242*
[101] *ADC Affiliate Limited and ADC & ADMC Management Limited v. The Republic of Hungary, ICSID Case No. ARB/03/16, Award on 2 October 2006.*
[102] *Ibid, paragraph 1*
[103] *Agreement between the Republic of Cyprus and the Government of the Hungarian People's Republic on mutual promotion and protection of investments (Cyprus-Hungary BIT) 24 May 1989 (entered into force 25 May 1990).*
[104] *At the moment of this dispute the Canada had not didn't ratified the ICSID Convention. Consequently, it was not a Member state. In fact, the Convention was ratified by Canada only seven years later on the 1st of November 2013.*
[105] *ADC Affiliate Limited v. Hungary paragraph 336,342, 343*

government of the Hungary could have included the requirements of a genuine link in respective BIT, but it chose not to do[106]*."*

Once again, the tribunal stated that there is no need to look further than what the wording of the BIT provides, because if the state wanted something to be different it should have included it in the provisions of negotiated BIT.

3.3 Conclusions concerning non- prohibitive approach

The above-mentioned cases which introduce non-prohibitive approach towards the phenomenon of treaty shopping share an identical justification from the side of the respondent states: the claim should be dismissed by taking into consideration an abusive corporate restructuring held by the claimant. Generally, the tribunal responded to these assertions in two diverse ways.

In the case of the ***Rompetrol*** the tribunal did not agree with the fact that the phenomenon of ***real and effective*** nationality can overrule the factual wording/language of the respective treaty. In the cases of ADC Awards**, Saluka and Tokios Tokelès** the tribunal considered some discussions concerning the claimant's factual activity without properly addressing the question of the in what circumstances the abusive conducts may/might lead to dismissal of claims under the investor -state arbitration[107].

Professor Mark Feldman referred to this in his opinion by stating that: *"(...) Any attempt to read additional requirements into a BIT's definition of investor*[108]*is likely to be unsuccessful. (...) The state of the law is unsettled concerning the impact, if any, that abusive corporate activity has on question of jurisdiction*[109]*."*

Therefore, these cases demonstrate that where an applicable BIT (or other IIA) adopts incorporation as the criterion for nationality, the tribunal generally interprets it as a sufficient requirement and refuses to look behind the corporate veil of the or to examine the existence of a genuine link[110].

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[106] *Ibid, paragraph 358*
[107] *Feldman, supra60, p.287-288*
[108] *By saying additional requirements, the author means the phenomenon of original capital, genuine connection, real links, etc.*
[109] *Feldman, supra 60, p. 288*
[110]

3.4 The Prohibitive approach: looking behind the treaty text

In the cases, where the tribunal qualified treaty shopping as abusive, it usually expended the borders of its research trying to determine the true intentions behind the change of investor's nationality. With the help of concluded awards concerning the cases of abusive treaty shopping some guidelines were developed. Still, these guidelines are not decisive: as a consequence, the line between the abusive treaty shopping and legitimate nationality planning remains blurry.

Phoenix Action Ltd. V. The Czech Republic[111]

Phoenix Action Ltd v. The Czech Republic case is a typical example which demonstrates how the factors behind the treaty text may become vital for determining if the corporate restructuring was abusive or not. In this case two Czech metal companies (Benet Praha and Benet Group) which were owned and controlled by the same individual (Czech national Vladimír Beňo) became involved in the proceedings before Czech courts[112]. Vladimír Beňo immediately sold this companies to Phoenix Action Ltd (a company which was construed under the Law of Israel). In fact, The Phoenix Action was controlled by family members of Mr. Beňo.

Only two months after the acquisition of the company, Phoenix Action Ltd informed about and later commenced arbitral proceedings under the BIT concluded between Israel and Czech Republic.[113]

The claimant declared that:

> "(…) *National courts of Czech Republic have failed to promptly resolve the actions involving Benet Praha ad Benet Group, which is equivalent to expropriation of the assets as well as violation of the fair and equitable treatment provisions and full protection and security provisions of BIT. (...)*[114]*."*

In contradiction the respondent claimed that:

> *"Phoenix's allegations fall outside the tribunals jurisdiction both rationa materia and rationa temporis. (...) Alleged breaches were of the BIT occurred before the claimant*

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[111] *Phoenix Action, Ltd. v. The Czech Republic, supra 26*
[112] *Skinner et.al. supra 8; p 250*
[113] *Agreement between the Government of the Czech Republic and the Government of the State of Israel for the Reciprocal Promotion and Protection of Investments (Israel-Czech BIT) 23 September 1997 (entered into force 16 March 1999).*
[114] *Phoenix Action Ltd. The Czech Republic supra 26, paragraphs 44-45*

acquired the Czech companies. So, the tribunal has no jurisdiction prior to that point of time[115]*."*

The respondent also claimed that the pure fact of the so-called purchase of the Phoenix Ltd cannot be considered as an "investment" both under the Article 25b of the ICSID convention and Articles 1 and 7 of the BIT[116].

Basing on the factual evidence the respondent also requested to the tribunal to lift the corporate veil by stating that:

"*Phoenix is nothing more than ex post facto creation of a sham Israeli entity created by the Czech fugitive from justice, Vladimír Beňo, to create diversity of nationality*[117]*."*

By taking into consideration the factual circumstances of this case the tribunal adopted a deep discussion of applicability and role of the good faith principle and as a consequence, dismissed the claimant's request. The decision was founded on the fact that the claimant was not entitled to bring a claim for reason of basis of the abusive treaty shopping. By this decision the Tribunal accepted the universality of the good faith principle in international investment[118].

The importance of this award also is not only in the fact that the tribunal has lifted the corporate veil but also that it has developed some criteria for determining the abusive treaty shopping.

Tribunal laid down four considerations to be taken into account in evaluating whether or not the investor had a *bona fide* objective to engage in economic activities in the host state:

- **Timing of the investment:** was the asset already distressed, and was the incoming investor aware of these difficulties when it bought in? The tribunal declared that the Phoenix bought the companies which were already burdened with litigation as well as problems with Czech tax and customs authorities[119].
- **Timing of the claim:** how long after the investment was made did the Claimant bring its ICSID claim? Is the claim only based on violations and damages that occurred

[115] *Ibid, paragraph 34*
[116] *Ibid paragraph 44 and 45*
[117] *Ibid paragraph 34*
[118] *De Brabandere Eric, ""Good faith". "Abuse of process" and the initiation of Investment Treaty Claims" Journal of International Dispute Settlement (2012) p. 642*
[119] *Phoenix Action Ltd. The Czech Republic, supra 26,paragraph 136*

pre-investment? Phoenix gave a notice to Czech Republic about an investment dispute even before its' ownership was properly(legally) registered[120].

(a) Substance of the transaction: what was the substance of the transaction and how was it carried out? In fact, the tribunal investigated all of the transfers of interests and came to conclusion that the dealings were not made in arm's -length basis. Hence, it found that alleged investments appeared to be redistribution of assets among Beňo family[121].

(b) True nature of the operation: Was any economic activity performed or genuinely intended by the investor? Phoenix had no business plan, no program of refinancing the Czech entities and no economic objectives[91]**.**

By looking through the each of the above-mentioned criteria, the tribunal declared that the transaction was not *bona fide,* but simply the claimant's creation of a legal fiction in order to gain access to an international arbitration procedure to which it was not entitled.[122]

Mobil Corporation, Venezuela Holdings v. Venezuela

The case of ***Mobil Corporation v Venezuela*** was likewise discussed in the framework of the good faith principle. However, the criteria for determination of the fact whether the actions in question (the fact of treaty shopping) was abusive or not were somewhat different.

The factual circumstances are the following: the Mobil Corporation and some of its affiliates entered into contractual relationships with the state. In 2006 and 2007 Venezuela came up with a series of measures, which caused a financial harm to the company. Mobil Corporation initiated arbitration under Netherlands-Venezuela BIT.

Venezuela challenged the jurisdiction of the ICSID tribunal: "*Mobil has engaged in illegitimate treaty shopping by inserting a Dutch holding company into an otherwise non-Dutch chain of corporate ownership in October 2005. This is done for the sole purpose of accessing the Netherlands-Venezuela BIT protection. (...) This constituted an abuse of process and abuse of rights*[123]*."*

[120] *Ibid paragraph 138*
[121] *Ibid paragraph 139*
[122] *Ibid paragraph 143*
[123] *Mobil corporation v. Venezuela, supra 27, paragraph 28*

Surprisingly enough, in this case the claimant did not dismiss these allegations, by admitting that it undertook a review of the extent of the legal protections for its investment in Venezuela and decided to undertake this change in corporate ownership structure[124].

In the light of this statement the tribunal concluded that the main purpose (if not the only purpose) of restructuring was to protect Mobil investments from Venezuelan measures in getting access to ICSID arbitration through the BIT.[125]In this case the tribunal held a position that the true issue before it was to decide distinction between legitimate corporate planning and abuse of rights depended on the circumstances in which the restructuring took place[126].

The tribunal acknowledged the notions of abuse of process and principle of good faith. Nevertheless, the tribunal achieved to conclusion that**:** "*The restructuring of investment to protect them against mistreatment by Venezuela by gaining access through BIT was perfectly legitimate goa; as far as it concerns future disputes*[127]."

After this acknowledgment the tribunal targeted the timing of the change of nationality. It has adjudged that his acknowledgment only concerns to disputes which have arose after the restructuring had took place [128]. By citing Phoenix Action case the tribunal based its reasoning on following statement: "(*...) Restructure investment only to gain jurisdiction under a BIT for such disputes would constitute abuse of the ISCID convention and the BIT*[129] ."

This case is appealing from the viewpoint of adoption of a kind of clear approach towards treaty shopping. It acknowledges that the treaty shopping (strategic corporate planning) is legal/permissive tool when used for securing overseas investment from the disputes that are yet to occur. At the same time, it highlights that a maneuver which is used only for purpose of finding a solution for past grievances is unacceptable[130]. Some questions still remain with no exact answer: how does the point of time when the dispute arose to be determined?

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[124] *Blyschak, "Access and advantage expanded: Mobil Corporation v Venezuela and other recent arbitration awards on treaty shopping", JWELB, (2011/4,) p. 34*
[125] *Mobil corporation v. Venezuela supra 27, paragraph 204*
[126] *Ibid paragraph 191*
[127] *Ibid paragraph 204*
[128] *Ibid paragraph 206; "The jurisdiction was accepted in relation of the claims to 2007 nationalization of Mobil's investments but dismissed jurisdiction over the claims concerning the increased royalties and taxes, which occurred before the establishment of Dutch entity"*
[129] *Ibid paragraph 205*
[130] *Blyschak, supra 119, p.35*

It is noteworthy that even while the case law develops, investors can (to some extent) sidestep the jurisprudence by appointing the right arbitrator – namely, treaty shopping may be frowned upon by some, but many arbitrators see it as a fact of international business life[131]

Philip Morris v. Australia[132]

The Philip Morris v. Australia case is one of the most debated cases, where jurisdiction was denied on the base of abuse of process. This was one of the first cases, where the tribunal came up with definite distinction between *abuse of process* objections and *ratione temporis* objections.

The dispute arose after the Australian Government introduced so-called Tobacco Plain Packaging Act of 21 November 2011, legislation developed in line with the World Health Organization's Framework Convention on Tobacco Control, 2003, adopted by 180 States[133]. This act established some strict restrictions on the appearance of tobacco products (preventing use of colors, logos, embellishments and trademarks)[134].

Philip Morris Asia was a Hong-Kong incorporated company serving as a regional headquarter of one of the biggest tobacco producing companies called Philip Morris International. In order to be able to initiate arbitration under the Hong-Kong Australian BIT, Philip Morris International have used a restructuring maneuver. It transferred its two Australian subsidiaries to Philip Morris Asia, hence putting the company into the chain of ownership and control of Australian investment[135].

Philip Morris Asia claimed that the adopted measures violated the intellectual property rights of its subsidiaries[136]. The main counterargument of the respondent was the *ratione temporis* objections: the claim is not under the scope of BIT because it, in fact, pre-dated the acquisition of ownership. Additionally, asserted that this action is tantamount to abuse of process.

The tribunal discussed the case in the framework of the following questions

- ***Were the requirements for the ratione temporis jurisdiction met?***

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[131] *Skinner et al. supra 7; p.283*
[132] *Philip Morris Asia Limited v. The Commonwealth of Australia, UNCITRAL, PCA Case No. 2012-12, Award on Jurisdiction and Admissibility (17 December 2015).*
[133] *The world healthcare organization's framework convention on tobacco control, Geneva, 21 May 2003,*
[134] *Linder Falk Ulf, "Philip Morris Asia Ltd v Australia – Abuse of Rights in Investor-State Arbitration" Nordic Journal of International Law, (2017) p.403–419*
[135] *Philip Morris v. Australia, supra 132, paragraph 6*
[136] *Ibid paragraph 527*

The Tribunal held that critical fact to be determined is date, when the stat adopted disputable measures, because before that investor's rights could not be affected.[137] The Tribunal came to the conclusion that the requirements for jurisdiction ratione temporis were met, based on the fact that restructuring was both decided and completed before the date when measures came into force.

Was there an abuse of rights?

In regard to this question the tribunal first of all highlighted that: "*It is clear and recognized by all earlier decisions that the threshold for finding an abusive initiation of an investment claim is high. (...) mere fact of restructuring an investment to obtain BIT benefits is not per se illegitimate (...) on the other hand, if restructuring is made to obtain BIT benefits foreseeable disputes it may amount to abuse of rights*[138]*."*

Some factors were in favor of the fact, that the dispute was foreseeable for the claimant. First of all, in 2009 the claimant already gave a notice to Australian Minister for Health that the package would interfere with its property rights. The announcement about implementation of major tobacco measures took place in 29 April 2010, a few month later the government also published the implementation schedule of the tobacco legislation.

The tribunal focused attention on the fact that, the Respondent's intention to introduce plain packaging regulation as of April 2010 were clear, thus there was at least a reasonable probability that such measures would eventually be adopted, which would trigger a dispute. Based on this fact a conclusion was that the dispute was foreseeable for the claimant.

In order to understand the claimant's real intentions, the tribunal also discussed claimants' commercial bases for restructuring. The legitimate and credible motive for restructuring might invalidate an otherwise abuse of process finding[139]. In this respect the claimant failed to prove that there was any other reason (e.g. tax benefits) which were decisive for reorganization. Hence, the tribunal found that that the claim is inadmissible and declined to exercise jurisdiction over the dispute.

In conclusion Philip Morris case was one of the first cases which has developed complex research tactic. It had viewed the question of abuse through the lens of two layered test. Primarily, the point in time, when the dispute was materialized should be determined. If the restructuring was made prior to the State measures jurisdiction exist. When the test is passed

[137] *Ibid paragraph 533*
[138] *Ibid paragraph 540, 545*
[139] *Baugmarter, supra 20, p. 210*

the tribunal can adequately adjudge admissibility of the claim using principle of abuse of process.

3.4.1 Conclusions concerning prohibitive approach

In the light of examination of above-mentioned awards, it can be concluded: *there is no universal rule, which, in some way, prohibits nationality planning and Treaty shopping*. Correspondingly, the Investors will continue practicing Treaty shopping, as long as it provides them with additional layer of protection of their Investments and business interests.

As we can conclude the Tribunals generally draw the line between abusive and permissive Treaty shopping based on two relevant factors:

- *the timing of restructuring*
- *the nature/purpose of restructuring*.

In fact, the Investors who have planned the act of Treaty shopping beforehand are rewarded with the benefits of particular investment arbitration, the ones who failed to do so are on the contrary "punished"

Thus, the current situation is not quite satisfactory. In the framework of investment arbitration, nationality plays a vital role: in order to prove a particular nationality lot of resources are being spent (energy, money, etc.). However, on the merits phase, distinctions on the basis of nationality are banned as IIAs generally contains rules against arbitrary and discriminatory treatment. Particularly, the discrimination on the basis of nationality would be a conspicuous violation of the FET standard. In Addition, a large scale of IIAs also contain national treatment, and MFN treatment clauses.

In view of foregoing, it can be concluded that deep-rooted paradox is surrounding the concept of nationality. From the perspective of the essence of IIL system, nationality has extreme importance, but simultaneously IIL is also on the path of eliminating differences based on the pure concept of nationality. *What role does the phenomenon of Treaty shopping play in this scenario?* The fact is that this phenomenon can be used both as a working tool for destabilization of IIL system, or as an instrument for broadening the fundamental concepts of equality, non-discrimination and fairness from the merits phase into the jurisdiction phase. Only time will show which is the right qualification of Treaty shopping in these regards.

CONCLUSION

Treaty shopping is relatively new phenomena in the IIL system. As such, it raises several questions. The nature treaty shopping is in certain degree controversial. From the first glance it has some contradictions with IIL system which we deem as being essentially bilateral and based on reciprocity. However, it should be noted, that in fact Treaty shopping does not grant the investor(treaty-shopper) anything more than that which the system of investment protection is originally about: possibility to resolve disputes through international investment arbitration and fair treatment. Hence, by looking at the concept of Treaty shopping from the viewpoint of the main rationale of IIL system, we can conclude, that they do not stand in contradiction, but the opposite- in compliance

Correspondingly the practice of arbitral tribunals which have dealt with the issue of Treaty shopping, seems to be in harmony with the above-mentioned reasoning. In some cases, the Treaty shopping may lead to violation of fundamental principles, upon which access to International Investment Arbitration will be denied by tribunals. However, timely corporate restructuring/nationality planning generally has been viewed by tribunals as legitimate. In fact, it is not *per se* illegal for an Investor, of one nationality, who protects his business interests, to establish a new entity in a jurisdiction recognized to provide a beneficial regulatory and legal environment, (including the availability of a favorable/more favorable investment treaty).The decisive factor here is completing the process in advance and in proper timely manner. Nowadays, the establishment of companies for the aim of obtaining benefits from domestic legal system and treaties is apparently becoming common practice in international business relationships. Nationality planning has become an equivalent tool of business managing to tax planning.

Are there any solutions?

Scholars offer various ways of suppressing treaty shopping, such as:

- renegotiating IIAs with more clear-cut definitions of Investor;
- termination of IIAs;
- broader usage of the good faith and abuse of process principles by arbitral tribunals, etc.

Addressing Treaty shopping within the framework of determining jurisdiction can be problematic and may lead to very variouse decisions, hence increasing uncertainty and weakening the IL system. It would be easier to deal with the concept at the level of substantive provisions of BITs. However, this might prove "*very time-consuming and burdensome, and is not likely to happen in the near future"*[140].

An alternatively purposed approach would be conclusion of comprehensive multilateral treaty. A global investment treaty could harmonize foreign investment law with other competing principles of international law, such as the protection and preservation of the environment and human rights. It latter would balance the rules and bring about consistency and uniformity in protecting foreign investors[141]. Furthermore, it would eliminate the necessity for treaty shopping altogether: it would address the substantive concerns of states, uphold reciprocity and disperse the paradox regarding the importance of nationality. In this context, treaty shopping could be seen as an engine behind the endeavor towards negotiating and concluding such a treaty[142]

The international IIL system definitely has its negative aspects, and the critics of the system experience no lack of well-reasoned arguments. However, as Former President of the ICJ, Judge Schwebel once mentioned:

"Can it really be supposed that States of North and South, East and West, developed and developing, of virtually all political complexions and economic models, some 180 countries, have been misguided in concluding some 3,000 investment treaties[143]*?"*

Only time will demonstrate whether the benefits of this practice outweigh the downsides. Until then, Treaty shopping has its stable place/role in the system, not as an enemy, but as an – if at times slightly burdensome – ally

[140] *Lee, supra 44, p.524*
[141] *Subedi, supra 7, p. 195*
[142] *Schreuer Christoph, supra 17, p 17*
[143] Schwebel Stephen, 'Keynote Address: In Defence of Bilateral Investment Treaties' (*International Council on Commercial Arbitration*, 6 April 2014).

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