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By

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1- Introduction

In foreign investments, the multinational corporate investors can be observed from an economic standpoint or from a legal one. From the economic standpoint, those investors perceive themselves as single economic units that operate in different parts of the world through departments that are not autonomous to define business strategies, manage the operation or dispose of the assets. But in order to conduct their operations, multinational corporate investors use different legal forms depending on the country in which they operate. In that sense, investors usually incorporate entities that might be considered independent and separate bodies from a legal standpoint. Thus from the legal standpoint the multinational corporate investors are not single economic units but a group of corporations related by common equity ownership.

In order to grant protection to investors that operate under the form of locally incorporated entities, many international investment agreements (IIAs) have expressly provided that wholly owned subsidiaries of foreign companies will be considered foreign investors and thus entitled to international protection.

The solution provided by IIAs seems to be in tune with one of the goals of the international law of foreign investment, i.e., to provide protection to foreign investors.

Based on that idea, a system of foreign investment dispute settlement has emerged where investors can challenge the actions of foreign States in a neutral and independent forum.

However, recent arbitration awards have put a perspective the other aspect of the issue, i.e. when the foreign investor is controlled by national shareholders.

The issue can be described as follows: Country X and Country Y have signed a Bilateral Investment Treaty (BIT) that protects international investments made by investors from Country X in Country Y and vice versa. Investors from country X register a company in Country Y to do business in Country X. A dispute arises between the company registered in Country Y and the Country X. As a result, the company registered in Country Y files for international investment arbitration against country X. Country X objects to the jurisdiction of the arbitral tribunal arguing that this is a dispute between local investors and their State.

The arbitration is filed with ICSID, and Article 25 of the ICSID Convention is referred to as the source of arbitral jurisdiction. However, it is argued that the article does not apply to the facts in question.

The issue then is whether this is a dispute between a foreign investor and a host State and consequently whether form should prevail over substance or on the contrary, whether substance should prevail over form and this dispute is not between a foreign investor and a host State.

2- Article 25 of the International Center for Settlement of Investment Disputes (ICSID) Convention¹

Accordingly, for ICSID to have jurisdiction, there needs to be a dispute of legal nature arising directly out of an investment between a State that is signatory of the Convention and a national of another State that is signatory of the Convention for which the two parties in dispute had given consent.

The above article covers jurisdiction *ratione personae* for individuals and corporations. For the latter, the article deals with two different possibilities: when the corporation has been incorporated in the home State and when the corporation has been incorporated in the host State but is controlled by investors from the home State.

The article states:

“(1) The jurisdiction of the Centre shall extend to any legal dispute arising directly out of an investment, between a Contracting State (or any constituent subdivision or agency of a Contracting State designated to the

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The opinions expressed here are personal and do not reflect the view of the organizations to which he is affiliated.

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¹ International Center for Settlement of Investment Disputes Convention, also known as Washington Convention, 1966. <http://www.worldbank.org/icsid/basicdoc/partA.htm>

Centre by that State) and a national of another Contracting State, which the parties to the dispute consent in writing to submit to the Centre. When the parties have given their consent, no party may withdraw its consent unilaterally.

(2) "National of another Contracting State" means:

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

(b) any juridical person which had the nationality of a Contracting State other than the State party to the dispute on the date on which the parties consented to submit such dispute to conciliation or arbitration and any juridical person which had the nationality of the Contracting State party to the dispute on that date and which, because of foreign control, the parties have agreed should be treated as a national of another Contracting State for the purposes of this Convention.

(3) Consent by a constituent subdivision or agency of a Contracting State shall require the approval of that State unless that State notifies the Centre that no such approval is required.

(4) Any Contracting State may, at the time of ratification, acceptance or approval of this Convention or at any time thereafter, notify the Centre of the class or classes of disputes which it would or would not consider submitting to the jurisdiction of the Centre. The Secretary-General shall forthwith transmit such notification to all Contracting States. Such notification shall not constitute the consent required by paragraph (1).”

Thus, the general rule is that ICSID arbitral tribunals can only handle legal disputes that arise out of an investment between a national of a Contracting State and another Contracting State. Under article 25 (2) (b) any juridical person with nationality other than that of the Contracting State involved in the dispute on the date the parties consented to submit the dispute to conciliation or arbitration can be party to the claim. Likewise, any juridical person with nationality of the Contracting State party to the dispute on that date and which, the parties have agreed will be treated as a national of another contracting state because of foreign control can be party to the arbitral claim.

The second part addresses the issue of foreign investors that have operated through a local subsidiary which later on gets involved into an investment legal dispute with the recipient country. In that sense, *ratione personae*, article 25(2)(b) equals the legal reality

of multinational corporate investors to the economic reality, as for most of those investors operating under the form of a local subsidiary that entity is not an independent and separate body but only a part of the economic unit. The second part of article 25 (2) (b) recognizes that and allows locally incorporated companies which are controlled by foreign companies to have access to international arbitration. It seems logic because the ICSID system is intended to deal with foreign investment disputes regardless of the forms.²

However, when the situation is different, that is when the investor has the legal form of foreign investors although it is controlled by national shareholders, article 25 of the ICSID Convention does not contain any provision.

It has been up to arbitral tribunals to deal with that issue.

3- Champion case

In *Champion Trading Company, Ameritrade International, Inc., James T. Wahba, John b. Wahba, Timothy T. Wahba v. Arab Republic of Egypt (Champion)*,³ the Claimants, all of which were shareholders of an Egyptian cotton trading company, alleged that the government of Egypt violated the terms of the U.S.-Egypt BIT and filed a claim through ICSID arbitration. Egypt objected to ICSID jurisdiction based on the argument that some of the individual Claimants had Egyptian nationality. The Claimants alleged that their real and effective nationality was American.

The individual claimants alleged that the real and effective nationality was the American. By looking at the issue of real and effective nationality, the Tribunal analyzed the Nottebohm ICJ decision and the A/18 decision from the IRAN-United States Claims Tribunal. The Tribunal quoted the A/18 decision and noted that, “real and effective nationality was indeed relevant ‘unless an exception is clearly established.’” The Tribunal found that such an exception existed in Article 25(2)(a) of the ICSID Convention which expressly provides that a National of another Contracting State does not include any person who, on either the date of the consent or on the date when the request was registered, had the nationality of a Contracting State party to the dispute. The Tribunal found that the individual Claimants had mentioned their Egyptian nationality in the documents establishing the investment vehicle without any reference to their U.S. nationality. The Tribunal declared that it did not have jurisdiction in the dispute as presented by the individual Claimants. However, while the individual Claimants were forbidden from bringing a claim against Egypt due to their Egyptian nationality, the Claimants were also American nationals and shareholders of the corporate Claimants both of which were American companies. The Tribunal held that the corporate Claimants

² In that sense, see *Banro American Resources, Inc. and Societé Aurifère du Kivu et du Maniema S.A.R.L. v. Democratic Republic of Congo*, ICSID Case No. ARB/98/7, Decision of 1 September, 2000.

³ In *Champion Trading Company, Ameritrade International, Inc., James T. Wahba, John b. Wahba, Timothy T. Wahba v. Arab Republic of Egypt*, decision of October 21, 2003.
<http://www.worldbank.org/icsid/cases/champion-decision.pdf>

were considered foreign investors for purposes of the arbitration and rejected the Respondent's objection to jurisdiction for the corporate Claimants.

4- Tokios case

In *Tokios Tokeles v. Ukraine*⁴(Tokios), a firm incorporated in Lithuania but with the majority of its shares owned by Ukrainian nationals, initiated arbitration against Ukraine, alleging the Ukrainian government breached the Ukraine-Lithuania BIT. Ukraine objected the Tribunal's jurisdiction, arguing, *inter alia*, that the Claimant was not a foreign investor. Hence the dispute was between a State and its own subjects and not a matter to ICSID arbitration.

The Ukraine-Lithuania BIT defined foreign investors as those entities incorporated in the other State party. Based on that the majority of the Tribunal stated that the parties to a BIT were free to determine the criteria used to determine nationality⁵ and set the definition of investor and foreign control of a local entity for purposes of article 25 (2)(b) of the ICSID Convention. It was not up to the Tribunal to question the criteria used therein.

The Tribunal stated: "...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."⁶

Thus the majority concluded that Tokios was a foreign investor under the terms of the BIT and rejected the Ukraine's objection to jurisdiction, stating, "In our view, however, neither the text of the definition of 'investment', nor the context in which the term is defined, nor the object and purpose of the Treaty allow such an origin-of-capital requirement to be implied. The requirement is plainly absent from the text...the origin-of-capital requirement is inconsistent with object and purpose of the Treaty, which ...is to provide broad protection to investors and their investment on the territory of the other party".⁷

The majority then held that, "the ICSID Convention contains no inchoate requirement that the investment at issue in a dispute have an international character in which the origin of the capital is decisive."⁸ Regarding the Convention's purpose, the majority considered that the decision had not allowed, "the Convention to be used for purposes for which it clearly was not intended."⁹

⁴ *Tokios Tokeles v. Ukraine*, Decision of April 29, 2004, Case No. ARB/02/18.

<http://www.worldbank.org/icsid/>

⁵ *Id* at paragraph 24.

⁶ *Id* at paragraph 39.

⁷ *Id* at paragraph 77.

⁸ *Id* at paragraph 82

⁹ *Id* at paragraph 39.

The dissenting arbitrator stressed that the purpose of the ICSID Convention was to govern international investments, which are characterized by a trans-border movement of capital rather than investment disputes between a country and its citizens.¹⁰ In the Dissenting Opinion, the minority arbitrator explains this distinction, stating, "...when it comes to ascertaining the international character of an investment, the origin of the capital is relevant, and even decisive. True, the Convention does not provide a precise and clear-cut definition of the concept of international investment –no more than it provides a precise and clear-cut definition of the concept investment–, and it is therefore for each ICSID tribunal to determine whether the specific facts of the case warrant the conclusion that it is before an international investment".¹¹

The dissenting arbitrator also objected to the right of Contracting Parties to extend the Convention's jurisdiction, explaining, "...it is within the limits determined by the basic ICSID Convention that the BITs may determine the jurisdiction and powers of the ICSID tribunal, and it is not for the Contracting Parties in their BITs to extend the jurisdiction of the ICSID tribunal beyond the limits determined by the basic ICSID Convention."¹²

5- Differences between *Champion* and *Tokios*

Although the *Champion* decision seems to have reached the same conclusion that *Tokios* eventually reached, there are some differences. First, in *Champion* the shareholders of the corporate claimants had Egyptian and American Nationality. A factor that was not present in *Tokios*. Secondly, the references made by the tribunal to *Nottebohm* and *A/18* decisions in terms of real and effective nationality would have been useful to dismiss the argument that the corporate claimant was an Egyptian investor had the possibility of disregarding the legal personality of a corporation been considered, because the real and effective nationality of the individual shareholders was American. Thirdly, the reference of Article 25 (2)(a) of the Convention which excludes dual nationals from invoking the protection of the Convention against the host country to which they are also nationals, only applies to individuals, not to companies of the other Contracting State when individuals with dual nationality are shareholders. Fourthly, the Tribunal in *Champion*, made a specific reference to article 32 of the Vienna Convention, which states that supplementary means of interpretation including the preparatory work of the treaty and the circumstances of its conclusion, can be used for interpretation in cases of ambiguity or unreasonable results. That provision could have allowed the hypothetical Tribunal to look at supplementary means of interpretation of the ICSID Convention to disregard the applicability of Article 25 (2)(a) if it led to an absurd or unreasonable result, such as the confirmation of ICSID jurisdiction to settle disputes between a State and a domestic investor. So, for example by looking at the ICSID Convention Preamble or the report from the executive directors on the ICSID Convention it would have been clear that that the primary purpose of the Convention is to stimulate international investment flows.

¹⁰ Professor Prosper Weil dissented from the majority. <http://www.worldbank.org/icsid/cases/awards.htm> April 29, 2004, at paragraph 19.

¹¹ *Id* at paragraph 20.

¹² *Id* at paragraph 13.

Therefore only legal disputes between foreign investors and host States arising out of foreign investments could have fallen under the turf of the arbitral Tribunal.

Thus, it is likely that if faced with the same issue *Tokios* addressed, i.e., a national investor disguised as a foreigner, the *Champion* Tribunal would have used the argument of unreasonable result and would have explored the purpose of the ICSID Convention in depth to declare that it did not have jurisdiction over a dispute between a national and its State.

6- Conclusion

The ICSID system was thought of for international investment disputes. Its rationale has been that on providing investors with a neutral and independent body where they could settle disputes with host States, investors would be better protected and that in turn would attract more investments to the countries that committed themselves to settle investment disputes through an international center. Furthermore, it was assumed that foreign investments would be a means for economic development of the attracting countries.

Thus, ICSID was meant to settle disputes between foreign investors and host States. The exception provided by second part of article 25(2)(b) of the Convention is meant to circumvent the formality of local incorporation of a foreign control wholly owned subsidiary.

But the rationale of the whole ICSID system and that of article 25(2)(b) of the Convention needs to be considered when analyzing facts in which there is doubt about the foreign nature of the investors.

To allow disputes between national investors, although disguised under the form of foreign and their own States to be settled before ICSID arbitral tribunals not only jeopardizes the ICSID system and opens the door to judicial chaos, but also damages the reputation and development of international law.

In *Tokios*, it seemed the investors were abusing the concept of legal personality. A cost-benefit analysis of the concept of corporation and legal personality in that case would have determined that the cost of protecting the legal personality of the subsidiary was higher than the benefits it provided to the society. Consequently, disregarding the legal personality of the claimant corporation in order to consider the subsidiary equal to the parent company was the appropriate remedy.

Future ICSID arbitral awards confronting the issue of a foreign company wholly owned by national shareholders would do a great service if they look at the rationale and purpose of the ICSID system and keep a less formalistic approach when analyzing the identity of the corporate investors.