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**Preserving Investment Treaty Reciprocity**

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## Reciprocal Foundation of Investment Treaties

- “[T]he purpose of these agreements [BITs] is to protect the investments of each party’s nationals and companies in the territory of the other.”

Kenneth J. Vandeveld, *The Bilateral Investment Treaty Program of the United States*,  
21 Cornell Int’l L. J. (1988) (internal footnotes omitted).



# Reciprocal Foundation of Investment Treaties

## Examples of BITs that Include “Reciprocal” in Title

- Agreement between the People’s Republic of China and the Federal Republic of Germany on the Encouragement and Reciprocal Protection of Investments (2003)
- Agreement on Reciprocal Promotion and Protection of Investments between the Government of the Republic of Austria and the Government of the Islamic Republic of Iran (2001)
- Agreement between the Government of the Republic of Peru and the Government of the People’s Republic of China Concerning the Encouragement and Reciprocal Protection of Investments (1994)



# Changing Nature of Foreign Investment by MNEs

## Increased use of:

- **International production networks (regional/global value chains)**
  - MNEs coordinate intertwined trade and investment activities, carried out across many jurisdictions
  
- **Transit investment**
  - Investment channeled through one jurisdiction before reaching its final destination in another jurisdiction

Mark Feldman, *Multinational Enterprises and Investment Treaties*, Yearbook on International Investment Law & Policy 2015-2016 (L. Sachs and L. Johnson, eds.) (Oxford) (2017) pp. 183-188



# Reciprocal Foundation of Investment Treaties

**MNE reliance on international production networks and transit investment threatens the reciprocal foundation of IIAs in three respects**

- **International production networks can weaken the nexus between a host State investment and the territory of a host State**, given that intertwined trade and investment activities often blur the territorial boundaries of a host State investment.
- **Transit investment** by MNEs often relies on special purpose entities (“SPEs”)—*i.e.* entities having little or no physical presence in their State of incorporation—to serve as “investors” in a host State by holding assets that reflect a financial interest in a host State investment. Such reliance on SPEs by MNEs **can weaken the nexus between investors and their home States**.
- Third, **transit investment** by MNEs – made through conduits – **can weaken the nexus between investors and their host State investments**.

Mark Feldman, *Multinational Enterprises and Investment Treaties*, Yearbook on International Investment Law & Policy 2015-2016 (L. Sachs and L. Johnson, eds.) (Oxford) (2017), p. 188





# Reciprocal Foundation of Investment Treaties

**Three categories of “free riding” claimants** (claimants that benefit from, without contributing to, reciprocal arrangements)

- Claimants acting as exporters rather than investors (**investment/host State nexus**)
- Claimants lacking any meaningful connection to their home State (**investor/home State nexus**)
- Claimants lacking any meaningful connection to their host State investment (**investor/host State investment nexus**)

**How policymakers and decision-makers ultimately respond to these free rider categories will shape, to a significant extent, the content of IIA rights.**

Mark Feldman, *Multinational Enterprises and Investment Treaties*, Yearbook on International Investment Law & Policy 2015-2016 (L. Sachs and L. Johnson, eds.) (Oxford) (2017), p. 188



## Investment Treaty Claims that Illustrate Potential for “Free Riding” by MNEs

- *Cargill v. Mexico* (claimant, U.S. manufacturer, recovered damages for distributor’s lost profits in the host State and lost profits that U.S. manufacturer would have earned by **exporting** goods to that distributor) (**investment/host State nexus**)
- *Yukos* cases (three related claims brought by holding companies that conducted no substantial business activities in their respective home States; awards against Russia totaled approximately \$50 billion) (**investor/home State nexus**)
- *Ampal-American Israel Corp. v. Egypt* (Delaware corporation held—through a corporate intermediary—less than 1% interest in a host State corporation; tribunal rejected host State argument that connection between Delaware corporation and host State corporation was too remote to fall within the scope of applicable IIA protections) (**investor/host State nexus**)

*Cargill, Inc. v. Mexico*, ICSID Case No. ARB(AF)/05/2

*Hulley Enterprises Limited (Cyprus) v. The Russian Federation*, PCA Case No. AA 226

*Yukos Universal Ltd (Isle of Man) v. The Russian Federation*, PCA Case No. AA 227

*Veteran Petroleum Ltd. (Cyprus) v. The Russian Federation*, PCA Case No. AA 228

*Ampal-American Israel Corp. v. Egypt*, ICSID Case No. ARB/12/11



## Investment/Host State Nexus

**When, if ever, should activities occurring outside the host State be considered part of a host State investment?**

- Activities “related”?
- Activities “intertwined”?





## Investment/Host State Nexus

### Tribunals finding activities outside host State fall within IIA protections

- **Cargill, Inc. v. Mexico**, ICSID Case No. ARB(AF)/05/2, Award, ¶ 523 (18 Sept 2009) (U.S. manufacturer's sales of high-fructose corn syrup to its investment in Mexico (a distributor) were “so associated with” the investment “as to be compensable” under NAFTA investment chapter)
- **SGS Société Générale de Surveillance S.A. v. Philippines**, ICSID Case No. ARB/02/6, Decision on Objections to Jurisdiction (29 Jan 2004) (pre-shipment inspection services performed outside the host State included within scope of IIA protections)
- **SGS Société Générale de Surveillance S.A. v. Pakistan**, ICSID Case No. ARB/01/13, Decision on Objections to Jurisdiction (6 Aug 2003) (pre-shipment inspection services performed outside the host State included within scope of IIA protections)



## The CPTPP Response: “Capacity” Limitation on Damages

### Article 9.19: Submission of a Claim to Arbitration

1. If an investment dispute has not been resolved within six months of the receipt by the respondent of a written request for consultations pursuant to Article 9.18.2 (Consultation and Negotiation):

- (a) the claimant, on its own behalf, may submit to arbitration under this Section a claim:
  - (i) that the respondent has breached:
    - (A) an obligation under Section A;
    - (B) an investment authorisation;<sup>31</sup> or
    - (C) an investment agreement; and
  - (ii) that the claimant has incurred loss or damage by reason of, or arising out of, that breach; and

## The CPTPP Response: “Capacity” Limitation on Damages

2. For greater certainty, if an investor of a Party submits a claim to arbitration under Article 9.19.1(a) (Submission of a Claim to Arbitration), it may recover only for loss or damage that it has incurred in its capacity as an investor of a Party.



## Investment/Host State Nexus

- How Should a Capacity Limitation be Applied?
- When Should Activities Undertaken in One's Capacity as a Host State Investor Include Activities Occurring Outside the Host State?



# When Should Activities Undertaken in One's Capacity as a Host State Investor Include Activities Occurring Outside the Host State?

## Five Proposed Factors

- Host State investment serves as center of gravity for an MNE's interrelated operations
- Scale of the host State investment—considered in the context of an MNE's interrelated operations—is significant
- Significant share of an MNE's claimed investment damages concern host State operations
- Significant share of the value created by an MNE's interrelated operations is captured in the host State
- MNE's operations outside the host State are intertwined with the MNE's investing activity in the host State.

Mark Feldman, *Multinational Enterprises and Investment Treaties*, Yearbook on International Investment Law & Policy 2015-2016 (L. Sachs and L. Johnson, eds.) (Oxford) (2017), pp. 191-204





## When Should Activities Undertaken in One's Capacity as a Host State Investor Include Activities Occurring Outside the Host State?

*Host State investment serves as center of gravity for an MNE's interrelated operations*

- Center of gravity in Cargill? Which operations are core operations? Which are peripheral?
- Claimant argued Cargill Inc.'s high-fructose corn syrup [HFCS] exports were “input[s]” for its host State investment, “an HFCS distribution network located in Mexico.”
- But could be argued that the distribution activities of Cargill de Mexico in Mexico supported and facilitated the core activities of Cargill, Inc. in the United States: the manufacture and export of HFCS.



## When Should Activities Undertaken in One's Capacity as a Host State Investor Include Activities Occurring Outside the Host State?

*Scale of host State investment—considered in the context of an MNE's interrelated operations—is significant*

- In *Apotex v. United States*, the tribunal observed that “all of the activities relied upon in relation to both sertraline and pravastatin [generic drug] products” – i.e. the formulation, development, and manufacturing of those products – occurred in the home State (Canada), not the host State (United States).

*Apotex, Inc. v. United States*, Award on Jurisdiction and Admissibility (14 June 2013)  
¶¶ 160-161.



## When Should Activities Undertaken in One's Capacity as a Host State Investor Include Activities Occurring Outside the Host State?

*Significant share of an MNE's claimed investment damages concern host State operations*

- **Cargill v. Mexico** (more than half of damages awarded concerned lost sales by a U.S. manufacturer and exporter operating outside the host State)
- **Apotex v. United States** (damages sought largely concerned lost sales by a Canadian manufacturer and exporter operating outside the alleged host State)
- **S.D. Myers v. Canada** (damages sought largely concerned lost sales by a U.S. service provider operating outside the host State)
- **SGS v. Pakistan** and **SGS v. Philippines** (damages sought largely concerned pre-shipment inspection services performed outside the host State)



## When Should Activities Undertaken in One's Capacity as a Host State Investor Include Activities Occurring Outside the Host State?

*Significant share of the value created by an MNE's interrelated operations is captured in the host State*

- The extent to which a host State investment contributes to a host State's development should be a relevant factor when determining whether a host State investment can include—for purposes of applying IIA protections—operations occurring outside the host State.
- IIAs that expressly include sustainability as an objective or in treaty text provide additional support for considering host State's share of value creation



## When Should Activities Undertaken in One's Capacity as a Host State Investor Include Activities Occurring Outside the Host State?

*MNE's operations outside the host State are intertwined with the MNE's investing activity in the host State*

- *Standard Chartered Bank v. Tanzania*: investing activity needed to satisfy investment requirement; investor must *make* (rather than merely hold) investment
- Operations occurring outside the host State should be interconnected with host State operations in order to be considered “investing activity”
- Exporting goods to a host State distributor: “investing activity”?





## Investor/Home State Nexus: Three Policy Options Regarding SPE Claims

### Policy Option One: Barring Claims by SPEs as Investors

- Definition of “investor” can include requirements that SPEs are not likely to meet (e.g. “seat” or “substantial business activities”)



# Investor/Home State Nexus: Three Policy Options Regarding SPE Claims

## Policy Option One: Barring Claims by SPEs as Investors

### “Seat” requirement

- *Tenaris S.A. v. Venezuela*, ICSID Case No. ARB/11/26, Award, ¶ 138 (29 Jan 2016) (setting out authorities relied upon by Venezuela in support of the proposition that “the terms ‘siège social’ and ‘seat’ may import a requirement of **effective or actual management**”)
- Benjamin Angelette, *The Revolution that Never Came and the Revolution Coming - De Lasteyrie Du Salliant, Marks & Spencer, Sevic Systems and the Changing Corporate Law in Europe*, 92 Virginia Law Review 1189, 1194 (2006) (real seat doctrine requires corporation to be “incorporated in the place where its **central management decisions are made and implemented**”)



# Investor/Home State Nexus: Three Policy Options Regarding SPE Claims

## Policy Option One: Barring Claims by SPEs as Investors

### Substantial business activities requirement

- IIAs have required—for companies to be able to access to treaty protections—that legal persons are “**actually doing business**” or have “**real economic activities**” in their respective home States

Anthony Sinclair, *The Substance of Nationality Requirements in Investment Treaty Arbitration*, 20 ICSID Review 357, 375 (2005)  
(quoting Philippines-U.K. BIT art. I(4) and Iran-Switzerland BIT art. 1(b)).



## Investor/Home State Nexus: Three Policy Options Regarding SPE Claims

### Policy Option Two: Allowing Case-by-Case Review of SPE Claims by Treaty Parties

- **Denial of benefits** provisions allow Parties to a treaty to deny benefits to claimants on a discretionary, case-by-case basis.



## **Investor/Home State Nexus: Three Policy Options Regarding SPE Claims**

### **Policy Option Two: Allowing Case-by-Case Review of SPE Claims by Treaty Parties**

#### **CAFTA-DR**

##### **Article 10.12: Denial of Benefits**

1. A Party may deny the benefits of this Chapter to an investor of another Party that is an enterprise of such other Party and to investments of that investor if persons of a non-Party own or control the enterprise and the denying Party:
  - (a) does not maintain diplomatic relations with the non-Party; or
  - (b) adopts or maintains measures with respect to the non-Party or a person of the non-Party that prohibit transactions with the enterprise or that would be violated or circumvented if the benefits of this Chapter were accorded to the enterprise or to its investments.
  
2. Subject to Articles 18.3 (Notification and Provision of Information) and 20.4 (Consultations), a Party may deny the benefits of this Chapter to an investor of another Party that is an enterprise of such other Party and to investments of that investor if the enterprise has no substantial business activities in the territory of any Party, other than the denying Party, and persons of a non-Party, or of the denying Party, own or control the enterprise.



## Investor/Home State Nexus: Three Policy Options Regarding SPE Claims

### Policy Option Three: Allowing Claims by SPEs as Investors

- Although the text of the applicable treaty under such an approach would not place limitations on SPE claims, tribunals nevertheless could limit SPE claims through reliance on the **abuse of right doctrine**.



# Investor/Home State Nexus: Three Policy Options Regarding SPE Claims

## Policy Option Three: Allowing Claims by SPEs as Investors

### Abuse of Right Doctrine

“[T]he initiation of a treaty-based investor-State arbitration constitutes an abuse of rights (or an abuse of process, the rights abused being procedural in nature) when an investor has changed its corporate structure to gain the protection of an investment treaty at a point in time when a specific dispute was foreseeable.”

*Philip Morris Asia Ltd. v. Australia*, PCA Case No. 2012-12, Award on Jurisdiction and Admissibility, ¶ 554 (17 Dec 2015)



## Claimant/Host State Nexus

- When does the nexus between a claimant and its host State investment become too weak to fall within IIA protections? (remoteness limitation)



## Claimant/Host State Nexus

- “[F]or an investment to be “of” an investor in the present context, some activity of investing is needed, which implicates the claimant’s control over the investment or an action of transferring something of value (money, know-how, contracts, or expertise) from one treaty-country to the other.”

*Standard Chartered Bank v. Tanzania*, ICSID Case No. ARB/10/12, Award (2 Nov 2012), ¶ 232



## Claimant/Host State Nexus

- “It is difficult to see how the treaty’s protections could promote investment by nationals of a Contracting State if the national of the Contracting State had no role in deciding to make the investment, funding the investment, or controlling or managing the investment after it was made.”

*Standard Chartered Bank v. Tanzania*, ICSID Case No. ARB/10/12, Award (2 Nov 2012), ¶ 228





## Claimant/Host State Nexus

- “[T]he Tribunal has concluded that protection of the UK-Tanzania BIT requires an investment *made* by, not simply *held* by, an investor. To be considered to have made an investment, SCB [the claimant] must have contributed actively to the investment.”

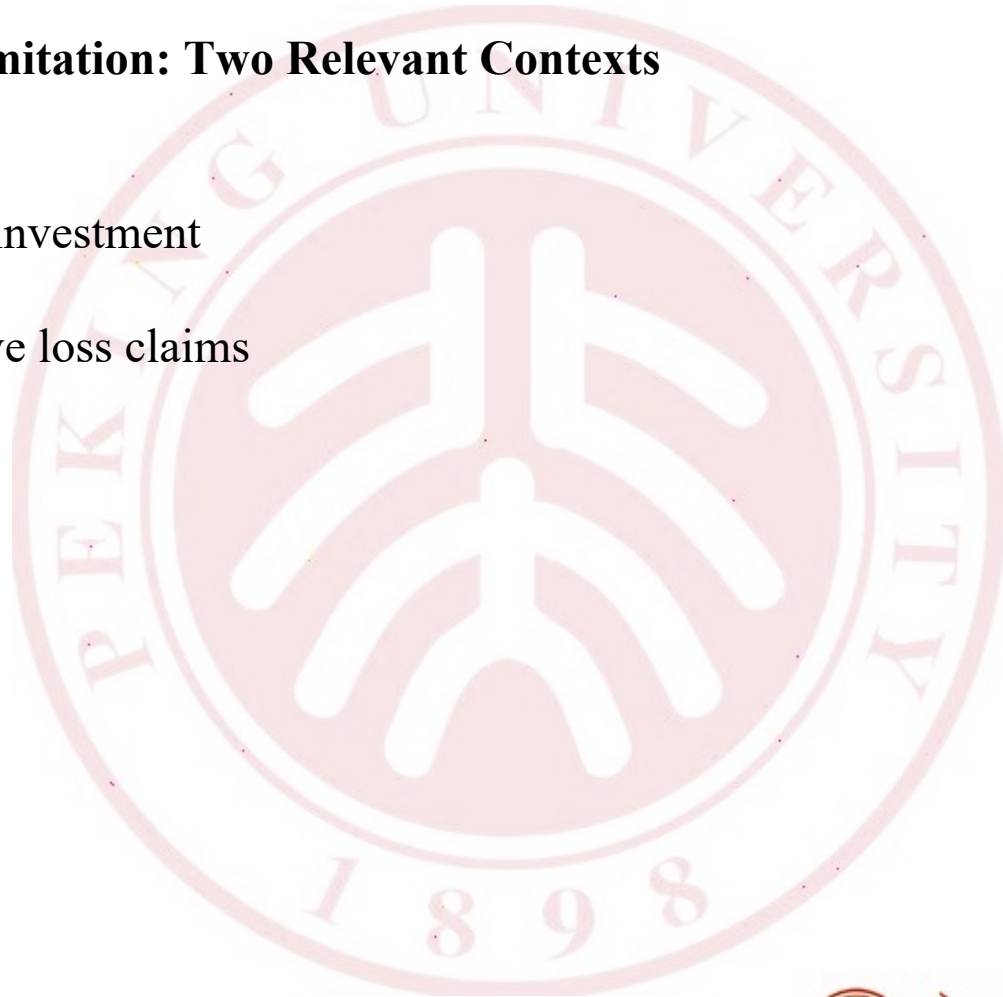
*Standard Chartered Bank v. Tanzania*, ICSID Case No. ARB/10/12, Award (2 Nov 2012), ¶ 257 (emphasis in original)



# Claimant/Host State Nexus

## Remoteness Limitation: Two Relevant Contexts

- 1. Indirect investment
- 2. Reflective loss claims



# Claimant/Host State Nexus

## Indirect Investment

- Investment arbitration tribunals generally have found that IIA protections extend to investments that have been made through intermediaries, regardless of whether an IIA expressly mentions indirect investment
- *Siemens A.G. v. Argentina*, ICSID Case No. ARB/02/8, Decision on Jurisdiction, ¶ 137 (3 Aug 2004) (“The treaty does not require that there be no interposed companies between the investment and the ultimate owner of the company”)
- *Teinver S.A. v. Argentina*, ICSID Case No. ARB/09/1, Decision on Jurisdiction, ¶ 230 (21 Dec 2012) (“nothing in broad language of Article I(2) of the Treaty suggests that shares held through subsidiaries are excluded from coverage under Article I(2)”)
- *Mobil Corp. v. Venezuela*, ICSID Case No. ARB/07/27, Decision on Jurisdiction, ¶165 (10 June 2010) (“The BIT does not require that there be no interposed companies between the ultimate owner of the company or of the joint venture and the investment”).



## Claimant/Host State Nexus

### Reflective Loss Claims

- Investment arbitration tribunals often have allowed shareholder claims under IIAs for “reflective loss” (loss incurred by a shareholder as a result of injury to the company in which they hold shares; amount claimed normally is the loss in value of the shares)
- Shareholder claims and reflective loss currently an UNCITRAL WGIII “concrete reform element”

